DISPUTE RESOLUTION AND AIRCRAFT OPERATING LEASES TO PRC AIRLINES: SIMPLY ARBITRATE?

Many older aircraft operating leases to PRC airlines provide for disputes to be resolved in the English or other non-Mainland courts, and sometimes include a unilateral option to arbitrate in favour of the lessor. The Mainland courts take a narrow approach to enforcing foreign judgments and there is no precedent of enforcement of English judgments. Further, there is a risk that including a unilateral option to arbitrate could result in difficulties enforcing an award. This has led to lessors preferring offshore arbitration in 'friendly' jurisdictions, such as Hong Kong. This is now particularly suitable in light of recent developments allowing for onshore interim relief in support of Hong Kong seated arbitrations.

Key points

- ***Advantages***: opting for Hong Kong seated arbitration offers various advantages, including the availability of interim relief and enforceability in the Mainland.
- ***Disadvantages***: traditionally, lessors have been attracted by the familiarity and predictability of English courts, as well as the flexibility of an option to arbitrate or litigate.
- ***Recommendation****:* there are significant advantages in opting for Hong Kong seated arbitration. However, each leasing arrangement should be assessed individually and in light of the specific PRC counterparty and relationship.

Arbitration is generally considered to be a preferred method for resolving disputes involving PRC parties. There is now a particular advantage for international lessors in providing for arbitration seated in Hong Kong administered by specific arbitral institutions (including the Hong Kong International Arbitration Centre ("**HKIAC**") or the International Chamber of Commerce – Asia Office ("**ICC**")) in their operating leases with PRC airlines (or in their other contractual arrangements with PRC entities) due to a new arrangement between the Mainland and Hong Kong coming into force. This arrangement allows parties to arbitrations seated in Hong Kong to seek interim measures from the Mainland courts.

In this respect it should be noted that, under PRC law, only parties to a contract with a 'foreign element' can elect to have their contracts governed by a foreign law and to arbitrate their disputes at a non-Mainland arbitral institution. A 'foreign element' can be established by, for example, one party to the contract being a foreign entity. Foreign invested enterprises in the Mainland are deemed to be domestic parties under PRC law.

Advantages

i. *Mutual availability of interim relief in support of arbitration:* 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 SAR came into force on 1 October 2019 (the "**Arrangement**"). This allows parties to apply to Mainland courts for interim measures in support of Hong Kong-seated arbitral

proceedings which are administered by institutions recognised by the PRC Supreme People's Court and the Hong Kong Department of Justice (which includes the HKIAC, ICC, and CIETAC HK). This is an important development for (i) parties entering into contracts with Mainland Chinese parties and (ii) for Mainland Chinese parties entering into contracts with offshore parties. Interim measures from Mainland courts were previously only available in support of onshore court or arbitration proceedings. The Arrangement makes Hong Kong the only jurisdiction outside of the Mainland where parties can arbitrate and also have recourse to Chinese courts for interim relief.

ii. *Enforcement of Hong Kong awards in the Mainland*: pursuant to the Arrangement between the Mainland and the Hong Kong SAR Concerning the Mutual Enforcement of Arbitral Awards which came into force on 1 February 2000, awards made in Hong Kong pursuant to the Hong Kong Arbitration Ordinance can be enforced in the Mainland on terms similar to the 1958 New York Convention. The PRC Supreme People's Court has also implemented safeguards which mean that only the PRC Supreme People's Court can make the final decision to refuse to enforce a foreign (and foreign related) arbitral award. While certain court judgments from Hong Kong are also subject to a mutual arrangement for enforcement in the Mainland, English court judgments do not have the benefit of any bilateral arrangement and are therefore subject to the principle of reciprocity under PRC law, and there is no precedent of enforcement of English judgments. Even where foreign judgments are enforceable in the Mainland, the process is not afforded the same safeguards as Hong Kong arbitral awards.

iii. *Avoiding issues relating to unilateral option clauses in the Mainland*: the prevailing view is that a foreign arbitral award rendered pursuant to an arbitration clause allowing one party the option to litigate (and where the law governing the arbitration clause is not PRC law and recognises the validity of option clauses) would be enforceable in the Mainland. However, this issue has not been tested before the Mainland courts; and there remains a possibility that the Mainland courts would refuse to enforce an arbitral award rendered pursuant to the option clause for being contrary to the "public interests of the Mainland".

iv *Hong Kong is a 'safe' seat for international arbitration*: Hong Kong courts are supportive of arbitration and are generally willing to exercise their supervisory powers to support arbitration proceedings in Hong Kong, for example, to preserve assets pending the resolution of disputes or to restrain a party from commencing court proceedings in breach of an arbitration agreement.

v. *Mainland parties prefer a Hong Kong seat*: Mainland parties are more likely to agree to arbitration as a dispute resolution mechanism if it is seated in Hong Kong (as opposed to, for example, London, Paris or Singapore). This is so given the close proximity between the Mainland and Hong Kong and linguistic and cultural similarities.

v. *Experienced arbitrators*: there are a number of international arbitrators in Hong Kong with experience in PRC-related disputes. Where the arbitration agreement provides for a three-member arbitral tribunal, each party can nominate one arbitrator and the agreement

can provide that the presiding arbitrator not be a Chinese national (Article 11.2 of the HKIAC Administered Arbitration Rules also provides that the chairman of a three-member arbitral tribunal shall not have the same nationality as any party unless specifically agreed otherwise by all parties in writing).

vi. *Avoid sovereign or crown immunity issues*: immunity from suit, which may be an issue in court proceedings where the PRC Central People's Government is involved, should not arise in the context of agreements to arbitrate and related arbitration proceedings.

Disadvantages

i. *Flexibility*: lessors have historically preferred the flexibility inherent in a dispute resolution clause providing for court proceedings with an option in favour of one or both parties to arbitrate (or vice versa). This is because it allows the party / parties to choose between litigation and arbitration, as appropriate. This can be particularly useful where the dispute resolution provision extends to other parties or other documents in the transaction, or where the public aspect of court proceedings may be of particular interest to the lessor. In addition, court proceedings can be commenced with relatively little initial work and cost (however arbitration is generally considered to be more efficient and cost effective overall). However, simply providing for arbitration removes this flexibility in favour of a binding and exclusive obligation to arbitrate.

ii. *Certainty of court*: lessors have also historically preferred litigation, especially before the English courts, given the desire for immediately enforceable relief from a state court and greater confidence in the litigation process.

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