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Arbitration in China: Practice, Legal Obstacles and Reforms

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Arbitration in China: Practice, Legal Obstacles and Reforms

By Fan Kun*

Increasing cross-border commercial exchanges and foreign investments have caused arbitration to become more frequently selected as a dispute resolution option in China. In response to this growing demand, China has taken significant steps to improve its arbitration system. Nevertheless, arbitration practice in China still displays many inconsistencies with international norms, causing concern for foreign investors.

This article looks at the practice, problems and prospects of arbitration in China through (i) an overview of the Chinese arbitration system, (ii) a description of the peculiarities of Chinese arbitration practice, (iii) an analysis of the legal obstacles that lie behind those peculiarities, and (iv) a review of past and future reforms.

I. Overview: domestic versus international arbitration in China

Prior to the enactment of its Arbitration Law (the 'Arbitration Law'), China made a distinction between domestic arbitration and international arbitration.¹ This distinction was reflected not only in the nature of the disputes to which arbitration was applied, but also in the institutions that handled the resulting cases.² Domestic arbitrations were administered by domestic arbitration bodies, which were affiliated to governmental administrative authorities and issued awards that were not final or binding. Hence, a party could initiate court proceedings if it was not satisfied with an arbitral award. International arbitrations, on the other hand, were administered by one of China's only two international arbitration institutions:³ the China International Economic and Trade Arbitration Commission ('CIETAC') or the China Maritime Arbitration Commission ('CMAC').

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¹ International arbitration is often referred to in Chinese as *she wai*, meaning foreign-related arbitration. For the sake of

consistency, only the expression 'international arbitration' will be used in this article.

² Wang Wenyong, 'Distinct Features of Arbitration in China: An Historical Perspective' (2006) 23 *Journal of International Arbitration* 49 at 61.

³ Often referred to in China as 'arbitration commissions'. For the purpose of consistency with internationally adopted terminology, this article will use the term 'arbitration institution'.

The Arbitration Law was enacted in 1994 to help reduce administrative interference and unify international and domestic arbitration in China.⁴ It provided for the reorganization of former domestic arbitration bodies placed under administrative authorities and the creation of several new arbitration institutions throughout the country, and as such marked a significant step forward. The new arbitration institutions shall be ‘independent of administrative organs and there shall be no relationship of subordination between arbitration institutions and administrative organs’.⁵ Pursuant to the Notice of the General Office of the State Council, domestic arbitration institutions were empowered to administer not only domestic arbitrations but also any international arbitrations that parties agree to submit to them. In reaction to the new competition that arose from this change, CIETAC revised its arbitration rules, with effect from 1 October 2000, so as to extend its jurisdiction to purely domestic disputes that parties agree to submit to it.⁶ Domestic cases have since become a substantial part of CIETAC’s caseload. Given that all Chinese arbitration institutions can now accept both domestic and international arbitration cases, subject to the parties’ agreement, the categorization of institutions as domestic or international has become meaningless.

The Arbitration Law nonetheless maintains a distinction between domestic and international arbitration. However, the sole criterion on which the distinction is made is the nature of the dispute, not the jurisdiction of the arbitration institutions. International arbitrations are generally regarded as arbitrations involving a foreign element, while domestic arbitrations are cases without a foreign element. A dispute involves a foreign element if: (i) one or both of the parties is a foreign national or a stateless person, or a company or organization domiciled in a foreign country; (ii) the legal facts establishing, changing or terminating the civil law relationship between the parties occur in a foreign country; or (iii) the subject of the dispute is situated in a foreign country.⁷

Chapter 7 of the Arbitration Law deals specifically with international arbitration. It covers the form of the administering organizations, the qualifications of arbitrators, arbitration rules, the courts involved in the support or supervision of arbitrations, and the grounds on which arbitral awards may be set aside or enforcement refused (which are distinct from those applying to domestic arbitrations).

II. Peculiarities of arbitration in China

The Arbitration Law incorporates many of the principles of modern arbitration. It enshrines (i) party autonomy—‘当事人意思自治’, meaning that the parties’ submission to arbitration shall be made ‘on the basis of both parties’ free will and an arbitration agreement reached between them’;⁸ (ii) denial of court jurisdiction when there is a valid arbitration agreement—‘或裁或审’; (iii) independence of arbitration

⁴ The Arbitration Law was adopted at the Ninth Session of the Standing Committee of the Eighth National People’s Congress of the People’s Republic of China on 31 August 1994, and came into force on 1 September 1995. It can be consulted at: <http://www.cietac.org.cn/english/laws/laws_5.htm>.

⁵ Article 14 of the Arbitration Law.

⁶ A further revision of CIETAC’s arbitration rules was made in 2005. It is this version that is currently applicable.

⁷ See Article 304, Supreme People’s Court, Several Opinions on the Application of the Civil Procedure Law (1992), <http://www.law-lib.com/law/law_view1.asp?id=54915> (in Chinese only).

⁸ Article 4 of the Arbitration Law.

—‘独立仲裁’, including the independence of arbitration institutions⁹ and the autonomy of the arbitration agreement;¹⁰ and (iv) the finality of arbitral awards —‘一裁终局’. These principles provide a foundation on which arbitration in Mainland China can develop in line with international standards.

There is nonetheless still some divergence between the Chinese arbitration system and international standards. As Peter Chow has pointed out, ‘Chinese arbitration is like Chinese chess—it shares a common ancestry with international arbitration standards, but also has differences that make it unique’.¹¹ The unique features of Chinese arbitration are reflected in (a) the conduct and (b) the effect of arbitral proceedings.

