Dispute Resolution in China

IMPORTANT CONSIDERATIONS FOR RESOLUTIONS OF DISPUTES WITH CHINESE BUSINESS PARTNERS

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Parties enter into transactions with the aim and expectation of a successful outcome – whether it is a prosperous joint venture, a problem-free turn-key project, timely delivery and payment under a sales contract, or other desirable result. Because of this expectation, parties often treat dispute resolution clauses in their contracts as an afterthought, something for the "papering" process only.

Unfortunately, problems sometimes do arise, despite all measures taken to the contrary. What are then the important considerations for parties to take into account when faced with a China-related dispute? And what are the benefits of involving experienced counsel early in the process in terms of promoting an efficient and satisfactory outcome?

1. First Steps In Response to a Budding Dispute

As a first step in deciding how to respond to any business dispute, it is important to define the company's goals and realistic expectations. Although these may change as the dispute progresses, the goals help to define the strategy to be pursued and the best approaches to reach the desired outcome.

Generally, the options to resolve a China related dispute are negotiation, arbitration and litigation. Negotiation, deeply enshrined in the Chinese culture, will almost certainly play an important role throughout the whole process.

However, the manner in which those negotiations are conducted may be influenced by the question of whether there are any realistic alternatives to a negotiated solution. If, for example, the contract contains an invalid or potentially invalid arbitration clause, that clause cannot be relied upon for protection if negotiations fail. Even if the clause is valid, it may provide little protection if the counterparty under the agreement is not the "real" party in interest, and is instead simply a shell with no assets. Absent a valid and effective arbitration clause, the only alternative if negotiations fail may be for the company to go to litigation to enforce its rights, and the company must assess whether it sees a realistic chance of recovery in this manner. In each of these scenarios, a company's negotiating position may be constrained by the knowledge that it has little realistic alternative to an amicable resolution to the dispute.

On the other hand, if there is a valid arbitration clause binding a counterparty with real assets, then the company may find that it has greater latitude in negotiations, because it has a fall-back position in the event that negotiations fail. The degree to which such latitude is exercised, however, will in turn be influenced by questions such as relative cost, as well as evaluations of the prospects of enforcing an award against the counterparty if arbitration is pursued and a successful result obtained.

It is therefore important to involve counsel sensitive to these issues early in the process to assist with evaluating options and advising on realistic strategies to pursue.

2. Negotiation in the Chinese Environment

When successful, a negotiated solution can provide the fastest and most cost-effective mechanism of resolving business disputes, and negotiation should thus in most cases be a cornerstone of efforts to resolve disputes in China.

A careful stakeholder analysis lies at the heart of an effective negotiation strategy. Besides the parties who are directly involved in the dispute, other parties often have an interest in its outcome, such as suppliers, shareholders, banks, or even members of the local government and other officials. With involvement of counsel at the early stages of this process, the company can often create a multi-pronged negotiation strategy that takes a holistic approach to the dispute to best achieve the desired results.

In addition, the manner and process of negotiation with Chinese business partners is likely to be substantially different from negotiation between parties with western backgrounds. Issues of "face", indirect as opposed to direct approaches to key points, time spent on side issues, and the like in negotiations have been the subject of numerous books and publications. During the actual negotiations it is therefore important to be able to rely on counsel who can interpret and react to these negotiation tactics in a way that ensures the best chances of a successful outcome for the company.

The choice of arbitration institution, the seat, requirements concerning nationality of arbitrators, and language of the arbitration may have a substantial impact on proceedings and costs if a dispute winds up in arbitration.

During negotiations it is also important that the company continue to document the parties' actions to lay a solid foundation for an arbitration/litigation claim if negotiations do not reach the desired result within an acceptable time period. Settlement discussions should be conducted on a "without prejudice" basis, and include necessary caveats to preserve a party's claim if arbitration or litigation becomes necessary. Also, the company should continue documenting in demand letters and other correspondence – plus, where relevant, internal memos to file and executive notes – the key elements of its actions and claims. This correspondence and internal documentation creates a record of the dispute that can then be used, if necessary, as evidence in any later proceedings.

It is important also for the company to have some sense of when "enough is enough" in terms of negotiations, and of when to proceed to arbitration or litigation. In this connection, initiation of such legal proceedings might provide additional incentives for the other party to settle. If settlement is reached when arbitration proceedings are ongoing, the settlement can often be recorded in the form of a consent award if desired, making it separately enforceable rather than just another contractual commitment between the parties.

3. Arbitration / What to Expect

When negotiations are unsuccessful, arbitration is generally the preferred option for resolution of the questions at issue. The advantages of arbitration that are frequently cited include its flexible procedure, confidentiality of proceedings and the award, the option to choose arbitrators with the knowledge required to judge the particular dispute, party autonomy, and the ability to enforce arbitral awards against assets of the counterparty almost worldwide.

However, arbitration is a consensual process, and only available on the basis of a specific agreement between the parties. While as a legal matter it is possible to reach such an agreement at any point in time – including after a dispute has arisen as a practical matter reaching agreement once a dispute already exists is difficult.

