

Rule of Law in China: Chinese Law and Business

CIETAC as a Forum for Resolving Business Disputes

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Executive Summary

- The China International Economic and Trade Arbitration Commission (CIETAC) is a leading international arbitration centre in mainland China and in the world. Most disputes are between Chinese and foreign counterparts, and there have been lingering doubts about the fairness of CIETAC arbitration among foreign scholars and practitioners. Statistical data, however, indicate that CIETAC arbitration is substantively fair. In cases involving US parties, for example, US parties' winning percentage is approximately equal to their losing percentage.
- CIETAC has also enacted many reforms to enhance the fairness of its procedures. CIETAC's 2005 Rules include a large number of changes and innovations, and are generally in line with the international norms and standards. The most important changes include: the possibility of appointing arbitrators from outside the panel, a new approach for appointing tribunal chairs, the option of using an adversarial approach for oral hearings, the introduction of dissenting opinions, and the removal of the cap on recoverable expenses. CIETAC has also taken measures to ensure arbitrators' independence and impartiality.
- The criticism of some of the CIETAC practices is attributable largely to two main factors: the impact of the planned economy and the neglect by some observers of cultural differences. Practices such as the low and unequal compensation of arbitrators, the occasional appointment of staff as arbitrators, the infrequent appointment of third country nationals as tribunal chairs and restriction on counsel, are indicative of the enduring impact of the planned economy. The prohibition of ad hoc arbitration in China, and CIETAC practices such as staff assisting arbitrators in drafting arbitral awards, the institutional scrutiny of awards, and the combination of arbitration and conciliation, while not necessarily unique to China, are characteristic of Chinese culture and practices.
- CIETAC charges a low arbitration fee on an *ad valorem* basis, and collects a modest 'special fee' to cover a foreign arbitrator's fee and expenses. The Chinese government currently exerts control over revenues and expenditures of arbitration institutions, but hopefully will lift the control for CIETAC; reform of the fee system necessary to encourage foreign-related arbitration will only be possible once this step is taken.
- CIETAC has long required arbitrators to draft the arbitral awards. Scrutiny of awards is not peculiar to CIETAC, and has proved to be a valuable tool for reducing errors and enhancing enforceability of awards. This being the case, scrutiny is unlikely to be abolished.
- Many are doubtful about the practice of arbitrators acting as conciliators, but it is a consensual process and parties are at liberty to forego conciliation. CIETAC also accommodates requests from parties for conciliation by independent conciliators in the course of arbitration.

CIETAC as a Forum for Resolving Business Disputes

The nature of the problem

For years, the China International Economic and Trade Arbitration Commission (CIETAC) was the only institution that arbitrated international commercial disputes in China. Although its monopoly was abolished in 1996 when local arbitration institutions established under the 1994 Arbitration Law were allowed to accept international cases (also called 'foreign-related' cases in China), CIETAC today still handles a majority of the foreign-related arbitrations in China. In 2006, CIETAC accepted 442 new foreign-related cases, roughly eight times as many as that of the Beijing Arbitration Commission, reportedly the second largest number among People's Republic of China (PRC) institutions.

CIETAC currently handles more arbitration cases annually than any arbitration centre in the world. Although CIETAC, in response to the loss of its monopoly over foreign-related disputes, started to handle domestic disputes since 1998, its annual international caseload remains stable at a number comparable to that of the International Chamber of Commerce (ICC) International Court of Arbitration, and the International Center for Dispute Resolution (ICDR) of the American Arbitration Association (AAA).

Arbitration is increasingly popular in China as a mechanism for resolving business disputes. Chinese companies negotiating transnational transactions will usually propose resolving disputes through arbitration at CIETAC. However, their foreign counterparts, which often lack prior experience with CIETAC, have expressed concerns about the fairness of arbitrating in China.

Substantive fairness of CIETAC arbitration

Notwithstanding lingering doubts among foreign companies regarding the fairness of CIETAC arbitration, statistics demonstrate that there is no bias against foreign parties.

