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"Arbitration as ADR in China: Applicability and actual award enforcement"

When contracting with Chinese parties it is crucial to select and draft jurisdiction and dispute resolution clauses carefully. This will dramatically increase the chances of a spontaneous performance of a judgement or award and smooth enforcement, in case the counterparty does not obey.

To this regard, PRC laws offer the contracting parties the right to opt for court or arbitration institutions that are either domestic or foreign (subject to the presence of "foreign elements" in the contract). In general, as far as the settlement of commercial disputes involving foreign parties is concerned, arbitration appears to be by far the preferred means of dispute resolution. This includes those involving the wholly owned subsidiaries of foreign companies, Foreign Funded Enterprises (FFE). In fact, the China International Economic and Trade Arbitration Commission's (CIETAC) 2019-2020 annual report on International Commercial Arbitration in China stated that 2019 saw 486,955 new cases in China, linked to 253 Chinese arbitration institutions, as Zhang Shouzhi of King & Wood Mallesons reported for Thomson Reuters on 1 March 2021. The total value of the sums under dispute was CNY 759.8 billion, an increase compared to 2018.

However, the choice between court and arbitration is not always straightforward. Foreign investors normally feel more confident when dealing with an arbitration institution, this might be for reasons of neutrality or a reduced risk of influence by the local counterparty on the judges, especially when state owned companies are involved. Other arguments for arbitrating abroad include a greater freedom to select and customise the arbitration committee, higher level of qualifications, arbitrators greater professionalism and international exposure (compared to local court judges), shorter average procedure duration, fewer formalities (in terms of legalisations) regarding the collecting evidence from overseas, the possibility to enforce foreign awards through the New York Convention (China is a

signatory), confidentiality, and greater final and conclusive force of awards. Of course, these pros must be balanced against the cons. These include higher costs, an impossibility to obtain preliminary injunctions, an impossibility to challenge the award (save for formal or procedural issues) and the fact that, depending on the province where the enforcement takes place, the procedure for enforcing a judgment issued by a local court through the enforcing court may be quicker than the award.

From a legal perspective, the choice of arbitration is regulated by the PRC Arbitration Law. It sets out the parties' rights to opt for an arbitration institution by written agreement (art. 6 and 16 of the PRC Arbitration Law). Regarding the right to choose foreign arbitration institutions, the main reference is article 128 of the PRC Contract Law, which reads: "Parties to a contract with "foreign elements" can opt for arbitration before Chinese arbitral institutions or at a foreign arbitral institution". The new Civil Code which entered into force on 1 January 2021 repealed the Contract Law, without maintaining the above principle, the foreign arbitration option is still found in the PRC Civil Procedure Law. Article 271 reads:

> Where disputes arising from economic, trade, transport or maritime activities involve foreign parties, if the parties have included an arbitration clause in their contract or subsequently reach a written arbitration agreement that provides that such disputes shall be submitted for arbitration to an arbitration institution of the People's Republic of China for foreign-related disputes or to another arbitration institution, no party may institute an action in a people's court. If the parties have neither included an arbitration clause in their contract nor subsequently reached a written arbitration agreement, an action may be instituted in a people's court.

Note that FFEs are not considered foreign companies and are not "foreign elements". Therefore, in disputes between two FFEs or an FFE and a Chinese company regarding a contract to be performed in China, parties must choose local arbitration institutions since neither is a "foreign element".

Furthermore, according to the PRC Arbitration law (articles 10 and 16), *ad hoc* arbitrations are not allowed and parties can only choose qualified permanent arbitration institutions, although some

exceptions exist in certain free trade zones. Conversely, when opting for a foreign arbitration institution, considering that China has signed the New York Convention, China shall, in theory, recognise and enforce awards issued by *ad hoc* arbitral institutions too. Indeed, the concept of arbitral awards under the New York Convention, includes those issued by non-permanent institutions. Yet, considering that all major cities in China have one or more arbitration institutions, foreign companies can benefit from a wide range of valid options. The most renowned arbitral centers are the CIETAC and the China Maritime Arbitration Commission in Beijing, the Shanghai International Arbitration Centre, and the Shenzhen Court of International Arbitration (the latter two are former CIETAC sub-branches). The CIETAC Hong Kong Arbitration Center is another valid option. However, due to the independent status of Hong Kong, as a separate and independent jurisdiction, its awards are subject to the prior recognition by PRC courts according to the bilateral treaty force between China and Hong Kong.

