The Applicability of Arbitration Agreements to A Non-Signatory Guarantor—A Perspective from the Chinese Judicial Practice

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It is axiomatic that an arbitration agreement is generally not binding on a non-signatory unless some exceptional conditions are satisfied or appear, while it could even be more controversial in cases relating to guarantee where a non-signatory third person provides guarantee to the master agreement in which an arbitration clause has been incorporated. Due to the close connection between guarantee contract and master agreement in their contents, parties or even some legal practitioners may take it for granted that the arbitration agreement in master agreement can be automatically extended to the guarantor albeit it is not a signatory, which can be a grave misunderstanding from judicial perspective and results in great loss thereby.

As a prime example, courts in China have long been denying the applicability of arbitration agreements to a non-signatory guarantor with rare exceptions based on specific circumstances as could be observed in individual cases, nonetheless, the recent legal documents have provided possibilities that may point to the opposite side. This short essay looks into this issue.

1. **The Basic Stance in China: Severability of the Guarantee Contract**

Statutes in China provide limited grounds for extension of arbitration agreement to a non-signatory. As set out in Articles 9 & 10 of the *Interpretation of the Supreme People's Court's (hereinafter, SPC) on Certain Issues Related to the Application of the Arbitration Law*?which was issued on 23 August 2006?, this may occur only under the following circumstances:

"(1) An arbitration clause is binding on the non-signatory who is the successor of a signed-party by means of merge, spilt-up of an entity and decease of a natural

person or;

(2) where the rights and obligations are assigned or transferred wholly or partially to a non-signatory, unless parties have otherwise consented".

Current laws are silent on the issue where there is a guarantee relationship. Due to the paucity of direct instructions, some creditors seeking for tribunal's seizure of jurisdiction over a non-signatory guarantor would tend to invoke Article 129 of the *SPC's Interpretation on Certain Issues Related to Application of Warranty Law* (superseded by SPC's *Interpretation on Warranty Chapter of Civil Code* since 2021 with no material changes being made), which stipulates that the guarantee contract shall be subject to the choice of court clause as set out in the main agreement, albeit the creditor and guarantor have otherwise consent on dispute resolution. Nevertheless, courts in China are reluctant to apply Article 129 to an arbitration clause by way of *mutatis mutandis.* In the landmark case of *Huizhou Weitong Real Estate Co., Ltd v. Prefectural People's Government of Huizhou*,[1] the SPC explicitly ruled that the Guarantee Letter entered into between creditor and guarantor had created an independent civil relationship which shall be distinguished from the main agreement and thereby the arbitration clause should not be binding on the guarantor and the court seized with the case could take the case accordingly. In a nutshell, due to the independence of the guarantee contract from the main contract, where there is no clear arbitration agreement in the guarantee contract, the arbitration agreement in the main contract cannot be extended to be applicable to the guarantor.

The jurisprudence of *Weitong* has been subsequently followed and acknowledged as the mainstream opinion for the issue. In SPC's reply to Guangxi Provincial High Court regarding enforcement of a foreign-related arbitral award rendered by CIETAC on 13 September 2006?*Dongxun*?,[2] where a local government had both issued a guarantee letter and signed the main agreement, the SPC opined that as there was no term of guarantee provided in the text of main agreement, the issuance of guarantee letter and signature of main agreement was not sufficient to make the government a party to the arbitration clause. In light of this, SPC agreed with the Guangxi Court's stance that the dispositive section regarding execution of guarantee obligation as set out in the disputed arbitral award had exceeded the tribunal's power and thus shall be rejected to be enforced. In the same vein, in its reply on 20 March 2013 to Guangdong Provincial High Court regarding the annulment of an arbitral award[3], the SPC

held that the disputed arbitral award shall be partially vacated for the arbitral tribunal's lack of jurisdiction over the guarantee for which the guarantor was a natural person. Hence, it can be drawn that whether the guarantor is a governmental institution or other entity for public interest is not the determining factor to be considered for this type of cases.

