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ARBITRATION FAILS TO REDUCE FOREIGN INVESTORS' RISK IN CHINA

Charles Kenworthy Harer

Abstract: Arbitration is often perceived as a fair and efficient method of reducing risk associated with business transactions and investments. In China, Arbitration is constrained by statute and local protectionism such that arbitration can fail to live up to the expectations of foreign investors. Arbitration in China divides all disputes into domestic or foreign-related disputes, with different procedures for each, and different standards for enforcement and judicial review of those awards. Local protectionism presents a substantial risk to foreign parties involved in arbitration. A general lack of expertise in foreign-related disputes law, and difficulty in enforcing arbitration awards in favor of foreign parties in Chinese Courts are major problems that investors must consider. In contrast, Chinese parties that receive arbitration awards will be able to pursue enforcement in foreign countries based on the New York Convention of 1958.

I. INTRODUCTION

Hundreds of thousands of foreigners are investing in businesses with Chinese parties¹ without an effective dispute resolution process in place. Unaware of arbitration's limitations, many foreign investors unquestioningly adopt arbitration as their dispute resolution process,² perhaps due to the success and popularity of arbitration in other parts of the world.³ Arbitration is a dispute resolution process where a neutral third party, authorized by the disputing parties and in accordance with certain procedural rules, renders a decision which is final and binding on those parties.⁴ Arbitration is currently the preferred dispute resolution method found in international commercial

¹ Jingzhou Tao, *Commercial Divorce*, CHINA BUS. REV., Nov. 1, 1998, available in 1998 WL 10921766. There have been about 316,280 foreign-invested enterprises formed in China since 1979, about 30,000 have dissolved already. Foreign-invested enterprises include joint ventures and wholly foreign owned Chinese entities. This number does not include business transactions where foreign parties only trade with Chinese parties. *Id.*

² Frederick Brown & Catherine A. Rogers, *The Role of Arbitration in Resolving Transnational Disputes: A Survey of Trends in the PRC*, 15 BERKELEY J. INT'L L. 329, 333 (1997).

³ James H. Carter, *Litigating in Foreign Territory: Arbitration Alternatives and Enforcement Issues*, Presentation Before the American Bar Association Center for Continuing Legal Education, National Institute, *Doing Business Worldwide* (Feb. 8-10, 1998). In discussing why arbitration is so popular in foreign litigation, the authors make multiple assertions including: 1) resulting awards have little risk of being set aside by courts; 2) arbitration awards are easier to enforce than court awards; 3) there is increased privacy; 4) the desire for predictability and avoidance of a potentially hostile foreign court is the largest incentive for choice of arbitration. *Id.*

⁴ WANG SHENG CHANG, *RESOLVING DISPUTES IN THE PRC* 5 (1996).

contracts.⁵ Features typically desired in international contract arbitration clauses include: choice of a neutral forum, parties' selection of arbitrators, choice of law, and protection from prejudice and unfamiliar legal practices.⁶ The idea that arbitration provides a refuge against the uncertainties of national courts is supported by the nature of arbitration, and the theory that the process provides control by the parties in shaping the arbitration proceedings.⁷

Arbitration has a long history as a means of settling commercial disputes in China, and its importance and influence has grown significantly over the last few decades.⁸ The Chinese International Economic Trade Arbitration Commission ("CIETAC") is now the largest international arbitration tribunal in the world.⁹ Over the past decade, China has made significant changes in its international arbitration process in an effort to conform more with international standards.¹⁰

Despite these changes, the Chinese arbitration process remains protective of local interests,¹¹ does not allow foreign parties to fashion an agreement that balances Chinese and foreign interests,¹² and carries little weight in enforcing awards against a Chinese party.¹³ The arbitration

⁵ Steven J. Burton, *Combining Conciliation with Arbitration of International Commercial Disputes*, 18 HASTINGS INT'L & COMP. L. REV. 637, 637 (1995).

⁶ *Id.* Generally, arbitration awards in international disputes are more readily enforceable than court judgments; arbitration provides a neutral forum; arbitration protects parties from prejudices and unfamiliar legal practices; the process allows parties to select arbitrators, and the process allows the parties to tailor the arbitral procedure to their specific disputes. *Id.*

⁷ Brown & Rogers, *supra* note 2, at 334.

⁸ WANG SHENG CHANG, *supra* note 4, at 5.

⁹ Carmen Collar Fernandez & Jerry Spolter, *International Intellectual Property Dispute Resolution: Is Mediation a Sleeping Giant?*, 53 DISP. RESOL. J. 62, 66 (1998). CIETAC arbitrated more than 900 cases from more than 45 countries in 1996. Of the 723 cases accepted by CIETAC in 1997, U.S. parties were involved in the largest number with 66 cases, followed by South Korea with 36 cases, and Japan with 30 cases. *China: Business Booms for China's Arbitrator*, CHINA BUS. DAILY, Feb. 16, 1998, available in 1998 WL 7594192.

¹⁰ Jun Ge, *Mediation, Arbitration and Litigation: Dispute Resolution in the PRC*, 15 UCLA PAC. BASIN L.J., 122, 132-33 (1996). Effective in 1995, CIETAC made major changes to its arbitration rules, bringing them more in line with recognized international standards. These included: 1) permitting foreign arbitrators; 2) allowing use of other languages if agreed by all parties; 3) allowing use of non-Chinese lawyers in the tribunal; 4) providing a nine month time limit for a decision; 5) providing that awards are considered binding and can not be reviewed by courts; 6) providing an alternate "fast track" procedure for smaller disputes. *Id.*

¹¹ Jake Stratton, *Despite the Opaque Legal Environment, Foreign Companies Continue to Brave the Risks of Doing Business in China*, CHINA BUS. REV., Jan. 1, 1998, available in 1998 WL 10921705. "China is one of the most difficult countries in the world in which to do business." *Id.*

¹² Brown & Rogers, *supra* note 2, at 332. International arbitration clauses in multimillion dollar contracts do not necessarily provide a viable means for resolving disputes or protecting an investment. *Id.*

¹³ *Id.* at 341. Enforcement problems are legendary for victorious parties seeking enforcement of awards in China. Prevailing parties are routinely unable to enforce arbitral awards. *Id.*

process is "stacked against" foreigners due to the lack of choice of forum,¹⁴ lack of an independent arbitral board,¹⁵ and the requirement that the Chinese rules be followed.¹⁶ Enforcement of a Chinese award against a foreign party will likely be successful in foreign courts,¹⁷ but the Chinese courts will most likely refuse to enforce an award in favor of a foreign party.¹⁸ If the Chinese party to an arbitration agreement does not voluntarily participate and comply with an award, the arbitration agreement can be a no-win situation for a foreign party transacting business with a Chinese entity.

While the Chinese government has taken significant steps towards meeting internationally accepted norms for conducting business and for resolving international business disputes, further changes are needed.¹⁹ Prior to 1982, there was no provision in Chinese law for the enforcement of arbitration awards.²⁰ Now there are written arbitration laws, civil procedure laws, and Chinese membership in the New York Convention; steps intended by the Chinese government to provide transparency in their legal system as it affects foreign trade.²¹

Despite these apparent efforts to conform to international standards, Chinese laws are not yet applied rationally and uniformly in a manner

¹⁴ Robert C. Goodwin, Jr. & Jennifer S. Casden, *Details Make the Difference*, CHINA BUS. REV., Mar. 1, 1998, available in 1998 WL 10921720. Contract provisions that pose the greatest problems for US exporters typically are those requiring that arbitration of any dispute take place in China rather than in a third country. *Id.*

¹⁵ Alastair Crawford, *Plotting Your Dispute Resolution Strategy: From Negotiating the Dispute Resolution Clause to Enforcement Against Assets*, in DISPUTE RESOLUTION IN THE PRC 22, 37 (Chris Hunter ed., 1995). Despite the introduction of foreign arbitrators to CIETAC, it is virtually unheard of for a foreigner to be appointed as either a single arbitrator, or as a Chief Arbitrator. Two of the three members of a board will be Chinese. *Id.*

¹⁶ Benjamin P. Fishburne, III & Chuncheng Lian, *Commercial Arbitration in Hong Kong and China: A Comparative Analysis*, 18 U. PA. J. INT'L ECON. L. 297, 322-23 (1997). There are no express provisions in Chinese law allowing parties to select their own procedural rules. The tribunal will follow its own rules. *Id.*

¹⁷ GUO XIAOWEN, CASE STUDIES OF CIETAC, INTERNATIONAL TRADE DISPUTES vii (1996). In accordance with the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (June 10, 1958) [hereinafter New York Convention] arbitration decisions from China are recognized and enforced in more than 90 countries. *Id.*

¹⁸ See Dexter Roberts et al., *Cheated in China? More American Companies Turn to Washington for Relief from Abuses*, BUS. WEEK, Oct. 6, 1997, available in 1997 WL 8271885. There is a lack of protection for foreigners under the Chinese legal system. "The scale of problem is greater than the number of publicized cases would indicate, because most companies keep quiet about their troubles with Chinese ventures for fear of retaliation by local officials." *Id.*

¹⁹ Stanley B. Lubman, *There's no Rushing China's Slow March to a Rule of Law*, L.A. TIMES, Oct. 19, 1997, available in 1997 WL 13991303.

²⁰ WANG SHENG CHANG, *supra* note 4, at 166.

²¹ Lubman, *supra* note 19. The World Trade Organization requires transparency in legal systems of its members in publishing laws that affect foreign trade, and requires rational and uniform administration of the laws. *Id.*

consistent with World Trade Organization requirements.²² Efforts to make China more transparent to outside investors are undermined by the country's decentralization, which gives local officials significant power.²³ The concept of the supremacy of law is absent in China, where the legal system does not yet have the independence and stature of its counterparts in western countries.²⁴ This structure does not yet provide protection to foreign entities doing business in China, and "China's tortuous passage to a credible system of dispute resolution still appears endless."²⁵

Faced with the rather gloomy prospects of obtaining and enforcing favorable arbitration agreements and awards in China, and the dismal view of the Chinese national courts toward foreigners, why do foreign investors still seem to flock into China to do business? One possibility is that foreign investors settle most of their disputes through more amicable means like mediation and conciliation.²⁶ Given the large number of invested foreign entities (in excess of 300,000)²⁷ and the small number of disputes handled by CIETAC (723 in 1997),²⁸ fewer than three out of every thousand foreign-invested companies have a dispute each year severe enough to proceed to arbitration. Alternatively, the numbers indicate that most disputes are either handled by the courts, or the foreign parties simply accept whatever the Chinese party chooses to give them.²⁹ Certainly some companies assume the risk that if they have problems in their Chinese business ventures, they will simply lose their investment.³⁰ Others come to the realization when problems occur that their legal options are not worth pursuing.³¹

²² Jeff Logan & William Chandler, *Incentives Needed for Foreign Participation in China's Natural Gas Sector*, OIL & GAS J., Aug. 10, 1998, available in 1998 WL 11541560. Transparency is one of the most difficult barriers to overcome in order to do business in China. "This refers to clarifying contracts, pricing, legal issues such as arbitration, and who has final decision-making authority. The commonly accepted ways of conducting international business are not always followed in China. Legal and financial practices should be clarified and brought closer in line with international standards." *Id.*

²³ Stratton, *supra* note 11.

