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POSSIBILITIES OF IMPARTIAL AND EFFECTIVE DISPUTE RESOLUTION IN INTERNATIONAL BUSINESS TRANSACTIONS WITH CHINA

Christoph J. Vaucher

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CHRISTOPH J. VAUCHER
CMS Zurich, Hong Kong and Shanghai

1. The problem: Litigation in Chinese or foreign Courts or CIETAC Arbtiration do not always provide an impartial and effective mechanism for the resolution of business disputes between Chinese and foreign parties

1.1 Introduction

The dramatic increase in foreign investment and trade with China since the beginning of Deng Xiaoping's groundbreaking economic reforms in 1978, which will experience another strong boost in the years following China's accession to the World Trade Organization (WTO) in September 2001, has resulted and continues to result in a rise in the number of disputes between foreign and Chinese business parties. Given its awareness that in order to promote further trade and to attract more foreign investment, the development of a fair, objective, efficient and predictable dispute resolution system is of crucial importance, the Chinese government has made remarkable efforts to improve the reliability and credibility of China's court system and to promote the rule of law. Furthermore, with the establishment of the new China International Economic and Trade Arbitration Commission (CIETAC) in 1988 (followed by the 1989, later amended CIETAC Arbitration Rules) and the promulgation of its first Arbitration Law on August 31, 1994, China put in place the basic institutions and laws which enable Chinese and foreign parties to have their business disputes resolved in China by alternative dispute resolution mechanisms such as mediation and arbitration.

The Chinese government doubtlessly deserves a great deal of respect and admiration for all these fundamental reforms of China's legal system in a very short period of time, notably in light of the fact that during the entire previous era of Mao Tse-tung from 1949 until 1976, the country had been almost exclusively governed by directives and orders of the Communist Party, rather than by enactments from legislative bodies, and courts would almost blindly follow such orders. But in spite of these hitherto impressive achievements in reforming the mechanisms of law-making and law-enforcement, China's current dispute resolution systems are still not entirely reliable, especially if they are measured against the standards of Western jurisdictions with a long-established modern legal culture.

This opinion is also shared by the next Director-General of the WTO, Thailand's former Deputy Prime Minister and Minister of Commerce, Dr Supachai Panitchpakdi (Dr Supachai's term will begin on September 1, 2002), who wrote in his recent book *China and the WTO; Changing China, Changing World Trade:* "Genuine economic development cannot occur without a strong legal system. World Bank data shows that countries with good legal institutions are richer, more literate and have dramatically lower rates of infant mortality. [...] The decision to build a stronger legal system isn't just a technical issue. It is, as [World Bank President James] Wolfensohn noted, a profoundly political one. And here it's hard to be optimistic about China. Officials talk too often of rule *by* law. Only the most enlightened talk of the rule *of* law, a system that in the courtroom puts a citizen on equal footing with the government."[1] These present shortcomings in China's dispute settlement system are even confirmed by some members of China's judiciary themselves. Recently, Wu Zaicun, a judge with the Beijing No. 1 Intermediate People's Court was quoted in China's English-language newspaper *China Daily* as follows: "A gap between the actual conditions of judges and expectations of the general public still exists."[2]

The lack of independence from political bodies, the often questionable impartiality, transparency, efficiency and effectiveness of Chinese courts and arbitration bodies who apply inconsistent and ambiguous laws can severely impair the justified interests of parties to a legal dispute, before all foreign parties doing business with China.

The purpose of this paper is to give an overview of the main shortcomings in the Chinese dispute resolution regime (Chapter 1), especially from the perspective of foreign businesses, and to present some possibilities of

1. Supachai Panitchpakdi and Mark L. Clifford, *China and the WTO; Changing China, Changing World Trade*, Singapore 2002 at p. 147.
2. Dian Tai in *China Daily*, article *Judges told to improve quality*, Vol. 22 of July 6–7, 2002 at p. 2.

how these problems can be avoided or at least minimised by choosing alternative means (Chapter 2).

1.2 Litigation in Chinese courts: Poorly trained judges susceptible to corruption and regional protectionism as the major obstacle to impartial and effective dispute resolution

China has recently made progress in developing a legal system that reflects, and in some respects is consistent with international norms. Prolific legislative activity and increased emphasis on law implementation and enforcement are positive steps and indicate that China is serious about the establishment of a genuine legal system based upon the principle of the Rule of Law, *i.e.* the regular and impartial administration of public rules.

