

# On the Principle of Competence-Competence in Comparative Perspective: Current Situation, Development and Breakthrough in China

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**Abstract.** This paper conducts an examination of the competence-competence principle in international arbitration, with particular attention paid to its development and implementation in both the United States and China. The paper is systematically organized into five distinct sections. Initially, the article offers an introduction to the competence-competence principle, emphasizing its crucial role within arbitration proceedings. Subsequently, the second section traces the evolution of this principle within the United States, analyzing its emergence and subsequent development through significant case law. In the third section, the article presents a comparative analysis of the application of the competence-competence principle in China and the United States, highlighting the contrasting approaches undertaken by the two nations. The fourth section derives valuable lessons from the United States' acceptance and adaptation of the principle, considering potential implications for China and the advantages of embracing the competence-competence principle in order to enhance the efficacy of arbitration processes. In conclusion, the fifth section outlines anticipated trends in Chinese arbitration law, encompassing the potential establishment of the competence-competence principle, the elimination of arbitration commissions' authority to rule on jurisdictional challenges, and the acknowledgment of the arbitral tribunal's supremacy. This research article contributes to a deeper understanding of the competence-competence principle in international arbitration and provides valuable insights into the prospective development of Chinese arbitration law.

**Keywords:** Competence-Competence, Chinese Arbitration Law, Jurisdiction, Arbitral Tribunal, Perspective of Comparative Law.

## 1. Introduction

### Analyzing the Principle of Competence-Competence in International Arbitration

Commercial arbitration plays a crucial role in resolving commercial disputes, with its security, privacy, and efficiency attracting an increasing number of individuals to opt for arbitration.<sup>1</sup> According to the Annual Report on International Commercial Arbitration in China (2020-2021), the China International Arbitration Center (CIAC) experienced an 8.5% year-on-year increase in arbitration cases, totaling 3,615 cases in 2020. Among these, 739 cases—a 20% rise from the previous year—involved 76 nations and areas, including Hong Kong, Macao, and Taiwan. Furthermore, 102 cases were conducted in English or bilingual Chinese and English. As Du Huanfang highlighted, China's arbitration sector maintained a positive and steady growth trend in 2020. The Ministry of Justice's Public Legal Services Administration reported that in 2020, arbitration committees nationwide dealt with 400,711 cases, including 261,047 traditional commercial arbitration cases, with a total subject matter worth 718.7 billion yuan.

The China International Economic and Trade Arbitration Commission (CIETAC) was ranked among the top five most popular arbitration institutions globally in the International Arbitration Survey 2021 conducted by Queen Mary University of London<sup>2</sup>. This ranking marked the first time a mainland Chinese arbitration institution was listed in the top five, reflecting the significant progress in China's arbitration development. However, the rapid growth of arbitration cases and the quality of arbitration institutions in China's booming economy are not paralleled by the inadequacy of legislation. One of the notable gaps is the absence of legislative recognition for the principle of competence-competence in China. The principle is a cornerstone of modern international arbitration, allowing arbitral tribunals to rule on their own jurisdiction. The absence of a clear legal framework

supporting this principle in China may result in parties questioning the jurisdiction of the tribunal or even attempting to bypass arbitration altogether. This could lead to delays, increased costs, and reduced efficiency in the arbitration process.

According to the principle of competence-competence, the arbitral tribunal has the authority to determine whether the arbitration agreement is valid and if it has jurisdiction over the dispute. As Bolson asserts, this principle is a critical achievement of modern arbitration.<sup>3</sup> Given the ongoing growth of arbitration practice and the international community's general acceptance of it as a highly independent method for settling business conflicts, traditional views on the self-governance of arbitral tribunals have evolved. Consequently, the legislation and practice of international commercial arbitration have gradually started to acknowledge and confirm the existence of the principle of competence-competence. In the context of the globalization of trade and investment, the increasing complexity of commercial transactions has led to a growing need for a flexible, efficient, and private dispute resolution mechanism, and arbitration has emerged as a preferred method to meet these requirements. The principle plays a crucial role in facilitating the efficiency and autonomy of the arbitration process by allowing the arbitral tribunal to determine its jurisdiction without the intervention of national courts. This, in turn, reduces delays and uncertainties that may arise from multiple court proceedings and jurisdictional challenges

