

# Will China follow the trend favouring international arbitration?

<sup>1</sup>Jones Day – Arbitration in China, 2004

<sup>2</sup>Economist Intelligence Unit – 23 October 2008

<sup>3</sup>South China Morning Post – 30 September 2008



As business becomes ever more complex and international, and especially during the current worldwide economic downturn, there is an increasing need for timely and appropriate resolution of cross border disputes. According to a recent study into international dispute resolution, international arbitration remains global companies' preferred dispute resolution mechanism for disputes arising from cross-border trade and/or investment. Furthermore, the larger the value of the dispute, the more likely it is to be resolved through international arbitration. The study, conducted by the School of International Arbitration, Queen Mary, University of London ("SIA"), examines the perceptions and attitudes of major corporations towards international arbitration, through analysis of over 80 questionnaires and through interviews with key members of staff at around 50 large global corporations. In East Asia, the trends relating to

international arbitration are also expected to follow the trend identified in the global report.

Arbitration, as opposed to negotiation, mediation or litigation, refers to the implementation by a third party (or private judge) of a resolution to a dispute, based on a pre-existing contractual Arbitration Agreement. The arbitrator should be impartial to the resolution of the agreement, and have sufficient professional competence to be able to objectively propose a resolution. Either party is entitled to challenge the impartiality of the arbitrator if they feel that this is appropriate. The key difference between arbitration and other methods of dispute resolution is that the third party imposes the result on the other two parties rather than the concerned parties volunteering their own propositions, and the resolution is usually binding to both parties, depending on the terms of the specific contract. Certain industries,

specifically insurance, energy, oil and gas and shipping companies have been found to use arbitration as the default method of dispute resolution, and nearly 90% of the companies included in the survey had used international arbitration.

The overall message of the study is very positive for arbitration lawyers and corporations alike. The study concludes that international arbitration is on the whole effective and most users are satisfied with its outcomes. The majority of cases are resolved satisfactorily, either through a settlement by the parties or voluntary compliance with an award. The settlement often occurs before the first hearing, as the two parties to the dispute seek to preserve key business relationships. Furthermore, there is also a high degree of compliance with arbitration settlements in comparison to other less binding, more ad hoc resolutions. The majority of prevailing parties are also prepared to negotiate a settlement after an award, and sometimes even offer a discount in order to encourage prompt payment.

A perhaps surprising result of the SIA study was that although international arbitration is used most commonly between corporations, over half of the respondents who had sought to enforce awards against states did not encounter any problems, despite a common perception that enforcing this kind of international arbitration would be problematic, particularly with some known difficult countries. However, only 19% of the corporations involved in the study had pursued this kind of action against a state rather than a corporation.

The majority of respondents who took part in the study also favored institutional arbitration rather than ad-hoc arbitration, as they felt that this facilitated a better monitoring system for arbitral awards.

In mainland China, arbitration settlements are governed by the PRC

Arbitration Law (1994), and the Law of Civil Procedure of the PRC (1991). Although these regulations cover both domestic and international arbitration proceedings, there are specific clauses which relate to international arbitration. Two main differences exist between the requirements for domestic arbitration and those relating to international disputes. Firstly, in relation to application to the courts for preservation of evidence, for foreign related arbitrations these are made to the Intermediate People's Court rather than the local level people's court, and secondly, the grounds for setting aside / refusal to enforce a foreign-related arbitral award are more restrictive than those relating to domestic disputes. Both of these differences suggest a commitment to appropriate enforcement of international arbitration cases in China.

A key finding of the SIA report is that despite the high level of voluntary settlement and compliance with arbitration results, not every dispute is settled this easily, and some cases need to be enforced through the local legal system. In emerging market economies such as China, there tends to be a time lag between legislation and effective enforcement, as the law filters down to lower levels. Although the arbitration law is now 14 years old, lack of confidence in the legal system, particularly in relation to international organizations, has perhaps hindered arbitration cases being pursued to enforcement in the mainland. Another piece of legislation in Hong Kong – the Arbitration (Amendment) Ordinance was passed in 2000, which allows cases of arbitration raised by registered institutions on the mainland to be enforced in the courts of Hong Kong. Pressure has been applied to the Chinese Government to make Hong Kong an international arbitration centre, under the one party two systems model. It is particularly suitable due to its

proximity to the mainland, and its high density of professionals, as well as its more developed and experienced institutional and legal infrastructure. Elsewhere in the region, in Singapore, tax exempt status has been given to arbitrators to encourage this method of dispute resolution.

Although there has been an increase in the number of cases referred to the Hong Kong International Arbitration Centre, from 218 in 1997 to 448 in 2007, the increase is not as large as might be expected, considering the findings of the recent report. This could indicate that as international arbitration increases in the region, proportionally more cases of international arbitration are being resolved directly in the mainland, rather than being referred to Hong Kong. As the Chinese legal system becomes more robust, and confidence grows in using mainland courts to enforce legal disputes, it is expected that the trend identified in the SIA report will extend to China, and dispute resolution will remain the favored settlement option in cases of business dispute.

Globally, the study finds that when there are enforcement difficulties in arbitration, most corporations are able to enforce arbitral awards within a year, and are able to recover up to 75% of the claim. If this is not possible, the difficulties in enforcement and collection are most commonly due, not to failure to reach an agreement, but due to insufficient assets of the non prevailing party. The study also discusses complications noted in relation to local enforcement issues, which also present difficulties in achieving settlement. However, the high overall level of voluntary settlement and settlement through enforcement underpins the success of the international arbitration process and justifies the users' confidence in it.