The United States is the second most represented foreign jurisdiction after Hong Kong in foreign-related disputes. According to CIETAC's official statistics, from 2004 to 2006, the Beijing headquarters accepted eighty-one cases involving US parties. Of the eighty-one cases, US parties were involved as claimant in thirty-five cases and as respondent in forty-six cases. In terms of outcomes, US parties prevailed in twenty-seven cases and lost in twenty-five cases, with the remainder settled or still pending by March 2007.¹ The statistics indicate that the winning percentage of US parties is about equal to the losing percentage, even though US parties are more often the defendant than the plaintiff. Statistics on outcomes of cases involving parties of other countries, such as Australia and Germany, are also similar.

Some critics have argued that substantively fair decisions do not necessarily mean that the procedures were fair. To evaluate whether foreign parties receive equal and fair treatment in CIETAC arbitration, a closer look at its proceedings, particularly the most controversial practices, is therefore necessary.

Procedural integrity of CIETAC arbitration *Structural integrity*

CIETAC is not subordinate to any government agency. Instead, CIETAC is affiliated with the China Council for the Promotion of International Trade (also known as 'China Chamber of International Commerce'), a non-governmental organization. For this reason, CIETAC itself is also a non-governmental, non-profit institution, and its arbitrations are free from administrative intervention. CIETAC is domiciled in Beijing and has offices (known as sub-commissions)

1. These figures were released in a speech by CIETAC Vice Chairman and Secretary General Yu Jianlong at a Juris Conference in New York on 26 March 2007.

in Shanghai and Shenzhen. Location in the capital city and the two economic hubs of China insulates the institution from local protectionism, which is widely perceived to be a major problem for local courts and local arbitration commissions.

Reforms to the arbitration rules

Over the years, CIETAC has striven to offer a fair and flexible arbitral procedure. Established in 1956, CIETAC has updated its Rules frequently (six times) in order to meet the growing needs of the business community for a fair and transparent procedure. CIETAC continually consults with experts, both in China and overseas, while updating Rules and introducing reforms to its procedure.

The current Arbitration Rules ('2005 Rules'), in force since 1 May 2005, reflect CIETAC's commitment to improving the arbitral procedure. The goals of the 2005 revisions were to enhance party autonomy and procedural flexibility, to foster transparency, and to streamline the arbitral procedure. As a result, CIETAC's Rules are now in general compliance with the international norms and standards.

Under the 2005 Rules, parties are free to agree upon a variety of matters, such as the language of arbitration, the seat of arbitration, the applicable law, and nationality of arbitrators. A few changes that demonstrate the trend toward convergence with international best practices and differentiate CIETAC from other arbitration bodies in the PRC are summarized below.

The 2005 Rules have removed the previous strict 'panel system', under which arbitrators could only be appointed from a list of arbitrators approved by CIETAC, to allow parties to appoint arbitrators from outside the panel of arbitrators. Further, the 2005 Rules allow the parties each to submit a list of up to three recommended candidates for the tribunal chair so as to increase chances of finding a mutually acceptable candidate.

The 2005 Rules also allow parties the option of using an adversarial approach for the hearing. Previously, CIETAC hearings were conducted using an

inquisitorial approach. Although China's legal system is historically influenced by the civil law tradition, CIETAC made the innovation because it realized that a large number of parties in CIETAC arbitrations are from common law jurisdictions and prefer an adversarial approach.

To promote transparency and enhance the quality of reasoning in the awards, the 2005 Rules now allow the dissenting arbitrator (of a three-member tribunal) to attach a dissent to the arbitral award. The dissenting opinion shall not form a part of the award, and the dissenting arbitrator may or may not sign his or her name on the award.

Previously, a winning party's recoverable expenses, including legal fees, were limited to no more than 10 per cent of the amount of the award. The 2005 Rules have removed the 10 per cent cap, although the recovery of expenses is subject to a test of reasonableness in which the tribunal shall take into account 'such factors as the outcome and complexity of the case, the workload of the winning party and/or its representative(s), and the amount in dispute, etc.'

Measures taken to ensure arbitrators' independence and impartiality

Unlike a court judge, who serves on the bench full-time, arbitration is usually a part-time job. It is not unusual that arbitrators run their own businesses, and have to deal with others in the arbitration world in their day-to-day activities. Moreover, for many lawyer-arbitrators, their role in arbitrations is dual, in that they are arbitrators in some cases and advocates in other cases, and they are repeat players in either context. In order to safeguard impartiality in the arbitration process, under the 2005 Rules, an arbitrator is required to disclose conflicts of interest before accepting a case. A party may challenge an arbitrator based on disclosures from the arbitrator or information obtained through other channels. CIETAC also established a Supervisory Department in 2004 to check arbitrators' compliance with these guidelines.