## **2. The Development and Application of Competence-Competence Principle in International Arbitration: A Comparative Overview**

Delving into the emergence and development of the principle of competence-competence, this doctrine was first developed in Germany during the 1950s and has since been widely recognized in international legislation and practice. Originating on the European continent, the principle of discretionary jurisdiction in arbitration legislation and practice traces back to the 1950s and beyond. It is thought to have originated from a discussion about whether parties might give arbitrators the authority to make binding rulings on their jurisdiction through an agreement during the old Federal Republic of Germany.

In 1955, the German High Court of Justice held that arbitrators had the final say on the scope of the arbitration agreement, upon which their competence was based. This decision, however, faced widespread criticism, and in 1977, another division of the court adopted a different approach. It ruled that parties could only give arbitrators the power to decide on their jurisdiction through a separate agreement, the validity of which would be subject to court review. The rationale for the principle of competence-competence includes (1) contractual authorization, (2) legal authorization, and (3) mission accomplishment or arbitration need. Legal authorization posits that the basis of the principle of competence-competence lies not in the arbitration agreement but in the legislation of the country where the arbitration takes place. On the other hand, mission achievement or arbitration necessity argues that if the arbitral tribunal lacks the authority to decide its own arbitration jurisdiction, the parties' dispute over the arbitration jurisdiction will need to be brought before the courts for settlement. This would unavoidably have an impact on how the arbitration would be conducted because it would have the parties appear before both the court and the arbitral panel, adding to their workload and maybe allowing one side to drag out the process. However, considering the commercial structure of the arbitration agreement, I prefer the contractual authorization basis, which will be the subject of the following debate.

According to the contractual authorization, arbitration as a method of resolving disputes is a result of the parties' consent and is not possible without an arbitration agreement.<sup>4</sup> Professor Schmitthoff emphasizes that the parties' consent gives an arbitral tribunal discretionary jurisdiction. There is no reason why parties cannot grant the arbitral tribunal the authority to determine its jurisdiction, and there is no reason why courts shouldn't accept the arbitral tribunal's ruling as valid, so long as the panel did not abuse its authority. Of course, even if it has, this may be rectified when the arbitral ruling is recognized and enforced. One problem with this idea is that if the arbitration agreement gives

the tribunal authority, how can it invalidate the arbitration agreement and then examine the claims made by the parties? After a hearing, the tribunal loses jurisdiction if it determines that the arbitration agreement is unlawful. This suggests that the arbitration agreement has never had legal force, even after being deemed unlawful, and that this is why there was never a legal foundation for the tribunal's authority. The tribunal's discretionary jurisdiction, however, primarily stems from the parties' approval, in my opinion, especially where it has been specifically stated by the parties that the tribunal will decide jurisdiction. Similar to how the tribunal's jurisdiction is derived, in my opinion, from the parties' agreement. There is no rationale for denying the tribunal its authority. From this vantage point, it is crucial to stress the fundamental importance of party autonomy in arbitration. Since party autonomy is the foundation of arbitration, parties are free to customize the arbitration procedure to suit their requirements and preferences. The principle of competence-competence improves the autonomy of the parties by allowing them to clearly agree that the tribunal will define its jurisdiction, fostering a more effective and satisfying conflict settlement process. Additionally, giving the tribunal the power to choose its jurisdiction improves the arbitral award's capacity to be enforced internationally. The New York Convention promotes the recognition and enforcement of arbitral awards, so giving the tribunal the authority to resolve jurisdictional disputes in accordance with the parties' agreement can lessen the likelihood that the award will be annulled or declared ineffective as a result of jurisdictional disputes in national courts.