2. **Controversies and Exceptions**

Theoretically, it is correct for the SPC to unfold the autonomous nature of arbitration jurisdiction, which shall be distinguished from that of litigation. Parties' autonomy to designate arbitration as a method of dispute resolution and the existence of an arbitration agreement are key elements for a tribunal to be able to obtain the jurisdiction. By this logic, the mere issuance of guarantee letter or signature of a standing-alone guarantee is not sufficient to prove parties' consent to arbitration as expressed in the main contract. The SPC is not alone in this respect. Actually, one of the much-debated cases by foreign courts is the decision made by the Swiss Supreme Court in 2008 which opined that a guarantor providing guarantee by virtue of a standing-alone letter was not bound by the arbitration clause as provided in the main agreement to which the guarantee letter has been referred, except there was an assumption of contractual rights or obligations, or a clear reference to the said arbitration clause. [4]

All that being said, the SPC's proposition has given rise to some controversies for the sacrifice of efficiency through a dogmatic understanding of arbitration. Moreover, the segregation of the main contract and guarantee contract may produce risks of parallel proceedings and conflicting legally-effective results. As some commentators have indicated, albeit the severability of guarantee contract in its formality, its content is tight with the main agreement. In the light of the tight connection,[5] the High Court of England ruled in *Stellar* that it was predictably expectable for a rational businessman to agree on a common method of dispute resolution as set out in the main contract, where the term of guarantor's endorsement was involved, based on the close connection between the two contracts.[6]

A like but nuanced approach, however, has been developed through individual cases in China, to the author's best knowledge, one of the prime cases is *Li* v. *Yu* decided by Hangzhou Intermediate Court on 30 March 2018 concerning an annulment of an award handed down via arbitration proceedings.[7] The case

concerns a main agreement entered into by the creditor, the debtor and the guarantor (who was also the legal representative of the debtor), which had set out a general guarantee term but did not provide detailed obligations. The guarantor subsequently issued a guarantee letter without any clear reference to arbitration clause as stated in main agreement. After the dispute arose, the creditor lodged arbitration requests against both the debtor and the guarantor, the tribunal ruled in creditor's favor after tribunal proceedings started. The guarantor then applied for annulment of the arbitral award on the basis that there was no valid arbitration agreement between the guarantor and the creditor, contending tribunal's lack of jurisdiction over the guarantor. The court, however, opined that the guarantor's signature in the main agreement, in combination of the general guarantee clause incorporated therein, was sufficient to prove the existence of arbitration agreement between the creditor and the guarantor and the guarantor's consent thereby. Therefore, the annulment application was dismissed by the court.

Admittedly, the opinion as set out in *Li* is sporadic and cannot provide certainty, largely relying on specific circumstances drawn from individual cases, hence it is difficult to produce a new principle hereby. However, the case does have some novelties by providing a new track for extension of arbitration agreement to a guarantor who is not clearly set out as one of the parties in main agreement. In other words, the presumption of severability of guarantee relationship is not absolute and thus rebuttable. To reach that end, creditors shall furnish proof that the guarantor shall be well aware of the details of the main contract (including arbitration clause) and has shown inclination to be bound thereby.

3. **New Rules That Shed New Light**

On 31 December 2021, the SPC released *Meeting Note of the National Symposium on Foreign-related Commercial and Maritime Trials*, which covers judicial review issues on arbitration agreements. Article 97 of the *Meeting Note* provides systematical approach in reviewing arbitration agreement where an affiliated agreement?generally refers to guarantee contract or other kinds of collateral contract?is concerned, which can be divided into two facets:

First, where the guarantee contract provides otherwise dispute resolution, such consent is binding on the guarantor and thus shall be enforceable. As a corollary, the arbitration agreement in main agreement is not extensible to the guarantor.

Secondly, while the guarantee contract is silent on the issue of dispute resolution, the arbitration agreement as set forth in the main agreement is not automatically binding on the guarantor unless the parties to the guarantee contract is the same as that of main agreement.

In summary, the *Meeting Note* has sustained the basic stance while providing an exception where the main agreement and the guarantee contract are entered into by the same parties. As indicated by one commentator, the *Meeting Note* is not a judicial interpretation which can be adopted by the courts to decide cases directly but it to a large extent reflects consensus of judges among China, [8] and hence will produce impact on judicial practice across the whole country.

Nevertheless, some uncertainties may still arise, for instance, whether a mere signature in the main contract by the guarantor is sufficient to furnish the proof about "the same parties", or shall be in combination with the scenario where an endorsement term of guarantor is incorporated in the main contract. On the contrary, it is also unclear whether a mere existence of term of guarantee is sufficient to make a non-signatory guarantor a party to the main contract.