²⁴ Richard H. Holton & Xia Yuan Lin, *China and the World Trade Organization: Can the Assimilation Problems Be Overcome?*, ASIAN SURV., Aug. 1, 1998, available in 1998 WL 13064625.

²⁵ *China: No Redress*, BUS. CHINA, Sept. 28, 1998, available in 1998 WL 16823923.

²⁶ WANG SHENG CHANG, *supra* note 4, at 6. For example, the people's conciliation system resolves six to seven million disputes each year. *Id.* See also *id.* at 33-47 for discussion on conciliation.

²⁷ Jingzhou Tao, *Commercial Divorce*, *supra* note 1.

²⁸ *China: Business Booms for China's Arbitrator*, *supra* note 9.

²⁹ *China: No Redress*, *supra* note 25.

³⁰ Stratton, *supra* note 11.

³¹ *China: No Redress*, *supra* note 25. "The lack of any effective mechanism to resolve contractual disputes has meant that when business relationships sour, there are rarely adequate means to obtain redress from the wayward partner." The author additionally describes the arbitration process as "an expensive and protracted lottery." *Id.*

The potential for profit combined with ignorance of the systemic problems with the dispute resolution process may lead many investors into situations from which they later cannot recover. There are disagreements among scholars about the level of difficulty in using arbitration in China, and about the objectivity of the process. On paper the system appears reasonably fair and enforceable.³² Statistics from the Secretariat of CIETAC indicate that among all the awards rendered by CIETAC, fewer than five percent had to go to the courts for enforcement, and less than eight percent were denied enforcement.³³ Conflicting recent information shows an increasing number of applications for enforcement of CIETAC awards in the Chinese courts, and that the courts enforce only about two-thirds of the awards brought before them.³⁴ Popular sentiment is that China has a relatively high perceived level of corruption,³⁵ and the lack of protection for foreign investors through arbitration and the courts is a much bigger problem than indicated by the cases that have been publicized.³⁶ Corruption on a broad scale is widely recognized as a major problem in China.³⁷

The current state of foreign-related arbitration in China indicates that if the Chinese party chooses not to participate in the arbitration process and comply with an award, a foreign party has little recourse. If the foreign party wins in arbitration, it is not likely to collect absent enforcement through the courts.³⁸ If a foreign party loses in an arbitration tribunal to a Chinese party, the Chinese courts will likely enforce the award, and the Chinese party stands an excellent chance of pursuing enforcement of an award in the foreigner's home country.³⁹

³² Jingzhou Tao, *Editor's Notes: CIETAC Arbitration Rules*, 1 China L. Reference Service (Asia L. & Prac.), Ref. No. 1450/98.05.06 (1998).

³³ WANG SHENG CHANG, *supra* note 4, at 180.

³⁴ *China: No Redress*, *supra* note 25. Applications for enforcement of CIETAC awards in the Chinese courts increased from eight per year in 1991, 1992, and 1993, to twelve in 1994, 34 in 1995, and 64 cases in 1996. Of the 1996 cases, 21 were not enforced by the Chinese courts, 43 applications were enforced by the Chinese courts. *Id.*

³⁵ Stratton, *supra* note 11. The legal environment in China has inadequate dispute resolution mechanisms, tends to breed corruption, and is commonly cited by foreign companies as a prominent feature of the PRC business environment. In 1997, China ranked number 12 of 52 countries in terms of its perceived level of corruption. *Id.*

³⁶ Roberts et al., *supra* note 18. Regarding the lack of protection under the Chinese legal system, most companies keep quiet about troubles with Chinese ventures for fear of retaliation by local officials. *Id.*

³⁷ Holton & Xia Yuan Lin, *supra* note 24.

³⁸ Brown & Rogers, *supra* note 2, at 336. More often than not foreign investors will need to seek enforcement in Chinese courts. *Id.*

³⁹ GUO XIAOWEN, *supra* note 17.

This Comment will look briefly at the background of arbitration in China,⁴⁰ including a look at the Arbitration Law of the People's Republic of China, the separation of domestic and foreign-related dispute resolution, and CIETAC. Then it will examine disparities between international arbitration theory in China and actual practice; examine problems foreigners may have with the bifurcated Chinese arbitration system; discuss practical problems foreign entities experience in conducting arbitration in China; and examine difficulties foreign parties experience with enforcement of arbitral awards with the Chinese. The Comment concludes that foreign investors in China may better protect assets in their home country by avoiding an arbitration agreement, because the Chinese parties will have more difficulty attaching the foreign party's foreign based assets with a Chinese court judgment than with a Chinese arbitration award.

II. THE DEVELOPMENT OF INTERNATIONAL ARBITRATION IN CHINA

Chinese society regards use of adversarial proceedings, including arbitration, as a last resort to settle disputes, because it indicates a shameful failure to settle matters amicably.⁴¹ China continues to rely on non-adversarial processes of discussion, mediation and compromise to resolve disputes and continue business relationships between parties after disputes have been settled.⁴² Many Chinese statutes and rules strongly encourage or require mediation as an alternative to arbitration,⁴³ and even the CIETAC arbitration rules allow mediation (conciliation) of disputes under its authority if either party requests it and the other does not object.⁴⁴

In contrast, absent amicable resolution of disputes, the international community emphasizes arbitration for dispute resolution,⁴⁵ and many investors consider it the most efficient method of resolving international

⁴⁰ See generally Ge Liu & Alexander Lourie, *International Commercial Arbitration in China: History, New Developments, and Current Practice*, 28 J. MARSHALL L. REV. 539 (1995) (detailing the history and process of international arbitration in China); WANG SHENG CHANG, *supra* note 4 (detailing the process of arbitration in China); DISPUTE RESOLUTION IN THE PRC, *supra* note 15 (detailing the laws and rules of international arbitration in China).

⁴¹ Michael F. Hoellering, *World Trade to Arbitrate or Mediate—That is the Question*, 49 DISP. RESOL. J. 67 (1994).

⁴² Crawford, *supra* note 15, at 23.

⁴³ Fernandez & Spoltner, *supra* note 9, at 68.

⁴⁴ Zhongguo Guoji Jingji Maoyi Zhongcai Weiyuanhui Zhongcai Guize (Xiuzheng) [CIETAC Arbitration Rules (Revised)] art. 45, translated in 1 China L. Reference Service (Asia L. & Prac.), Ref. No. 1450/98/05.06 (revised and adopted May 6, 1998) [hereinafter CIETAC Rules]. Article 46 allows CIETAC to conduct mediation in the manner it deems appropriate.

⁴⁵ Fernandez & Spoltner, *supra* note 9, at 67-68.

commercial disputes.⁴⁶ A cursory analysis of international arbitration in China indicates that foreign parties in internationally related agreements with Chinese parties can control the arbitration process they will use, choosing with whom and where to arbitrate, the language to be used, and procedures to be followed.⁴⁷ Investors accept arbitration because of an independent character that does not exist in court.⁴⁸ Autonomy of the parties is a basic principle in the arbitration system of countries worldwide.⁴⁹

The National Congress of the People's Republic of China adopted the Arbitration Law of the People's Republic of China in 1995. This was China's first law specifically enacted to regulate both domestic and international arbitration.⁵⁰ The legislation was an effort to normalize economic relationships between China and foreign parties.⁵¹ The Arbitration Law provides that a valid and enforceable arbitration agreement must meet specific criteria.⁵² The mandatory elements of an agreement to arbitrate are: 1) a clear declaration of the intention to submit disputes to arbitration; 2) specificity of what matters are subject to arbitration; and 3) the selection of an arbitration commission.⁵³ If the first two elements are not clearly written into the agreement, it is void; the tribunal may be selected at a later date.⁵⁴

The Arbitration Law provides that the validity of an arbitration agreement may be challenged in the arbitration commission or in Chinese courts.⁵⁵ If an arbitration agreement is ambiguous as to the choice of tribunal, a supplemental agreement to decide this issue is allowed, but failure

⁴⁶ Ge Liu & Lourie, *supra* note 40, at 539-40.

⁴⁷ Jun Ge, *supra* note 10, at 132.

⁴⁸ ARBITRATION LAWS OF CHINA 103 (The Legislative Affairs Commission of the Standing Committee of the National People's Congress of the People's Republic of China ed. & trans., 1997). See also *id.* at 17-100 (providing background and guidelines regarding formulation of the Arbitration Law, and annotations to the translated text of the Law).

⁴⁹ *Id.*

⁵⁰ Ge Liu & Lourie, *supra* note 40, at 540.

⁵¹ Zhonghua Renmin Gongheguo Zhongcaifa [Arbitration Law of the People's Republic of China] art. 16, translated in ARBITRATION LAWS OF CHINA, *supra* note 48 [hereinafter Arbitration Law].

⁵² *Id.*

⁵³ DISPUTE RESOLUTION IN THE PRC, *supra* note 15, at 183 (editor's commentary on the Arbitration Law).

⁵⁴ "An arbitration agreement shall contain the following particulars: 1) an expression of intention to apply for arbitration; 2) matters for arbitration; and 3) a designated arbitration commission." Arbitration Law art. 16.

⁵⁵ A party challenging the validity of an arbitration agreement "may request the arbitration commission to make a decision or apply to the People's Court for a ruling. If one party requests the arbitration commission to make a decision and the other party applies to the People's Court for a ruling, the People's Court shall give a ruling." *Id.* art. 20.

to agree will invalidate the entire arbitration agreement.⁵⁶ If challenged in court, local law will govern challenges to the validity of the arbitration agreement and the arbitrability of the specific dispute.⁵⁷ When parties dispute the validity of the arbitration agreement and raise the issue before both an arbitration tribunal and a PRC court, the decision of the court will prevail if the decisions conflict.⁵⁸

The Chinese system of arbitration established under the Arbitration Law is bifurcated.⁵⁹ Disputes are classified as either domestic or foreign-related, and separate tribunals and procedures are provided for each.⁶⁰ Domestic and international arbitration have separate laws, rules and regulations.⁶¹ China established an arbitration tribunal for international trade disputes in 1954, but it arbitrated only thirty-eight cases between 1956 and 1979.⁶² Following name changes in 1980 and 1988, this tribunal became the China International Economic Trade Arbitration Commission ("CIETAC"), and it has broadened its jurisdiction to include any dispute arising from international economic and trade transactions.⁶³ The China Maritime Arbitration Commission ("CMAC") also handles a small number of international cases each year.⁶⁴

Until recently, foreign traders and investors in China were required to use CIETAC for all international arbitration.⁶⁵ CEITAC has revised its rules to bring them more in line with recognized international arbitration standards.⁶⁶ The parties are permitted to designate languages other than

⁵⁶ Xiaomin Sun & Ying Zeng, *Settling Out of Court, New Rules Codify Existing Practices in an Attempt to Improve Enforcement of Commercial Arbitration Awards*, CHINA BUS. REV., Sept. 1, 1996, available in 1996 WL 8669523.