Nevertheless, the Confucianist and communist legacy of the past and persistent political interference raise questions as to whether a true rule of law exists, or will ever exist in China. The extensive use of personal connections combined with the widespread institutions of nepotism which has allowed senior party cadres and their families to monopolise key business and local or regional political power seriously undermines the public's confidence in the judicial system. *Consequently, there is currently no assurance that the Chinese courts follow the written law without regard to politics.*

Local protectionism is still a serious problem in many Chinese courts, especially if these courts have to deal with economic disputes involving non-local Chinese or even foreign parties. It often occurs that a Chinese court refuses to accept or delays a case brought by a party from outside the area, competes with other courts for jurisdiction over cases, or favors local parties in adjudication, mediation and the enforcement of judgments. This problem arises because judges are typically drawn from the area in which they reside and is exacerbated by the fact that the budget for each court is determined by the local government where the court sits. Local allocation of funds for judicial services has led to inconsistent levels of service from province to province and has also rendered courts dependent the whims of local ties and relationships. Hence, it is in the self-interest of a judge to protect local litigants by either taking jurisdiction over such cases and issuing rulings favorable to local litigants or refusing or delay to enforce unfavorable rulings rendered by other courts against local litigants.[3]

The problem of partiality of judges is often combined with the inadequate legal training of Chinese judicial personnel. For many years, judges had been appointed from the ranks of military and had little legal background. Only quite recently have judges been required to pass an examination that establishes a minimum level of competency in law and only in 1995, China enacted the Judges Law which specifies the educational and legal requirements for membership in the judiciary.[4] But in spite of these efforts, most Chinese judges are still far from being sufficiently trained to adjudicate complex disputes, notably disputes arising out of intricate international business transactions which require a high degree of technical legal and economic knowledge.

1.3 Litigation in foreign courts: Often impartial and effective, but choice of foreign forum and enforcement of foreign judgments in China faces numerous obstacles

Although far from being flawless, there can be no serious doubt that litigation in the courts of western European jurisdictions or in the United States characterises itself to be based on firmly established, predictable, sophisticated and enforceable legal rules. These courts act independently from the political powers of the legislative and executive bodies and their fact and law finding process follows the principle of Due Process. Finally, although there may be significant differences between and within certain countries, judges must usually fulfil comparatively high standards of legal training before they are appointed.

Under the Chinese Civil Procedure Code (Article 244 CPC), the parties to a contract involving foreign interests can include a *choice of forum clause* in their contract, *i.e.* they may stipulate that a foreign court at a foreign venue shall resolve any dispute arising out of or in connection with their contract. But this provision is limited in application. For a dispute involving a Chinese-foreign equity joint venture, a Chinese-foreign cooperative joint venture, or a Chinese-foreign joint venture involving natural resources exploration and development in China, *the Chinese people's courts have mandatory jurisdiction and also the application of Chinese law is mandatory* (Article 246 CPC). Moreover, the forum chosen must have "substantial connections" to the dispute which is a rather vague requirement which can be applied in many ways, often depending on what protects more the interests of the local Chinese party to a dispute.

In the remaining cases for which Chinese law allows the parties to choose a foreign forum and law (*e.g.* sales, distribution or license contracts between Chinese and foreign parties), the past experience of many foreign parties has been that *enforcement of foreign court judgments in China is very difficult to obtain, notably if the judgment-debtor is a Chinese party.* Up to date and in contrast to foreign arbitral awards (see Chapter 2.3 below), China has not entered into any international treaty on the recognition and enforcement of foreign judgments. As a consequence, the recognition and enforcement of foreign court judgments in China still entirely depends on Chinese law (notably Article 267 and 268 CPC) which stipulates the following conditions:

3. Margaret Y. K. Wool, *Law and Discretion in the Contemporary Chinese Courts*, Pacific Rim Law & Policy Journal, Vol. 8 No. 3, 1999 at 591.

4. *Id.*, at 587.

- The foreign judgment must be "legally effective", *i.e.* final and binding and not be subject to appeal and further challenge.
- The court is required to evaluate the judgment in terms of reciprocity, which means that the Chinese courts may impose the same restrictions upon a foreign party that are imposed upon Chinese litigants by the courts of the applicant's country.
- The judgment must not violate the basic principles of the laws of the PRC, state sovereignty, security or the public interest.