China's law, enacted by the National People's Congress, follows a civil law tradition, while in the United States, the Supreme Court affirms it through case law, adhering to the common law system. Despite significant differences between the two countries in terms of judicial systems, legal sources, and legal methodologies, both China and the United States, as the world's first and second-largest economies today, handle a large number of commercial arbitrations each year. Companies in these two countries mutually need to resolve numerous disputes through commercial arbitration annually. The purpose of promoting and encouraging the healthy and orderly development of international commercial arbitration in China and the United States is the same. The United States establishes the principle through case law, while China, despite individual cases citing the principle, still lacks a specific standard. However, there is a trend toward westernization in China's judicial reform, and China is in the process of learning from the United States and other countries.

China's Tort Liability Law (2010) bears a closer resemblance to American tort law than it does to traditional civil law, an observation that applies in many respects. The objectives and perspectives articulated in the United States' tort law discourse, which encompass law and economic analyses as well as corrective justice theories, are reflected in China's legal documents, official explanations, and academic commentaries that contributed to the development of the country's tort laws. This could suggest a trend towards harmonization. Furthermore, it's worth noting from an international perspective that international business arbitration constitutes a body of law with transnational applicability that deserves study and implementation. One particularly notable and fascinating characteristic of this domain is the diversity of national jurisdictions represented in any given dispute, not only by the involved parties, their legal counsel, and arbitrators, but also in the law applied and the enforcement of the award, often requiring legal proceedings in several countries<sup>5</sup>. The field maintains a transnational consistency, thanks to a surprisingly large number of countries adopting the same fundamental concepts and principles.

### **3. Competence-Competence in China and the United States: A Comparative Study of Legal Frameworks and Applications**

The Federal Arbitration Act (FAA), Title 9, Chapter 1, Section 3, permits courts to step in at any time to determine whether the arbitration agreement is legitimate without having to wait until a judgment has been given. <sup>6</sup>The US court in *Brake Masters System, Inc. v. Gabbay*<sup>7</sup>, supported this stance of the law when it noted that the U.S arbitration statutes and the weight of authority from other

countries enable either a pre-arbitration or a post-arbitration assessment of arbitrability. The arbitral tribunal should make the decision if the parties agree to leave the decision of arbitrability to it.

Conversely, if the parties have not agreed that the arbitrability issue should be decided by the arbitral tribunal, then the court should decide the issue independently, as it would if the court were hearing a matter not submitted to arbitration by other parties. In *First Options of Chicago v. Kaplans*<sup>8</sup>, The US Supreme Court acknowledged the parties' rights to grant arbitrators the last say in relation to some components of arbitral power<sup>9</sup>. Regarding debts owed to First Options of Chicago, a company that clears stock trades, a judgment was made against MK Investments and its owners Mr. and Mrs. Kaplan in this case. However, the Kaplans disputed that their dispute with First Options was subject to arbitration since they had not personally signed the paper containing the arbitration provision. The Supreme Court confirmed that the Kaplans were not bound by the arbitration agreement but went further, urging the court to grant the arbitrator significant discretion and only overturn their judgment in very specific situations. The decision of "who (the court or the arbitral tribunal) has the primary authority to decide the question of arbitrability of a disputed matter" relies on the wishes of the parties, according to the U.S. Supreme Court in 1995.

As for the question of whether China has adopted the principle of competence-competence, there are still two distinct views: one view is that China's legislation has not adopted the principle. First, there is no explicit provision in current legislation that allows an arbitral tribunal to determine its arbitration jurisdiction. According to the provisions of Arbitration Law article 20 states 10. if the parties disagree about whether the arbitration agreement is valid, they may ask the arbitration institution or the court to render a decision; however, if the jurisdictional objection is raised before both the arbitration institution and the court, the people's court shall have the final say. The self-determination jurisdiction of the arbitral tribunal is not made explicit in this article, and when the jurisdictional objection is brought before the arbitral institution and the court simultaneously, the arbitral institution's ability to decide on jurisdiction is clearly disallowed. No. 1 of Ten Model Cases Regarding the Trial of Foreign-related Commercial Cases Issued by the Primary People's Court of Pudong New District of Shanghai Municipality: *BY. O. v. Yushang Group Co., Ltd*<sup>11</sup>. (case regarding a dispute over jurisdiction objections in the service contract). That arbitration is final and arbitration and litigation are mutually exclusive are often incorrectly understood among the parties, who often execute an "arbitration before trial" agreement. In such an agreement, they agree to resolve disputes by arbitration and litigation for the same dispute, but it clearly stipulates or indicates that the arbitration is applied before litigation. The "arbitration before trial" agreement consists of an arbitration clause and a litigation clause (including the conditions applicable to the litigation clause and the designation of the court to which the litigation is brought).

