



HAN KUN LAW OFFICES

Legal Commentary



CHINA PRACTICE • GLOBAL VISION

December 4, 2018

Dispute Resolution

Offshore Emergency Arbitration Procedures and the Need for Emergency Refinancing Restricted by Investors' Consent Rights

Chen Xianglin | Sun Ying

A company requires emergency refinancing but is restricted by the original investors' consent rights—is there a legal channel for the company to seek relief? The answer is “yes”. Emergency arbitrator procedures can be initiated to seek relief if international arbitration is the agreed dispute resolution method in the cross-border investment and financing agreements, and the selected arbitration institution rules provide for emergency arbitrator procedures. This article will provide a brief introduction to emergency arbitrator procedures in international commercial arbitration and the review criteria on which arbitrators will grant emergency relief.

What are emergency arbitrator procedures?

Parties to a dispute often encounter certain emergency circumstances after the dispute occurs. In such cases, the parties may suffer irreparable loss or damage if they do not seek emergency relief from an authoritative third party. In judicial proceedings, the parties involved are generally allowed to apply to a court for temporary measures (such as pre-action security, prior execution, etc. under PRC law) before or concurrently with the proceedings.

In international commercial arbitration, many international arbitration institutions provide emergency arbitrator procedures to solve the urgent needs of the parties involved. Emergency arbitrator procedures refer to the appointment by an arbitration institution, at the request of a party, of an emergency arbitrator to hear an application for emergency relief from the party and to make a decision, order or award, at the initial stage of the arbitration case (before the formal constitution of the arbitral tribunal).

Emergency arbitrator procedures have the following characteristics:

- **Urgency.** Considering the urgency of issues awaiting to be decided, emergency arbitrator procedures have a tight schedule from commencement to end. The arbitration rules of many arbitration institutions have clear time limits for the arbitration institution to appoint an emergency arbitrator and time limits for the emergency arbitrator to make an emergency decision after the procedure commences.
- **Procedural.** An emergency arbitrator hears applications for emergency relief only for the purpose of deciding whether to grant emergency relief. The emergency arbitrator will only preliminarily review, and will not decide on, substantive issues, which will be left for the formally constituted arbitral tribunal.
- **Temporary.** An emergency arbitrator may no longer exercise his powers after the arbitral tribunal has been constituted. An emergency arbitrator who has already exercised his powers before the arbitral tribunal is constituted may not be appointed as a member of the arbitral tribunal. An Emergency Decision that has been issued may be amended, suspended or terminated by an emergency arbitrator or the arbitral tribunal (once constituted).

What is the process to appoint of an emergency arbitrator?

Taking the “Arbitration Rules” (Appendix 4) promulgated by HKIAC on November 1, 2018 as an example, the basic procedures for appointing an emergency arbitrator are as follows:

- **The party submits an application for the appointment of an emergency arbitrator.** The party applying for emergency relief may submit an application for the appointment of an emergency arbitrator to the arbitration institution before, at the same time as or after the submission of an arbitration notice (in any case, before the constitution of an arbitral tribunal). If necessary, the applicant should also submit other documents or information that will help to improve the efficiency of reviewing the emergency arbitration application.
- **Designating an emergency arbitrator.** If HKIAC decides to accept the emergency arbitration application, it will appoint an emergency arbitrator within 24 hours of receipt of the application and advance payment, and subsequently hand over the relevant case materials to the emergency arbitrator.
- **Case hearings.** The emergency arbitration procedure can be carried out in the manner as the emergency arbitrator deems appropriate after the emergency arbitrator takes over the case. For example, an emergency arbitrator may stipulate the time limit for the parties to express opinions and submit evidence, and may decide on the specific hearing arrangements.

- **Rendering an Emergency Decision.** The emergency arbitrator will render a decision with respect to the emergency relief application submitted by the parties within 14 days from the date of receiving the case from HKIAC, or within a time limit as otherwise agreed by the parties or extended by HKIAC.

What are the criteria for reviewing an emergency relief application?

