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THE  
INTERNATIONAL  
ARBITRATION  
REVIEW

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EDITOR  
JAMES H CARTER

LAW BUSINESS RESEARCH

THE INTERNATIONAL  
ARBITRATION REVIEW

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SECOND EDITION

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JAMES H CARTER

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## EDITOR'S PREFACE

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International arbitration is a fast-moving express train, with new awards and court decisions of significance somewhere in the world rushing past every week. Legislatures, too, constantly tinker with or entirely revamp arbitration statutes in one jurisdiction or another. The international arbitration community has created a number of electronic and other publications that follow these developments regularly, requiring many more lawyer hours of reading than was the case a few years ago.

Scholarly arbitration literature follows behind, at a more leisurely pace. But there is a niche to be filled for analytical review of what has occurred in each of the important arbitration jurisdictions during the past year, capturing recent developments but putting them in the context of the jurisdiction's legal arbitration structure and selecting the most important matters for comment. This volume, to which leading arbitration practitioners around the world have made valuable contributions, seeks to fill that space.

The arbitration world is consumed with debate over whether relevant distinctions should be drawn between general international commercial arbitration and international investment arbitration, the procedures and subjects of which are similar but not identical. This volume seeks to provide current information on both of these precincts of international arbitration, treating important investor–state dispute developments in each jurisdiction as a separate but closely related topic.

I thank all of the contributors for their fine work in compiling this volume.

**James H Carter**  
Dewey & LeBoeuf LLP  
New York  
July 2011

## Chapter 8

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# CHINA

*Brenda Horrigan, Felix Hess and Siew Lin Mok\**

### I INTRODUCTION

In recent years, there has been a fast and steady increase in the number of arbitration proceedings seated in China. According to Chinese statistics, more than 60,000 arbitration cases per year are filed with over 200 local arbitration commissions established in mainland China. By far the most important arbitration institution within the mainland is the China International Economic and Trade Arbitration Commission ('CIETAC'). The total value in dispute of proceedings filed with CIETAC in 2010 was some 13.75 billion renminbi. A total of 1,352 arbitration cases (934 domestic and 418 foreign-related) were filed with CIETAC in 2010, making CIETAC the most active arbitral institution worldwide by number of published cases. Currently, the majority of foreign-related disputes seated in mainland China are submitted to CIETAC, with the Beijing Arbitration Commission ('the BAC') being the second choice. The BAC has been actively promoting itself recently as an attractive venue for cases directly or indirectly involving foreign capital.

#### i Legal framework

The legal framework for arbitration seated in China is set out in the PRC Arbitration Law ('the Arbitration Law') supplemented, in some respects, by the PRC Civil Procedure Law, a number of judicial interpretations, as well as the arbitration rules published by CIETAC and other arbitration institutions. In recent years the legal environment has been gradually improving as some important questions were clarified and improved by

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\* Brenda Horrigan is a partner, Felix Hess is of counsel and Siew Lin Mok is a senior associate at Salans LLP. The authors would also like to acknowledge the assistance of Michael Lin, an associate at Salans LLP, in the preparation of this chapter.

People's Court interpretations and circulars<sup>1</sup> as well as the revision of the PRC Civil Procedure Law that took effect in April 2008.

## ii Domestic and foreign-related disputes

Chinese arbitration law draws an important distinction between domestic disputes and foreign-related disputes (i.e., disputes with a 'foreign element'). This distinction can affect:

- the choice of the arbitration institution, which in case of a domestic dispute must be an institution registered in China;<sup>2</sup>
- the seat of the arbitration, which in case of a domestic dispute must be in China;<sup>3</sup>
- the amount of fees payable in CIETAC proceedings, as fee schedules are different for domestic and foreign-related arbitration; and
- most importantly, the grounds on which awards can be set aside or enforcement can be denied, which are much broader for domestic arbitrations than for arbitrations with a foreign element.

A dispute will have a 'foreign element' if (1) at least one party is foreign, or (2) the subject matter of the contract is located in a foreign country, or (3) the act creating, modifying or extinguishing rights and obligations under the contract occurs in a foreign country. With respect to the first criterion, it is important to note that a foreign-invested enterprise registered in mainland China is always a domestic entity, even if 100 per cent owned by a non-Chinese investor. Conversely, Hong Kong is treated as 'foreign' for these purposes, so participation of a Hong Kong-based company would give a transaction the 'foreign element' necessary to allow the seat of arbitration to be outside of the mainland.