A. Conduct of arbitration

1. Determination of arbitral jurisdiction

i) International standards

It is generally accepted that an arbitral tribunal has the power to decide on its own jurisdiction, in accordance with the doctrine of competence-competence.¹² For example, Article 16 of the UNCITRAL Model Law on International Commercial Arbitration provides that: ‘The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement.’

ii) Chinese practice

a) Court versus arbitration institution

The competence-competence doctrine is notably absent from arbitration legislation and practice in China. The power to decide on jurisdiction lies not with the arbitral tribunals but with the courts and the arbitration institutions. Article 20 of the Arbitration Law suggests that the jurisdiction of the People’s Court takes precedence over that of the arbitration institution when one party has asked the People’s Court and the other party the arbitration institution to rule on the validity of their arbitration agreement.

According to a Supreme People’s Court Notice of 1998, where challenges against jurisdiction are made to both the court and the institution, the People’s Court shall not accept the case if the arbitration institution has already decided the matter. However, if the arbitration institution has not yet made a decision, the People’s Court should accept the case and instruct the institution to suspend the arbitration.¹³ A subsequent document from the Supreme People’s Court entitled ‘Interpretation on Certain Issues Relating to the Application of the Arbitration Law of the People’s Republic of China’,

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Article 14 of the Arbitration Law provides that arbitration institutions shall be ‘independent of administrative organs and there shall be no relationship of subordination between arbitration institutions and administrative organs. There shall also be no relationship of subordination between arbitration institutions.’

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Article 19 of the Arbitration Law provides that ‘the arbitration agreement exists independently, and its validity is not affected by the revision, avoidance, termination or invalidity of the main contract’.

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Julius Melnitzer, ‘Reforms Make Arbitration in China a Safer Bet, Regs Still Not Up to U.S. Standards’, *InsideCounsel*

(August 2005), <<http://www.insidecounsel.com/Issues/2005/August%202005/Pages/Reforms-Make-Arbitration-In-China-A-Safer-Bet.aspx>> (last visited 8 March 2009).

12

See Martin Hunter & Alan Redfern, *Law and Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 2004) at 252.

13

Supreme People’s Court Reply on Several Questions Regarding the Determination of the Validity of Arbitration Agreements, Fa Shi [1998] No. 27, issued on 26 October 1998.

issued in 2006 (hereinafter ‘SPC Interpretation 2006’), took the matter one stage further by providing that once an arbitration institution has made a decision on the validity of an arbitration agreement, no applications can be made to the People’s Court for a ruling on the validity of the arbitration agreement or for the institution’s decision to be set aside.¹⁴

Chinese practice here stands in contrast to the international norm, according to which it is generally considered that an arbitral tribunal is not prevented from making a decision on jurisdiction by the fact that its decision could subsequently be overruled by a competent court.¹⁵ The peculiarity of the Chinese system is that the People’s Court has *direct* power to decide whether an arbitration agreement is valid. The court’s involvement is not by way of judicial review after the arbitral tribunal has made its decision, but through direct intervention when the challenge is made, provided no decision has yet been made by the arbitration institution. This approach has caused much concern, insofar as it may lead to the removal of the arbitration institution’s power to rule on its own jurisdiction.

b) Arbitration institution versus arbitral tribunal

A related issue that deserves attention is the power of arbitration institutions to rule on arbitral jurisdiction.

Permanent arbitration institutions and individual arbitral tribunals are generally regarded as having different functions in this regard. The ICC International Court of Arbitration, for example, will make a *prima facie* determination as to whether an arbitration agreement *may* exist, but leaves the arbitral tribunal to finally decide whether the arbitration agreement is valid and whether the objection against arbitral jurisdiction is justified.¹⁶

In China, however, only the arbitration institution is authorized to rule on jurisdiction. Clearly, the fact that the arbitrators are ousted from making a final decision on their jurisdiction flies in the face of the competence-competence doctrine discussed above. What happens in actual practice, however, is as follows.¹⁷ Before an arbitral tribunal is constituted, CIETAC issues a preliminary ruling on jurisdiction based on a *prima facie* assessment (as is the practice of the ICC Court, for example). If, after the arbitral tribunal has been constituted, an objection is made against its jurisdiction, the arbitral tribunal will generally express its view on the jurisdictional objection to CIETAC, which will usually respect that view. If the arbitral tribunal and the arbitration institution have conflicting views on the jurisdictional objection, then the arbitrator may have no choice but to resign from hearing the case, which is a far from satisfactory solution.

This situation may also open the door to delaying tactics. A recalcitrant respondent could deliberately delay making a jurisdictional objection until the very last minute, i.e. just before the first hearing. As the tribunal does not have the power to rule on its own jurisdiction, it would have to wait for the arbitration institution’s decision on the challenge before being able to rule on the substance. The efficiency of the arbitration would thereby be impaired and its cost most likely increased.

¹⁴ Article 13 of the SPC Interpretation. Fa Shi [2006] No. 7.

¹⁵ Martin Hunter & Alan Redfern, *supra* note 12 at 252.

¹⁶ See Article 6(2) of the ICC Rules of Arbitration.

¹⁷ Information received during a research trip to China (Hong Kong, Beijing, Wuhan), undertaken by the author with Professor Gabrielle Kaufmann-Kohler in March–April 2007, during which a number of legal experts in China were interviewed, including academics, legal counsel, arbitrators, judges and government officials.

CIETAC has endeavoured to overcome the drawbacks described above by introducing in its most recent arbitration rules the possibility of allowing arbitral tribunals to decide on their own jurisdiction on the basis of a delegation of power granted by the institution.¹⁸ The practical effects of this reform remain to be seen.