Independence of arbitrators

There have been allegations that CIETAC arbitration, though fair in most cases, is under undue influence of factors such as local protectionism, government intervention, and corruption of arbitrators, where the dispute involves a high amount. It is conceivable that for any commercial disputes being litigated or arbitrated, the higher the amount involved, the more likely a party is to exhaust whatever means available in pursuit of an outcome in his/her favour.

It was indeed true that some arbitrators in China used to neglect ethical requirements upon themselves, and there were allegations of *ex parte* contact between arbitrators and parties. The situation culminated when an arbitrator at a case in Tianjin Arbitration Commission was videotaped having dinner with the claimant's counsel the ensuing widely publicized scandal leading to the arbitrator's removal from the panels of five institutions for which he served as arbitrator, including CIETAC. This was an epoch-making event in China's history of arbitration, and in 2006 the legislature incorporated a provision into the Sixth Amendment of the Criminal Code that subjects arbitrators who pervert law in making decisions to up to seven years' imprisonment.

In CIETAC arbitration, disclosure by, challenges to, and withdrawals of arbitrators are now increasingly frequent, and confidence in the fairness of CIETAC arbitration is growing.

Compensation of arbitrators

Currently, CIETAC charges an arbitration fee on an *ad valorem* basis, which amounts to much less than that charged by the ICC, the London Court of International Arbitration (LCIA), or the Hong Kong International Arbitration Centre (HKIAC), for example, making CIETAC a much lower cost option, but also a less attractive proposition for foreign arbitrators.

To reconcile the low *ad valorem* arbitration fee that CIETAC charges and a foreign arbitrator's expected compensation, when a foreign arbitrator is appointed (and the arbitration fee becomes inadequate), CIETAC charges the appointing party a 'special fee' to cover

the foreign arbitrator's fee and expenses. Complaints about the 'special fee' not only come from foreign arbitrators who still feel they are being underpaid, but also from Chinese arbitrators who are upset that they are not paid equally for the same work. However, in light of the inquisitorial nature of most CIETAC proceedings, the 'special fee' is not as low as supposed. In recent years, CIETAC has tried to satisfy a foreign arbitrator's request for higher pay, and will often make appointment of a foreign arbitrator subject to the appointing party's agreement to pay the requested amount.

CIETAC's ability to raise fees and control its budget is subject to certain constraints. Before 2002, CIETAC was financially independent from any government agency, and could freely expend and allocate all its revenues. However, a government regulation issued in 2002 requires all arbitration institutions to submit their revenues and annual expenditure budget to the Ministry of Finance for approval. This practice gives rise to doubts about CIETAC's independence, and serves to undermine the development of CIETAC and arbitration in China as a whole. Arbitration institutions in China have been in dialogue with the Ministry for some time, and hopefully the restriction upon arbitration institutions will be lifted in the near future.

Reform recommendations with regard to compensation of arbitrators and allocation of arbitration fees include:

- elimination of the financial restrictions such that CIETAC regains control over its revenues and expenses;
- improved transparency through division of the arbitration fee into the administrative fee paid to the institution and the arbitrators' fees and expenses;
- increased party autonomy through revision of the Arbitration Rules or national legislation to allow parties to specify by agreement on what basis (*ad valorem* or hours expended combined with hourly rate) arbitrators' fees are to be collected; and
- the adoption of uniform practice with regard to compensation of Chinese and foreign arbitrators.

Neutrality of arbitral tribunal

Unlike international arbitration elsewhere, where an arbitral tribunal is to be neutrally constituted, with one arbitrator being appointed by each party, and one third country national being appointed to chair the three-member tribunal, tribunal chairs in CIETAC arbitrations are usually Chinese nationals.

CIETAC justifies its practice regarding composition of tribunals by the fair outcomes achieved, alleging on the strength of statistics that there is no bias towards foreign parties no matter what arbitrators' nationalities are. While that is true, subject to successful reform of its fee system, CIETAC might consider appointing more third country nationals as tribunal chairs when the two party-appointed arbitrators are of different nationalities, so as to achieve neutrality in the composition of arbitral tribunals.