## iii Designated arbitration institution

When drafting an arbitration clause it is important to keep in mind that Chinese law requires that there be 'certainty in the designated institution' for administration of the arbitration.<sup>4</sup> This has been interpreted to mean that 'one-sided' arbitration agreements that one might encounter in other jurisdictions – such as where one party is given the right to choose between arbitration and litigation, or between two different arbitration institutions, at the time the dispute arises – are invalid in China. Additionally, if the parties to a domestic dispute only agree on the applicable arbitration rules but fail to specify the arbitration institution, the agreement will only be valid if the selected arbitration rules

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1 Most importantly, the Interpretations of the Supreme People's Court Concerning Some Issues on Application of the Arbitration Law of the People's Republic of China, effective as of 8 September 2006.

2 See Article 128 of the PRC Contract Law.

3 *Ibid.*

4 See Article 16 of the PRC Arbitration Law.

clearly provide for the selection of the relevant arbitration institution.<sup>5</sup> *Ad hoc* arbitration (i.e., administrative proceedings that are not administered by an established arbitration organisation) is not permitted under Chinese law for arbitrations conducted on the mainland. Therefore, only parties to a dispute with a foreign element who choose to seat their proceedings outside of the mainland can agree on *ad hoc* arbitration.

#### iv Selection of arbitrators

The CIETAC and BAC rules both limit the choice of arbitrators. In CIETAC proceedings, arbitrators must be chosen from the panel of arbitrators provided by CIETAC,<sup>6</sup> which currently lists some 998 names of which 282 are non-Chinese (including for this purpose 64 arbitrators from Hong Kong, Macao and Taiwan). Appointments beyond the panel are only permitted upon agreement of all parties and confirmation by the Chairman of CIETAC.<sup>7</sup> In BAC proceedings, appointments in domestic cases must be strictly made from the panel,<sup>8</sup> while appointment in foreign-related cases can be made from outside the panel.<sup>9</sup>

In practice, CIETAC's low fee scale for arbitrators imposes some limitations on the selection of arbitrators, although some *ad hoc* fee-setting is tolerated with CIETAC's approval. The BAC, on the other hand, allows non-Chinese arbitrators to charge whatever the market will bear, which in theory increases the pool of arbitral talent from which to choose.

#### v Fees and award on costs

Case-handling fees and registration fees charged by CIETAC and the BAC for small amounts in dispute are generally lower than fees charged by most other international institutions. On the other hand, fees charged in cases with high amounts in dispute can exceed the fees charged by the International Chamber of Commerce ('the ICC'), the Singapore International Arbitration Centre and other international institutions.

With respect to counsel fees and costs, a prevailing party can recover 'reasonable' amounts incurred. It is common for arbitral tribunals to make their own assessments of the reasonableness of fee amounts claimed, which can be much lower than international standards. In such cases it is common for only part of the costs, fees and expenses to be awarded to the prevailing party.

#### vi Language

Both the CIETAC and the BAC Arbitration Rules provide for Chinese to be the default language of the arbitration, although both sets of rules permit the parties to agree otherwise. In arbitrations involving parties with a foreign interest it is therefore

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5 See Interpretations of the Supreme People's Court Concerning Some Issues on Application of the Arbitration Law of the People's Republic of China, effective as of 8 September 2006.

6 See Article 21(1) of the CIETAC Arbitration Rules.

7 See Article 21(2) of the CIETAC Arbitration Rules.

8 See Article 17 of the BAC Arbitration Rules.

9 See Article 55 of the BAC Arbitration Rules.

advisable to choose English as the language of the arbitration to enlarge the pool of available experienced arbitrators and to ensure that all parties can fully participate in the proceedings.

**vii Arb-Med and Med-Arb**

Both the PRC Civil Procedure Law and the CIETAC Arbitration Rules enshrine conciliation as a (voluntary) part of the arbitration process.<sup>10</sup> If the conciliation procedures fail to result in a settlement, the arbitral tribunal will proceed with the arbitration and render an award. There is widespread discussion on the question of whether arbitrators who participated in conciliation negotiations will be able to ignore completely the confidential information disclosed and proceed with the arbitration as if the settlement negotiations had not happened.

**viii Enforcement and annulment of Chinese arbitral awards**

Under PRC arbitration and civil procedure law, arbitral awards are final and binding. If a party fails to fulfil its obligations pursuant to the orders in the award, the other party can petition the competent People's Court to enforce the arbitral award.

An award rendered in a domestic arbitration seated in mainland China may be reviewed and refused enforcement by a Chinese court on both substantive and procedural grounds. Of particular concern, courts have the right to overturn an award upon a finding of a clear error in the application of law by the arbitral tribunal, and/or lack of evidence to ascertain the facts.<sup>11</sup> These grounds provide considerable latitude for *de novo* court review of, and interference in, the decisions of the arbitral tribunal.