2. Combination of arbitration and conciliation¹⁹

China has a millennia-long tradition of preferring consensual processes such as conciliation and mediation²⁰ to the confrontation of litigation. This preference was an important part of Confucian philosophy, which laid emphasis on harmonization and the avoidance of conflict.²¹ In this context, litigation was considered to be disgraceful conduct, with the result that mediation was not so much an alternative but rather the cornerstone of China's legal culture.

The modernization of China's legal system and the increasing involvement of Chinese citizens in commercial disputes have had the effect of reducing the amount of prejudice against litigation, although it is still regarded unfavourably in many quarters. However, conciliation, with its aim of promoting social harmony by avoiding the permanent destruction of existing relationships, continues to carry great weight in both the legal system and arbitration practice in China.

Prior to the enactment of the Arbitration Law, CIETAC had already adopted the practice of combining arbitration with conciliation, which proved an effective means of resolving many cases.²² According to Professor Tang Houzhi, Honourable Vice-Chairman of CIETAC, conciliation is applied in almost 50% of arbitration cases, with a success rate of between 40% and 50%.²³

The Arbitration Law now permits and actively encourages the practice of conciliation during arbitration proceedings. Article 49 of the Arbitration Law allows parties to seek a settlement on their own initiative, notwithstanding the commencement of arbitration proceedings. If successful, they may request the arbitral tribunal to render an award in accordance with the terms of their settlement agreement.

It is also possible for the conciliation to be conducted by the arbitral tribunal. Article 51 of the Arbitration Law provides that the arbitral tribunal *may* carry out conciliation prior to rendering an award, and *shall* conduct conciliation proceedings if both parties so request.

i) Conciliation statement or consent award?

If conciliation leads to a settlement agreement, the parties have two ways of formalizing the terms of their agreement: either through a written conciliation statement or by way

¹⁸ See Article 6(1) of CIETAC's 2005 rules.

¹⁹ For more comments concerning the practice of combining arbitration with conciliation, see: Gabrielle Kaufmann-Kohler & Fan Kun, 'Integrating Mediation into Arbitration—Why it Works in China' (2008) 25 *Journal of International Arbitration* 479.

²⁰ The terms 'mediation' and 'conciliation' are used interchangeably in China. This article will use the term 'conciliation' for consistency.

²¹ The main Confucian values are praise of harmony, moderation in all things, concession or yielding, and avoidance of

conflict. Confucianism formed the mainstream thought in traditional Chinese political culture. This rationale has survived the overthrow of dynasties and undeniably affects China's modernization of its legal system.

²² Wang Wenyong, 'Distinct Features of Arbitration in China—An Historical Perspective' (2006) 23 *Journal of International Arbitration* 49 at 74.

²³ Tang Houzhi, 'Is There an Expanding Culture that Favors Combining Arbitration with Conciliation or Other ADR Procedures?' (1996) *ICC Congress Series No. 8* (Seoul).

of a consent award. Both are based on the express terms of the settlement. They are signed by the arbitrators, sealed by the arbitration institution and served on both parties.²⁴ Article 51 of the Arbitration Law provides that a conciliation statement shall have the same legal effect as an arbitral award.

The main difference between a written conciliation statement and a consent award is that a consent award becomes effective immediately after being rendered whereas a written conciliation statement, which is not an award, becomes binding upon the parties only when they have signed for its receipt. If a party changes its mind before signing, the arbitral tribunal will pursue the proceedings and render an award. There are also implications with regard to enforceability. In the case of a consent award, the party seeking enforcement may institute proceedings in a Chinese court or, if appropriate, seek enforcement overseas on the basis of the New York Convention. A written conciliation statement, on the other hand, is not an enforceable ‘award’ (unless the country in which enforcement is sought defines the term very broadly). For this reason, parties concerned about the enforceability of their settlement agreement may prefer to opt for a consent award.²⁵

ii) Failure of the attempt at conciliation

Should an attempt at conciliation fail, the conciliator will return to being an arbitrator and the arbitration proceedings will resume. The rules of both CIETAC and the Beijing Arbitration Commission provide that any view, statement or proposal expressed by the parties during the conciliation process shall not be invoked as a ground for any claim, defence or counterclaim in the subsequent arbitration proceedings.²⁶

The Chinese practice of allowing arbitral tribunals to act as conciliators has caused concern amongst some Western practitioners, especially those from the common law system, who fear that the conciliator-arbitrator’s impartiality in the subsequent arbitration proceedings could be compromised. However, an increasing number of legal experts believe that, if proper precautions are taken, the two types of proceedings can be successfully combined, giving arbitral proceedings a more consensual spirit and leading to fruitful cross-fertilization between Western and Chinese models of dispute resolution.

B. Effects of arbitration

As stated by Tao Jingzhou, ‘[a] meaningful arbitral award is conditional upon an effective and reliable enforcement mechanism. In China, as elsewhere, this task lies beyond the remit of the arbitration tribunal.’²⁷ If one party refuses to honour an arbitral award, the winning party will have no alternative but to seek enforcement in a competent court.

1. Types of awards

The procedure for enforcement in China depends on the type of the award: ‘domestic’, ‘international’ or ‘foreign’.

²⁴ Article 52 of the Arbitration Law.

²⁵ See Cao Lijun, ‘Combining Conciliation and Arbitration in China: Overview and Latest Developments’ (2006) 9 *International Arbitration Law Review* 84 at 91.

²⁶ Article 40(8) of CIETAC’s 2005 rules. Article 38(4) of the Beijing Arbitration Commission’s rules.

²⁷ Tao Jingzhou, *Arbitration Law and Practice in China* (The Hague/London/New York: Kluwer Law International, 2004) at 131.

