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ALERT MEMORANDUM

March 3, 2014 clearygottlieb.com

Drafting Arbitration Agreements for Arbitrations Seated in Mainland China

Drafting an arbitration agreement providing for potential disputes to be arbitrated in mainland China is a task which arises with ever more frequency and which presents a unique set of challenges. Dispute resolution by way of arbitration is the predominant choice for European and U.S. companies doing business with Chinese parties. Despite recent improvements in law and practice, the Chinese court system is considered to be relatively nontransparent and the outcome of a case correspondingly unpredictable.

As a result of certain characteristics of Chinese arbitration practice, European and U.S. companies in contractual relationships with Chinese parties generally prefer arbitration agreements that foresee arbitrations seated outside of mainland China and administered by an internationally recognized arbitral institution.[1] This represents familiar terrain, and indeed the enforcement of resulting foreign awards in mainland China has become easier in recent years. China is a member state of the New York Convention and has agreed to apply the Convention to arbitral awards rendered in another member state and which relate to "commercial" disputes as conceived in the Convention.

Yet what if the Chinese party to a contract (*e.g.*, a state-owned enterprise) insists on agreement to a seat of arbitration in mainland China?

The first question that arises is whether or not the dispute to be arbitrated is "foreign-related" since, if this is the case, a different set of rules governs the arbitration proceedings as well as enforcement of the award.[2] A "foreign-related" dispute is defined as a dispute in which (1) at least one of the parties is "foreign," (2) the subject matter of the contract is located in whole or in part outside of mainland China, or (3) there are other legally relevant facts regarding the occurrence, modification or termination of legal

[1] Stockholm and Vienna are frequently chosen as the seat of arbitration in contracts with Chinese parties because they have a long history as neutral locales for arbitration between East and West. Singapore and Hong Kong have also been chosen with some frequency as they combine the advantages of a Chinese-influenced local culture with the application of international arbitration standards, the availability of a local administration by the International Chamber of Commerce (ICC), and – in the case of Hong Kong – an agreement with mainland China regarding the enforcement of arbitral awards.

[2] For example, with respect to purely domestic disputes (*i.e.*, those that do not qualify as "foreign-related"), an arbitration seated outside of mainland China is not permitted, the application of Chinese law is mandatory regardless of the law chosen by the parties (which follows, impliedly, from Article 126 of the Contract Law), and the parties may appoint only Chinese arbitrators (which follows, impliedly, from Article 67 of the Chinese Arbitration Act, which allows selection of arbitrators "from among foreigners" only in the case of foreign-related arbitrations).

rights and obligations that occurred outside of mainland China. Foreign companies should be aware that their Chinese subsidiaries, so-called foreign-invested entities incorporated in China, are not considered "foreign" for purposes of Chinese arbitration law. A dispute between such a foreign-owned Chinese subsidiary and another Chinese party would thus not automatically be deemed "foreign-related" and would be subject to the less flexible rules governing domestic arbitration in mainland China. As a result, when structuring their contract, foreign parties may wish to ensure that any resulting dispute will qualify as "foreign-related," for example by including the foreign parent company as a party to the contract or by providing for the contract performance to take place partly outside of mainland China.

Below we address the main issues in the drafting of arbitration agreements with a seat in mainland China where the potential dispute is foreign-related: (1) the arbitral institution and local seat, (2) the applicable law, (3) the language of the arbitration, (4) the arbitrators, (5) interim relief, (6) taking of evidence, (7) confidentiality, and (8) arbitration-mediation.

1. Arbitral Institution and Local Seat

Ad hoc arbitrations, *i.e.*, those conducted without any or any substantial institutional administration, are not permitted in mainland China. The Chinese Arbitration Act provides in Article 16: "… *An arbitration agreement shall contain the following particulars: … (3) a designated arbitration commission*." As such, any arbitration conducted with a seat in mainland China must be administered by an arbitral institution. An agreement to a seat in mainland China with a pure *ad hoc* structure or *ad hoc* arbitration under the UNCITRAL Ad Hoc Arbitration Rules, by way of example, would be deemed void from a Chinese perspective.

