

## Foreign Commercial Dispute Settlement in the People's Republic of China

Sally Lord Ellis

Laura Shea

Follow this and additional works at: <http://digitalcommons.law.umaryland.edu/mjil>



Part of the [International Law Commons](#), and the [International Trade Commons](#)

---

### Recommended Citation

Sally L. Ellis, & Laura Shea, *Foreign Commercial Dispute Settlement in the People's Republic of China*, 6 Md. J. Int'l L. 155 (1981).  
Available at: <http://digitalcommons.law.umaryland.edu/mjil/vol6/iss2/3>

This Articles & Essays is brought to you for free and open access by DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Journal of International Law by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact [smccarty@law.umaryland.edu](mailto:smccarty@law.umaryland.edu).

# FOREIGN COMMERCIAL DISPUTE SETTLEMENT IN THE PEOPLE'S REPUBLIC OF CHINA

SALLY LORD ELLIS\*  
LAURA SHEA\*\*

## I. INTRODUCTION

The new leaders of The People's Republic of China have charted a course of economic progress based on the "four modernizations" of industry, agriculture, science and technology and defense, that is intended to bring the P.R.C. into the forefront of industrialized nations by the year 2,000. Crucial to the achievement of the "modernizations" is the acquisition of foreign technology — ranging from the importation of whole plants to technological "know how". To obtain foreign technology and equipment, China must earn hard currency by developing her exports of manufactured goods and natural resources. Foreign trade<sup>2</sup> is thus an essential element in China's economic plans for the remaining two decades of the century.

China's rapid development of foreign trade has resulted in the increasing complexity of her own domestic handling of trade disputes. Settlement of disputes arising out of foreign trade and business arrangements is not new in China. The course of dispute resolution has developed in a pattern, however, that is uniquely Chinese. Unlike Western models of litigation under civil or common law, Chinese dispute settlement has never relied on either; indeed, the Chinese have traditionally avoided courts as a means for settling disagreements. Instead, China has developed a system of settlement involving non-adversarial and non-litigible techniques — "friendly negotiations," conciliation and joint conciliation, and finally, arbitration.

---

\* Attorney, Office of the Assistant General Counsel for the International Trade Administration, Department of Commerce.

\*\* Office of the Assistant General Counsel for the International Trade Administration, Department of Commerce.

1. The Four Modernizations were announced by Zhou En-lai at the Fourth National People's Congress in 1975.

2. Two-way trade between the United States and China (in millions of dollars) has been: 1976 — \$337.3; 1977 — \$374; 1978 — \$1142.2; 1979 — \$2308.8. *See* U.S. DEPT. OF COMMERCE, U.S.-P.R.C. TRADE TRENDS (March 1980). For 1980 Figures, U.S. DEPT. OF COMMERCE, U.S. TRADE STATUS WITH COMMUNIST COUNTRIES (Mar. 6, 1981).

The recent establishment of "economic courts"<sup>3</sup> has added a fourth dimension to these dispute resolution techniques. But these courts so far have not been fully tested. Most cases to date have involved domestic economic issues, or suits concerning Hong Kong businesses. There is also a question whether, under the recent Lawyers Regulations,<sup>4</sup> foreign counsel would be allowed to appear in court to represent foreign firms.

This paper will examine the institutions and processes for foreign commercial dispute settlement in the P.R.C. There is no body of case law on such settlement. Arbitration cases are usually conducted in private and their results are rarely reported.<sup>5</sup> Rather than recount the cases that are known, this paper will focus on the structure of dispute settlement, and will offer suggestion for its successful use. A brief look will be taken at historical Chinese attitudes towards law and dispute resolution. International arbitration regimes<sup>6</sup> presently being used by other countries will then be discussed.

Next, China's four dispute settlement techniques of "friendly negotiations," conciliation, joint conciliation and arbitration will be examined in detail. Particular emphasis will be given to conciliation, which is a pre-arbitration step much favored by the Chinese, and arbitration, which to the foreign observer, is the most structured and most readily intelligible. The two arbitration commissions set up under the China Council for the Promotion of International Trade (CCPIT) will be analyzed. The foreign arbitration systems the Chinese recognize, notably the UNCITRAL rules, will also be reviewed.

---

3. The first economic courts were set up in 1979 and 1980 in Tianjin, Beijing and Guangzhou.

4. The Provisional Regulations on Lawyers were adopted by the 15th Session of the 5th NPC Standing Committee on 26 August, 1980. The controversial section which may limit practice of law in the P.R.C. to Chinese citizens is Article 8, which states, in pertinent part: "These citizens who cherish the PRC, support the socialist system and have the right to elect and be elected are eligible to be lawyers after passing an examination and if they have the following qualifications . . ."