Another more arbitration-friendly method can be observed from the draft for Revision of Arbitration Law that has been released for public consultation since 30^{th} July of 2021, Article 24 of which provides that the arbitration clause as set out in the main agreement shall prevail over that in the guarantee contract where there is a discrepancy; where the guarantee contract is silent on dispute resolution, any dispute connected thereto shall be subject to the arbitration agreement as set out in main agreement. This article is a bold one which will largely overturn the SPC's current stance and makes guarantee relationship an exception. A piece of more exciting news comes from the newly-released law-making schedule of 2022 by the Standing Committee of the National People's Congress,[9] according to which the revision of Arbitration Law is listed as one of the top priorities in 2022 whilst it is still to be seen whether Article 24 in the draft can be retained after scrutiny of the legislature.

4. **Concluding Remarks**

It is not uncommon that a guarantee for certain debts is provided by virtue of a standing-alone document which is separated from the main contract, whether it is a guarantee contract or a unilaterally-issued guarantee letter. It shall be borne in

mind that the close connection between the guarantee document and main contract alone is not sufficient to extend the arbitration agreement as set out in main agreement to a non-signatory guarantor per the consistent legal practice in China over the past 20 years. While the new rules have provided more arbitration-friendly approaches, uncertainties and ambiguities will probably still exist.

From a lawyer's perspective, as the mainstream opinion in judicial remains unchanged currently, it is necessary to attach higher importance while reviewing a standing-alone guarantee contract which is separated from a master agreement in its formality. In the light of avoiding prospective parallel proceedings incurred thereby, the author advances two options in this respect:

The first option is to insert an article endorsing guarantee's obligation into the master agreement, and require the guarantor to sign the master agreement, which resembles the scenario in *Stellar* and *Li*. Whereas this approach may be less feasible in the post-negotiation phase of master agreement when all terms and conditions are fixed and endorsed, the option mentioned below can be served as an alternative.

The second option is to incorporate into guarantee document a clause which unequivocally refers to the arbitration agreement as set out in master agreement, in lieu of any revision to the master agreement. This approach is in line with Article 11 *SPC on Certain Issues Related to the Application of the Arbitration Law* which provides that parties can reach an arbitration agreement by reference to dispute resolution clauses as set out in other contracts or documents. While it is noteworthy that from judicial practice in China, such reference shall be specific and clear, otherwise the courts may be reluctant to acknowledge the existence of such arbitration agreement.

[1] Case No: 2001 Min Er Zhong No. 177.

[2] Case No: 2006 Min Si Ta No. 24.

[3] Case No: 2013 Min Si Ta No. 9.

[4] Case No. 4A_128/2008,decided on August 19, 2008, decided by Tribunal federal(Supreme Court) of Swiss, as cited in *Extension of arbitration clause to*

non-signatories (case of a guarantor) – Arbitration clause by reference to the main contract (deemed too general and therefore not admitted), available at https://www.swissarbitrationdecisions.com/extension-of-arbitration-clause-to-non-signatories-case-of-a-gua.

[5] See Yifei Lin: Is Arbitration Agreement in Master Agreement Applicable to Guarantee Agreement? Available at http://www.360doc.com/content/16/0124/11/30208892_530188388.shtml.

[6] Stellar Shipping Co Llc v Hudson Shipping Lines [2010] EWHC 2985 (Comm) (18 November 2010).

[7] Case No: 2018 Zhe 01 Min Te No. 23.

[8] Lianjun Li *et al?China issues judicial guidance on foreign related matters,* Reed Smith In-depth?25 April 2022??available at https://www.reedsmith.com/de/perspectives/2022/04/china-issues-judicial-guidance-on-foreign-related-matters.

[9] For more details, please see the news post available at https://m.thepaper.cn/baijiahao_18072465. Moreover, per the news report released in late May of 2022, The National Committee of Chinese People's Political Consultative Conference had discussed the revision of Arbitration Law in its biweekly symposium held on 30 May 2022, where the attendees had stressed the significance of party autonomy in commercial arbitration, available at: http://www.icppcc.cn/newsDetail_1092041.