⁵⁷ Brown & Rogers, *supra* note 2, at 335.

⁵⁸ *Id.* at 340.

⁵⁹ Vivienne M. Ashman, *New York Convention and China's 'One Country, Two Systems'*, N.Y.L.J., July 2, 1998.

⁶⁰ *Id.*

⁶¹ Jun Ge, *supra* note 10, at 129.

⁶² Ge Liu & Lourie, *supra* note 40, at 541.

⁶³ *Id.*

⁶⁴ *China: Courts Handle Maritime Cases*, CHINA DAILY, Sept. 22, 1998, available in 1998 WL 7598316. China Maritime Arbitration Agency handles only 20 international cases a year. It is the only Maritime arbitration agency in China, and has 97 maritime law experts. *Id.*

⁶⁵ Carter, *supra* note 3, at 4.

⁶⁶ Brown & Rogers, *supra* note 2, at 339-40. Trends indicating compliance with international standards include:

- China's enhancement of the Arbitration Law;
- CIETAC awards being enforced outside of China;
- CIETAC's large case load;
- CIETAC's list of arbitrators including younger arbitrators with exposure to foreign legal systems;
- foreign arbitrators being allowed on the Arbitration panels;

Chinese for an arbitration proceeding.⁶⁷ The list of CIETAC approved arbitrators includes a number of non-Chinese nationals whom the parties may select.⁶⁸ At least on paper, the Chinese international arbitration practice is now in line with international norms.⁶⁹

The last decade has seen significant increases in the use of arbitration to settle disputes between Chinese and foreign parties, most handled by CIETAC.⁷⁰ CIETAC now handles more international arbitrations each year than any other international arbitration tribunal world wide, with 902 cases admitted in 1995,⁷¹ and 723 cases in 1997.⁷² According to CIETAC statistics, of the cases concluded in 1995, 82.6% were concluded by award, 7.1% were concluded by mediation or conciliation, and 10.2% were withdrawn.⁷³ Of the CIETAC cases, about half relate to international trade, and about a third relate to joint venture disputes with overseas partners.⁷⁴

Confirmation of arbitral awards by the Chinese courts includes recognition of the award and enforcement of the award.⁷⁵ Recognition means giving effect to the award to bar litigation on the same issues settled in arbitration, enforcement means applying judicial remedies to assure that the award is carried out.⁷⁶ In 1986, China joined the Convention of Recognition and Enforcement of Foreign Arbitral Awards of 1958 ("New York Convention") to make its arbitration awards effective in foreign countries.⁷⁷ Depending on the type of arbitration, the courts may use different standards to review the process and decision of the arbitration board.⁷⁸ While a CIETAC award is usually considered final, in review of

the use of non-Chinese attorneys by parties being allowed, and; Chinese is not the only language being allowed in the process.

Id.

⁶⁷ Fishburne & Chuncheng Lian, *supra* note 16, at 323.

⁶⁸ WANG SHENG CHANG, *supra* note 4, at 113. In 1996 there were 350 arbitrators on the CIETAC main panel of arbitrators: 260 Chinese nationals; 64 foreign nationals from over 20 countries; and 26 Hong Kong citizens. *Id.*

⁶⁹ Xiaomin Sun & Ying Zeng, *supra* note 56.

⁷⁰ *China to Strengthen Trade Arbitration*. XINHUA NEWS AGENCY, May 15, 1998, available in 1998 WL 4802283.

⁷¹ Xiaomin Sun & Ying Zeng, *supra* note 56.

⁷² *China to Strengthen Trade Arbitration*, *supra* note 70.

⁷³ WANG SHENG CHANG, *supra* note 4, at 69-70. Conciliation is a process where a neutral third party helps the disputing parties negotiate an amicable settlement agreement. The conciliator may or may not make settlement recommendations. *Id.* at 6.

⁷⁴ Ge Liu & Lourie, *supra* note 40, at 542.

⁷⁵ Carter, *supra* note 3, at 7.

⁷⁶ *Id.*

⁷⁷ Ge Liu & Lourie, *supra* note 40, at 548.

⁷⁸ WANG SHENG CHANG, *supra* note 4, at 156. Grounds for setting aside domestic as compared to international awards: 1) domestic award can be set aside for defect in substance (merit defects); 2) domestic awards may be set aside for failure to follow arbitration law, but nonconformance with tribunal

domestic arbitration awards, Chinese courts can review the legal reasoning of an arbitration award as well as the procedures used, meaning an arbitral decision is not final.⁷⁹

III. CHALLENGES FOR FOREIGN INVESTORS IN USING ARBITRATION TO SETTLE DISPUTES WITH CHINESE PARTIES

A. *Arbitration in China: Disparities Between Theory and Practice*

In theory, the Arbitration Law allows a foreign party to negotiate a balanced arbitration agreement tailored to its needs.⁸⁰ The arbitration process should provide parties control to shape the arbitration proceedings, but in practice, this control is not allowed in China.⁸¹ The following paragraphs explain why foreign parties have no realistic option but to accept terms of an arbitration agreement which provides for arbitration in a Chinese tribunal, conducted in the Chinese language, before a panel comprised mostly of Chinese nationals, using Chinese procedural rules.

In practice, foreigners must agree to arbitration in a Chinese tribunal, because the Chinese government need not approve contracts with arbitration agreements that provide for tribunals outside of China, and the Chinese courts may void those agreements.⁸² A number of regulations and legal provisions specifically "recommend" that foreign-related disputes go to CIETAC.⁸³ Chinese contract provisions typically require that arbitration take place in China rather than a neutral country.⁸⁴ Even if the parties have contracted for arbitration in a foreign jurisdiction, the Chinese courts can nullify the parties' choice.⁸⁵ This nullification could void the entire agreement to arbitrate because venue is one of the three required elements in the agreement to arbitrate.⁸⁶

rules do not automatically cause awards to be set aside; 3) if subject matter of the award is non-arbitrable, the award may be set aside. *Id.*

⁷⁹ Brown & Rogers, *supra* note 2, at 347.

⁸⁰ Arbitration Law art. 4. Arbitration "shall be on the basis of both parties' free will and an arbitration agreement reached between them." *Id.*

⁸¹ Brown & Rogers, *supra* note 2, at 334.

⁸² *Id.* at 345.

⁸³ Ge Liu & Lourie, *supra* note 40, at 542.

⁸⁴ Goodwin & Casden, *supra* note 14.

⁸⁵ Brown & Rogers, *supra* note 2, at 345.

⁸⁶ If an agreement contains no or unclear provisions concerning the matters for arbitration or the arbitration commission, the parties may reach a supplementary agreement. If no such supplementary agreement can be reached, the arbitration agreement shall be null and void. Arbitration Law art. 18.

There are additional barriers to the selection of non-Chinese arbitration tribunals. Under Chinese law, PRC companies need government approval to engage in foreign trade, and then only have limited capacity to enter into agreements.⁸⁷ Foreign forums are unpopular with local authorities, which often pressure joint ventures into selection of a domestic tribunal before approving their contracts.⁸⁸ Selection of a foreign tribunal, therefore, leaves an arbitration agreement subject to being voided by the government or the courts.

Certain kinds of disputes are prohibited from arbitration, or must be directed to specific administrative tribunals. For example, Article 3 of the Arbitration Law expressly excludes certain disputes, including administrative disputes that must be handled by administrative authorities.⁸⁹ Other matters not arbitrable include marital disputes, adoption, guardianship, fosterage, succession disputes, and situations where agreements are void because the subject matter cannot be legally arbitrated.⁹⁰

The Arbitration Law also codifies the exclusion of PRC government departments from arbitration and provides that their disputes be settled in administrative tribunals or the Chinese courts.⁹¹ Because most foreign trade agreements with the Chinese are with state owned entities,⁹² administrative agencies may have exclusive jurisdiction over any disputes with which they are involved. Other disputes cannot be agreed to be arbitrated because a Chinese government agency has assumed jurisdiction. For example, the Chinese National Copyright Administration created a Copyright Protection Center to arbitrate copyright disputes.⁹³ Issues of patent validity are not arbitrable under Chinese law and can only be adjudicated by the Patent Administrative Authority.⁹⁴ As a result of government exclusions, foreigners run the risk that the arbitrability of a dispute will not be

⁸⁷ Xiaomin Sun & Ying Zeng, *supra* note 56.

⁸⁸ *China's Rocky Road to Dispute Resolution: Rough Justice*, BUS. CHINA, Feb. 2, 1998, available in 1998 WL 16823697.

⁸⁹ WANG SHENG CHANG, *supra* note 4, at 78. An arbitration agreement shall be void if the agreed matter for arbitration exceeds the range of arbitrable matters as specified by law. Arbitration Law art. 17, § 1.

⁹⁰ WANG SHENG CHANG, *supra* note 4, at 79.

⁹¹ Xiaomin Sun & Ying Zeng, *supra* note 56.

⁹² *China Trade Relations and the Possible Accession of China to the World Trade Organization, 1997: Hearings before the Subcomm. on Trade, of the House Comm. on Ways and Means*, 105th Cong. (1997) (statement of Robert R. Aronson, Chairman of Revpower Limited) available in 1997 WL 14152874 [hereinafter Statement of Robert Aronson].

⁹³ *China Sets Up Copyright Protection Center*, CHINA BUS. INFO. NETWORK, Sept. 23, 1998, available in 1998 WL 13494614; see also Patrick H. Hu, "Mickey Mouse" in China: Legal and Cultural Implications in Protecting U.S. Copyrights, 14 B.U. INT'L L.J. 81, 117 (1996).

⁹⁴ Xiaomin Sun & Ying Zeng, *supra* note 56.

established until after it has developed, or arbitrability may be challenged when enforcement of an award is attempted.