On the other hand, awards rendered in arbitral proceedings seated in mainland China concerning disputes with a 'foreign element' can only be denied enforcement or set aside due to severe breach of procedural rules similar to grounds under the New York Convention (see *infra*), such as the absence of an effective arbitration agreement or failure to notify a respondent of the proceedings.<sup>12</sup>

**ix Recognition and enforcement of foreign arbitral awards**

China is Member State of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ('the New York Convention'), and the refusal to recognise and to enforce in China a foreign arbitral award rendered outside of mainland China may therefore only be based on the grounds set forth in the Convention that centre on severe infringement of procedural rules.<sup>13</sup> China has also entered into arrangements for

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10 See Article 51 of the PRC Civil Procedure Law and Article 40 of the CIETAC Arbitration Rules.

11 See Article 213 of the PRC Civil Procedure Law.

12 See Article 70 of the PRC Arbitration Law and Article 258 of the PRC Civil Procedure Law.

13 See Article 5 of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958).

mutual recognition and enforcement of arbitral awards with Hong Kong and Macao that provide for similar grounds for rejection as the New York Convention.<sup>14</sup>

x **Pre-reporting system**

In an attempt to deter the improper annulment or non-enforcement of foreign-related awards and avoid biased or protectionist decisions at the subordinate level courts, the Supreme People's Court ('the SPC') adopted a pre-reporting system in 1995 for non-enforcement of foreign-related awards (and also foreign awards and Hong Kong awards). In 1998, the SPC also adopted the same system for annulment of foreign-related awards. These decisions must be reported to the superior court, which, if it wishes to uphold the decision, must in turn report to the SPC, which will then take the final decision.

xi **Efficiency of actual enforcement**

There are, however, widespread concerns about the efficiency of the actual enforcement proceedings handled by Chinese courts. There have been reports of delays, inactivity, local protectionism and governmental intervention and hiding and concealing of assets as obstacles to successful enforcement. China has recognised these problems and is taking steps to address these issues, some of which are outlined *infra*.

## II **THE YEAR IN REVIEW**

### i **Developments affecting international arbitration**

#### *General trends*

Recent court rules suggest that arbitration will play an increasingly important role as an indispensable alternative dispute resolution mechanism in China.

On 24 July 2009, the SPC issued the Opinions on the Establishment and Improvement of a Dispute Resolution Mechanism that Incorporates both Litigation and Non-Litigation Approaches ('Opinions'). According to these Opinions, the SPC expressed its intention to improve the development of non-litigation dispute resolution mechanisms, especially arbitration.

The Opinions request the local courts to carefully implement the PRC Arbitration Law and the relevant judicial interpretations, to respect the nature of arbitration procedures and allow arbitration to develop fully as a form of dispute resolution. In particular, the Opinions request the local courts to expeditiously handle applications for evidence preservation and attachment of property required in an arbitration proceeding.

It is also worth noting that the Opinions allow arbitration commissions to mediate disputes that do not even have pre-signed arbitration agreements. In this situation, the parties concerned may file the case with a specific mediation organisation set up under

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14 See Memorandum of Understanding on the Mutual Enforcement of Awards signed by Supreme People's Court and the Hong Kong government on 21 June 1999 and the Arrangement between the mainland and the Macau SAR on Reciprocal Recognition and Enforcement of Arbitration Awards, dated 12 December 2007.

the arbitration commission for mediation. After the mediation, the mediation agreement reached by the parties has binding effect.

### *Developments within CIETAC*

CIETAC prides itself on being one of world's busiest arbitral institutions in terms of the number of cases administered. In 2010 CIETAC accepted a total of 1,352 new cases (down from 1,482 in 2009), 672 of which were administered by CIETAC's headquarters in Beijing, 476 by its Shanghai sub-commission and 182 by its sub-commission in Shenzhen. The relatively new sub-commissions in Tianjin and Chongqing accepted 12 and 10 cases respectively. 1,382 cases were resolved in 2010 (up from 1,329 in 2009).

CIETAC is taking considerable efforts to improve and strengthen its reputation as one of the world's leading arbitration institutions and to take its seat in the international arena. As one current example, 14 April 2011 saw the launch of the CIETAC Foreign Arbitrators Forum in London, a platform that is designed to give foreign arbitrators, especially those listed on the CIETAC panel, an opportunity to network, learn more about CIETAC arbitration and become acquainted with China's laws and regulations. The forum is also open to non-listed CIETAC arbitrators. On the following day, CIETAC and the British Institute of International and Comparative Law co-hosted a high-profile conference in London discussing 'The Ins and Outs of CIETAC Arbitration'.