Appointment of CIETAC staff as arbitrators

The practice of appointing members of its staff as arbitrators started before the Cultural Revolution. The practice was justified by the reality that the country had only a small number of lawyers and few persons other than its staff were knowledgeable about international arbitration. The 1994 Arbitration Law does not expressly prohibit the practice, but rather implicitly allows staff members of arbitration commissions to act as arbitrators.

Most arbitration commissions in China today still appoint staff members as arbitrators. CIETAC hires staff members from among graduates of top law schools in China, and it is indeed true that senior staff members of CIETAC make excellent arbitrators. However, in 2005 CIETAC imposed some restrictions upon the appointment of staff in response to claims that the practice involves staff in conflicts of interest. Nowadays, CIETAC staff members are no longer allowed to accept party appointment; they can only be appointed as arbitrator by the chairman of CIETAC, usually when a party defaults in making an appointment. Furthermore, CIETAC staff members are only appointed for small-claim disputes. In practice, such appointments are limited in number.

The practice of appointing staff members as arbitrators is likely to be completely abolished in the near future.

Restriction on counsel

It has been well settled in most jurisdictions that the local bar enjoys monopoly over legal representation in judicial proceedings. By contrast, in most jurisdictions, foreign counsels are allowed under national statutes or case precedents to appear before an arbitral tribunal, although some jurisdictions narrow such allowance to international arbitration. The rationale underlying the different role of foreign attorneys in the context of arbitration, as opposed to litigation, is that allowing foreign attorneys to represent parties in dispute is compatible with the consensual nature of arbitration.

The current legislation and CIETAC Rules do not exclude foreign attorneys from participating in arbitration. However, in 2002, the State Council promulgated the Regulation regarding the Representative Offices of Foreign Law Firms in China, and the Ministry of Justice subsequently introduced an implementing regulation explicitly prohibiting 'representative offices' and 'representatives' of foreign law firms from interpreting 'Chinese legal matters' in, among other things, arbitration activities.² Subsequently, foreign attorneys involved in CIETAC arbitration often had to face challenges from Chinese counterparts for alleged violation of the regulations.

To ease the anxiety of foreign attorneys, CIETAC sent an official letter to the Ministry in September 2002, suggesting revisions of the two regulations so as to lift the restrictions upon foreign attorneys in arbitration activities. A few months later, the Ministry later confirmed through an official reply to CIETAC that the regulations do not serve to prohibit

2. Under the regulations, a representative office of a foreign law firm shall have a chief representative and a number of representatives who are bar members of a foreign jurisdiction. Qualified Chinese lawyers can be employed as staff, but are not allowed to practice Chinese law.

'representative offices' or 'representatives' of foreign law firms from representing clients in arbitration proceedings, but to disallow them from providing opinions or comments in relation to the application of Chinese law. The reply further states that foreign attorneys shall cooperate with Chinese attorneys when the interpretation of Chinese law arises and that the methods of cooperation can be flexible, suggesting that 'representatives' may either seek a written legal opinion before an oral hearing, or engage a local co-counsel in the oral hearing. Where international conventions, trade usages, or foreign laws apply, there is no restriction on foreign attorneys at all.

The aforesaid regulations came as a surprise to the legal community as they repealed China's long-standing policy of allowing parties free choice of counsel. The restriction on counsel not only runs counter to world norms, but also harms CIETAC's foreign-related business and China's chances of being selected as the seat of arbitration.³ Local attorneys may have a competitive advantage for some time, but will perceivably lose out to foreign counterparts in arbitration business in the long term.

For the foregoing reasons, the current restriction on counsel must be lifted, especially with regard to international commercial arbitration.

Restriction on ad hoc arbitration

In most jurisdictions, parties to an arbitration agreement may opt for either institutional arbitration or ad hoc arbitration, but in China, ad hoc arbitration is banned. The 1994 Arbitration Law provides in Article 16 that a valid arbitration agreement shall include, among other things, designation of an arbitration commission.⁴

3. Japan and Singapore used to restrict foreign attorneys' role in international arbitration conducted within their territories, but has in recent years eased such restriction. The shift of attitudes in these jurisdictions illustrates the necessity of freedom to counsel.