Foreign awards are those rendered outside Mainland China (i.e. those rendered in cases where the place of arbitration is located outside Mainland China, including in Hong Kong, Macao and Taiwan). Awards rendered within Mainland China will be considered either domestic awards or international awards, depending on whether there is a foreign element present. Foreign investors should be aware that Foreign Invested Enterprises ('FIEs', including China-foreign equity joint ventures, China-foreign cooperative joint ventures and wholly-owned foreign enterprises) are treated as Chinese entities under Chinese law. Therefore, disputes involving FIEs are considered as domestic, unless there are other foreign elements present.

The enforcement of international and foreign arbitral awards is generally subject to the purely procedural condition that no irregularities have occurred in the arbitration process. When it comes to enforcing domestic awards, on the other hand, Chinese courts are allowed to review both procedural and substantive issues.

i) Domestic awards

Article 58 of the Arbitration Law sets out the grounds on which domestic awards may be set aside by the People's Court, namely: (i) there is no arbitration agreement; (ii) the matters decided exceed the scope of the agreement or are beyond the authority of the arbitration institution; (iii) the formation of the tribunal or the arbitral procedure was not in conformity with the statutory procedure; (iv) evidence on which the award was based was forged; (v) the other party withheld evidence sufficient to affect the impartiality of the arbitration; (vi) the arbitrators have committed embezzlement, accepted bribes, conducted malpractice for their personal benefit or perverted the law; or (vii) the award proves to be contrary to the social and public interest. The list of grounds on which the enforcement of domestic awards may be refused broadly coincides with that above, but includes two additional grounds, namely that (i) there has been a definite error in the application of the law; or (ii) there is insufficient evidence to verify the facts.²⁸

ii) International awards

As far as international awards are concerned, the scope of the court's review is limited to a number of procedural matters. The grounds for setting aside and denying enforcement of an international award are identical and are found in Articles 70 and 71 of the Arbitration Law (both of which refer to Article 260.1 of the Civil Procedure Law). Those grounds are as follows: (i) there is no arbitration clause in the parties' contract and no subsequent written arbitration agreement between them; (ii) the party against which the application for enforcement is made was not given notice of the appointment of an arbitrator or of the initiation of the arbitration proceedings or was unable to present its case due to causes beyond its responsibility; (iii) the formation of the arbitral tribunal or the arbitration procedure was not in conformity with the rules of arbitration; or (iv) matters covered in the award lie outside the scope of the arbitration agreement or the arbitral tribunal was not empowered to deal with them. Due to ambiguity in the wording of the relevant legislation, it is unclear whether international awards may be set aside or refused enforcement on the ground of their being contrary to 'social and public interest', as provided in Article 260(2) of the Civil Procedure Law.

²⁸

See Article 63 of the Arbitration Law, in conjunction with Article 217(2) of the Civil Procedure Law.

iii) Foreign awards

Foreign awards may be recognized and enforced in China on the basis of either international agreements or treaties to which China has acceded or the principle of reciprocity.²⁹ The New York Convention is the principal international treaty applicable for this purpose in China.³⁰ Article V of the New York Convention provides an exhaustive list of the grounds on which the recognition or enforcement of an award may be refused. These grounds are limited to matters of procedure. The ‘public policy’ ground has worried many commentators because of the risk of its being misinterpreted for the purpose of denying recognition or enforcement.³¹ However, publicly available information suggests that Chinese courts have not used this ground to deny enforcement of a foreign arbitral award.³²

2. Different standards of review

There has been debate over the need to distinguish between international and domestic arbitrations, so as to subject the former to less strict control than the latter. In China, different standards of review apply to domestic, international and foreign awards. The Chinese courts’ power to review domestic arbitral awards with regard to their substance is particularly significant for disputes involving FIEs. As explained above, FIEs are considered as domestic companies, even if they are wholly-owned by foreign investors. This means that an arbitration between a China-incorporated subsidiary of a German company and a China-incorporated subsidiary of a US company would be considered domestic, provided no other foreign elements are present. Accordingly, the arbitral awards rendered in such an arbitration would be open to substantive review by a Chinese court from which an enforcement order is sought.

The application of different standards to the enforcement of different types of awards has led to confusion, with some courts erroneously setting aside or refusing enforcement of international awards after reviewing the substance of the award. For instance, in the case of *Hong Kong Huaxing Development Company v. Xiamen Dongfeng Rubber Manufacturing Company*,³³ the Xiamen Intermediate People’s Court denied enforcement of a CIETAC award on the ground that the main evidence in support of the facts was insufficient under Article 217 of the Civil Procedure Law. There was a foreign element present in this case, as one of the parties was a company domiciled in a foreign country (Hong Kong, Macao and Taiwan are considered foreign in this context), so it should have been treated as an international arbitration. The grounds for denying enforcement of international awards are clearly set forth in Article 260(1) of the Civil Procedure Law and are limited to procedural matters. The court’s review of the merits and its reference to Article 217 of the Civil Procedure Law were thus questionable. This risk is expected to diminish as legislation improves and judges become better informed.

²⁹ Tao Jingzhou, *supra* note 27 at 160.

³⁰ China acceded to the New York Convention on 2 December 1986. It came into effect with respect to China on 22 April 1987. On 10 April 1987, the Supreme People’s Court issued the document ‘Notice of the Supreme People’s Court on the Implementation of the New York Convention’, which has the effect of implementing legislation and provides the basis for implementation of the New York Convention in China.

³¹ Tao Jingzhou, *supra* note 27 at 161, citing Song Huang, ‘The Enforcement of Chinese Foreign-Related Arbitral Awards’ *Arbitration and Law Report* (August 1999) 11.

³² Li Hu, ‘Enforcement of Foreign Arbitral Awards and Court Intervention in the People’s Republic of China’ (2004) 20 *Arbitration International* 177.