CIETAC also revamped its panel of arbitrators effective as of 1 May 2011 after the previous panel had been in place for a term of three years. There are a total of 998 arbitrators on the new panel. Of that total, 716 arbitrators are from mainland China, 44 are from China Hong Kong SAR, one is from China Macau SAR, and there are 19 arbitrators from the China Taiwan Region. The remaining 218 are foreign arbitrators from over 30 countries from around the world, accounting for 28.26 per cent of the total. In the course of the review of its panel CIETAC reappointed 771 out of 965 arbitrators and removed 175 names from the panel. CIETAC also evaluated 581 applications for new listings, of which 175 have been successful. Among these new appointments are 37 non-Chinese practitioners, including seven individuals listed in *Who's Who Legal – Commercial Arbitration*. As a result of these changes, CIETAC has fulfilled its declared objective of creating a new panel that further improves the international character of CIETAC, implements a more reasonable age structure, enhances overall objective quality of arbitrators, covers more professional categories and has a wider geographical distribution.

### *Revision of the CIETAC Arbitration Rules*

The current version of the CIETAC Arbitration Rules has been in effect since 1 May 2005 and a revision of these rules is well under way. In December 2009 CIETAC invited suggestions and comments from arbitration practitioners and scholars in an effort to accommodate domestic and international arbitration developments and to provide users with more efficient and high-quality services. The collection of comments was completed several months ago and internal drafts have been prepared. The promulgation of the revised CIETAC Arbitration Rules is expected soon but the exact date of promulgation is still uncertain. The revisions are also eagerly awaited by the international academic and student world, not least because the CIETAC Arbitration Rules will be used in the fact pattern for the 2012 Vis Moot competition.

Up to now CIETAC has not circulated any drafts of the revised rules. Nevertheless, some indications of the revisions to be expected have been given by members of CIETAC at various conferences, in particular by CIETAC's Vice Chairman and Secretary General, Yu Jianlong. According to those individuals, the forthcoming revision could liberate the parties to also appoint arbitrators that are not listed on the CIETAC panel. Currently, parties can only appoint arbitrators 'off list' upon mutual agreement of all parties and confirmation of the appointed arbitrator by the Chairman of CIETAC.<sup>15</sup> Under the revised rules arbitrators chosen beyond the panel will still have to qualify as arbitrators under Article 13 of the PRC Arbitration Law (i.e., only persons may be appointed as arbitrators that have eight years of experience as a lawyer, judge or arbitrator, or that are senior academics or senior professionals with legal knowledge). It has been indicated that confirmation of the appointment by the Chairman of CIETAC will also still be required.

CIETAC also grants a certain degree of party autonomy to the users. One important example is the principle of competence-competence, which is not recognised under Chinese law. According to Chinese law the decision on the effectiveness of an agreement to arbitrate is made either by the People's Courts or by the arbitration institution.<sup>16</sup> CIETAC has indicated, however, that an agreement of the parties to delegate to the arbitral tribunal the power to decide on the effectiveness of the arbitration agreement would be respected by CIETAC.

One additional feature of Chinese arbitration that has led to considerable discussion is the use of Arb-Med and Med-Arb (see Section I(vii), *supra*). The concern raised in such discussions will most likely not be addressed in the revised version of the CIETAC Arbitration Rules, as CIETAC has recently pointed to the use of Arb-Med as highly effective in practice. According to CIETAC statistics, some 20 to 30 per cent of cases of all CIETAC cases are settled by this method.

It is also anticipated that the lump-sum fee schedules used by CIETAC will remain in place under the revised rules, although the amounts may be changed. The fee schedules provide for a fixed fee payable to cover administrative fees as well as arbitrators' fees. This amount is the same irrespective of whether the arbitration is heard by a sole arbitrator or by a panel of three arbitrators. Fees paid from CIETAC to the arbitrators are usually below international standards. In many cases the parties and the arbitrators agree on separate fee arrangements, because there is a risk that the arbitrator would otherwise not accept the appointment.

### ***Construction Dispute Review Rules of CIETAC***

CIETAC also recognises the need to specifically address different types of disputes. In 2005 CIETAC promulgated the CIETAC Financial Disputes Arbitration Rules and in last year's edition of *The International Arbitration Review* we introduced the background and contents of the CIETAC Online Arbitration Rules that came into effect on 1 May

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15 See Article 21 of the CIETAC Arbitration Rules.

16 See Article 20 of the PRC Arbitration Law.

2009. At the time of writing CIETAC is still waiting to resolve its first dispute under the Online Arbitration Rules.

Last year, on 1 May 2010, the CIETAC Construction Dispute Review Rules (Trial) came into effect for trial implementation. The Construction Dispute Review Rules govern the resolution of construction disputes by a so-called disputes board, preceding actual arbitration. The same mechanism is also incorporated in the FIDIC Conditions of Contract for Construction ('the FIDIC Red Book').

### *New rules on conflict of laws*

Last year, China also saw the promulgation of the Law of the People's Republic of China on Application of Laws to Foreign-Related Civil Relations, which came into effect on 1 April 2011. The new law aims at unifying existing conflict of law rules under Chinese law and to supplement these rules where necessary. Improvements particularly concern the conflict of law rules pertaining to family matters and inheritance.