Accordingly, any arbitral award resulting from an agreement to *ad hoc* arbitration proceedings is *per se* unenforceable when the seat of the arbitration is in mainland China. By contrast, an award rendered in an *ad hoc* arbitration seated outside of mainland China is generally enforceable in mainland China (provided the dispute fulfills the Chinese requirements for being "foreign-related," the award fits within the framework of the New York Convention for purposes of its application, and the applicable local law permits *ad hoc* arbitration). Additionally, the Chinese Supreme People's Court recently clarified that arbitral awards rendered under the rules of foreign arbitral institutions and having a seat outside of mainland China can generally be recognized and enforced in the courts in mainland China.

An open question remains whether parties may select a foreign arbitral institution (*e.g.*, the ICC, SCC or LCIA) to administer an arbitration seated in mainland China. Until recently, arbitral awards rendered in an arbitration seated in mainland China under the auspices of a foreign arbitral institution were deemed unenforceable in mainland China, because the "*designated arbitration commission*" referenced in Article 16 of the Chinese Arbitration Act was deemed to encompass only Chinese institutions. This interpretation may be undergoing some change. In a much-quoted judgment, the Ningbo Intermediate People's Court on April 22, 2009 confirmed an arbitral award rendered in an ICC arbitration seated in Beijing. It is unclear and somewhat doubtful, however, whether this judgment of an intermediate court by itself will contribute to a fundamental change in the acceptance of foreign arbitral institutions in mainland China. In the case at issue, the respondent had failed to raise its jurisdictional objection prior to the first hearing, a requirement specifically spelled out by the Supreme People's Court. In its 2006 Interpretation, the Supreme People's Court had clarified in Article 13 that a court shall not

accept a party's application to declare the arbitration agreement void where the party failed to raise its objection prior to the first hearing in the arbitration proceeding. As such, the judgment confirming the award was in line with the 2006 Interpretation. The majority of legal commentators continues to advise against agreeing on a foreign arbitration institution to administer an arbitration in mainland China (despite, notably, the availability of a modified model ICC arbitration agreement intended for use in China).

In light of the continued risk of enforcement problems associated with foreign arbitral institutions administering arbitrations seated in mainland China, the most prudent choice at this time would appear to be an agreement to administration by a Chinese arbitral institution. While there are more than 200 arbitral institutions in mainland China, foreign parties would be well advised to choose one of the major institutions specifically set up for foreign-related disputes, including:

- CIETAC (China International Economic and Trade Arbitration Commission)
- SHIAC (Shanghai International Arbitration Center, formerly CIETAC Commission)
- SCIA (Shenzhen Court of International Arbitration, formerly CIETAC Commission)
- CMAC (China Maritime Arbitration Commission)
- BAC (Bejing Arbitration Commission)
- SHAC (Shanghai Arbitration Commission)
- GZAC (Guangzhou Arbitration Commission).

The most frequently chosen arbitral institution in mainland China is CIETAC. Founded in 1956 under the name Foreign Trade Arbitration Commission (FTAC), it is the oldest, largest, and most recognized Chinese arbitral institution. CIETAC administers well over 1,000 disputes every year, which makes it larger measured by caseload than the ICC, which administers some 800 disputes per year.

If an arbitration seated in mainland China is the only option available to a foreign party, it would be wise to agree in the arbitration clause to administration by CIETAC and to the CIETAC Arbitration Rules. The CIETAC Rules were revised in 2012, and that revision has brought the CIETAC Rules more into conformity with best practices in international arbitration.

When considering which seat to agree to within mainland China, parties are advised to choose one of the major commercial centers such as Beijing or Shanghai. By agreeing to one of these venues as the seat, the parties maximize the likelihood, in the case of intervention or supervision by local courts at the seat, of benefiting from judges with substantial experience respecting interim and conservatory relief, assistance in taking of evidence, etc. in arbitrations involving foreign elements.

2. Applicable Law

As in the case of contracts generally, parties should state expressly the governing substantive law. In a foreign-related contract, the parties are, in principle, free to choose the substantive law applicable to their contract.[3] In that context, parties should bear in mind the distinction which may be drawn, at least in

[3] Some contractual transactions, however, are subject to the mandatory application of Chinese law even if the contract is foreign-related. Such transactions are listed in Article 126 of the Chinese Contract Law and in Article 8

some cases, between the law governing the substance of the contract on the one hand and the law governing the arbitration agreement on the other hand.