It is noticable that the third condition is quite broad in its language and gives room for wide discretion which increases the risk that the Chinese courts may deny recognition and enforcement of a foreign judgment for political reasons or because of the pressure from local cadres or other influential individuals (see Chapter 1.2 above). In such cases, to find an alleged violation of a "public interest" may often serve as a pretext for yielding to local influence or pressures and for denying the enforcement of a foreign judgment.

1.4 Arbitration with the China International Economic and Trade Arbitration Commission (CIETAC): Mostly effective, but biased towards the interest of the Chinese party

1.4.1 Introduction to CIETAC arbitration

The arbitration organisation which adjudicates most of the international commercial disputes with Chinese parties is CIETAC (China International Economic and Trade Arbitration Commission) in Beijing, with further arbitration centers (Sub-Commissions) in Shanghai and Shenzhen (also see Chapter 1.1 above).[5] CIETAC is an administrative body appointed by the China International Chamber of Commerce (Article 66 Arbitration Law) which is itself a governmental body. The fundamental requirement for CIETAC to have jurisdiction over a dispute is a valid arbitration agreement between the parties which provides for CIETAC arbitration. Under Chinese law, in order to be valid, an arbitration agreement or clause must include the following elements:

- The written expression of the parties' intent to arbitrate any dispute.
- A written description of the items or issues which are suitable for arbitration.[6]
- Designation of the arbitral tribunal having authority to hear the parties' dispute.

The model arbitration clause recommended by CIETAC is as follows:

> *"Any dispute arising from or in connection with this contract shall be submitted to China International Economic and Trade Arbitration Commission for Arbitration which shall be conducted in accordance with the Commission's arbitration rules in effect at the time of applying for arbitration. The arbitral award is final and binding upon the parties."*

In economic contracts between Chinese and foreign parties, this clause is often combined with a *choice of law clause* stipulating that the CIETAC arbitral tribunal shall decide the dispute pursuant to the laws of the PRC (regarding the choice of law issue, also see Chapter 2.2 below). *Chinese parties normally insist that their contracts with foreign business partners contain an arbitration clause which provides for CIETAC arbitration and Chinese law to be applicable.*

1.4.2 Main disadvantage of CIETAC arbitration: Intrusive powers of the CIETAC Arbitration Commission, mostly to the detriment of the foreign party[7]

Foreign parties often underestimate the potential significant disadvantage they accept by agreeing to a CIETAC arbitration clause containing a choice of Chinese law. According to many legal scholars and practitioners, the main disadvantage (compared to other international arbitration regimes; see Chapter 2 below) is the *insufficient independence of the arbitrators in a CIETAC arbitration and the corresponding lack of autonomy of the parties to decide themselves the course of their arbitration.* This is due to the *far-reaching jurisdictional power of the CIETAC Arbitration Commission.* In contrast to the rules of all other leading international arbitration institutions, this jurisdictional power of the Commission does *not* cease to exist once the arbitral tribunal has been constituted, but continues to have effect, for example:

- Only the Commission and not the arbitral tribunal has exclusive authority to decide the arbitral tribunal's jurisdiction. Moreover, the parties cannot freely choose the arbitrators but have to select them from a mandatory list of accredited arbitrators (Article 24 CIETAC Rules).
- If the parties fail to appoint the presiding arbitrator to a panel composed of three arbitrators, the Chairman of the Commission usually appoints a Chinese national to this task.
- CIETAC arbitrators lack the authority to rule on interim measures. Only the people's courts can do so upon prior request of the Commission (Article 23 CIETAC Rules).

5. The China Maritime Arbitration Commission (CMAC) is the Chinese arbitration institution for maritime disputes. Its Arbitration Rules are similar to the CIETAC Arbitration Rules.

6. Pursuant to Art. 3 Arbitration Law, disputes of the following matters are not subject to arbitration: disputes over marriage, adoption, custody, support and inheritance as well as administrative disputes which are to be handled by administrative organs and courts.

7. Some parts of this Chap. and Chap. 1.4.4 below are excerpts from the following textbook published in the *Swiss Commercial Law Series*: Marc Blessing, *Introduction to Arbitration—Swiss and International Perspectives*, Basel 1999 at pp. 76–78.