The new law also contains an article on the law applicable to arbitration agreements, which may be either the law at the seat of the arbitration or the law at the place of the arbitration institution.<sup>17</sup> It is not specified whether a general choice of law clause would also apply to the law governing the substance and validity of the arbitration clause contained in a contract.

### *Prohibition of listed arbitrators to act as counsel*

In 2010 there was a stir among the domestic arbitration community in China, caused by the new Measures concerning Punishment of Lawyers and Law Firms for Illegal Acts that were promulgated on 8 April 2010. According to these Measures it constitutes an illegal act for a lawyer to serve 'as an attorney in a case handled by the arbitral body where he used to or currently work as an arbitrator'. This provision can be interpreted to prohibit legal practitioners who currently are listed, or have been listed in the past, on a panel of a Chinese arbitration institution from ever acting again as counsel in a case administered by the same institution. There seems little justification for such a far-reaching prohibition of professional activities. Given that many qualified and experienced arbitrators also frequently act as counsel, there are concerns that the new provisions will alienate important and indispensable talent from being registered as arbitrators on panels of important institutions such as CIETAC. This has also been recognised by the authorities and there are ongoing discussions on how to rectify the provision, but no immediate steps have yet been taken. With a view to similar situations in the past it seems likely that this provision will remain in place but will not be strictly enforced. It remains to be seen whether counsel in arbitrations seated in China will use this provision to lodge challenges of opposing counsel and thus cause unnecessary costs and delays in arbitral proceedings.

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17 See Article 18 of the Law of the People's Republic of China on Application of Laws to Foreign-Related Civil Relations.

ii Arbitration developments in local courts

China has generally been perceived by corporate counsels as one of the more hostile jurisdictions towards enforcement of foreign arbitration awards, although much of the support given for this perception is anecdotal.<sup>18</sup>

However, there have been encouraging developments in the past few years. The SPC and its local counterparts have chosen to take a broader approach when reviewing the validity of arbitration clauses, and Chinese courts increasingly seem to be trying to recognise and enforce foreign arbitration awards. While there are no official documents explicitly supporting this assertion, a few recent cases and SPC circulars point in this direction.

*Positive attitude toward arbitration clauses/enforcement*

As noted *supra*, the PRC Arbitration Law requires a clear reference to an arbitration institution, not merely that institution rules for an arbitration clause to be valid. In the past, this requirement has prevented foreign arbitration awards from being enforced in China, on grounds that the institution was not adequately specified.<sup>19</sup> In responding to this, the SPC clarified in a judicial interpretation on PRC Arbitration Law issued in 2006 that where an arbitration clause refers only to arbitration rules but not to a particular institution, such arbitration clause should be deemed as valid as long as the arbitration rules cited can be used to identify the institution.

In 2008<sup>20</sup> and 2009,<sup>21</sup> the SPC further clarified that an *ad hoc* arbitration award issued in Hong Kong can be enforced in mainland China pursuant to the Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and Hong Kong Special Administrative Region. This is a further sign of goodwill showing the support of Chinese courts towards international arbitration, since previously Chinese courts would not recognise and enforce international *ad hoc* arbitral awards, on the basis that an *ad hoc* arbitration clause fails to identify an institution for the arbitration, as required by the PRC Arbitration Law.

In the same 2009 circular, the SPC also singled out the Arbitration Court of the ICC, confirming that foreign arbitral awards issued in Hong Kong, in particular those under the ICC Rules, should be recognised and enforced in China as awards issued in Hong Kong. This is particularly encouraging as it overturns a previous SPC decision that an ICC Hong Kong award should be treated as one issued in France (because the

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18 See e.g., International Arbitration: Corporate Attitudes and Practices 2008, PricewaterhouseCoopers.

19 'Arbitration: ICC Rules, Shanghai shall apply' was insufficient to identify the arbitration institution chosen by the parties and therefore should be held as invalid.

20 Internal meeting minutes of a judicial meeting circulated by the SPC to the Chinese court system concerning arbitration awards renders by the arbitration institutions of Hong Kong SAR and Macao SAR and arbitral awards made by *ad hoc* tribunals in Hong Kong SAR and Macao SAR.

21 See SPC of the PRC Circular on Issues Relevant to the Enforcement of Hong Kong Arbitration Awards in mainland China; Fa (2009) No. 415; issued on 30 December 2009.

ICC is an organisation is registered in France) instead of Hong Kong.<sup>22</sup> This brings the Chinese courts' treatment of such awards more in line with the international arbitration practice.

Ambiguity remains concerning arbitral awards issued by foreign institutions within China, however, with one recent ICC award rendered in mainland China being upheld as a foreign award under the New York Convention. Many commentators have criticised the reasoning in the court's decision, although applauding its outcome, and as a practical matter practitioners continue to advise parties to avoid arbitration clauses providing for arbitration in mainland China under the rules of foreign institutions.