If the parties wish to choose a law to apply to their arbitration agreement other than that of the seat of arbitration (*i.e.*, Chinese law), they should state so expressly in the arbitration agreement. The Supreme People's Court, in a 2006 Judicial Interpretation, confirmed that in a foreign-related arbitration seated in mainland China, the validity and scope of an arbitration agreement shall be governed by the law agreed upon by the parties or – absent a choice of law – by the law of the seat of the arbitration.

That said, it is unclear whether and to what extent, by choosing a foreign law to govern the arbitration agreement, parties can effectively opt out of or circumvent the restrictions of Chinese arbitration law. Parties who wish to choose a foreign law to apply to the validity and scope of their arbitration agreement for a foreign-related arbitration seated in mainland China are advised not to disregard the restrictions of Chinese arbitration law in order to avoid having their arbitration agreement later be deemed invalid.

3. Language of the Arbitration

It is recommended that parties state expressly the language in which they would like to conduct the arbitration proceedings. In the absence of an agreement to this effect by the parties, the CIETAC Rules provide that the language of the arbitration shall be Chinese or another language designated by CIETAC.[4] Practically speaking, the only language other than Chinese that can conveniently be handled by CIETAC is English. While a fully bilingual arbitration in English and Mandarin Chinese runs the risk of being less efficient (both in terms of time and expense), the parties may want to agree that the arbitral award will be rendered in both languages with a view to facilitation of potential enforcement proceedings in the Chinese courts.

4. Arbitrators

The Chinese Arbitration Act requires arbitral institutions to maintain a panel of arbitrators. Under the CIETAC Arbitration Rules, parties must generally select arbitrators from CIETAC's panel of arbitrators. Since 2005, parties have had the opportunity to opt out of the panel in their arbitration agreement. CIETAC's current arbitrator panel consists of 998 arbitrators, of whom 218 are foreigners. Foreign parties may wish to stipulate in the arbitration clause the right to appoint arbitrators from outside of the CIETAC panel. Any non-listed arbitrator appointed by a party must first be approved by CIETAC, but such approval is regularly granted in foreign-related arbitrations.

Under the CIETAC Arbitration Rules, the parties may each name an arbitrator (failing which CIETAC will appoint the arbitrator on behalf of such party) and suggest up to five candidates for the position of the presiding arbitrator. If the parties' lists of candidates contain one match, that person will be

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of the Rules of the Supreme Court concerning the Application of Law in Civil and Commercial Disputes dated 23 July 2007.

[4] The Chinese Arbitration Act does not contain any provisions regarding the language of arbitration proceedings.

appointed as the jointly nominated presiding arbitrator. If the parties' lists contain more than one match, CIETAC will choose a presiding arbitrator from among the common candidates. If the parties' lists of candidates contain no match (or if the parties otherwise fail to jointly nominate a presiding arbitrator), the presiding arbitrator will be appointed by CIETAC. In such a case, CIETAC may or may not select a non-Chinese arbitrator. However, the parties may provide in the arbitration agreement that the presiding arbitrator be of a nationality other than that of the parties. In a recent case, a CIETAC tribunal was – for the first time – composed of three non-Chinese, non-CIETAC panel arbitrators.

In order to have access to suitably experienced foreign arbitrators, the parties may wish to agree to depart from the standard arbitrator remuneration under the CIETAC fee schedule. To that end, the parties may wish to set out in the arbitration agreement that the arbitrators be compensated according to their accustomed hourly rates rather than the standard CIETAC rates.

5. Interim Relief

Until recent changes in the CIETAC Rules and the Chinese Civil Procedure Law, arbitral tribunals in mainland China did not have the power to grant interim relief, and interim measures were generally not available prior to commencement of arbitration proceedings. During the pendency of an arbitration, only the national courts had power to grant interim measures, and such measures were limited to preservation of assets or evidence. Interim relief was also regularly subject to delays, since a request for interim relief needed to be submitted to the relevant arbitral institution, which would then forward it to the competent national court for a decision, without any applicable time limits. In practice, foreign parties arbitrating in mainland China were not able to obtain interim relief in an effective manner.