As mentioned, parties to contracts with foreign elements can opt either for local or foreign arbitration institutions (or *ad hoc* arbitration) and thus the choice of the seat of arbitration is of utmost importance to ensure or obstruct enforcement. But, despite the common belief of foreign investors, selecting a neutral seat in a jurisdiction without links to the disputed transaction, may not be, enforcement-wise, the best option.

Choosing the arbitral institution's seat requires careful strategic planning. Account for which party may be likely to breach (or be deemed as breaching) the agreement, what interests are to be safeguarded, where the parties' relevant assets are, and who is likely to be plaintiff and defendant. Consider, for example, a product liability dispute arising from an international sale of high-tech equipment manufactured overseas and subject to specific operational requirements. The Chinese buyer may not be able to operate or may not find certain raw materials or spare parts in China for solving mechanical issues. The Chinese buyer, due to some initial difficulties in operating the equipment, will probably raise product defective issues and thus require the contract's termination and reimbursement of the purchase price (assuming that the purchase price, or its instalments, were settled). In such a case, opting for a foreign arbitration institution, in a neutral seat with rules

well-known to the seller, may appear to be a better option for the foreign seller. They could prove the lack of defects, in line with the principles of the burden of proof, by explaining the product's functions before an international arbitration commission, which may be knowledgeable regarding the technology involved.

On the contrary, there are a couple of situations where a Chinese arbitration institution is advantageous. Firstly, it will be of benefit if, in case of non-spontaneous enforcement, a party intends to obtain an award and enforce it against a Chinese party's assets (assuming the relevant assets are in China) within a relatively short time. The same is true if, secondly, a party wishes to obtain punitive measures immediately after the issuance of the award, against the Chinese party which is not spontaneously obeying the award (either the company and its representatives). This could include being blacklisted and downgraded in the social credit system. If a party is seeking such measures to back up enforcement, the best choice would be an arbitration institution in China whose final and conclusive award shall be directly enforceable before the relevant PRC courts without time-consuming and cumbersome recognition procedures.

Note that, although domestic award enforcement is not subject to recognition procedures according to the relevant treaties or conventions, they can be suspended or set aside, on limited procedural grounds (such as a lack of a valid arbitration agreement), by the higher court or supreme court upon the losing party's request. This applies to both purely domestic or foreign-related awards; that is, those issued in a dispute between a foreign and domestic party by a local arbitral institution.

Regarding the enforcement of foreign awards, according to the PRC Civil Procedure law, the enforcement of an award issued by a foreign arbitral institution shall be subject to the prior recognition by the relevant intermediate People's Court in China. In addition, the recognition and enforcement procedure may be quite time-consuming. The intermediate Chinese court will review all procedural aspects related to the foreign award, and decide, according to PRC laws and bilateral treaties, whether to recognise and enforce it or to reject it.

The PRC courts relevant to this matter — the intermediate, high and supreme court — may, notwithstanding the existence of the New York Convention or bilateral treaties, reject foreign awards by arguing that they fall beyond the subject of the claims raised upon the submission. They might also rule that it is non-binding because it has been set aside or suspended by a foreign court in case the enforcee applied to the foreign court for setting aside the foreign award due to procedural issues. Additionally, an award may be considered non-binding in court pursuant to other laws in the foreign jurisdiction, if it was issued on grounds that violated Chinese public policy, or due to defect of international notification. This happens very often in case of default judgments; when the Chinese party does not formally appear during an overseas arbitration, PRC courts can claim that default judgments violate the principle of an adversarial process.

Good choices in Asia are Hong Kong and Singapore, if the parties want to choose a neutral and easy-to-manage location for both parties. As far as enforcement in China is concerned, Hong Kong is preferable since it holds an *ad hoc* bilateral agreement (The Arrangement Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and Hong Kong, which replaced the New York Convention). Moreover, considering the fact that Hong Kong plays a key role in the Great Bay Area, the Chinese authorities should adopt a more relaxed approach during the recognition assessment prior to enforcing awards issued by Hong Kong arbitral institutions, especially within the Guangdong area.

In conclusion, although the choice of seat must be made after careful assessment, keeping in mind all the pros and cons, the arbitration is without a doubt an efficient ADR method for handling disputes with Chinese counterparts.