Although the Arbitration Law allows for a choice of languages in conducting an arbitration, in practice, Chinese is the only language parties can use.⁹⁵ Chinese is still the official language of CIETAC, although parties are allowed to mutually agree to use an alternate language.⁹⁶ Parties are rarely able to reach mutual agreement to adopt an alternate language, and are left with Chinese by default.⁹⁷ Though not specified in the Arbitration Law, foreigners should assume that disputes handled in domestic arbitration tribunals will require that the Chinese language be used.⁹⁸

In practice, the autonomy of parties to appoint arbitrators of their choice is limited.⁹⁹ Although the Arbitration Law allows parties to jointly select the presiding arbitrator, if they do not agree, the chairman of the tribunal will select that member.¹⁰⁰ If at CIETAC, arbitrators must be drawn from a list maintained by CIETAC.¹⁰¹ The foreign party may choose one arbitrator on a panel of three,¹⁰² and the Chairman of CIETAC appoints the Chief Arbitrator.¹⁰³ This selection process ensures a majority of arbitrators on every tribunal are Chinese.¹⁰⁴ It is virtually unheard of for a non-Chinese national to be appointed chairman (Chief Arbitrator) of a tribunal.¹⁰⁵ The appointment of the Chief Arbitrator is significant because in the event of a

⁹⁵ The Arbitration Law is silent on language, but Article 73 allows foreign-related arbitration rules to be formulated by the China International Chamber of Commerce. The parent organization for CIETAC is the China International Chamber of Commerce. Jingzhou Tao, *Editor's Notes: CIETAC Arbitration Rules*, *supra* note 32. CIETAC Rules Article 75 allows for an alternate language other than Chinese for the arbitration.

⁹⁶ Fishburne & Chuncheng Lian, *supra* note 16, at 323.

⁹⁷ Sally A. Harpole, *How China Organizes Arbitral Tribunals: Arbitration in China*, 52 DISP. RESOL. J. 72, 74 (1997) [hereinafter Harpole, *How China Organizes Arbitral Tribunals*].

⁹⁸ Chinese is the required language of the arbitration under the procedural rules of the domestic tribunals. Sally A. Harpole, *Editor's Notes: State Council General Office, Several Problems to be Clarified Concerning the Thorough Implementation of the <<PRC, Arbitration Law>> Circular*, translated in 1 China L. Reference Service (Asia L. & Prac.), Ref. No. 1450/96.06.08 (1997) [hereinafter Harpole, *Editor's Notes on State Council Circular*].

⁹⁹ Fishburne & Chuncheng Lian, *supra* note 16, at 320. The arbitrators must be drawn from the panel maintained by CIETAC. See also CIETAC Rules arts. 24-27 (regarding selection of the arbitrators and the CIETAC Commissioner's role in that selection).

¹⁰⁰ ARBITRATION LAWS OF CHINA, *supra* note 48, at 69.

¹⁰¹ Fishburne & Chuncheng Lian, *supra* note 16, at 319. See also CIETAC Rules arts. 24-27.

¹⁰² CIETAC Rules art. 24.

¹⁰³ Ge Liu & Lourie, *supra* note 40, at 547.

¹⁰⁴ *Id.* The parties may jointly agree to the appointment of the chief arbitrator, but in the event they do not agree, the chief arbitrator is appointed by the Chairman of the Arbitration Commission. ARBITRATION LAWS OF CHINA, *supra* note 48, at 69.

¹⁰⁵ Harpole, *How China Organizes Arbitral Tribunals*, *supra* note 97, at 74.

deadlock among arbitrators, the opinion of the Chief Arbitrator will form the basis of the award.¹⁰⁶

In practice, foreign parties cannot adopt their own procedural rules for the arbitration process.¹⁰⁷ There are no provisions in Chinese law allowing parties to select their own procedural rules, and presumably, a tribunal will follow its own rules.¹⁰⁸ The domestic arbitration tribunals have no foreign national arbitrators, and no proper rules to apply to foreign-related arbitration.¹⁰⁹ The procedural rules for the domestic commissions state that procedures for foreign-related cases shall be uniform with the rules for domestic cases.¹¹⁰

Additionally, consistent with China's civil law tradition, CIETAC tribunals have the power to conduct their own investigations and collect evidence on their own initiative.¹¹¹ Any arbitration tribunal may collect evidence as it considers necessary.¹¹² This independent investigative authority could open the arbitration up to a broader scope than a party desires, causing additional delay and expense in the process.

As a result of these practical constraints on arbitration, foreign investors find themselves with no realistic option but to accept terms of arbitration agreements which provide for arbitration in a Chinese tribunal, conducted in the Chinese language, before a panel comprised mostly of Chinese nationals. The publicly espoused fairness and the contention that the Chinese dispute resolution process conforms with international standards may convince foreigners that their interests are protected when in practice they are not.¹¹³

B. *China's Bifurcated System of Arbitration*

A significant unsettled issue relating to Chinese arbitration of foreign-related disputes is the bifurcated system that designates disputes as either domestic or foreign-related, and provides separate tribunals and procedures

¹⁰⁶ Arbitration Law art. 53. See also Ge Liu & Lourie, *supra* note 40, at 560.

¹⁰⁷ Fishburne & Chuncheng Lian, *supra* note 16, at 322-23.

¹⁰⁸ *Id.*

¹⁰⁹ WANG SHENG CHANG, *supra* note 4, at 23.

¹¹⁰ Harpole, *Editor's Notes on State Council Circular*, *supra* note 98.

¹¹¹ CIETAC Rules art. 38. Article 39 allows the tribunal to consult experts, and to require parties to produce experts/appraisers and related information, documents, property or goods for browsing, inspection, and or appraisal by the experts/appraisers. *Id.* art. 39. If CIETAC does investigate, it may need to offer opportunity for parties to comment on their findings. Fishburne & Chuncheng Lian, *supra* note 16, at 324.

¹¹² Arbitration Law art. 43. If the tribunal uses an appraiser, the parties may question the appraiser subject to the permission of the arbitration tribunal. *Id.* art. 44.

¹¹³ Jingzhou Tao, *Commercial Divorce*, *supra* note 1. "Chinese local authorities tend to be charming and demonstrate great hospitality when foreign investors shop for a place to invest. However they tend to be absent or reluctant to advocate for the foreign investors' interests when a dispute arises." *Id.*

for each.¹¹⁴ The arbitration process differs between the foreign and domestic tribunals, with the domestic tribunals exhibiting significant shortcomings for the foreign investor.¹¹⁵ There is currently confusion among the Chinese courts and CIETAC about what disputes are foreign-related; about what tribunals are competent to hear foreign-related disputes; and about how the foreign business entity's structure will affect the choice of forum.¹¹⁶ The result is that foreign parties may find themselves unable to participate in the tribunal they have selected in an arbitration agreement.¹¹⁷

The Chinese authorities disagree about what arbitration tribunals can settle disputes involving foreigners and foreign-related transactions.¹¹⁸ The Arbitration Law does not expressly define what disputes are domestic or foreign-related.¹¹⁹ In theory, CIETAC has jurisdiction over any foreign party, but disputants can challenge CIETAC's jurisdiction in Chinese courts, which have the ultimate say in who does have jurisdiction.¹²⁰ The Chinese courts have not been favorable towards foreigners in determining when a dispute is international or foreign-related, or if it meets the additional requirement of being commercial in nature.¹²¹

While CIETAC revised its rules in 1998 to clearly accept disputes concerning foreign funded businesses,¹²² the State Council and the courts appear to be pushing more disputes into the domestic arbitration tribunals.¹²³ A 1996 notice from the State Council contains provisions that end

¹¹⁴ Ashman, *supra* note 59.

¹¹⁵ Domestic arbitration commissions are considerably less attractive than CIETAC to foreign investors due to the lack of foreign arbitrators and weaker technical capabilities. Jingzhou Tao, *Editor's Notes: CIETAC Arbitration Rules*, *supra* note 32.

¹¹⁶ Although CIETAC has extended its own jurisdiction to include foreign-invested enterprises, the People's Court has refused to enforce CIETAC awards in the few cases it has heard that involved foreign-invested enterprises. *Id.*

¹¹⁷ If a Chinese company has not been approved by the PRC government to enter into a foreign commercial contract, the contract and any included arbitration agreement will be void under Chinese Law. Donald Lewis, *Editor's Notes: PRC Arbitration Law, translated in 1 China L. Reference Service (Asia L. & Prac.)*, Ref. No. 1450/94.08.31 (1994).

¹¹⁸ Xiaomin Sun & Ying Zeng, *supra* note 56.

¹¹⁹ Arbitration Law, Part Seven: Special Provisions on Foreign-related Arbitration, which includes Articles 65 to 72. Article 65 states only: "This part shall apply to the arbitration of disputes arising from economic, trading, transportation and maritime activities involving a foreign element." *Id.* art. 65.

¹²⁰ Xiaomin Sun & Ying Zeng, *supra* note 56.

¹²¹ Fishburne & Chungcheng Lian, *supra* note 16, at 310. CIETAC rules do provide that CIETAC has jurisdiction in virtually all foreign involved disputes, but the courts often disagree. *Id.* CIETAC Rules Article 2 provides jurisdiction over economic and trade transactions, whether contractual or non-contractual, between foreign legal persons and Chinese legal persons. CIETAC Rules art. 2.

¹²² *China to Strengthen Trade Arbitration*, *supra* note 70.

¹²³ Xiaomin Sun & Ying Zeng, *supra* note 56. Chinese courts classify disputes involving foreign entities on a case-by-case basis. Only disputes involving foreign and PRC enterprises that involve international transactions tend to fall within CIETAC. Other kinds of disputes involving the same entities will be classified as domestic. *Id.*

CIETAC's exclusive jurisdiction over foreign-related disputes, and makes it more difficult to designate CIETAC in arbitration clauses in standard-form government contracts.¹²⁴ At the same time, CIETAC is attempting to assert jurisdiction over more potential disputes, including those disputes involving Chinese legal entities engaged in foreign business relations.¹²⁵ Although no foreign entity should voluntarily submit to domestic arbitration, in the end, many have no choice.¹²⁶

The State Council has expanded the authority of the domestic arbitration tribunals to handle foreign-related disputes as well as domestic disputes,¹²⁷ prompting several domestic tribunals to take steps to attract and accommodate foreign-related disputes.¹²⁸ The new CIETAC and State Council rules allow a large degree of overlap between CIETAC and the domestic arbitration commissions.¹²⁹ The State Council now suggests that standard-form contracts designate only domestic arbitration tribunals, making it more difficult to arbitrate before CIETAC.¹³⁰ There are now 120 domestic arbitration commissions competing with CIETAC for foreign-related dispute resolution.¹³¹

This competition for jurisdiction may have severe consequences for foreign investors. For example, the use of a foreign-owned Chinese corporate entity to limit liability and protect assets in a foreign parent company's home country will likely make CIETAC unavailable to resolve disputes that arise, forcing disputes before domestic arbitration tribunals.¹³² Chinese registered entities are considered Chinese legal persons under Chinese law, and as such, CIETAC cannot have jurisdiction over them.¹³³

¹²⁴ Harpole, *Editor's Notes on State Council Circular*, *supra* note 98. See also Brown & Rogers, *supra* note 2, at 345. The 1996 notice from the State Council contains significant provisions that end CIETAC's exclusive jurisdiction over foreign-related disputes, and makes it more difficult to designate CIETAC in arbitration clauses in standard-form government contracts. *Id.*

¹²⁵ *China: CIETAC to Expand Arbitration Scope*, CHINA DAILY, Apr. 29, 1998, available in 1998 WL 7595422.