### *Use of public policy reservation*

In terms of the use of public policy reservation, it is interesting to note that while local courts in China (intermediate courts and high courts) may take a hostile approach towards foreign arbitral awards due to local protectionism or other reasons and use the public policy exception to deny foreign awards, the SPC has in recent years adopted a rather conservative approach and is known to have dismissed at least some applications for non-enforcement of foreign arbitral awards filed by local courts. One such example can be found in the SPC decision in *GRD Minproc v. Shanghai Feilun*, issued in 2009.

In *GRD Minproc v. Shanghai Feilun*, GRD Minproc Limited ('GRD') entered into a contract ('GRD Contract') with Shanghai Feilun Industry Co Ltd ('Feilun') in 1995 for the sales of devices and materials used in battery recycling equipment from GRD to Feilun. The goods were imported to Feilun and commissioned in its workshop in early 1999. Later, lead dust pollution was detected in the workshop and there was a dispute between GRD and Feilun as to whether the pollution was caused by the defects of the goods and whether the goods met the contractual and industry requirements.

In 2003, Feilun filed a request for arbitration with SCC in Stockholm for the termination of the GRD Contract. The tribunal determined in the SCC award that there was no proof to support the non-compliance of the goods with any binding requirements and therefore dismissed the claims of Feilun.

When GRD applied for the recognition and enforcement of the SCC award with the local court in Shanghai, Feilun argued, *inter alia*, that the SCC award was against the public order of China, on grounds that the lead dust produced by the goods had formed pollution and damaged the health of workers. Both the Intermediate and High Court in Shanghai supported Feilun's argument. However, given the pre-reporting system for the non-enforcement of foreign awards in China, the Shanghai local courts could not render the decision to deny the SCC award directly, but instead had to report to the SPC for a final determination.

In its formal reply to the report of Shanghai courts, the SPC determined that the lead dust pollution might have been the result of multiple factors, and that the tribunal had already decided on the quality issues of the goods based on its authority to arbitrate. Therefore the SPC held that the enforcement of the SCC award would not violate public

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22 *Hong Kong Weimao v. Shanxi Tianli* [2004].

policy or the public interests of China, and ordered the Shanghai courts to recognise and enforce the SCC award.

The result of this case suggests that while local protectionism could be an issue (in its decision not to enforce the SCC award, the Shanghai court took into consideration a number of local concerns), the SPC could still uphold the principle of non-interference with the substantial part of a foreign award on public policy grounds. There was a similar case in 2008, *Noble Group v. Zhoushan Zhonghai*, in which the SPC also dismissed the report of the local court requesting authorisation for the non-enforcement of a Hong Kong International Arbitration Centre award.

### *Enforcement of local arbitration awards worldwide*

There have also been developments with respect to the enforcement of local arbitration awards in jurisdictions outside mainland China. In a recent case, *Gao Haiyan and Another v. Keeneye Holdings Ltd and Another* [2011] HKEC 514, the Hong Kong court of first instance refused to enforce an arbitration award issued by the Xi'an Arbitration Commission ('XAC') on public policy grounds where one of the arbitrators acted as both arbitrator and mediator and, in doing so, created an appearance of partiality. This indicates that the Arb-Med practice, when not carefully applied, remains a potential threat to the enforcement of local arbitration awards.

However, the holding in the case is highly fact-specific, and cannot be seen as a blanket indictment of all Arb-Med as conducted in China. The facts of the case were as follows.

In July and August 2008, pursuant to a share transfer agreement and a supplementary share transfer agreement, Gao and Xie transferred their interests in a BVI company to Keeneye Holdings and New Purples. In July 2009, the respondents commenced arbitration proceedings in Xi'an, claiming that the agreement was valid while the applicants counterclaimed that the agreement was invalid. At the end of the first arbitration hearing in December 2009, both parties agreed, when asked by the tribunal, to attempt mediation to settle their disputes.

The tribunal then appointed the Secretary General of XAC (Mr Pan) and the arbitrator nominated by the applicants (Mr Zhou) to contact the parties with a proposal that the parties settle the case by the respondents paying 250 million renminbi to the applicants in return for a decision in the respondents' favour (i.e., that the agreement would remain valid). Mr Pan, Mr Zhou and the representative of the respondents then discussed this matter over a dinner at the Xi'an Shangri-la Hotel on 27 March 2010, but later the respondents refused to pay 250 million renminbi to the applicants. Arbitral proceedings resumed, and an award was published on 17 June 2010 in favour of the applicants that the agreement was invalid. When the applicants sought to enforce the award in Hong Kong, the respondents applied to set aside the court's order enforcing the award.

