Introduction to Arbitration in the People's Republic of China

By Brenda Horrigan and Helen Tang

With the PRC now the world's second largest economy and with its exponential expansion around the world, the number and size of business dealings by international companies with Chinese counterparties are rapidly increasing. Hand in hand with this increase in the number of transactions has come an increase in the number of disputes. Moreover, as the bargaining power of Chinese companies (especially Chinese state-owned companies) rises, an ever-growing number of such disputes are being heard through arbitration within the PRC.

While arbitration within the PRC remains preferable to litigation in PRC courts—which is more likely to suffer from local protectionism, rigid and alien court procedures and a less sophisticated judiciary—it entails certain jurisdiction-specific features that differentiate it from international arbitration outside of the PRC.

This article will discuss the basics of arbitration within the PRC, the risks that one should try to avoid, and some tips for facilitating conduct of an arbitration seated in the PRC.

Distinction Between Domestic and Foreign-Related Disputes

For arbitrations in the PRC, the first distinction one needs to make is between "domestic" disputes and "foreign-related" disputes. This distinction is important because it will affect the way that a dispute can be resolved, and also the standard of review on enforcement.

Domestic disputes can only be resolved by litigation in PRC courts or by domestic arbitration seated in the PRC, administered by a Chinese arbitration commission; neither arbitration outside of the PRC nor *ad hoc* arbitration within the PRC is allowed for such matters. Foreign-related disputes, on the other hand, may be arbitrated or litigated either within or outside of the PRC, and if arbitrated outside of the PRC may be either administered by an international arbitration institution or conducted on an *ad hoc* basis.

Another difference, as discussed below, is that the PRC courts have more scope to review an award rendered in a domestic arbitration within the PRC than they do with respect to awards rendered in foreign or foreign-related arbitrations.

The PRC Supreme People's Court has provided guidelines to aid in distinguishing between domestic and foreign-related disputes.[1] A dispute with one or more of the following elements is regarded as foreign-related:

(1) At least one of the parties is foreign. For a company, this means that its place of incorporation must be outside of the PRC. A foreign-invested company incorporated in the PRC, even if 100% foreign-owned, will be regarded as a domestic Chinese party. On the other hand, companies incorporated in Hong Kong, Macau and Taiwan are regarded "foreign" for this purpose, and their participation in a transaction would give it a foreign element. It is also common practice, when two foreign-invested Chinese companies enter into a contract, for their foreign parents to enter into a guarantee arrangement with an arbitration clause so that future disputes can be submitted to arbitration between the parent entities outside of the PRC.

(2) The subject matter of the contract with respect to which dispute arises is or will be wholly or partly outside of the PRC. For example, a contract for acquisition of an asset in Hong Kong would normally be foreign-related; similarly, if the subject matter of the contract is goods to be exported abroad, it will generally be regarded as foreign. (It should be noted, however, that there are cases where contracts for the sale of parts in China, which were then to be assembled into end products to be exported abroad, have been held to be not foreign related.)

(3) There are other legally relevant facts "as to occurrence, modification or termination of civil rights and obligations" which occur outside the PRC. Some commentators argue that if a contract is executed outside the PRC, it should be regarded as foreign-related. However, a completely "artificial" foreign element, e.g., where two Chinese parties fly to Hong Kong solely to execute a contract that has no other foreign element, would normally not be sufficient. Given the uncertainties in interpretation, this ground is not widely used to establish the "foreign-related" qualifications of a dispute.

Arbitration Seated in the PRC

As mentioned above, all domestic disputes must be arbitrated (or litigated) within the PRC. Also, although not compulsory, there are an increasing number of foreign-related contacts that provide for arbitration seated in the PRC, usually because the Chinese party has stronger bargaining power (e.g., the Chinese party is a high-powered State-owned enterprise).

Arbitration seated in the PRC has some special features that differentiate it from international arbitrations commonly seen in other developed countries. Understanding these features and taking measures to mitigate the relevant risks can make an arbitration seated in the PRC more manageable.