³³ See *Hong Kong Huaxing Development Company v. Xiamen Dongfeng Rubber Manufacturing Company*, Selected Cases of the People’s Courts (Xiamen Intermediate People’s Court, 1994).

3. Reporting system

Another concern relating to enforcement is local protectionism by lower courts.³⁴

To reduce the risk of decisions being invalidated because of local protectionism and lower court corruption, in August 1995, the Supreme People's Court issued a document entitled 'Notice of the Supreme Court Regarding the Handling by the People's Court of Certain Issues Relating to International Arbitration and Foreign Arbitration', establishing a centralized report and review system (the 'Reporting System').³⁵ Under this system, where the Intermediate People's Court considers that an international award or foreign award ought not to be enforced, it must first report its finding to the Higher People's Court. In turn, should the Higher People's Court concur with the Intermediate People's Court, it must submit an approval advice to the Supreme People's Court. The Intermediate People's Court may not refuse enforcement until the Supreme People's Court issues a determination. The same Reporting System applies where the Intermediate People's Court considers that the arbitration agreement is invalid or incapable of being enforced. In other words, for international cases, a lower court cannot deny the validity of an arbitration agreement without the prior examination and confirmation of the Supreme People's Court.

Subsequently, in April 1998, the Supreme People's Court issued another notice establishing a Reporting System specifically applicable to any decision by lower courts to set aside an international award.³⁶ This mechanism effectively serves to ensure that an international award may not be set aside by a lower court without the prior examination and confirmation of the Supreme People's Court.

The above Reporting System has had a very positive effect in practice. It is said to 'have significantly bolstered the confidence of foreign investors in fear of local protectionism'.³⁷ However, there are concerns that it may lead to significant delays in proceedings, as no time limit is set for the completion of the process. Further, there are no provisions on liability or on compensation due to the parties when the lower court fails to comply with the reporting requirements.³⁸ As noted by one commentator: '[t]he centralized report and review system is merely an interim measure designed to safeguard the legitimate rights and interests of the holders of arbitral awards in an environment of local protectionism. Over time, as such problems recede and the rule of law takes hold, the need for this type of mechanism will ultimately subside.'³⁹

34 There are four levels of courts in China: the District People's Court (existing in districts within large cities —e.g. four in Beijing), the Intermediate People's Court in large city municipalities (two each in Beijing and Shanghai), the Higher People's Court in the capitals of provinces or autonomous regions or in municipalities directly answerable to the Central People's Government, and at the highest level the Supreme People's Court in Beijing. See Denis Brock & Kathryn Sanger, 'Legal Framework of Arbitration' in Daniel R. Fung & Wang Sheng Chang, eds., *Arbitration in China: A Practical Guide*, vol. 1 (Hong Kong, 2004) at 25–45.

35 Notice of the Supreme People's Court on Several Issues Regarding the Handling by the People's Courts of Certain Issues Pertaining to International Arbitration and Foreign Arbitration, issued by the Supreme People's Court on and effective from 28 August 1995.

36 Notice of the Supreme People's Court on Relevant Issues Relating to the Setting Aside of International Awards by the People's Courts, issued by the Supreme People's Court on and effective from 23 April 1998.

37 Tao Jingzhou, *supra* note 27 at 149.

38 See Liang Kun, *The Revision of the English 1996 Arbitration Act and the Chinese Arbitration Law: Issues Related to Arbitration Agreement* (Beijing: Law Press China, 2006) at 64.

39 Tao Jingzhou, *supra* note 27 at 149.

III. Legal obstacles

To better understand the peculiarities of Chinese arbitration practice highlighted above, it is necessary to look at the social, economic and political context in which it is set. In so doing, we will enquire into the main obstacles faced by arbitration under China's current legal regime.

A. Gaps and ambiguous provisions in current legislation

Although the enactment of the Arbitration Law marked a great improvement in China's arbitration system, current legislation still contains ambiguous provisions and gaps that remain unaddressed.

Firstly, many provisions in the Arbitration Law are too simple and vague, and give no clear guidance on how they are to be applied. For instance, Article 61 of the Arbitration Law establishes a re-arbitration system by providing generally that 'if, after accepting an application for setting aside an arbitral award, the People's Court considers that the case may be re-arbitrated by the arbitral tribunal, it shall notify the tribunal that it shall re-arbitrate the case within a certain time limit and shall rule to stay the setting-aside procedure. If the arbitral tribunal refuses to re-arbitrate the case, the People's Court shall rule to resume the setting-aside procedure', without stipulating specifically how the re-arbitration system should be applied in practice. The SPC Interpretation 2006 has since clarified the circumstances in which the court may exercise its power in this connection,⁴⁰ and has permitted applications for setting aside the new awards made in the re-arbitration proceedings.⁴¹ However, silence continues to reign on several critical issues, such as the scope of the re-arbitration, the time limit for the re-arbitration, and whether a new tribunal should be formed in the re-arbitration proceedings. There is a danger that the lack of clear legislative guidance may lead to inconsistent practices amongst the courts.

In addition, there are inconsistencies between the Arbitration Law and the Civil Procedure Law, which require clarification. The Civil Procedure Law was promulgated in 1991, prior to the establishment of a formal arbitration system in China. By the time the Arbitration Law came into force in 1995, arbitration in China had significantly improved, but several references were still made back to the Civil Procedure Law. Such references create inconsistencies that the Arbitration Law fails to address.

For example, concerning the enforcement of international awards, Article 71 of the Arbitration Law refers only to paragraph 1 of Article 260 of the Civil Procedure Law, which causes uncertainty as to whether 'social and public interest' as provided in paragraph 2 of Article 260 can be used as a ground for refusing to enforce an international award. There is a similar uncertainty over the enforcement of domestic awards, as Article 63 of the Arbitration Law refers only to paragraph 2 of Article 217 of the Civil Procedure Law, whereas the 'social and public interest' ground is provided for in paragraph 3 of Article 217.