¹²⁶ *China's Rocky Road to Dispute Resolution: Rough Justice*, *supra* note 88.

¹²⁷ Sally A. Harpole, *Following Through on Arbitration*, CHINA BUS. REV., Sept. 1, 1998, available in 1998 WL 10921747. Notice was issued June 8, 1996. *Id.*

¹²⁸ Sally Harpole, *Tradition of Middlemen Remains an Arbitrary Solution to Disputes, Familiarity with New Laws and Rules on the Mainland Arbitral System Are a Must*, S. CHINA MORNING POST, Aug. 13, 1998, available in 1998 WL 22024921 [hereinafter Harpole, *Tradition of Middlemen*].

¹²⁹ *Id.*

¹³⁰ Brown & Rogers, *supra* note 2, at 345.

¹³¹ *China: CIETAC to Expand Arbitration Scope*, *supra* note 125.

¹³² Brown & Rogers, *supra* note 2, at 344.

¹³³ *Id.* The 1995 revised CEITAC Rules allowed CIETAC to arbitrate foreign-related matters between two Chinese legal persons. However, in 1996 the Shanghai Municipal Intermediate People's Court ruled that CEITAC did not have jurisdiction over two Chinese legal persons, despite the CEITAC Rules. *Id.* The current CIETAC Rules continue to allow jurisdiction over two Chinese legal entities if one is at least partially foreign-invested. CIETAC Rules art. 2,

The popular Chinese legal interpretation, which is supported by Chinese Court decisions, holds that any dispute between Chinese registered entities, regardless of whether they are foreign-invested, shall be deemed a domestic dispute unless the matter in dispute is clearly international in nature.¹³⁴ Courts can refuse to enforce arbitration agreements that are “beyond the arbitral authority” of CIETAC.¹³⁵ Therefore, while CIETAC is willing to arbitrate an agreement between Chinese legal persons, if one of the parties challenges jurisdiction in court, the case can be removed from CIETAC. The Chinese Supreme Court has not yet had occasion to determine which disputes are foreign-related, making it unclear if even those Chinese entities that are entirely foreign owned could enforce an arbitration agreement designating use of CIETAC.¹³⁶ The inability to ensure that an arbitration would be conducted before CIETAC significantly reduces the appeal to foreigners of an arbitration agreement to settle disputes.

The uncertainty of whether a foreign investor will find itself settling a dispute before a domestic tribunal or CIETAC presents a significant risk to foreign parties.¹³⁷ Under the Arbitration Law, China applies different sets of rules and procedures to foreign-related versus domestic arbitration both in conducting the arbitration and in enforcement of arbitral awards.¹³⁸ It is unclear if foreign or domestic dispute resolution procedures will govern foreign-related disputes when they come before domestic tribunals.¹³⁹ If the arbitration is determined to be a domestic arbitration, the specific local tribunal will determine the applicable rules, because no uniform rules have been adopted for use by local arbitration associations.¹⁴⁰

In addition, foreign parties finding themselves in domestic tribunals will face other difficulties. In domestic tribunals, delays and expenses can be great when the stakes are high; skilled arbitrators may not be available; interim protection measures for disputed assets may be unavailable; and it may be difficult to join third parties or compel them to give evidence.¹⁴¹ For many types of disputes, Chinese arbitration procedures lack comprehensive discovery mechanisms, and foreign parties cannot adequately protect

¹³⁴ Harpole, *How China Organizes Arbitral Tribunals*, *supra* note 97, at 73.

¹³⁵ WANG SHENG CHANG, *supra* note 4, at 179.

¹³⁶ Fishburne & Chuncheng Lian, *supra* note 16, at 311.

¹³⁷ Brown & Rogers, *supra* note 2, at 346.

¹³⁸ Harpole, *Following Through on Arbitration*, *supra* note 127.

¹³⁹ Brown & Rogers, *supra* note 2, at 346.

¹⁴⁰ Fishburne & Chuncheng Lian, *supra* note 16, at 307.

¹⁴¹ Don J. Lewis et al., *Domestic Commercial Arbitration in the People's Republic of China*, in DISPUTE RESOLUTION IN THE PRC, *supra* note 15, at 74, 91.

themselves.¹⁴² Domestic tribunals have a problem finding sufficient numbers of competent arbitrators to operate the tribunals, and because the Arbitration Law has open-ended qualification standards, they allow for questionable competence of the arbitrators.¹⁴³ These issues make claims that arbitration is faster and cheaper than litigation in court appear increasingly unfounded.¹⁴⁴

Finally, local protectionism is a major obstacle in the effective operation of the domestic arbitration tribunals.¹⁴⁵ Despite efforts by the Chinese government to separate the arbitration commissions from the PRC administrative control,¹⁴⁶ political and administrative interference in the domestic arbitral process is still a distinct possibility.¹⁴⁷ The foreign investor faces significant disadvantages in participating in the domestic arbitration tribunals, yet due to the uncertainty of the current law, is also unable to ensure an alternate more favorable tribunal in an arbitration agreement.

C. *Practical Problems with Conducting Arbitration*

The following paragraphs explain how the arbitration process in China presents several challenges and uncertainties to the foreign investor. Some disputes are not subject to arbitration or will not be covered by an arbitration agreement; the process is time consuming and expensive; the problems of the Chinese legal system affect the arbitration process; protection of assets in dispute is difficult; and, the predictability of an arbitral decision is uncertain.

Foreign parties using arbitration agreements could find themselves in disputes that are not covered by the agreements. Prior to the Arbitration Law of 1995, non-contractual disputes including fraud and other torts could not be arbitrated.¹⁴⁸ Now the Arbitration Law states that non-contractual disputes can be arbitrated, including disputes such as patent infringement

¹⁴² Edward J. Fitzpatrick & Heidi C. Chen, *PLI'S SECOND ANNUAL INSTITUTE FOR INTELLECTUAL PROPERTY LAW 1996*, at 381 (PLI Pat., Copyrights, Trademarks, & Literary Prop. Course Handbook Series, No. 454, Sept. 1996.)

¹⁴³ Lewis et al., *supra* note 141.

¹⁴⁴ Burton, *supra* note 5, at 637.

¹⁴⁵ Lewis et al., *supra* note 141.

¹⁴⁶ Arbitration Law Article 14 states that arbitration commissions shall be independent from administrative authorities. Arbitration Law art. 14.

¹⁴⁷ Lewis et al., *supra* note 141.

¹⁴⁸ Xiaomin Sun & Ying Zeng, *supra* note 56. In 1985, Swiss Industry Resources tried to enforce an arbitration agreement against China National Technical Import & Export Corp. The Chinese court refused to enforce arbitration because the dispute was a tort action of fraud, not a contract dispute. The Chinese appellate court affirmed. *Id.*

and protection of intellectual property.¹⁴⁹ While authorities claim that non-contractual disputes are clearly arbitrable,¹⁵⁰ the parties must have an agreement in place to arbitrate those disputes.¹⁵¹ Patent or copyright infringement by Chinese parties with whom a foreign entity has no contract will not be covered. If an arbitration agreement has not specified that it covers fraud or other non-contractual claims such as patent or copyright infringement, the foreign party will not be protected.¹⁵²

The arbitration process can be very time consuming when considering the process leading up to arbitration, the process of the arbitration itself, and the enforcement of an award. Although an unchallenged arbitration may be faster than the Chinese judicial process, speedy relief is unlikely.¹⁵³ For many disputes, especially involving technology or intellectual property, Chinese arbitration will not be fast enough to be a satisfactory dispute resolution process.¹⁵⁴ Chinese arbitration, like international disputes generally, are prone to frequent delays because of distance, difficulties in communication and language.¹⁵⁵

Moreover, there may be litigation attempts by the Chinese party to avoid arbitration.¹⁵⁶ Because of cultural pressure to resolve disputes amicably, arbitration tribunals may stay the proceedings until mediation or other measures conclude.¹⁵⁷ If the losing party refuses to honor an award, additional time for enforcement must also be considered, as the winning party usually must wait for the expiration of time limits given for the losing party to comply before seeking court enforcement.¹⁵⁸

When timeliness could be a major concern, foreign investors should specify in advance a time limit for mediation or conciliation rather than leaving these options open-ended.¹⁵⁹ The requirements of CIETAC are that a tribunal must rule and make an award within nine months of the formation of the tribunal, but that time may be extended if CIETAC considers it

¹⁴⁹ *Id.*

¹⁵⁰ Fishburne & Chuncheng Lian, *supra* note 16, at 314.

¹⁵¹ Xiaomin Sun & Ying Zeng, *supra* note 56.

¹⁵² The types of disputes are to be specified in the agreement. Arbitration Law art. 16.

¹⁵³ Carter, *supra* note 3, at 1.

¹⁵⁴ Fernandez & Spoltnr, *supra* note 9, at 68. "Arbitration dominates the international dispute resolution field, but 'clients will be voting with their feet' in the direction of mediation since arbitration has become so expensive, time-consuming and marked by difficult-to-enforce awards." *Id.*

¹⁵⁵ Brown & Rogers, *supra* note 2, at n.30.

¹⁵⁶ Carter, *supra* note 3, at 2.

¹⁵⁷ WANG SHENG CHANG, *supra* note 4, at 54.

¹⁵⁸ *Id.* at 165. The time limit for enforcement of an award if neither party is an individual is six months. Ge Liu and Lourie, *supra* note 40, at 564.

¹⁵⁹ Fitzpatrick & Chen, *supra* note 142, at 397.

necessary.¹⁶⁰ The nine-month period does not start until after the tribunal reviews the claim and response, the parties select their arbitrators, and the CIETAC chairman selects a chief arbitrator.¹⁶¹ CIETAC determines the sufficiency of an application for arbitration, and can ask for additional materials or clarification.¹⁶² Only when CIETAC determines the completeness of the application will it notify the parties of additional steps.¹⁶³

Additionally, the arbitration process for foreign investors can be very costly. Administrative costs for CIETAC are high, especially compared to the nominal cost to file a case in the Chinese courts.¹⁶⁴ Fees can range from tens of thousands to hundreds of thousands of U.S. dollars for the process.¹⁶⁵ A request for a non-Chinese arbitrator requires a party to deposit additional fees of about US\$7,000 depending on the location of the arbitrator.¹⁶⁶ If the Chinese party refuses to participate or refuses to honor the decision of the arbitration board, the expense of arbitration will be increased by the litigation expense the foreign party will incur in the courts.