According to article 16 of the PRC Arbitration Law, a valid arbitration agreement (or arbitration clause in the relevant contract) providing for arbitration seated in the PRC must be concluded in writing, and it must include:

(1) an indication of the intention to arbitrate;

(2) clear provisions on the scope of matters to be arbitrated; and

(3) a selection of an arbitration commission.

The prevailing view in the PRC is that the requirement of "indication of the intention to arbitrate" makes invalid the type of "one-sided" arbitration agreements that one might encounter in other jurisdictions—such as where one party is given the right to choose between arbitration and litigation, or between two different arbitration institutions at the time the dispute arises.

The third requirement under Article 16 is the most difficult. In most arbitration-friendly jurisdictions, the lack of a selection of an arbitration institution in an arbitration clause will not make the whole clause invalid, although it might make the arbitration process more complicated. In the PRC, however, an arbitration clause will be struck out as void if it does not specify an "arbitration commission." A clause with clear choice of the rules of arbitration, but lacking a clear choice of the arbitration commission, can also be held to be void, unless the selected arbitration rules clearly provide for the selection of the relevant arbitration commission.

Moreover, the general view is that the "arbitration commission" selected must be a domestic PRC arbitration commission, and not an international arbitration institution such as the ICC or the Hong Kong International Arbitration Center ("**HKIAC**"). There have been cases where the PRC courts have held that an arbitration clause providing for ICC arbitration seated in the PRC is void.[2] In a more recent 2008 case, the intermediate people's court in Ningbo city did recognize and enforce an arbitral award rendered by an arbitration administered by the ICC within the PRC;[3] however, the legal reasoning of the case has been widely criticized, and the case in any event has no binding or persuasive effect on any future decisions.[4]

The most commonly selected arbitration commission within the PRC, especially for foreign-related disputes, is the China International Economic and Trade Arbitration Commission ("**CIETAC**"), headquartered in Beijing. CIETAC was established in 1956 and, according to its annual reports, has administered around 500 foreign-related arbitrations each year for the past decade. The Beijing Arbitration Commission ("**BAC**") and the Shanghai Arbitration Commission are also acceptable choices for administering foreign-related arbitrations, although neither yet has a caseload history matching that of CIETAC. Other local arbitrations commissions[5] within the PRC tend to be less sophisticated and their case management skills are unlikely to meet international standards.

According to article 13 of the PRC Arbitration Law, arbitrators for arbitrations seated in the PRC must meet certain qualifications, including a requirement of having eight years of arbitration or legal experience (as a lawyer or a judge), or having equivalent professional knowledge. Each arbitration commission keeps its own panel/list from which arbitrators are drawn. The CIETAC panel contains some 1,000 names, of which 45 are from Hong Kong, Macau and Taiwan, and another 218 are from elsewhere outside the PRC. In a CIETAC arbitration, appointments from outside of the CIETAC panel are only permitted upon agreement of all parties and confirmation by the chairman of CIETAC.[6] In BAC arbitrations, appointments from outside the panel are permitted as long as the dispute is foreign-related.[7]

There are also practical differences between the manner in which arbitrations are conducted by CIETAC or BAC as compared to many other international arbitration institutions. As a general matter, most proceedings involve only a single round of pleadings (although with a Reply to Counterclaim allowed if a counterclaim is raised by the Respondent) which are often completed prior to full constitution of the tribunal. There is little or no provision for discovery/disclosure. Submission of documentary evidence and witness statements (if any) occur relatively late in the process, and there is only limited reliance (if any) on expert testimony (even for questions of quantum). Additionally, although the institution may prepare a recording or other record of the hearing for use by the tribunal in its deliberations, that record generally is not made available to the parties.