The new Civil Procedure Law, which was promulgated on 28 October 2007 and came into force on 1 April 2008, does not resolve these uncertainties.

⁴⁰ See Article 21 of the SPC Interpretation 2006.

⁴¹ Article 23 of the SPC Interpretation 2006.

B. Administrative interference in arbitration practice

At institutional level, arbitration suffers from persisting administrative intervention. Although the Arbitration Law attempts to establish an independent system of arbitration institutions to protect party autonomy from interference by administrative authorities,⁴² arbitration remains largely under institutional control rather than subject to party autonomy, due to the predominance of institutions in the Chinese legal system.

As a result, the arbitration system has become tainted in the following respects : (i) arbitration institutions largely rely upon government support for their establishment, and some local arbitration institutions are established by local government ‘for administrative needs, rather than the market demand for dispute resolution’;⁴³ (ii) the government retains strong financial control over arbitration institutions even after they have been established: all the income they receive is considered to be a State asset and must be submitted to the government, which decides on its distribution according to the reported expenditures;⁴⁴ and (iii) most of the leading positions in arbitration institutions are held by government officials.

C. Lack of party autonomy

The absence of a free economy and a legal tradition in private law has meant that party autonomy is traditionally foreign to Chinese minds. Although the Arbitration Law sets forth party autonomy as one of the basic principles for the development of arbitration in China, there are still restrictions on parties’ choices, which derive from the procedural rules of the courts.

1. Lack of flexibility in the arbitration procedure

Many international treaties and national laws give parties considerable freedom to determine their own procedural rules. For instance, Article 19(1) of the UNCITRAL Model Law on International Commercial Arbitration provides that: ‘Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.’ The aspects of the procedure that the parties are free to determine include the place of arbitration, the language to be used, the date of commencement of arbitral proceedings, and the manner in which evidence will be presented.

In contrast, the Arbitration Law lays down a number of rigid requirements for arbitration proceedings. Article 45, for example, requires that ‘the evidence shall be presented during the hearings’. This provision overlooks the fact that arbitrations may be conducted without a hearing and denies the parties the right to specify at what stage of the proceedings certain evidence will be presented, as happens in international practice.

⁴² See Articles 10 and 14 of the Arbitration Law.

⁴³ Gu Weixia Gu & Zhang Xianchu, ‘The China-Style Commission-Oriented Competence on Arbitral Jurisdiction: Analysis of Chinese Adaptation into Globalization’ (2006) 9 *International Arbitration Law Review* 185 at 194.

⁴⁴ See Joint Notice, 9 May 2004, issued by relevant departments of the State Council, in which ‘arbitration fee’ is defined as ‘administrative fee’ and thus characterized as a State asset.

2. Strict requirement for a valid arbitration agreement

At international level, a liberal view is generally taken towards the validity of an arbitration agreement. What matters is that the parties' intention to submit to arbitration is clear. For instance, Article 7(1) of the UNCITRAL Model Law on International Commercial Arbitration states that an arbitration agreement is 'an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not'.

In contrast, three specific requirements must be met for an arbitration agreement to be valid in China. Article 16 of the Arbitration Law provides that an arbitration agreement must include: (1) the expression of the parties' wish to submit to arbitration; (2) the matters to be arbitrated; and (3) the arbitration institutions selected by the parties.

Article 18 of the Arbitration Law further provides that if the parties fail to designate an arbitration institution in the arbitration agreement, or if such designation is unclear, the arbitration agreement will be considered invalid, unless the parties reach a supplementary agreement.

Read together, Articles 16 and 18 of the Arbitration Law may be thought to imply that the designation of an arbitration institution actually constitutes a compulsory requirement for a valid arbitration agreement. These conditions go far beyond the parties' mere consent to arbitrate and make arbitration agreements vulnerable to invalidation by the courts.⁴⁵ Moreover, they have a number of practical consequences, as described below.

i) Exclusion of ad hoc arbitration

Article 16(3) of the Arbitration Law is generally read as excluding the possibility of *ad hoc* arbitrations in China.⁴⁶

This provision reflects the Chinese government's belief that institutional arbitration should be the only acceptable type in China since it allows the government to monitor arbitral institutions and cases conveniently.⁴⁷ The reluctance by Chinese legislators to recognize *ad hoc* arbitration reflects the fear that if arbitration is allowed to be conducted without supervision by an established administrative body, it would be difficult to control the behaviour of arbitrators and to ensure the quality of arbitration, and the government would remain ignorant about *ad hoc* arbitrations unless a party initiated court proceedings. They believe that it is still too early to introduce *ad hoc* arbitration, which presupposes a system of trust that has not yet fully developed in China.⁴⁸

China's socio-political system has however changed significantly since the days when its arbitration system was first established. *Ad hoc* arbitration, which has been practised around the world for several centuries,⁴⁹ offers a fast, cost-effective and above all flexible alternative to institutional arbitration. If practised in China, *ad hoc* arbitration could

⁴⁵ Chi Manjiao, 'Is the Chinese Arbitration Act Truly Arbitration-Friendly: Determining the Validity of Arbitration Agreement under Chinese Law' (2008) 4 *Asian International Arbitration Journal* 104 at 111.

⁴⁶ Tao Jingzhou, *supra* note 27 at 55–56.

⁴⁷ Zhou Jian, 'Arbitration Agreements in China: Battles on Designation of Arbitral Institution and *Ad Hoc* Arbitration' (2006) 23 *Journal of International Arbitration* 145 at 169.

⁴⁸ According to the arbitration experts whom the author interviewed during the aforementioned research visit to China in March–April 2007.