Generally, emergency arbitrators will substantively review the emergency relief applications mainly from the following three perspectives:

- **Urgency and the Need to Avoid Irreparable Harm**

One of the key considerations in the review of an emergency relief application is whether the relief is so badly needed that it cannot be delayed until the constitution of the arbitral tribunal. Article 2 of Appendix 4 of the HKIAC Rules stipulates the contents to be included in an emergency arbitration application, which explicitly provides that the applicant must state in the application the reasons for applying for emergency relief before the constitution of the arbitral tribunal.

In order to prove the “urgency” of the application, applicants are also required to prove that irreparable harm would potentially be result if emergency relief is not granted. In practice, applicants are required to prove that they may suffer irreparable harm and the subsequent arbitration procedures may not provide sufficient relief if emergency relief is not granted.

Specifically, the company seeking emergency refinancing in our hypothetical may try to prove that it will face an imminent risk of bankruptcy and completely lose access to the relevant markets if alternative financing is not allowed and a rapid infusion of funds is not obtained. In most cases, the applicant only needs to present persuasive proof in support of its position and does not need to prove that bankruptcy will necessarily occur if no relief is obtained.

- **Likelihood of Success on the Merits**

If the arbitration requests of the applicant for emergency relief are likely to be completely untenable, the emergency relief, if granted, will be at high risk being inconsistent with the final arbitration award. Therefore, the likelihood of an applicant for emergency relief to succeed on the merits of its claims in arbitration is one of the basic considerations in deciding whether to grant emergency relief in international arbitration practice. For example, section 23.4(b) of the HKIAC Rules provides that a criterion for granting emergency relief is the likelihood of success on the merits of the underlying claims.

The likelihood of success is typically judged on the basis of a “reasonable possibility” standard. Applicants for emergency relief bear the burden of proving that there is a reasonable possibility of success. Emergency arbitrators will generally consider the likelihood of success from the

perspective of a reasonable third person who understands the relevant factual background. This means that emergency arbitrators will heavily depend on their discretionary evaluation of evidence to make a decision with respect to a specific case.

It is worth noting that an emergency arbitrator's determination of the "likelihood of success" is mainly based on his general understanding of the case and a review of the prima facie evidence during a short period of time. This determination should not affect the arbitral tribunal's hearing and judgment of the substantive issues of the case once it has been constituted.

➤ **Balance of Convenience / Harm**

In practice, serious harm may result if emergency relief is improperly granted. Therefore, emergency arbitrators should weigh the damage avoided by the emergency relief and the harm potentially caused if the relief is improperly granted. Emergency arbitrators will prefer not to grant emergency relief if the damage caused by the emergency relief is likely to be greater than the damage avoided by the relief itself. In international arbitration, the above principle is broadly used for determining whether or not to grant emergency relief and interim measures, and is known as the "balance of harm" or "balance of convenience" principle.

Specifically, factors that emergency arbitrators will consider in applying the balance of convenience principle include: the damages which may result from granting the emergency relief, the damages which may result if the emergency relief is not granted, whether the relevant damages can be remedied through due process and the possibility of the wrongly granting emergency relief. Some of these factors overlap with the irreparable harm principle and likelihood of success on the merits principle. In essence, the purpose of the balance of convenience principle is to guide emergency arbitrators to review emergency relief applications from a holistic perspective and to make decisions that produce more equitable outcomes.

The company applying for emergency refinancing relief may face bankruptcy if its application is denied and it is unable to obtain alternative financing. In this respect, the granting of emergency relief would benefit all shareholders (including those with consent rights). On the other hand, if the company's application is approved, alternative financing may cause certain harm to the original investors, such as equity dilution, stock devaluation and so on. Thus, the emergency arbitrator in this case should give consideration to reducing the concerns of investors with consent rights when reviewing the company's emergency relief application.

● **Important Announcement**

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact **Mr. Chen Xianglin** (xianglin.chen@hankunlaw.com, Wechat ID: 13521469731).