Furthermore, arbitration in China is directly tied to China's court system and will always be subject to the court's limitations.¹⁶⁷ Corruption is commonly cited by foreign companies as a prominent feature of the PRC business environment, bred by a legal environment that lacks adequate dispute resolution mechanisms.¹⁶⁸ The Chinese have an emerging framework of rules governing commercial transactions, and are slowly acquiring a consciousness of legal rights, which were unknown in traditional Chinese society and were

¹⁶⁰ CIETAC Rules art. 52. See also Harpole, *How China Organizes Arbitral Tribunals*, *supra* note 97, at 77.

¹⁶¹ Ge Liu & Lourie, *supra* note 40, at 557. To commence arbitration in CIETAC a claimant must submit application with evidence, appoint its arbitrator and pay applicable fees. *Id.* CIETAC is not bound by any time limitation for review of application, and CIETAC decides if it is complete. CIETAC Rules art. 15. Respondent then has 45 days from notice from CIETAC to respond. *Id.* art. 17. Arbitration may proceed unaffected by the lack of response. *Id.* art. 21. Only after both parties submit their choice of arbitrators will the chairman of CIETAC appoint the chief arbitrator, and on this date the tribunal is officially formed. Ge Liu & Lourie, *supra* note 40, at 557.

¹⁶² Harpole, *How China Organizes Arbitral Tribunals*, *supra* note 97, at 77.

¹⁶³ *Id.*

¹⁶⁴ Brown & Rogers, *supra* note 2, at n.30. For a US\$2 million dispute, the arbitration filing fee is US\$19,500, plus US\$10,450 to US\$45,000 per arbitrator. *Id.* The minimum and maximum arbitration fee per arbitrator in a matter valued at US\$5 million are US\$17,450 and US\$96,500. Hunter, *supra* note 15 at 29.

¹⁶⁵ Crawford, *supra* note 15, at 29.

¹⁶⁶ WANG SHENG CHANG, *supra* note 4, at 135. Amount of deposit ranges from US\$6,500 for Hong Kong, Japan, or Korea resident arbitrators, to US\$7,500 for more distant arbitrators. *Id.*

¹⁶⁷ Brown & Rogers, *supra* note 2, at 348.

¹⁶⁸ Stratton, *supra* note 30. In a 1997 survey, China ranked twelfth out of 52 countries for perceived level of corruption. *Id.*

deformed by communism.¹⁶⁹ Consistent application of existing legal principles remains a problem in China.¹⁷⁰ In addition, the writing and practice of laws in China are intentionally ambiguous so that policymakers and officials have flexibility in interpreting and implementing them.¹⁷¹ This legal environment, within which foreigners must conduct and enforce their arbitration agreements, poses additional risk to foreign investment.

During the lengthy arbitration process, the disputants run a risk that assets available to fulfill an award will disappear, leaving nothing for the winning party to recover. Chinese Civil Procedure Law provides for emergency protection of property, but the Arbitration Law does not.¹⁷² The Civil Procedures Law of the PRC requires that arbitration commence prior to application in court for property protection, and the tribunal must make the request.¹⁷³ Notification to the other party of pending arbitration provides them an opportunity to dispose of property that could otherwise satisfy an award.¹⁷⁴ In foreign-related arbitration, CIETAC must rule first on the need for property protection, which then must be submitted to the Chinese courts to have any effect.¹⁷⁵ In about thirty percent of CIETAC arbitration cases the parties seek property preservation, but the courts will deny such requests absent a security guarantee by the claimant.¹⁷⁶ A foreign party must therefore put additional assets at risk to provide the security guarantee to protect the assets already in dispute.

The arbitration process in China is prone to bias, and may lack expertise in deciding foreign-related cases.¹⁷⁷ Even when a foreign party is successful in keeping a dispute within CIETAC, the arbitration process may

¹⁶⁹ Lubman, *supra* note 19. The author states there is no principle in China that law is supreme, and conflicts between the law and the supremacy of the Chinese Communist Party have not yet been addressed. *Id.*

¹⁷⁰ Fishburne & Chuncheng Lian, *supra* note 16, at 331.

¹⁷¹ Holton & Xia Yuan Lin, *supra* note 24. The authors suggest that the laws are intentionally vague, and provide too much room for disparate interpretation by Chinese officials and businesspersons to allow China to function in the World Trade Organization. *Id.*

¹⁷² Ge Liu & Lourie, *supra* note 40, at 562. In foreign-related arbitration, if a party requests preservation of evidence, the tribunal shall submit a request to the courts. Arbitration Law art. 68.

¹⁷³ If a party requests preservation of property, the arbitration tribunal shall submit an application to the Intermediate People's Court either at the place of domicile of the person with the assets, or where the property is located. Zhonghua Renmin Gongheguo Minshi Susongfa [Civil Procedure Law of the People's Republic of China] art. 258, translated in 3 China L. Foreign Bus.: B. Reg. (CCH Austl. Ltd.) ¶ 19-201, at 23,919 (April 9, 1991) [hereinafter Civil Procedure Law].

¹⁷⁴ Ge Liu & Lourie, *supra* note 40, at 562.

¹⁷⁵ When a party requests property preservation measures, the commission shall transmit the application to the People's Court. CIETAC Rules art. 28.

¹⁷⁶ Ge Liu & Lourie, *supra* note 40, at 562. Emergency requests for property protection can be granted by the courts in as little as 48 hours, but only after the arbitration commission has determined it is necessary. *Id.*

¹⁷⁷ Fitzpatrick & Chen, *supra* note 142, at 397.

not provide a competent and impartial forum. While the list of arbitrators now includes many non-Chinese panelists, CIETAC foreign arbitrators are poorly compensated, and therefore less likely to accept many CIETAC appointments.¹⁷⁸ Chinese arbitrators are also poorly compensated, receiving only about US\$100 per arbitration.¹⁷⁹ A Chinese arbitration body may lack technical expertise, and if it seeks the help of Chinese experts, those experts may be biased against a foreign party in the same manner that an individual arbitrator may be.¹⁸⁰ With any Chinese tribunal, the arbitrators may be influenced by a superior authority who could compel the arbitrator to vote with bias in favor of a local party.¹⁸¹ Finally, Chinese arbitration is subject to all of the problems that can plague any arbitration as a dispute resolution process, including the tendency to split the difference rather than finding one side right or wrong.¹⁸²

Furthermore, an arbitration panel may not act consistently with applicable Chinese law, for example, by recognizing unwritten implied amendments to contracts, despite a clear legal requirement that contracts be made and amended in writing.¹⁸³ Therefore, a correct legal interpretation of a contract and applicable law does not ensure that a party will prevail in arbitration on that issue. Moreover, a foreign party losing in arbitration will have no appeal process.¹⁸⁴ An erroneous ruling by CIETAC cannot be challenged in the courts based on the merits of the case or errors of law.¹⁸⁵ Given the potential for bias on an arbitration panel, an error of law is more likely to favor a Chinese party and leave a foreign party no possibility for review.¹⁸⁶

D. *Enforcement of Arbitration Awards*

Enforcement of awards granted to foreign parties poses a major challenge to the Chinese arbitration process.¹⁸⁷ If a losing Chinese party

¹⁷⁸ Crawford, *supra* note 15. A foreign arbitrator can expect to be paid about US\$1000, less than they typically can command in other areas of the legal profession. *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ Fitzpatrick & Chen, *supra* note 142, at 398.

¹⁸¹ *Id.*

¹⁸² Carter, *supra* note 3, at 2.

¹⁸³ GUO XIAOWEN, *supra* note 17, at 187.

¹⁸⁴ CIETAC Rules art. 60. A party has 30 days to ask the arbitration tribunal to correct errors in the writing, topography, computation or similar errors contained within the award. *Id.* art. 61.

¹⁸⁵ Hunter, *supra* note 40, at 185. CIETAC awards can not have judicial review of errors of law made by the tribunal. This approach is generally in keeping with the wishes of the international business community, making the tribunal's decision final. *Id.*

¹⁸⁶ Arbitration Law art. 9. A system of a single and final award shall be practiced for arbitration. *Id.*

¹⁸⁷ Brown & Rogers, *supra* note 2, at 336.

voluntarily complies with an arbitration award, enforcement is not an issue.¹⁸⁸ However, if a losing Chinese party does not, the foreign party must seek enforcement through local courts, which present a variety of challenges and tend to protect Chinese parties. CIETAC rules state that its arbitration decisions are final, and that neither party may appeal to the courts,¹⁸⁹ but the arbitration tribunal has no power to enforce the award.¹⁹⁰ Foreign investors who "obtain a favorable arbitration award against a Chinese party more often than not will be forced to seek enforcement from Chinese courts."¹⁹¹ Among the reasons cited for the delay in China's admittance to the World Trade Organization is China's spotty record in honoring international arbitration awards.¹⁹² In principle, the rules governing enforcement of arbitral awards from CIETAC or any other international arbitration body leave little discretion but to enforce awards, but in practice the Chinese courts do as they please.¹⁹³ There are different problems with Chinese court enforcement of awards from Chinese tribunals than from foreign tribunals, and other issues involved when enforcement of a Chinese arbitration award against a foreigner is sought in the foreign party's home country.

1. *Chinese Judicial Enforcement of Chinese Arbitration Awards*

Foreign parties may have difficulty convincing the Chinese courts to enforce any arbitral award in their favor. The Arbitration Law defines specific circumstances when awards need not be enforced, including when a court determines that enforcement is against Chinese social or public interest. While a CIETAC award is usually considered final, in review of domestic arbitration awards, the courts are free to review the legal reasoning of the award as well as the procedures used, meaning a domestic arbitral decision is not final.¹⁹⁴ The Chinese Court systems suffer from a lack of qualifications and resources, as well as local protectionism. Chinese courts may decline to enforce any arbitral award, and allow awards to be set aside

¹⁸⁸ ARBITRATION LAWS OF CHINA, *supra* note 48, at 120. According to CIETAC, 90 percent of awards rendered are performed by the parties automatically, and less than 10 percent required court enforcement. *Id.*

¹⁸⁹ CIETAC Rules art. 60. "The arbitral award is final and binding upon both the disputing parties. Neither party may bring a suit before a court of law or make a request to any other organization to revising the arbitral award." *Id.*

¹⁹⁰ WANG SHENG CHANG, *supra* note 4, at 165.

¹⁹¹ Brown & Rogers, *supra* note 2, at 336.