To ensure that arbitration is a possibility, therefore, careful attention to drafting of the arbitration clause at the time the transaction documents are negotiated is vital. Among other factors, the choice of arbitration institution, the seat, requirements concerning nationality of arbitrators, and language of the arbitration may have a substantial impact on proceedings and costs if a dispute should arise. Mandatory provisions of domestic law must also be taken into account in this respect. In addition, special questions, such as issues related to multi-party contracts or multi-contract transactions, should also be reflected in the underlying agreement to prevent later problems.

If a valid arbitration agreement exists, the claimant initiates the arbitration by filing a statement of its case and commencing the process of constitution of the arbitral tribunal. The parties' designation in the arbitration agreement of number of arbitrators will generally be controlling, but if the agreement is silent, the default provisions of the applicable institutional rules chosen by the parties will apply. Some rules provide for appointment of three arbitrators unless the circumstances of the case (e.g. its size and complexity) justify a single arbitrator, while other rules provide the opposite.

The process of selection of arbitrators to hear the case is of significant importance, as the experience, background and preferences of the arbitrators will play a role in the procedures by which the arbitration is conducted – and in particular on such issues as whether there will be any allowance for limited requests for production of documents from the other party, and the extent of and weight given to cross examination and testimony of factual and expert witnesses.

The language of the arbitration is also important. If the parties have chosen a language in the arbitration agreement, such choice will normally be respected. If no choice has been made, under the arbitration rules of the China International Economic and Trade Arbitration Commission (CIETAC) the default language will be Chinese. Most other institutional rules give the tribunal the power to determine the language in such circumstances. The language chosen/applied has practical implications not only on translation/interpretation costs, but also in respect of a need to appoint arbitrators who

read and speak the chosen language and can draft the award in that language, which can result de facto in limitations on the pool of internationally experienced arbitrators from which to choose.

Once the arbitral tribunal has been appointed, the file is handed over to the tribunal, which guides and coordinates the arbitration from that point onwards. For the most part the procedures are relatively flexible and can be agreed between the parties and the tribunal, with the tribunal generally having latitude to decide on the specific steps and timeline of the proceedings in procedural orders issued by it. However, the choice of rules and choice of seat for the arbitration, as well as the backgrounds and experience level of the arbitrators on the tribunal, will have an impact on the manner in which the arbitration is conducted, and the details of the established practices can vary considerably.

4. Recognition and Enforcement of Arbitral Awards

When the arbitration is completed, the tribunal will render an award with its findings. If the award is not paid/performed voluntarily by the losing party, the prevailing party then takes the award into a jurisdiction where the losing party has assets, and has it recognised and enforced in that jurisdiction against the losing party.

China is signatory to the NY Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and has ratified the convention on behalf of Hong Kong as well. The NY Convention has currently a total of 144 member states. As a result, awards rendered in China or Hong Kong can be recognised and enforced almost wordwide in other member states of the NY Convention, and vice versa. In addition, pursuant to the "Arrangement between the Mainland and the Hong Kong SAR on the Mutual Enforcement of Arbitral Awards", a Mainland award can be enforced in Hong Kong, and a Hong Kong award enforced on the Mainland.

Recognition and enforcement of foreign arbitral awards sought pursuant to the NY Convention or the Hong Kong/Mainland agreement can only be refused on limited grounds, mostly involving procedural irregularities or "public policy". In addition, the Supreme People's Court has implemented a reporting system which requires that a lower court decision to refuse enforcement of a foreign arbitral award first be approved by the Supreme People's Court in order to become effective.

Enforcement within Mainland China of an award rendered in an arbitration seated in Mainland China, on the other hand, is governed by domestic Chinese law. Pursuant to those provisions, a Chinese court may review and refuse enforcement of the award on substantive grounds (including improper application of the law and/or lack of evidentiary foundation) as well as on grounds of procedural irregularities. This provides considerable latitude for de novo court review of, and interference in, the decision of the arbitral tribunal.

In practice, enforcement of both foreign and domestic arbitral awards in China remains of concern, with issues of local protectionism and perceived lack of impartiality and independence of the Chinese People's Courts being frequent complaints. It can, therefore, be useful to additionally attempt to locate assets (such as accounts receivable, shareholdings, real property and the like) of the counterparty outside of China in a member state of the NY Convention where enforcement may face fewer obstacles.

5. Litigation in China

If no valid arbitration agreement exists, then a party's recourse if negotiations fail will be to litigation before the Chinese People's Courts. However, businesses often have concerns relating to neutrality, local protectionism and potential bias of court members, making domestic litigation a less attractive option than arbitration. Another disadvantage of litigation for foreign parties is the PRC Civil Procedure Law requirement that documentary evidence created outside of the PRC must be notarised by a public notary and legalised by the Chinese embassy in the country where the document was issued. This provision can cause a substantial administrative and monetary burdens. The fact that the law does not establish mandatory timelines for foreign related court cases is another concern.

Litigation outside China may not give rise to the same concerns. However, court rulings from other countries can only be enforced against assets located in China if a treaty on recognition of court awards is in place between China and the country where the decision was rendered. To date, only a limited number of countries have concluded such treaties with China.

6. Concluding Thoughts

It is an unfortunate fact of life that not all business disputes can be avoided. However, advance planning in the early stages of drafting of the transaction documentation, to include an effective dispute resolution mechanism that provides recourse against a counterparty with assets, combined with early involvement of counsel as soon as a dispute arises, can in many cases limit the impact of that dispute and contribute to its efficient and effective resolution.