While the court confirmed that there is nothing wrong in principle with an arbitrator acting as a mediator in the same proceedings, the judge expressed serious reservations about the conduct of the arbitrator who acted as mediator in this case, holding that it would cause a fair-minded observer to apprehend a real risk of bias. As such, the award was found to be contrary to public policy in Hong Kong. In the eyes of the court, there were problems with the mediation from the onset, as neither the tribunal

as a whole nor the chief arbitrator conducted the mediation. To add to the problem of apparent bias, Mr Pan and Mr Zhou never conducted a mediation with all the parties present.

This case warns that parties engaged in arbitrations in mainland China, where there is a likelihood of enforcement outside of mainland China, must be careful when engaging in Med-Arb or Arb-Med because any signs of actual or apparent bias exerted by the tribunal may lead to the subsequent award becoming invalid and unenforceable.

The decision is a rare example of the Hong Kong court refusing enforcement of a foreign award on public policy grounds. It has also caused much interest among practitioners and users given the high degree of usage of Arb-Med in many jurisdictions including mainland China. Having said the above, we should also note that the new Hong Kong Arbitration Ordinance, which came into effect on 1 June 2011, allows mediator-arbitrators.

### iii Investor–state disputes

One of the most significant recent developments for investment treaty arbitration with respect to China is the Decision on Jurisdiction and Competence in the case of *Tza Yap Shum v. the Republic of Peru* released on 19 June 2009,<sup>23</sup> which involved interpretation of the investment treaty between China and Peru.

In this case, despite wording in the treaty limiting arbitration to disputes ‘involving the amount of compensation for expropriation’, the arbitral tribunal held that it had jurisdiction to determine questions of liability, namely, whether the claimant had suffered an expropriation by the Peruvian government, and not solely the amount of compensation due.

The claimant in the case, filed with ICSID on 29 September 2006 under the China–Peru BIT, was Tza Yap Shum, a Chinese national resident in Hong Kong. Mr Tza had owned 90 per cent of a Peruvian food products company (TSG Peru SAC, or ‘TSG’), which exported and distributed fish flour. In the suit, Mr Tza claimed that in December 2004, the Peruvian Tax Administration’s allegation that TSG owed a tax debt of 12 million Peruvian new sols and the Peruvian tax authority’s freezing of the company’s bank account a month later (while the company’s legal challenge to the charge was still pending) paralysed the company and resulted in an expropriation for which the company had not been compensated.

The arbitral tribunal reached two particularly significant conclusions with respect to jurisdiction in the case. First, Mr Tza had argued that where a bilateral investment treaty (‘BIT’) does not expressly provide for arbitration of claims of fair and equitable treatment, that limitation could be overcome by operation of the BIT’s most-favoured nation (‘MFN’) clause, which requires the host state to extend investor treatment no less favourable than that extended to investors from third-party states. Mr Tza in this

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23 Since the Decision on Jurisdiction and Competence in the case of *Tza Yap Shum v. the Republic of Peru* released on 19 June 2009, the tribunal held a hearing on the merits of the case during the period of May to June 2010. The tribunal’s decision on the merits is pending at the time of writing.

connection pointed to other BITs (e.g., the Peru–Columbia BIT) that allowed for claims apart from expropriation to be submitted for arbitration, and argued that Peru should extend to the claimant the right to arbitrate such claims.

The tribunal rejected this argument on the grounds that the dispute resolution clause contained in the Chinese–Peru BIT specifically excluded arbitration of other claims except with the separate agreement of the parties. The tribunal held that the specificity of the clause precluded the more general application of the MFN clause.

However, the tribunal also had to decide the scope of the BIT’s dispute resolution provision, which allowed for arbitration of claims ‘involving the amount of compensation for expropriation’. Peru’s argument was that the tribunal could only act when the expropriation had been determined through other means (e.g., by the Peruvian courts) and the tribunal could only decide on the amount of compensation due to the investor. Peru argued that the BIT language did not give the tribunal the latitude to determine whether the tax authorities’ actions constituted an expropriation of Mr Tza’s investment *per se*.

The tribunal rejected Peru’s interpretation, and instead sided with Mr Tza’s argument that a literal and formalistic reading of the BIT was inappropriate and that the tribunal did have jurisdiction to examine more than simply the amount of compensation due. The tribunal based its determination on a number of factors, including the text of the treaty, as well as the negotiating history and the object and purpose of the treaty. Specifically, the tribunal concluded that in order to give meaning to all the elements of the article on expropriation, it must be interpreted that the words ‘involving the amount of compensation for expropriation’ includes not only the mere determination of the amount but also any other issues normally inherent to an expropriation, including whether the property was actually expropriated in accordance with the BIT provisions and requirements, as well as the determination of the amount of compensation due, if any.