Another view is that China has accepted this principle. The reason why some scholars believe that the principle has been accepted in China's arbitration legislation is mainly that the arbitral institution and the arbitral tribunal have a close relationship, and it is likely to be mistaken that the arbitral institution has some substantive rights. The arbitral institution indeed has the power to decide whether to accept a case at the stage of case acceptance before the constitution of the arbitral tribunal, but this power is extremely limited.

In my opinion, from the existing arbitration legislation and judicial interpretations in China, which give the courts the priority jurisdiction to directly deal with arbitration jurisdiction challenges and provide for arbitration institutions to determine arbitration jurisdiction, we can in no way conclude that China has accepted the principle of competence-competence. The provisions of the existing legislation and judicial interpretations are undoubtedly a fundamental denial of the principle.

Meanwhile, China is trying to improve this ambiguous situation. On July 30, 2021, the Ministry of Justice drafted the Arbitration Law of the People's Republic of China (Revision) (Draft for Comments). From the content of the Article 28<sup>12</sup>, it can be seen that the "Draft for Comments" formally confirms the initial and exclusive jurisdiction of the arbitral tribunal, without the need to consider the possibility of court intervention in the early stage of the circumstances, the arbitral

tribunal has priority over the court in deciding whether the arbitration agreement exists and whether it is valid, and the role played by the court has changed from the final decision maker to the reviewer, which also plays an important judicial supervisory role. Under this provision, the arbitral proceedings can proceed uninterrupted even if the court begins its review, which will undoubtedly facilitate the efficient conduct of the arbitral proceedings.

#### **4. Learning from the US Approach to Competence-Competence: Implications for China's Arbitration System**

In the United States, the Supreme Court has primarily established the principle of competence-competence and continued refining it through case law to derive new principles. In contrast, in China, legal scholars have expressed their views through published treatises to promote the improvement of the law. These phenomena reflect the characteristics of the common law and civil law systems, and the different approaches taken by the two legal systems in accepting a principle can be drawn from them.

In the United States, "the combination of the parties' will and the requirement for effective arbitration has led to the acceptance of the principle of competence-competence." The rules established by the U.S. First Options decision take the principle one step further, with the breakthrough of providing the parties with the possibility of freely agreeing to have the arbitrator make a final decision on jurisdictional issues. This, in reality, will undoubtedly further satisfy some parties' greatest desire to save time and costs.

In China, the negative recognition of the principle of competence-competence leads to a limited role for the arbitral tribunal. The negative recognition of the principle in the law leads to uncertainty in the arbitration process and limits the role that arbitration itself should play.

Firstly, since procedural and substantive aspects of a dispute often arise one after the other in practice, it is likely that under the current Arbitration Law, the power to determine the validity of the arbitration agreement will ultimately be vested in the courts. This effectively divides the power of the arbitral tribunal to determine procedural issues and often results in a fragmentation of the arbitration process. A party wishing to circumvent the arbitration hearing and delay the case may choose to challenge the validity of the arbitration agreement before the court, impeding the arbitration process. Secondly, the effective and speedy character of the arbitration is one of the reasons that parties to an arbitration agreement submit their dispute to the arbitral tribunal. A court's decision on the arbitration agreement's legality would definitely complicate the arbitral jurisdiction, waste material, financial, and human resources, and unavoidably overshadow the benefits of arbitration over litigation.

To improve the arbitration process and embrace the principle of competence-competence, China can draw lessons from the United States' experience in several aspects:

1. Clear legislative recognition: By incorporating the principle of competence-competence explicitly into the arbitration legislation, China can provide a clear legal basis for the arbitral tribunals to determine their jurisdiction, which can strengthen the role of the tribunal and promote legal certainty.