⁴⁹ See Julian D.M. Lew, Loukas A. Mistelis & Stefan M. Kroll, *Comparative International Commercial Arbitration* (Kluwer Law International, 2003) at 31–35.

encourage arbitration institutions to improve their service and enhance China's appeal as a venue for arbitration by offering parties more freedom and greater flexibility.

ii) Unclear status of foreign arbitration institutions

Articles 16 and 18 of the Arbitration Law also leave the status of foreign arbitration institutions unclear. As a recent study has pointed out, these provisions amount in reality to a 'Great Wall' barring foreign arbitration institutions, on account of the protectionism that informs the interpretation of these provisions by the Chinese courts, especially where pathological arbitration agreements are involved.⁵⁰

Although the Arbitration Law does not expressly state that the arbitration institutions to which it refers may not be foreign, the attitude of the People's Court suggests that it would not recognize an award rendered in an arbitration seated in China but administered by a foreign arbitration institution.

In the famous case *Zublin International GmbH v. Wuxi Woco-Tongyong Rubber Engineering Co. Ltd.*,⁵¹ the Supreme People's Court decided on 8 July 2004, in answer to the Higher People's Court of Jiangsu, that an arbitration clause providing for 'arbitration: ICC Rules, Shanghai shall apply' was invalid under the laws of the People's Republic of China. The reason it gave for its decision was that the arbitration clause did not explicitly designate an arbitration institution and was therefore deemed to be invalid under Article 16 of the Arbitration Law.

To avert this risk, ICC took the step of recommending that 'it would in any case be prudent for parties wishing to have an ICC arbitration in Mainland China to include in their arbitration clause an explicit reference to the ICC Court of Arbitration'.⁵² Accordingly, the Chinese version of ICC's standard arbitration clause was amended to include a specific reference to the ICC International Court of Arbitration, which reads as follows: 'All disputes arising out of or in connection with the present contract shall be submitted to the International Court of Arbitration of the International Chamber of Commerce and shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.'⁵³

The SPC Interpretation 2006 has since clarified that the lack of an express reference to an arbitration institution does not automatically invalidate the arbitration clause if the arbitration institution can be ascertained on the basis of the rules. As far as ICC is concerned, its Rules of Arbitration contain ample references to the administration of arbitrations by the International Court of Arbitration, the arbitration body attached to ICC.

The question that remains is whether foreign arbitration institutions such as ICC may qualify as an 'arbitration institution' within the meaning of Article 16 of the Arbitration Law.

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See Jingzhou Tao & Clarisse von Wunschheim, 'Articles 16 and 18 of the PRC Arbitration Law: The Great Wall of China for Foreign Arbitration Institutions' (2007) 23 *Arbitration International* 309.

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For details of the case, see 4th Civil Trial Division of the Supreme People's Court, *Guide on Foreign-Related Commercial and Maritime Trials* (People's Court Press) 2004:3, pp. 36–40.

52
(2004) 15:2 ICC IC Arb. Bull. 7.

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See 'ICC arbitration clause for China', news posted on the website of the ICC International Court of Arbitration in January 2005, <<http://www.iccwbo.org/court/arbitration/id4185/index.html>>.

Some recent ICC awards have confirmed the validity of arbitration agreements providing for ICC arbitration with a seat in Mainland China, but it has yet to be seen whether such awards will be successfully enforced in the Chinese courts. Further assurances in the law regarding the status of foreign institutions administering arbitrations seated in China would be helpful and would remove any remaining doubts over the enforcement of awards rendered in such arbitrations.

iii) Limitation on the appointment of arbitrators

In China, the parties' freedom of choice is limited when it comes to choosing arbitrators. Article 13 of the Arbitration Law requires each arbitration institution to draw up a panel of arbitrators by profession. This requirement is generally seen as creating a compulsory panel system in China.⁵⁴ At the present time there are more than 185 arbitration institutions in China, each of which maintains its own list of arbitrators. Only those persons whose names appear on the list of a given institution are eligible to be appointed as arbitrator by that institution. Thus, an arbitrator on CIETAC's list cannot be appointed in an arbitration administered by the Beijing Arbitration Commission (unless also on the latter's list).

Parties expecting the greatest possible freedom in their choice of arbitrators will remain unsatisfied, for the panel system cannot provide expertise in all technical fields nor cover all nationalities. CIETAC has tried to give parties greater freedom in its latest arbitration rules by allowing them to choose arbitrators outside CIETAC's panel list, subject to confirmation by CIETAC's Chairman.⁵⁵ This loosening of the panel system is expected to increase the pool of foreigners available to serve on CIETAC tribunals. However, the tendency so far has been to continue appointing arbitrators from CIETAC's panel list.

The appointment of the chairman of the arbitral tribunal has drawn comment from foreign observers. Previous versions of the CIETAC rules gave the CIETAC Chairman the fallback power of appointing the presiding arbitrator if no agreement was reached by the parties. The chairman of the arbitral tribunal so appointed would very likely be Chinese. If the Chinese party had already appointed a Chinese arbitrator (which is usually the case), two of the three arbitrators would be Chinese, giving at least an appearance of imbalance within the arbitral tribunal.

CIETAC's 2005 rules limit its role in selecting the chairman of the tribunal by allowing each party to provide a list of candidates for the position. CIETAC makes a choice only if there is no candidate common to the lists provided by the parties.⁵⁶ This novel approach is expected to 'help deflect persistent criticisms that CIETAC's role in the selection of the chairman under the 2000 Rules allowed it to "stack" tribunal membership in favour of Chinese nationals'.⁵⁷

The main reason given by CIETAC for its reluctance to appoint foreign arbitrators was the concern that the remuneration offered would be too low to make such appointments attractive to foreign arbitrators.⁵⁸ This handicap will hopefully be overcome in due course with the increase of arbitrators' remuneration, which in turn

⁵⁴ See Daniel R. Fung & Wang Shengchang, *Arbitration in China: A Practical Guide*, vol. 1 (Sweet & Maxwell, 2004) at 159.