4. In practice, the court recognizes the validity of an arbitration agreement calling for ad hoc arbitration outside mainland China so long as the law applicable to the validity of the arbitration agreement or the law of the place of arbitration allows ad hoc arbitration, following a recent judicial interpretation of the Supreme Peoples' Court in 2006.

CIETAC has been open-minded about opening the arbitration market to outsiders, including ad hoc tribunals. However, it is unlikely that the Chinese legislators will accept ad hoc arbitration at this stage, for a variety of reasons. Firstly, the persistent emphasis on institution instead of individuals is the cultural root for neglect of ad hoc arbitration; that is, arbitration by a small group of individuals. Secondly, the legislature and judiciary still hold a conservative stance toward ad hoc arbitration for fear that such a flexible proceeding might get out of control and unduly harm the legal system of China. Thirdly, the judiciary lack the maturity and knowledge about international commercial arbitration necessary to ensure the success of an ad hoc arbitration system, especially for the purpose of interim measures of protection, or in order to break the impasses caused by a recalcitrant respondent who refuses to nominate arbitrators or to submit an arbitration fee.

Given that party autonomy as the overriding principle for the arbitration process is widely respected in China, in the long term, the Chinese legislature might well expand its programme of reforms to allow ad hoc arbitration.

Drafting of the arbitral award

CIETAC arbitrations are fully administered. Chinese culture shows a high degree of respect for institutions, and people feel comfortable with institutions playing an active role. For each CIETAC case, the Secretariat nominates a staff member to take care of procedural matters, with this role continuing even after the tribunal is constituted. Most staff members, though referred to as 'secretaries', are comparable to 'counsels' at the ICC Court. In the past, the 'secretaries' drafted all arbitral awards under guidance of arbitrators, but since 2000 or so, arbitrators have been required to draft awards. 'Secretaries' are still responsible for drafting procedural rulings on behalf of the institution, such as rulings on jurisdiction issues, and for drafting procedural correspondence under the guidance of the arbitrators.

Scrutiny of the draft award

Another example of CIETAC's active role is the scrutiny of arbitral awards. Arbitrators in a CIETAC case are required to submit the draft award for review of its form and points of substance, in order to reduce clerical and legal errors that otherwise may affect the enforceability of arbitral awards. Scrutiny of awards is not unique to China. The ICC Court scrutinizes both draft awards and draft Terms of Reference. The Singapore International Arbitration Center (SIAC) recently revised its Rules and introduced the scrutiny system.

It might be questioned whether arbitrators' independence in adjudicating a pending dispute is prejudiced by the scrutiny. In this regard, CIETAC's practice is exemplary. Arbitrators are at liberty to maintain their original position and disregard the suggestions of the scrutiny team, although most arbitrators do consider them carefully.

The scrutiny system is an instrument for balancing the institutional interests in producing quality arbitral awards, and arbitrators' independence in making awards. Given the way the system currently operates, there is no need to abolish it as the results are, on the whole, positive.

Arbitrators acting as conciliators

The Confucian philosophy strongly supports the idea of 'emphasizing moral behaviour and curbing litigation', which accounts for China's long history of using conciliation (also known as mediation) as an important channel for resolving conflicts throughout society. Notwithstanding an increase in litigation and decline in mediation over the last thirty years, mediation is still seen as an important tool for building a 'harmonious society'.

CIETAC has a long tradition of combining conciliation and arbitration, or Arb-Med. In recent years, parties settle their disputes through conciliation by arbitrators in about 30 per cent of cases. Internationally, there are two conflicting views concerning arbitrators acting as conciliators. One is that an arbitrator should not act as a conciliator since different skills and qualities are required to

perform the two functions. In addition, an arbitrator may through conciliation get to know new information. For instance, the arbitrator might learn the parties' bottom line for concessions (although such information is privileged and is given on a 'without prejudice' basis). As a result, if conciliation fails, the arbitrator might consciously or subconsciously render an award that is safely within the acceptable range of both parties.

Proponents of the alternative view that an arbitrator should be allowed to act as a conciliator note that an arbitrator is in a unique position to know the facts and circumstances of the dispute, and therefore Arb-Med is the most cost-effective option if conciliation is to be tried anyway.