¹⁹² *Id.* at 348.

¹⁹³ *China's Rocky Road to Dispute Resolution: Rough Justice*, *supra* note 88.

¹⁹⁴ Brown & Rogers, *supra* note 2, at 347.

if the court finds justification.¹⁹⁵ The losing party in an arbitration may also petition the courts to request that an award not be enforced.¹⁹⁶

Reasons for refusal to enforce or to set aside an award are set out in China's Civil Procedure Law, Article 260 and include: 1) when there is no binding arbitration agreement; 2) where the parties did not receive proper notice of the proceedings; 3) when a party is unable to state opinions or arguments due to reasons beyond its control; 4) where the tribunal or process did not conform with the arbitration rules; 5) when the award exceeded the scope of the arbitration agreement or is beyond the jurisdiction of the arbitration body; or, 6) if the Chinese court believes the award is contrary to Chinese social and public interests.¹⁹⁷ The Arbitration law supplements the list, and allows the court to set aside an award if: 1) an award is based on false evidence; 2) a party has withheld evidence which would affect the results of the arbitration; 3) an arbitrator conducted himself in an illegal manner; or 4) the award is clearly inconsistent with the law.¹⁹⁸

The Arbitration Law empowers the courts reviewing both foreign and domestic arbitration awards to set aside an award if it determines that the award is contrary to Chinese "social or public interests."¹⁹⁹ "Social and public interest" has on occasion been broadly interpreted by the courts to justify non-enforcement of an award.²⁰⁰ Some judges base their interpretation on the economic and social consequences that would befall the local community in the event enforcement is granted.²⁰¹ The Chinese intermediate courts have denied enforcement of CIETAC awards finding that enforcement would seriously harm the economic interest of the State and the public interest of society.²⁰² This interpretation allows courts to refuse enforcement of awards at their own discretion.

¹⁹⁵ Ge Liu & Lourie, *supra* note 40, at 554.

¹⁹⁶ *Id.* Following such a request, the court must announce its ruling within two months. *Id.*

¹⁹⁷ Civil Procedure Law art. 260. See also Ge Liu & Lourie, *supra* note 40, at 551.

¹⁹⁸ Arbitration Law art. 63, (referencing Civil Procedure Law art. 217). This allows the court to decline award enforcement where the law has clearly been applied incorrectly. *Id.* CIETAC Rules provide that an arbitration award is final, even if it is clearly inconsistent with Chinese law. CIETAC Rules art. 60.

¹⁹⁹ Arbitration Law art. 58. "Where the People's Court determines that the arbitration award violates the public interest, it shall rule to set aside the award." *Id.*

²⁰⁰ Crawford, *supra* note 15, at 42.

²⁰¹ *Id.*

²⁰² WANG SHENG CHANG, *supra* note 4, at 179. In 1992, the Zhengzhou Intermediate People's Court denied enforcement of a CEITAC award. Pursuant to state policies and regulations, the court found enforcement would seriously harm the economic interest of the state and the public interest of the society. This ruling "failed to provide logical and lawful reasoning." The Chinese court's interpretation was inconsistent with the New York Convention meaning of public policy that would legitimately allow refusal to enforce an award. *Id.*

The bifurcated system of arbitration separating foreign and domestic disputes increases the uncertainty of whether a foreign party can enforce an arbitral award. If the arbitration cannot be successfully retained within CIETAC, there is greater doubt as to whether the arbitral awards are final, binding, and enforceable.²⁰³ Enforcement of foreign-related awards rely on a determination that no procedural irregularities occurred in the arbitration process, but courts can review domestic awards on procedural and substantive issues of the arbitration.²⁰⁴ For domestic arbitration awards, the courts may examine the merits of the case and the decision of the arbitration tribunal.²⁰⁵ In addition to procedural irregularities, the court will not enforce awards if they find evidence for ascertaining the facts insufficient or other errors of law.²⁰⁶ If the court finds fault with the process or the decision, the court may not modify the award; it may only set it aside and ask the arbitration tribunal to re-hear the arbitration.²⁰⁷

Many of the courts are not capable or not qualified to handle requests for enforcement of foreign-related arbitration awards.²⁰⁸ The Chinese court system is extremely inefficient due to a lack of resources and staff,²⁰⁹ and chronic under-funding.²¹⁰ Chinese courts are often unaware of international law or may choose to ignore provisions of international law related to enforcement of international arbitration awards.²¹¹ There are also reports of local judges reviewing the merits of CIETAC decisions due to their lack of knowledge that the decision cannot be challenged under the law.²¹²

Following the State Council mandate to allow foreign-related cases in the domestic tribunals, procedures for enforcement of foreign-related awards became even less certain. The New York Convention is no help to the foreign party, since it applies only to arbitration awards made within other member

²⁰³ Harpole, *Tradition of Middlemen*, *supra* note 128.

²⁰⁴ Harpole, *Following Through on Arbitration*, *supra* note 127.

²⁰⁵ Arbitration Law art. 58.

²⁰⁶ Harpole, *Tradition of Middlemen*, *supra* note 128.

²⁰⁷ Arbitration Law art. 58 (allowing the award to be set aside); art. 61 (allowing a court request for the arbitration tribunal to re-arbitrate the dispute). The court may not modify an award, only set it aside. The court can ask the arbitration tribunal to re-hear the arbitration and will stay all its proceedings during that process. Ge Liu and Lourie, *supra* note 40, at 554 n.88.

²⁰⁸ Xiaomin Sun & Ying Zeng, *supra* note 56.

²⁰⁹ Daniel Behrendt, Computer Software Copyright Law in the PRC, 2 U.C. DAVIS J. INT'L L. & POL. 1, 21 (1996).

²¹⁰ Brown & Rogers, *supra* note 2, at 342.

²¹¹ Xiaomin Sun & Ying Zeng, *supra* note 56. Applicable laws include the New York Convention, Arbitration Law § 7, and the Civil Procedure Law art. 257. For additional information on the New York Convention see INTERNATIONAL COMMERCIAL ARBITRATION, NEW YORK CONVENTION (Giorgio Gaja ed., 1978), including official translations of the Convention in Chinese and other languages, and national judicial decisions interpreting the Convention from around the world.

²¹² Crawford, *supra* note 15, at 43.

countries, not to foreign-related arbitration awards made within China.²¹³ Adding to the foreign party's enforcement difficulties is the requirement that foreigners file suit to enforce arbitration awards in the local area where the losing party is located and is known.²¹⁴ Local party and government officials frequently interfere with litigation that threatens local enterprises.²¹⁵

When foreign parties sue for enforcement of arbitration awards in local Chinese courts, local protectionism may prevent collection of any money.²¹⁶ For smaller companies especially, stonewalling by Chinese courts is a familiar hazard.²¹⁷ As recently as 1992, China's central authorities openly acknowledged the problem of local protectionism.²¹⁸ Systemic protections against bias in local courts have been slow to emerge.²¹⁹ Probably the most serious obstacle is the influence of the Communist Party and local government over judges in the decisions of the courts.²²⁰ The Chinese legal system is skewed against strangers.²²¹ American attorneys find local protectionism present in all cases, and the decisive factor in decisions by the courts.²²²

Even when the Chinese courts recognize the validity of an arbitration award, they may fail to actively enforce the award. The possibility of arbitration to secure a binding resolution to an international commercial dispute is not comforting.²²³ The arbitration award is merely a piece of paper, dependent for execution on the often elusive cooperation of local officials.²²⁴ Law enforcement is problematic because of informal codes and

²¹³ Harpole, *Following Through on Arbitration*, *supra* note 127. The New York Convention only applies to relationships that China determines are commercial in nature. *Id.* The time limit for enforcement of an award if neither party is an individual is six months. This period of time for filing an enforcement application is very short. Enforcement of CIETAC awards in China is not governed by the New York Convention. Ge Liu and Lourie, *supra* note 40, at 563.

²¹⁴ Crawford, *supra* note 15, at 42. Local protectionism is made worse because the party seeking enforcement must take the application for enforcement to the Intermediate People's Court where the "losing" party is domiciled or has its assets. *Id.*

²¹⁵ Lubman, *supra* note 19.

²¹⁶ *Id.*

²¹⁷ Roberts et al., *supra* note 18. Large foreign corporations have greater power and will suffer less abuse in Chinese court than smaller firms since they can take their grievances to higher government levels to resolve them. Stratton, *supra* note 11.

²¹⁸ Hunter, *supra* note 40, at 43.

²¹⁹ Brown & Rogers, *supra* note 2, at 333.

²²⁰ Crawford, *supra* note 15, at 42.

²²¹ Statement of Robert Aronson, *supra* note 92.

²²² *Id.* (quoting Matthew D Bersani, an attorney with Paul, Weiss, Reficind, Wharton & Garrison, New York and Beijing).

²²³ Andre G. Gigon, *China: Enter at Your Own Risk*, BUS. WEEK, Oct. 20, 1997, available in 1997 WL 14813803. The author is a director of Tetras, a French company that won an arbitration award and could not collect.

²²⁴ Brown & Rogers, *supra* note 2, at 342.

customs based on personal connections and relationships.²²⁵ These informal codes can be especially troubling for smaller companies, and in remote parts of China where local officials' power may go unchecked.²²⁶

If the Chinese courts refuse to enforce CIETAC awards, the parties may re-arbitrate, or the parties may proceed to the Chinese courts to litigate the matter normally. However, if the court refuses to enforce the award due to tribunal composition, or because the award is contrary to Chinese social or public interest, it is not clear that the courts have jurisdiction to rehear the case.²²⁷ If the People's Court has denied enforcement of an award, the applicant still has a valid arbitration agreement, which a party may try to get enforced in a different location.²²⁸ However, most Chinese businesses do not have assets in other countries that could be attached to fulfill an award.²²⁹ Refusal by the Chinese court to recognize or enforce an award is, therefore, a substantial risk to foreign parties.

2. *Chinese Enforcement of Foreign Tribunal Awards*

Enforcement of awards from foreign arbitration tribunals against Chinese parties is even more difficult than enforcement of Chinese awards. China's participation in the New York Convention was supposed to facilitate enforcement of foreign arbitral awards in the Chinese courts, but actual enforcement is limited by a lack of resources and expertise in the Chinese courts, a lack of knowledge by Chinese courts about the New York Convention, and local protectionism.

Despite signing onto the New York Convention in 1987, the Chinese courts have often been unwilling to accept or enforce foreign awards.²³⁰ In 1997, the Beijing Supreme Court ordered that all international arbitration awards were to be enforced, but this ruling is widely ignored by the local courts.²³¹ China is considered a "one-way street;" Chinese awards are

²²⁵ Stratton, *supra* note 11.