⁵⁵ Michael J. Moser & Peter Yuen, 'The New CIETAC Arbitration Rules' (2005) 21 *Arbitration International* 391 at 396, citing Article 21(2) of CIETAC's 2005 rules.

⁵⁶ See Article 22(3) of CIETAC's 2005 rules.

⁵⁷ Michael J. Moser & Peter Yuen, *supra* note 55 at 396.

⁵⁸ According to Professor Tang Houzhi, speech at 12th Global Arbitration Forum, 8 December 2006, Geneva, Switzerland.

presupposes financial reform in Chinese arbitration institutions, so as to ensure, for instance, their financial independence vis-à-vis government control.⁵⁹

IV. Reforms and prospects

Arbitration in China has already undergone various reforms, in response to the concerns and criticisms expressed by foreign investors and legal experts. These changes demonstrate the will of Chinese government officials to bring Chinese arbitration more in line with international standards.

Through regulations and notices, the Supreme People's Court has sought to address the lingering issues that are at odds with international standards.⁶⁰ Although not part of the law, its interpretations of the law play an important role in practice, particularly in areas where the law is changing rapidly and existing law is not equipped to deal with new issues that have emerged. Since the adoption of the Arbitration Law in 1994, the Supreme People's Court has made numerous pronouncements to guide lower courts in their application of the Arbitration Law, including with regard to such issues as jurisdiction over interim measures, the handling of jurisdictional challenges, and the setting aside and enforcement of awards. The SPC Interpretation 2006 represents China's latest effort to bring both the law and practice of arbitration more closely in line with commonly accepted international norms.

Arbitration institutions also play an essential role in improving arbitration practice in China. As the leading arbitration institution in China, CIETAC's efforts serve as a driving force for institutional reform. CIETAC regularly reviews and revises its arbitration rules, so as to keep them in line with modern international standards. The most recent revision, dating from 2005, contains many positive innovations, including less stringent panel requirements,⁶¹ the power of arbitral tribunals to decide on their own jurisdiction upon CIETAC's delegation,⁶² the list system for selecting the chairman of an arbitral tribunal,⁶³ the freedom of parties to choose the seat of the arbitration and the place of the hearing,⁶⁴ and the discretion given to arbitral tribunals to decide whether to take an inquisitorial or an adversarial approach. Although institutional rules do not have the force of law, they certainly help to promote the practice of arbitration, facilitate the legislative process and further the process of adaptation.

At local level, the reforms undertaken by the Beijing Arbitration Commission are impressive.⁶⁵ As far as financial resources are concerned, the Beijing Arbitration Commission is self-sufficient, maintaining its facilities through its own arbitration fees without the need for government support. It is thus able to make independent financial decisions, free from the intervention of the Beijing People's Government. As far as technology is concerned, it is equipped with sophisticated case-management software,

59 On the financial reform of arbitration institutions, see Wang Hongsong, 'To Solve the Problem of the Separation of Income and Distribution in the Arbitration System', <<http://www.bjac.org.cn/news/view.asp?id=1520>> (in Chinese only).

60 The Supreme People's Court was granted the power to interpret and clarify national laws by a notice of the National People's Conference Standing Committee on 10 June 1981. This power has been extended to allow it to issue provisions supplementing national laws.

61 See Article 21(2) of CIETAC's 2005 rules.

62 See Article 6(1) of CIETAC's 2005 rules.

63 See Article 22(3) of CIETAC's 2005 rules.

64 See Articles 31 and 32 of CIETAC's 2005 rules.

65 For details of these reforms, see Wang Hongsong, 'Grasping the Spirit of Arbitration Law, and Building Up the Modern Arbitration Institution' (2005) 57 *Journal of Beijing Arbitration* 1.

enabling its staff to handle the cases more efficiently and to provide a better service. It has also recently inaugurated stand-alone mediation rules and revised its arbitration rules, both of which came into force on 1 April 2008. The initiatives of the Beijing Arbitration Commission might indeed inspire local arbitration institutions across the country.

References to foreign arbitration institutions in contracts relating to China are becoming increasingly frequent, as illustrated by the statistics of the ICC International Court of Arbitration. In 2006, China (including Hong Kong) for the first time headed the list of most frequently represented nationalities in ICC arbitration in South and East Asia. In 2007, the new cases filed with the ICC Court involved 27 parties from Mainland China, which accounts for 11.58% of the parties in South and East Asia and is double the number of parties from Mainland China ten years ago.⁶⁶

In recognition of the growth of international trade and arbitration in China and in order to meet the needs of local users of ICC arbitration, ICC has opened a branch of the Secretariat of its International Court of Arbitration in Hong Kong, staffed with a new case management team. This initiative is intended to facilitate the conduct of ICC arbitration in China and in the Asia-Pacific region more generally.

The emergence of foreign arbitration institutions in the Chinese market is likely to increase competition for local arbitration institutions, but such pressure may be a strong incentive for Chinese arbitration to become more efficient.

However, greater clarification is needed in China to ensure safe and open access to international arbitration administered by international institutions such as ICC, and to facilitate the enforcement of awards. Further reforms are needed to strengthen the independence of arbitration institutions, bring legislation closer to international standards, and allow fuller expression to party autonomy.

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See the annual Statistical Report, published in the *ICC International Court of Arbitration Bulletin*, available at <<http://www.iccdri.com>>.

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