Further, the tribunal noted that the BIT’s dispute settlement provision contained a ‘fork-in-the road’ clause that required an investor to make a final and binding choice between submitting claims to domestic courts or arbitration. The tribunal reasoned that to force an investor to first submit to domestic courts to decide on whether an expropriation had taken place would trigger the ‘fork-in-the-road’ clause, effectively precluding recourse to arbitration. The tribunal held that this result would not accord with the object and purpose of the BIT.

This broader reading of the dispute resolution provision gives support for individuals and companies with investments in China, and likewise, Chinese investors in the reciprocal countries, to rely on directly enforceable protections under a wide range of older BITs that were previously thought to be very limited in scope.

Another recent investment arbitration brought by three Chinese companies against Mongolia<sup>24</sup> in relation to the cancellation of a mining licence under the

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24 *China Heilongjiang International Economic & Technical Cooperative Corp, Beijing Shougang Mining Investment Company Ltd and Qinhuangdaoshi Qinlong International Industrial Co Ltd v. Mongolia.*

China–Mongolia BIT shows the increasing reliance of Chinese investors on treaty arbitration to safeguard their rights. The scope of the arbitration clause in the China–Mongolia BIT is similar to that in China–Peru BIT, which was interpreted in the *Tza Yap Shum* case, which limits arbitration to disputes ‘involving the amount of compensation for expropriation’. It remains to be seen what scope of jurisdiction the arbitrators appointed in that case will find for themselves.

Finally, what is believed to be the first ever investment treaty claim filed against China was registered by ICSID on 24 May 2011. The case, *Ekran Berhad v. People’s Republic of China* (ICSID Case No. ARB/11/15), involves a dispute in the sphere of arts and cultural facilities and arises under the Agreement Between the Government of the People’s Republic of China and the Government of Malaysia Concerning the Reciprocal Encouragement and Protection of Investments. No other information is available at the time of this writing.

Apart from the above-mentioned cases, two notable trends in recent BITs entered into by China (e.g., Netherlands–China BIT, Germany–China BIT, New Zealand–China Free Trade Agreement) should be highlighted. The first such trend is that newer Chinese treaties incorporate much broader arbitration provisions covering ‘any dispute concerning investments’. This type of broader arbitration provision was also adopted in the China/ASEAN Investment Agreement 2009,<sup>25</sup> which was signed on 15 August 2009 and came into effect in February 2010. With China’s increasingly significant outbound investments, especially in the area of natural resources, it is likely that China may revisit and renegotiate the older BITs, which have the more restrictive arbitration provision to avail itself to treaty arbitration to protect its overseas investment. The second trend is that recent BITs also allow either contracting party to submit the dispute to an *ad hoc* tribunal. These developments point in the direction of arbitration being a more viable form of dispute resolution for future investor–state disputes involving China or Chinese investors.

### III OUTLOOK AND CONCLUSIONS

As a consequence of the growing Chinese economy and closer economic ties with the global economy, the number and value of China-related arbitration cases are increasing rapidly; more and more cases are administered by arbitration institutions within China. In addition, on a larger scale, Hong Kong and Singapore have become major arbitration centres for international commercial arbitration. The opening of the first overseas ICC branch in Hong Kong on 19 November 2008, and of the new Maxwell Chambers on 22 January 2010 in Singapore, are clear signs of this trend. There are also increasing numbers of internationally renowned arbitrators and counsel relocating to the region, moves that are largely driven by an increase in China-related arbitration.

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25 Agreement on Investment of the Framework Agreement on Comprehensive Economic Cooperation Between the Association of Southeast Asian Nations and the People’s Republic of China.

Despite the positive developments there are still widespread concerns regarding effective enforcement of arbitral awards in China. China is taking a number of positive actions to facilitate enforcement, with the pre-reporting system that has been discussed in the first part of this chapter being the most notable step forward. Another important step was the introduction on 30 March 2009 of a public database on enforcement matters.<sup>26</sup> The database lists all parties subject to enforcement actions by Chinese courts from cases after 1 January 2007 and has approximately 6 million records providing the name of the debtor, ID card number or organisation code, name of the relevant court, case number, executed objects and current status of the case. There are also rules in place that restrict debtors that fail to perform a court judgment or arbitral award and that are subject to enforcement actions from leaving the country, and in extreme cases permit the public security bureau to take the debtor or its directors or officers into custody.<sup>27</sup>

While many aspects of arbitration in China are still less than perfect, practitioners are seeing dynamic developments in China and in the region that, over time, are likely to bring arbitration in China much closer to international standards in connection with arbitral proceedings and enforcement.

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26 <http://zhixing.court.gov.cn>.

27 See 'Several Provisions Regarding Tracking and Controlling Parties Against Whom Enforcement Action is Taken and Their Vehicles', jointly issued by the High Court of Guangdong Province and the Guangdong Provincial Public Security Bureau on 13 September 2009.

## Appendix 1

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