²²⁶ *Id.* The possibility of costly legal disputes arising between foreign and Chinese parties remains a significant risk for investors. *Id.*

²²⁷ Ge Liu & Lourie, *supra* note 40, at 565.

²²⁸ WANG SHENG CHANG, *supra* note 4, at 185. The applicant can attempt enforcement in another country where the agreement is recognized, or can re-arbitrate the dispute in an effort to get an award the court will enforce. The party can also abandon the arbitration award and sue in the People's Court to settle the dispute. Arbitration Law art. 9.

²²⁹ Brown & Rogers, *supra* note 2, at 336.

²³⁰ *Swedish Arbitral Award Enforced in Beijing*, INT'L COM. LITIG., June 1, 1998, available in 1998 WL 13328926.

²³¹ Peter Seidlitz & David Murphy, *Foreigners Stuck in Legal Trap, Mainland Courts are in the Dock*, S. CHINA MORNING POST, Oct. 25, 1998, available in 1998 WL 22023925.

automatically enforced in other New York Convention signatory countries, but it is still very difficult to enforce foreign awards in China.²³²

Chinese courts should base decisions to refuse enforcement of foreign awards on Article 5 of the New York Convention,²³³ but in practice, the courts have tended to do as they please.²³⁴ A court may simply refuse to accept an application for enforcement of an arbitration award by a foreign party.²³⁵ When an American company was granted an award by the Swedish Arbitration Institute against a Chinese state-owned business, the Shanghai Court refused receipt of the award for two years, and failed to enforce the award for at least two more years.²³⁶ After a French company had won an award from a Chinese company, a Chinese court recognized the award as binding, but refused to notify the parties of its decision, effectively blocking the enforcement mechanism and execution of the award.²³⁷ The refusal of the Chinese Court to recognize or enforce a foreign award will effectively render the award worthless.

3. *Enforcement of Chinese Awards in Foreign Countries*

Given the difficulties that foreign parties face in convincing the Chinese courts to enforce an arbitration award, the chances of settling a dispute favorably seem poor. The foreign investor entering into arbitration should also consider the result of an award against the foreign party. The foreign party stands a significant risk of being relegated to the domestic arbitration tribunals,

²³² *Swedish Arbitral Award Enforced in Beijing*, *supra* note 230.

²³³ Harpole, *Following Through on Arbitration*, *supra* note 127. See New York Convention art. V. There are a number of conditions under which enforcement of a foreign arbitration award may be declined, including where the agreement is invalid, the losing party was not notified of the proceedings, the matter or arbitration procedure was not within the scope of the arbitration agreement, or the award had been set aside by the courts of the country making the award. *Id.* § 1. Courts may decline to enforce if the subject matter is not arbitrable under the laws of the country in which enforcement is sought, or where "recognition or enforcement would be contrary to the public policy of that country." *Id.* § 2.

²³⁴ *China's Rocky Road to Dispute Resolution*, *supra* note 88.

²³⁵ Statement of Robert Aronson, *supra* note 92.

²³⁶ *Id.* An award was made in favor of RevPower by the Swedish Arbitration Institute on July 13, 1993. The assets of the state-owned company were transferred to parent and grandparent companies during the delay in enforcement by the Chinese courts. The "Chinese laugh at New York Convention . . ." *Id.* It came as a surprise in 1998 when the People's Intermediate Court accepted a Swedish arbitration award for enforcement two years after application for enforcement. *Swedish Arbitral Award Enforced in Beijing*, *supra* note 230. A two million US dollar award against a Chinese business was obtained in April 1995. RevPower applied to the Chinese court in November 1995 and the application was accepted for enforcement in November 1997. *Id.* See also *Creditor Banks Win Control of Olympic*, S. CHINA MORNING POST, Oct. 28, 1998, available in 1998 WL 22024272. On October 27, 1998, the Chinese Middle Court affirmed a 1995 CIETAC decision allowing a bank to take over a hotel that had defaulted on loans. *Id.*

²³⁷ Gigon, *supra* note 223. The French company was Tetras. See also Brown & Rogers, *supra* note 2, at 341.

and whatever Chinese tribunal is used, foreigners risk significant bias and local protectionism. Most likely, the same forces that make it difficult for a foreign party to obtain and enforce an arbitral award will make it easy for a Chinese party to obtain and enforce an award against a foreigner. Chinese parties are more likely to initiate arbitration to force a settlement than are foreign parties, perhaps due to the Chinese parties' better chances of success.²³⁸

Although Chinese enforcement of awards favoring foreigners is challenging, Chinese arbitration awards against foreigners are recognized in more than ninety other countries, and have been successfully enforced in over seventy cases.²³⁹ For example, if the arbitration tribunal finds in favor of a Chinese party against a U.S. corporation, the award will likely be enforced in the U.S. courts.²⁴⁰ The United States has been a strong supporter of international arbitration, and has passed significant legislation to support enforcement of foreign arbitration awards, even where domestic law would not allow an award.²⁴¹ The Federal Arbitration Act implements the New York Convention and makes foreign arbitral awards involving commercial matters enforceable in the United States.²⁴² The United States Code requires confirmation of awards by foreign countries that are party to the New York Convention except in limited circumstances.²⁴³

²³⁸ GUO XIAOWEN, *supra* note 17, at iv. In 1988, the Chinese party brought 58 percent of disputes at CIETAC, and the foreign party brought 42 percent. *Id.*

²³⁹ *Id.* at vii.

²⁴⁰ Edward Lehner, *China Revisited*, N.Y.L.J., Oct. 2, 1997. The author states: "Arbitration awards of the Shanghai Arbitration Tribunal have generally been enforced in [U.S.] courts." *Id.*

²⁴¹ Erik Langeland, *The Viability of Conciliation in International Dispute Resolution*, 50 DISP. RESOL. J. 34, 37 (1995). The US is a strong supporter of international arbitration and has upheld international awards where comparable domestic law would not allow. *Id.* The U.S. Supreme Court encouraged the emergence of strong regime of international arbitration, saying the national courts need to "shake off the old judicial hostility to arbitration" and need to cede jurisdiction of a claim arising under domestic law to a foreign or transnational tribunal. *Id.* The U.S. Supreme Court stated it would be necessary for national courts to subordinate domestic notions of arbitrability to the international policy favoring commercial arbitration. *Id.*

²⁴² Carter, *supra* note 3, at 7. Federal Arbitration Act 9 U.S.C. §§ 1-14 (1947). See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, ch. 2, 9 U.S.C. § 201 (implementing the New York Convention. See the Federal Arbitration Act, ch. 1 (giving standards for vacating awards from other countries which include: 1) the award was procured by corruption, fraud or undue means; 2) partiality or corruption of an arbitrator; 3) misconduct by arbitrators, lack of due process, or ex parte communications; 4) the arbitrators exceeded their powers or misapplied them. Manifest disregard of applicable law is a judicially created additional ground for refusal to enforce a foreign arbitration award.)

²⁴³ See 9 U.S.C. § 207 which requires confirmation of awards by foreign courts that are party to the New York Convention unless one of seven grounds for refusal or deferral specified in the convention are met. The opponent to recognition of an award carries the burden of proof. The grounds are as follows: 1) invalidity of the arbitration agreement due to party incapacity or if the agreement is illegal; 2) lack of notice or opportunity to present case; 3) the award deals with matters beyond the submission; 4) the tribunal or its procedures fail to follow the arbitration agreement or local law; 5) the award is not binding in the country where it was decided; 6) the subject is not capable of settlement in the U.S. by arbitration; 7) public policy of the U.S. prohibits enforcement. *Id.* art. V(2)(b).

A Chinese arbitration award against a foreign party from a nation that is a signatory to the New York Convention is easier to enforce against a foreign party than a Chinese court judgment.²⁴⁴ Enforcement of court awards depends on a network of bilateral treaties which provide poor international coverage.²⁴⁵ China is party to few of these treaties, which do not include major trading partners like the United States, Japan, Germany, and the United Kingdom.²⁴⁶

Moreover, pursuant to the New York Convention, arbitration awards of the Shanghai arbitration tribunal have been enforced by U.S. courts.²⁴⁷ Whether a U.S. court will enforce a judgment from a Chinese court is not clearly settled, with the U.S. court required to consider the fairness of the practice of the particular Chinese court.²⁴⁸ In contrast, Chinese arbitration awards are unconditionally enforceable in the 130 member countries of the New York Convention.²⁴⁹ The result is that foreign parties could find it much easier to protect assets in their own country from a Chinese court award than from a Chinese arbitration award. Foreign investors risk may be reduced by refusing arbitration as a dispute resolution process and forcing the dispute into the courts.

IV. CONCLUSION

Foreign investors should be aware of the risks they assume when entering into agreements with the Chinese to arbitrate disputes. Given the lack of conformance of the Chinese arbitration process with the norms of the international business community, the usual benefits expected from arbitration are unlikely to be present. In China, "arbitration has become so expensive, time-consuming and marked by difficult-to-enforce awards,"²⁵⁰ that foreign investors should choose alternate dispute resolution methods. The questions surrounding whether the domestic or international tribunal would preside over disputes with foreign-related parties reduces the certainty commonly associated with the arbitration process. The Chinese arbitration process can be time consuming, expensive, and strongly biased against

²⁴⁴ Carter, *supra* note 3, at 1.

²⁴⁵ Crawford, *supra* note 15, at 26.

²⁴⁶ *Id.* The difficulty of enforcing Chinese court awards outside of China is often considered a problem with litigation as a dispute resolution process. *Id.*

²⁴⁷ Lehner, *supra* note 240.

²⁴⁸ *Id.*

²⁴⁹ China: *Business Booms for China's Arbitrators*, CHINA DAILY, Feb. 16, 1998, available in 1998 WL 7594192.

²⁵⁰ Fernandez & Spolner, *supra* note 9, at 68.

foreign parties, making arbitration an unsatisfactory dispute resolution process for many foreign investors. Enforcement difficulties foreign parties may experience in the Chinese courts can turn a successful arbitral award into hollow victory. Foreign investors' interests are not protected by arbitration as currently practiced in China.

The current state of foreign-related arbitration in China indicates that if a Chinese party does not choose to participate in the arbitration tribunal, or chooses not to comply with an award from a tribunal, the foreign party has little recourse. If the foreign party wins it will not likely be able to enforce payment. If a foreign party loses in any Chinese arbitration tribunal, the Chinese courts will likely enforce the award, and the Chinese party stands an excellent chance of pursuing enforcement in the foreigner's home country if it is party to the New York Convention. Therefore, foreign investors entering into business in China may be better protected absent an arbitration agreement, because it will make pursuit by Chinese parties of the foreign based assets more difficult. Refusing to enter into an arbitration agreement to settle disputes with the Chinese may be the foreign investors' best course of action.