

6 Key Considerations in China-related Arbitrations

Differences in enforcement and arbitral rules could cause difficulties for unwary parties engaged in or considering arbitration in mainland China.

China's economic growth has attracted significant foreign investment in recent years. However, as commercial ties between mainland China and the rest of the world broaden and deepen, the number of China-related commercial disputes has also increased. Arbitration is widely recognized as an effective and efficient method of dispute resolution, providing a neutral decision maker as well as the ability to enforce against the assets of the counterparties. Unlike court proceedings, arbitrations are generally confidential, which can help protect reputation, proprietary information, and client identities. Arbitrators are often specialists chosen by the parties on the basis of their industry experience, and so are often better suited than judges to resolving disputes involving complex business transactions or sophisticated investment products and structures. Aside from these general considerations, parties should understand specific characteristics particular to arbitration in mainland China and within the wider region. The six considerations described below can help parties to enhance their chances of award enforcement, or may create difficulties in their commercial dispute resolution.

Background: The Chinese Court System

The Chinese court system is divided into four levels: the Basic People's Court, the Intermediate People's Court, the Higher People's Court, and the Supreme People's Court (SPC). Generally, within the context of international arbitrations, the Basic Court is not involved. Rather, the Intermediate People's Court is responsible for hearing challenges as to the validity of arbitral agreements and the enforcement of foreign arbitral awards. In compliance with a pre-reporting scheme implemented by the SPC, if an Intermediate Court decides not to enforce a New York Convention arbitral award or a foreign-related arbitral award, the Intermediate Court must submit the case to the Higher People's Court for further review. If the Higher People's Court agrees with the decision of the Intermediate Court not to enforce such an award, the High People's Court must submit the case to the SPC for review. In this way, China ensures that it complies with its New York Convention obligations and that arbitral awards are not enforced only in exceptional cases.

1. Enforcement prospects of interim measures is enhanced if arbitration is conducted in PRC

When a dispute arises with a Chinese counterparty, arbitration within the PRC may improve prospects for enforcement. Since 2012, the Chinese Civil Procedure Law has allowed for the attachment of property before initiating arbitration. However, Chinese courts do not currently recognize or enforce foreign interim rulings that allow for the attachment of property in mainland China. Thus, from the perspective of enforcement of interim measures, arbitrating outside mainland China may be less advantageous for foreign parties seeking to enforce against a Chinese counterparty without assets abroad.

2. Ad hoc and UNCITRAL arbitrations in the PRC are not enforceable

Article 16 of the Arbitration Law stipulates that an arbitration agreement must designate an arbitration commission. Arbitration agreements providing for domestic ad hoc arbitrations (including UNCITRAL arbitrations) are therefore generally considered invalid in China. That said, the recent Opinions on Providing Judicial Protection for the Construction of Pilot Free Trade Zones issued by the SPC (the FTZ Opinions) in December 2016 provide that “two companies registered within the pilot free trade zones, which provides for arbitration in a specified location in mainland China pursuant to specified arbitration rules and by specific arbitrators” may be held valid, which appears to open the door to ad hoc arbitrations in limited situations in China. Nonetheless, foreign arbitral awards obtained through ad hoc proceedings are generally recognized and enforceable in PRC courts.

3. ICC arbitrations should generally be seated outside of mainland China

While the Arbitration Law does not expressly forbid International Chamber of Commerce (ICC) arbitrations in mainland China, there is a general presumption that foreign arbitration institutions are not allowed to operate in the country.¹ If a party wishes to have an ICC arbitration with hearings in mainland China, the party may wish to specify in its arbitration agreement that the seat of the arbitration is outside of the PRC — for example, in Hong Kong or Singapore.² Alternatively, a party may wish to use the ICC clause specially designed for mainland China.

However, changes may be afoot. In February 2016, the ICC established its representative office in the Shanghai Pilot Free Trade Zone (SFTZ), modeled after the Hong Kong International Arbitration Centre and the Singapore International Arbitration Centre. The ICC said the SFTZ would follow two SPC decisions published in 2014 to uphold arbitration agreements that subject relevant disputes to ICC arbitration in Shanghai and Beijing. While it remains uncertain whether the ICC can administer arbitration proceedings in China or select mainland China to be the place of arbitration, the permission of entry into China marks a positive step for foreign arbitral institutions to have a formal presence in China.

4. Two PRC legal persons may not arbitrate outside mainland China

Chinese law provides no basis for allowing two PRC legal persons to choose a foreign arbitration institution or engage in ad hoc arbitration outside the territory of the PRC.³ The scope of a ‘PRC legal person’ is broader than it appears at first glance: a foreign-invested enterprise (FIE) incorporated as a legal person in the PRC constitutes a domestic entity under the Arbitration Law, even if the investors in the FIE are foreign parties. In that event, the arbitration must take place within the PRC. The FTZ Opinions appear to have removed this prohibition for companies registered in SFTZ, by providing that arbitration agreements between FIEs registered in SFTZ providing for overseas arbitration shall not be held as invalid simply because the disputes involve no foreign elements.

5. Hong Kong arbitral awards are enforceable in the PRC

Arbitral awards, including ad hoc awards, issued in Hong Kong are recognized and enforceable in mainland China under a “mutual arrangement.” However, non-monetary awards, such as injunctions, are not covered by the arrangement. A claimant should therefore consider the desired outcome when choosing between Hong Kong and the PRC as an arbitration seat.

6. One belt one road

As China’s major global “Belt and Road” initiative — to revive and modernize the ancient Silk Road with both land and maritime corridors from China to Europe — progresses, the number of attendant Belt and Road disputes is also likely to increase. So the China International Economic and Trade Arbitration Commission (CIETAC) published new rules for the international investment disputes (for trial

implementation), which took effect on 1 October 2017. Depending on parties' agreement and choice of arbitration place, investment dispute arbitrations may be submitted to and managed by CIETAC's Dispute Resolution Centre in Beijing, or CIETAC Hong Kong. The new rules expressly recognize third-party funding, and provide that this (along with details of the funding) must be disclosed to the other parties, the tribunal, and CIETAC. Furthermore, the arbitral tribunal may consider third-party funding as a factor when deliberating on arbitration fees and other costs.

Conclusion

Parties to commercial disputes in mainland China, especially FIEs, should carefully consider if and how to pursue arbitration within the PRC or elsewhere in the region.

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Endnotes

- ¹ In *Züblin International GmbH v Wuxi Woke General Engineering Rubber Co, Ltd*, the Supreme People's Court held that the recognition and enforcement of an ICC arbitral award with a seat in Shanghai should be refused on the grounds that there was "no explicit designation of an arbitration institution" because the agreement merely provided for arbitration under "ICC rules."
- ² Although in *Duferco SA v Ningbo Arts & Crafts Import & Export Co*, the Ningbo Intermediate People's Court recently enforced an ICC award with a seat in Beijing, this was on the grounds that judgment debtor was procedurally barred from arguing that the arbitration agreement was void because he failed to raise the objection prior to the first arbitral hearing. The influence of this holding is likely quite limited.
- ³ See *Jiangsu Aerospace Wanyuan Wind Power Co, Ltd. v. LM Wind Power (Tianjin) Co, Ltd.*. This holding reflects a desire to prevent domestic parties from bypassing Chinese courts and jurisprudence.