2. Judicial deference to arbitral tribunals: Encouraging courts to respect and defer to the decisions of arbitral tribunals on jurisdictional issues can help reduce fragmentation in the arbitration process and discourage dilatory tactics. This approach requires a shift in judicial attitudes towards arbitration, emphasizing the supporting role of courts in the arbitration process.

3. Promotion of party autonomy: By allowing parties to agree on the extent to which the arbitral tribunal can decide on its jurisdiction, China can further the principle of party autonomy and enable parties to tailor the arbitration process to their needs, contributing to the overall efficiency of the process.

4. Development of consistent jurisprudence: Drawing from the United States' experience in developing a coherent body of case law around the principle of competence-competence, China can

encourage the publication of arbitral awards and scholarly analysis, fostering a consistent and harmonized understanding of the principle among practitioners and academics.

5. International collaboration and harmonization: Engaging in dialogues and cooperation with other jurisdictions and international arbitration institutions can help China to learn from best practices and incorporate them into its arbitration framework. This will not only strengthen the Chinese arbitration system but also enhance its global reputation and attractiveness to foreign parties.

By implementing these lessons from the United States' experience, China can strengthen the role of the arbitral tribunal, simplify the arbitration process, and promote the efficiency of arbitration proceedings. Furthermore, the recognition of the principle of competence-competence would contribute to the harmonization of arbitration practices across different legal systems and enhance the global reputation of Chinese arbitration institutions.

## **5. The Future of Chinese Arbitration Law: Embracing Competence-Competence and Aligning with International Practices**

At present, the majority of national arbitration laws and arbitration rules recognize the principle of competence-competence, and courts are increasingly seen as *ex post facto* reviewers of the tribunal's jurisdiction. The new provisions in the Chinese Exposure Draft, which address the discretionary jurisdiction of arbitral tribunals, undoubtedly reflect the alignment of Chinese arbitration law with international practices. Affirming the principle can effectively reduce the negative impact of court review on the power of the arbitral tribunal, which is conducive to a more comprehensive role of the arbitral tribunal in dispute resolution and reduces the workload of the courts in reviewing arbitration jurisdiction. It is anticipated that this provision will be implemented and refined in the revision of the Arbitration Law.

Regarding future trends in Chinese Arbitration Law, we can foresee the following developments: the abolition of the right of arbitration commissions to decide on jurisdictional challenges, the establishment of the principle of competence-competence, the abolition of the right of courts to decide on jurisdictional challenges to arbitration, and the recognition of the primacy of the arbitral tribunal. These developments will help streamline the arbitration process in China, making it more efficient and internationally recognized.

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- [10] Arbitration Law of the People's Republic of China, Art. 20 "If a party challenges the validity of the arbitration agreement, they may request the arbitration commission to make a decision or apply to the people's court for a ruling. If one party requests the arbitration commission to make a decision and the other party applies to the people's court for a ruling, the people's court shall give a ruling."
- [11] *BY. O. v. Yushang Group Co, Ltd.*(case regarding dispute over jurisdiction objections in service contract)

- [12] Notice of the Ministry of Justice on the Arbitration Law of the People's Republic of China (Amendment) (Draft for Public Comments), Art. 28 “If the parties have objections to whether an arbitration agreement exists or is equally effective, or to the jurisdiction of an arbitral case, it shall be submitted within the time limit prescribed by the arbitral rules and the court shall make a decision. Prior to the establishment of the arbitral tribunal, the arbitration body may decide on the basis of superficial evidence whether to continue the procedure. Where the parties object directly to the people's court without the procedure prescribed in the preceding paragraph, it shall not be accepted. Where a party has objections to the validity of the arbitration agreement or the decision on jurisdiction, it shall, within ten days from the date of receipt of the decision, submit a review to the middle-level people's court of the place where the decision is made. Where a party disagrees with the ruling that the arbitration agreement is invalid or that an arbitral case has no jurisdiction, it may apply for reconsideration to the people's court at the higher level within 10 days from the date of delivery of the decision. The people's court shall make a decision within one month from the date of acceptance of the application for reconsideration. The examination by the people's courts shall not affect the course of the arbitration procedure.