CIETAC rules reflect the second view. The 1994 Arbitration Law also expressly endorsed the availability of conciliation in the course of arbitration. In almost all CIETAC arbitrations, conciliation, if any, is conducted by arbitrators. The aforesaid concern that an arbitrator may unduly use 'without prejudice' information for adjudication of the merits does not seriously undermine CIETAC's practice, as conciliation by arbitrators is only feasible when both parties consent, and parties sensitive to the possible negative impact of disclosing information are at liberty to reject such conciliation in the first place.

From time to time, foreign attorneys allege that they feel compelled to accept an arbitrator's proposal for conciliation for fear that refusing would be perceived as disrespect towards the arbitrators and thus result in an unfavourable award. This concern is overstated. CIETAC arbitrators are well aware of the consensual nature of conciliation in the course of arbitration, and shall make awards only in accordance with the law and the proved facts.

Moreover, CIETAC now allows parties to request conciliation by a panel of independent conciliators in the course of arbitration, although 2005 Rules do not expressly provide for this practice, and as a result, many parties are unaware of this option. Future CIETAC Rule reforms should make more explicit reference to this provision, to highlight this option available to parties.

Conclusion

In terms of substantive outcomes, CIETAC arbitration is fair. Over the years, CIETAC has continually striven to enhance procedural fairness and to be responsive to foreign concerns. Consequently, CIETAC is compliant with international best practices and, as such, is a reliable forum for resolving China-related transnational disputes.

Several practices of CIETAC remain controversial. These practices, however, are either the undesirable legacies of the planned economy, or arise out of misconceptions about certain cultural features of Chinese society and business practice.

The enduring impact of China's planned economy helps explain the low and unequal compensation of arbitrators, the occasional appointment of staff as arbitrators, the infrequent appointment of third country nationals as tribunal chairs, and the restriction on counsel.

Reform of practices that are legacies of the planned economy is difficult and will only be achieved in the long term. Problems inherent in the old economic system can only be fixed through overhaul of the current arbitration legislation and reform of the financial system to give full control to CIETAC over revenues and costs. On the whole, the pace of institutional change at CIETAC has been remarkably swift, as CIETAC has responded to the criticisms of legal scholars and investors, and sought to maintain a competitive edge in an increasingly dense market of international arbitration.

Cultural differences are also predominant factors in several of the more contested practices. At least two features of Chinese culture shed light on the unique practices of CIETAC. Firstly, Chinese society traditionally was characterized by a strict hierarchy that emphasized institutions over individuals. With regard to arbitration, the emphasis on institutions explains in part why ad hoc arbitration is banned in China, and why institutional arbitration in China plays a significant role for the commission and its

staff. CIETAC's active involvement in arbitrations, such as staff members assisting arbitrators in drafting legal documents and institutional scrutiny of arbitral awards, can be traced to this cultural trait. Secondly, historically, Chinese culture has emphasized resolving disputes through amicable means rather than through litigation. This accounts in part for CIETAC's practice of combining conciliation and arbitration.

Generally speaking, practices characteristic of Chinese cultural norms will continue, but alternative practices have been, and should continue to be, developed at CIETAC to meet the demands of the international business community. Although CIETAC's foreign-related business has remained stable, CIETAC is now facing increased competition. Other international arbitration centres, especially the HKIAC, the SIAC and the ICC Court, have witnessed a rapid increase in China-related business. To remain competitive, both the Chinese authorities and CIETAC will need to introduce further reforms to better adapt to the needs of diversified arbitration users.

Policy recommendations

Government reforms might profitably focus on giving parties and arbitration institutions more autonomy and flexibility by reducing interference with arbitration activities. Specifically, this would include:

- an overhaul of the financial system of arbitration institutions to give them full control over their finances;
- abolishing the restriction on foreign counsel in foreign-related arbitrations to allow them to comment on PRC law;
- revised legislation to provide uniform guidelines for arbitrators' conduct; and
- the lifting of restrictions on ad hoc arbitration once the judiciary is sufficiently mature and competent to enable its effective implementation.

CIETAC itself should instigate measures to ensure the neutrality of arbitral tribunal, by appointing third country nationals as tribunal chairs when necessary, and to avail parties of more autonomy and flexibility.



The Foundation

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Rule of Law in China: Chinese Law and Business

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