REVIEW OF CHINA ARBITRATION

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INTRODUCTION

Arbitration has a strong tradition in China due to encouragement by the Chinese government and an underdeveloped judiciary, which most foreign parties want to avoid. More arbitrations are handled each year in China than by any other arbitration institution or country. There are currently over 160 arbitration commissions throughout China.

China has a bifurcated arbitration system—domestic and foreign related (international). 'Domestic' cases include not only two Chinese parties, but also parties with foreign investors. 'Foreign related' means at least one foreign party, or a foreign subject matter, is involved in the arbitration.

The current arbitration regime in China is based on the 1995 *Arbitration Act* (the 'Act') which revised the 2005 CIETAC (China International Economic and Trade Arbitration Commission) Rules. This regime represents a significant advance in arbitration as it has been traditionally practised in China–related disputes. The regime places greater focus on international arbitral 'best practice' and as such will provide significant reassurance to parties investing in China and parties in dispute with Chinese counterparts. That being said, Chinese arbitration continues to be in a state of development.

Some important features include:

• If there is a valid arbitration clause, the jurisdiction of the Chinese Courts is precluded and interference by the Courts and government administration is disallowed. Courts usually only get involved at the enforcement stage, with the Supreme People's Court vetting any decision of a lower court not to enforce.

• The parties are free to appoint Chinese or foreigners as their arbitrators from the CIETAC Panel, which comprises about 1,000 arbitrators, 400 from overseas. Additionally there are specialist panels such as construction.

• Foreign lawyers can be employed to act as agents in the process of arbitration.

• The parties are free to choose the proper law applicable to the settlement of disputes, except disputes arising from an Equity Joint Venture, foreign investment enterprise or contracts on joint exploration of natural resources, to which Chinese law must apply.

• Arbitration awards rendered in China are final, and not subject to appeal to the Court.

• It is possible to select an arbitration body other than CIETAC, if this is specified in the arbitration clause of the contract, or by an agreement signed after the dispute occurs (Article 128 of the Contract Law).

CIETAC RULES

CIETAC is the main arbitration commission for resolving disputes between Chinese and foreign parties. Some of the main features of the CIETAC rules are set out below:

• In response to some criticism, the 2005 rules adopted many best practice standards of international arbitration bodies.

• Parties may now select an arbitrator by agreement who is not on the CIETAC panel (but who must be approved by CIETAC). There are around 400 foreigners on the CIETAC panels, which include a panel for Foreign Related Disputes and six specialised panels, of which construction is one.

• Parties now have the freedom to adopt their own rules or to modify

CIETAC rules, except where such agreed rules conflict with the mandatory laws of the seat of arbitration.

• Parties can select a seat (or venue) of arbitration outside China. However, a note of caution—in arbitrations involving only Chinese parties, an award made outside China may not be enforceable. Under Article 128 of PRC Contract Law, parties to a contract with 'a foreign element' have the option to arbitrate inside or outside China, but interpretations of PRC law indicate that the two PRC parties must maintain China as the seat of arbitration. This is a significant issue for foreign investors, because common forms of investment in China are either through an Equity Joint Venture, a PRC incorporated foreign investment enterprise, or a joint exploration of natural resources, where both parties are treated in arbitration as Chinese 'domestic parties', and are therefore subject to the domestic arbitration regime.

• Article 29 provides that the tribunal is to act impartially and fairly, and must afford the parties a reasonable opportunity for presentation and debate. CIETAC attaches great importance to the arbitrators' neutrality and independence. The tribunal is also permitted to adopt either an inquisitional, or an adversarial approach, subject to any agreement by the parties. This is a significant step for those lawyers from a common law background, who like to have the opportunity to cross–examine witnesses.

• The previous restriction on capping recoverable costs by the winning party (10% of total award) has been removed. The tribunal has wide discretion to award costs to the winning party.

• The time limit for the Arbitral Tribunal to produce an award has been reduced from nine to four months. However this can be extended by agreement.

• One of the only measures that the revised CIETAC Rules has not addressed, is the requirement that the sole or presiding arbitrator be of a different nationality to either party. However if this requirement is specified in institutional rules, it will be honoured. Yet absent agreement, it is inevitable that in any CIETAC arbitration there will be two Chinese arbitrators. This often worries foreign investors. Despite this, unofficial statistics show that for CIETAC arbitrations involving three Chinese arbitrators, or a tribunal of two Chinese arbitrators and one foreign arbitrator, over half of those arbitrations were concluded in favour of the foreign party.

CONCILIATION AS PART OF ARBITRATION

A positive feature of CIETAC arbitration is the combination of arbitration with conciliation, which has a long history in China. Conciliation depends on mutual agreement of the parties. This process is popular because it avoids a separate conciliation procedure, saves time and costs, enables the parties to keep good relations and guarantees an enforceable settlement arrangement (settlement is made into an award).