Most of these practical differences, however, can be ameliorated through appointment of experienced international arbitrators to the tribunal. By providing in the arbitration agreement requirements that English be the language of the arbitration, that a 3-member tribunal be appointed, that the chair be of a nationality different from that of the parties to the dispute, and that the parties are free to appoint arbitrators from outside of the panel system, the contracting parties can help to ensure that they are able to draw upon as broad of a pool of experienced practitioners as possible to hear their dispute.

Enforcement of Arbitration Awards in the PRC

When it comes to enforcement of arbitral awards in the PRC, the distinction between domestic and foreign-related disputes is again very important.

The PRC is a member state of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("**Convention**"). As a result, enforcement of PRC-seated arbitral awards in other Convention countries, and enforcement in the PRC of arbitral awards rendered in other Convention countries, are fairly straight forward. PRC courts can only refuse recognition or enforcement of an arbitral award rendered outside of the PRC based on the grounds set forth in the Convention, which are generally limited to severe infringements of procedural norms.

In addition, as a further protection for enforcement of foreign arbitral awards, the PRC courts have introduced a pre-reporting system. Under that system, a request for recognition and enforcement of a foreign arbitral award is first submitted to an intermediate people's court. If that court decides to recognize and enforce the award, it may do so without any further report to or approval from its superior court. However, if an intermediate people's court is minded to refuse recognition or enforcement of a foreign arbitral award, that court must report its intention to its superior court to get approval. If the superior court agrees with the proposal to refuse recognition and enforcement, that court must in turn report that intention to the Supreme People's Court. Through this system, no foreign award can be refused recognition and enforcement without the blessing of the Supreme People's Court. The existence of this pre-reporting system has reduced the incentive of courts to refuse recognition or enforcement of foreign awards on arbitrary bases, although the system does result in delays in the recognition and enforcement process.

A foreign-related arbitration award rendered within the PRC will be protected by this same pre-reporting system, and the standard of review under PRC law for such awards essentially parallels that existing under the New York Convention for foreign awards. However, if the underlying dispute is purely domestic, the pre-reporting system will not apply. Moreover, in reviewing awards rendered within the PRC with respect to domestic disputes, the relevant PRC court has considerable latitude in its review of, and interference in, the decisions of the arbitral tribunal, both on substantive grounds and on grounds of procedural irregularities. Specifically, in addition to New York Convention-type grounds, PRC courts have the right to overturn an award rendered in respect of a domestic dispute upon a finding of (1) error in the application of law by the arbitral tribunal; (2) lack of evidence to ascertain the facts; (3) a showing that the evidence on which the award was based was forged; or (4) a showing that a party withheld evidence sufficient to affect the impartiality of the arbitration.

Conclusion

As demonstrated above, there are many challenges and pitfalls involved in arbitration in the PRC. However, with careful planning and foresight, many of these difficulties can be avoided or minimized. As the number of arbitrations within the PRC involving foreign parties continues to increase, arbitration within the PRC will continue its progression towards parity with international standards.

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Endnotes

1. See Article 178 the Opinions of the Supreme People's Court on Several issues concerning the Implementation of the General Principles of the Civil Law on 26 January 1998, and Article 304 of the Opinions of the Supreme People's Court on Several issues concerning the Implementation of the PRC Civil Procedure Law on 14 July 1992.
2. See, e.g., *Züblin International GmbH v. Wuxi Woke General Engineering Rubber Co., Ltd.* (decided by the PRC Supreme People's Court in July 2006).
3. *Duferco SA v. Ningbo Arts & Crafts Import & Export Co* (decided by the Ningbo City Intermediate People's Court in April 2009).
4. The Ningbo court relied on the New York Convention in its decision to enforce, treating the award (though rendered within the PRC) as a "French" award because the ICC's headquarters are in France. Because the lower court ordered enforcement, its decision was not reviewed by the higher courts and the Supreme People's Court's view on this case is unknown.
5. According to statistics available, there are over 200 arbitration commissions in China.
6. See article 24(2) of the 2012 CIETAC Rules.
7. See article 55(1) of the 2008 BAC Rules.

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