Recent changes in the Chinese Civil Procedure Law (effective as of January 1, 2013) and the CIETAC Arbitration Rules (effective as of May 1, 2012) have resulted in a greater availability of interim relief in a timely and effective manner. An amendment to the Civil Procedure Law now also allows national courts to grant interim measures to secure assets or evidence even before commencement of the arbitration. Furthermore, under the new CIETAC Rules, a request for interim relief may now be decided upon by the arbitral tribunal itself (in addition to the national courts), and interim relief is no longer limited to preservation of assets or evidence. It remains to be seen which additional kinds of interim relief will be granted directly by arbitral tribunals under the new CIETAC Rules (*e.g.*, compelling attendance of witnesses or security for costs).

The extended powers of arbitrators under the new CIETAC Rules to grant interim measures may be a blunt instrument, however, as soon as a party seeks to enforce such measures in the competent courts in mainland China. The Chinese Arbitration Act and Civil Procedure Law have not been amended in line with the CIETAC Rules. They are silent on the authority of arbitral tribunals to grant interim relief and still provide that in arbitration proceedings interim relief is limited to conservatory measures. As a result, it is unclear if and to what extent interim measures granted by an arbitral tribunal under the CIETAC Rules will be enforced by Chinese courts.

If Chinese courts should refuse to enforce interim measures issued by arbitral tribunals, the recent changes in the CIETAC Rules would be relevant only if a party voluntarily complies with the interim measure or seeks to enforce the measure outside of mainland China (provided such enforcement is

permissible under the law of that foreign locale). Since the new CIETAC Rules already foresee the issuance of interim measures by arbitral tribunals and in light of the limitations on their issuance as set out in the law, it is not necessary to include any further stipulation on this issue in the arbitration agreement.

6. Taking of Evidence

Chinese arbitration proceedings tend to be more inquisitorial than adversarial in nature, especially with a tribunal comprised wholly or primarily of Chinese nationals. Some key adversarial elements common in international arbitration practice are typically lacking in such inquisitorial arbitrations, including requests for production of documents and cross-examination of fact or expert witnesses by opposing counsel. While certain limited requests for production of specific documents are allowed and are, in fact, becoming increasingly popular in foreign-related disputes, there is no formal document disclosure process and there are few detailed rules regarding the scope of disclosure. In this regard, Continental European parties may be more familiar with the Chinese approach than are Anglo-American parties.

If the parties wish to depart from the standard inquisitorial approach, they should expressly agree on an "adversarial procedure" in the arbitration agreement, including document production and cross-examination. To that end, parties may wish to provide in the arbitration agreement for the application of the 2010 IBA Rules on the Taking of Evidence in International Arbitration. Practice has shown that such agreement is generally respected by CIETAC arbitral tribunals.

7. Confidentiality

While the Chinese Arbitration Act and the CIETAC Rules both have confidentiality provisions, they arguably do not cover the confidentiality of the arbitration proceedings as such and of any documents exchanged in the course of the proceedings. As a result, parties may wish to include a more expansive agreement on confidentiality in the arbitration agreement, respecting a mutual obligation of confidentiality of all participants in the arbitration regarding the fact, pendency, contents and outcome of the arbitration.

8. Arbitration-Mediation

The concept of conciliation is deeply ingrained in Chinese legal culture and arbitration practice. Chinese arbitral tribunals frequently engage in a combination of arbitration and conciliation efforts, also referred to as arbitration-mediation or arb-med. Foreign parties, unfamiliar with this Chinese custom, are sometimes uncomfortable with the idea of having their dispute decided by the same arbitrators with whom they previously shared information during a voluntary, but ultimately unsuccessful, conciliation process. Parties concerned about the combining of arbitrator and conciliator roles may wish to provide in the arbitration agreement that any conciliation process as part of the arbitration proceeding may not be conducted by the same arbitrators, but rather solely by independent conciliators.

The foregoing discussion may provide a basis from which foreign parties may draw inspiration when drafting arbitration agreements with Chinese parties that foresee an arbitration seated in mainland China for a foreign-related dispute. However, such generalized recommendations are no substitute for the advice of counsel who is experienced with arbitration in mainland China.

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If you have any questions, please feel free to contact Thomas M. Buhl, Richard H. Kreindler, Nicole Rothe, Annett Rombach or any of your regular contacts at the firm. You may also contact our partners and counsel listed under "Litigation and Arbitration" located in the "Practices" section of our website http://www.clearygottlieb.com/.

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