Conciliation in arbitrations has had a high success rate. Many western lawyers might question whether parties would, in reality, be willing to disclose their true bottom line to the conciliator, because, if no deal is achieved, this may jeopardise their pleaded claims in the arbitration. Nevertheless, this procedure has proved to be a success in China.

AD HOC ARBITRATION

Ad hoc arbitration is invalid in China by reason of Article 16 of the PRC Arbitration Law which provides that the arbitration agreement must designate 'an arbitration commission' selected by the parties. Article 18 further provides that if the arbitration agreement does not reference an arbitration commission, absent the parties reaching a supplemental agreement, the arbitration agreement shall be invalid (*Peoples Insurance Company of China, Guangzhou Branch v Guangdong Guangzhe Power Co Ltd* [2003]).

Despite these provisions, it should be noted that foreign ad hoc arbitration awards have been enforced in China. *Guangzhou Ocean Shipping Company v Marships of Connecticut* (1990) recognised three arbitral awards made by an ad hoc tribunal in London.

A question often asked by foreign investors is whether the International Chamber of Commerce (ICC), and any other foreign arbitration institution is recognised as an 'arbitration commission' that may conflict with Chinese judicial decisions. Two Supreme Court decisions have deemed foreign arbitral institutions as 'arbitration commissions'. However *Guangzhou Maritime Case* (2005) held that a clause specifying the ICC clause was invalid.

Parties should note that if they specify that UNCITRAL (United Nations Commission on International Trade Law) Rules apply as the commission, the arbitration clause would be held invalid as UNCITRAL is not an 'arbitration commission' under Chinese arbitration law.

INVALID ARBITRATION CLAUSES

Based on the above laws, it is likely that poorly drafted arbitration clauses are invalid for the reasons set out below:

• clause provides the option to submit dispute to arbitration or to the Court

• clause specifies more than one arbitration institution—void unless the parties reach agreement on one institution

• clause provides for 'arbitration at the commission in Shanghai.' There is more than one institution in Shanghai—void unless parties reach agreement on one institute, and

• clause inaccurately states the name of the arbitration commission—void unless one can reasonably infer the name, e.g. CIETAC spelt CETAC.

ENFORCEMENT OF FOREIGN AWARDS

China ratified the New York Convention in 1987 with a reciprocity reservation and commercial reservations. Therefore, recognition and enforcement of foreign arbitral awards in China is limited to awards made in other contracting states to the NY Convention, or states with which China has entered into a bilateral treaty concerning enforcement of awards. Further, China will only enforce 'commercial awards' as convention awards, but 'commercial' is given a wide definition in the convention.

CIETAC awards or foreign arbitration awards may be enforced in China upon direct application to the Intermediate Peoples Court.

(a) The Civil Procedure Law sets out the rules and procedures governing the recognition and enforcement of foreign arbitration awards. An application must be made within six months of the publication of the award in the case of companies, and one year for individuals.

(b) Once the court accepts the application it will examine the case, but this does not involve any investigation of the facts or on the application of the law.

(c) Pursuant to Article 58 of Chinese Arbitration Law, enforcement may be refused only on limited grounds, in accordance with the NY Convention which includes:

• Invalidity of the arbitration agreement or incapacity of a party.

• Lack of proper notice of the appointment of the tribunal.

• The award was made wholly or partly outside the arbitral tribunal jurisdiction.

• The composition of the arbitral tribunal, or the arbitration procedures, was not in accordance with the agreement of the parties, or with the law of the place of arbitration.

• Evidence on which the award is based was forged, or the arbitrators committed embezzlement.

• The award is contrary to social and public interest (Article 260 of PRC Civil Procedural Law)—It is difficult to know under what circumstances a court would hold that the award contravenes 'public policy'. However, mere incompatibility with law of seat of arbitration is not a sufficient ground.

(d) In the past, foreign companies have experienced difficulty in enforcing arbitration awards in China, due to cosy connections between the courts and local companies, against whom an award has been issued. Notwithstanding, the current law makes it much more difficult to resist enforcement, due to the limited grounds available, and the supervisory role of the People's Supreme Court.

(e) Hong Kong and China international (foreign) awards are enforceable in both jurisdictions pursuant to a 1999 Memorandum of Understanding.

It should be noted that it is still extremely difficult to enforce a foreign court judgment in China. Given this, arbitration is to be preferred as a method of binding dispute resolution.

CONCLUSION ON ARBITRATION IN CHINA

Chinese arbitration laws are often subjected to criticism, much of if it unwarranted. Current China arbitration laws, and CIETAC Rules, are now in line with international practice and the efficiency and effectiveness of the process will continue to improve. Problems do remain however, including with enforcement of awards in China due to a weak and undeveloped judiciary, but there have been noticeable improvements, particularly in relation to the People's Supreme Court's overall supervisory role.

Foreign investors should also beware that adopting certain structures for investment will make Chinese law mandatory, and consequently the arbitration must also be held in China.

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