5. There are some seventy-five conventions, draft uniform laws, agreements, enactments and arbitration rules dealing with the use of arbitration of international disputes. See Kerr, *International Commercial Arbitration*, J. BUS. L. 164, 167 (May 1980) (hereinafter cited as *Kerr*), which cites a compilation, *INTERNATIONAL COMMERCIAL ARBITRATION*, (2d ed. Clive M. Schmitthoff, ed. 1979). The New York Convention is the most important of the conventions, having replaced the Geneva Protocol of 1923 and the Geneva Convention of 1927. A useful yearbook on arbitration and awards has been published since 1967 by the International Council for Commercial Arbitration (ICCA).

The advantages and disadvantages of using Chinese dispute settlement institutions will be considered next. Practical advice to lawyers advising foreign clients doing business in the P.R.C. will be offered in particular, suggestions for a model arbitration clause will be made, and questions of interpreting aspects of such a clause will be discussed.

Finally, conclusions will be drawn on the future of China's dispute resolution institutions and processes, with a focus on the increased willingness by the Chinese to use other countries as fora for arbitration cases.

## II. CHINESE ATTITUDES TO LAW AND DISPUTE SETTLEMENT

The Chinese have traditionally had an aversion to courts of law because they associate litigation with penal codes and punishment. This attitude toward law and courts may be traced back to the Legalists, such as Han Fei (d.233 B.C.) and Li SSu (d.208 B.C.), who helped the first emperor of the Ch'in Dynasty unify China through a system of rules and regulations.<sup>6</sup>

The association in the Chinese mind between courts and criminal law has continued to the present day. A criminal code was among the first laws to be enacted in 1979 when the Chinese began drafting laws after the Cultural Revolution.<sup>7</sup> China's legal system has developed into a criminal system, rather than a civil one. Domestic disputes of a civil nature have been traditionally resolved informally by the head of an extended family or by the elders in a village. Since 1949, these types of disputes have continued to be settled informally — through the People's Mediation Committee<sup>8</sup> in the individual communes. Informal resolution of disputes is preferred, hence very few civil cases are brought before the People's Court for formal litigation.<sup>9</sup>

---

6. Many of the writings of Han Fei and Li Ssu survive today. For a general history of the Ch'in Dynasty, see 1 *SOURCES OF CHINESE TRADITION*, (De Bary ed.) (1970); REISCHAUER AND FAIRBANK, *EAST ASIA THE GREAT TRADITION* (1972). A recent excavation in China has unearthed more laws from the Ch'in era, when the tomb of a judge who was buried with legal documents inscribed on bamboo slips was opened. Li Xueching, from the Antiquities Research Department of the Science Academy in Beijing gave a lecture at the University of Washington in Seattle on the recent excavations in the summer of 1979. See *Kao Ku* (Antiquities) for more information on excavations.

7. After the Cultural Revolution, the P.R.C. began promulgating a number of laws to establish order and encourage trade. In July 1979, the New Criminal Law and Law of Criminal Procedure were adopted at the Second Session of the Fifth National People's Congress. See 33 *Beijing Review*, Aug. 17, 1979. For a discussion of traditional views of Chinese toward criminal law and criminal law from 1949 to 1963 see generally COHEN, J., *THE CRIMINAL PROCESS IN THE PEOPLE'S REPUBLIC OF CHINA* (1968).

8. A thorough description of the People's Mediation Committees and criteria used in resolving domestic disputes can be found in Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 *CALIF. L. R.* 1284 (1967).

9. A first-hand account of trial processes is given in Paragon, *The Administration of Justice and Law in New China*, 83 *Case & Comment* 49 (Nov.-Dec. 1978).

The spate of recent laws dealing with foreign trade — the Joint Venture Law, the Individual Income Tax law, and the Joint Venture Income Tax law,<sup>10</sup> as well as a host of regulations affecting foreign trade<sup>11</sup> — has been both remarkable and encouraging. They are remarkable in that the laws represent a break from China's strict import-export method of trade and reflect a determination to become more competitive in world markets by modernizing the structure and bases of their foreign trade system, and they are encouraging in that the laws represent a commitment by China's rulers that the legal aspects of foreign trade will be made more responsive to international trade practices.

### III. INTERNATIONAL ARBITRATION SYSTEMS

Arbitration of commercial disputes arising out of foreign trade is a well established system of settlement in the international arena. In the view of a British authority on the subject, "in international cases where jurisdictional problems are bound to arise in the event of dispute, the practice of incorporating arbitration clauses into contracts is becoming almost universal."<sup>12</sup>

Since the founding of the International Chamber of Commerce (ICC)<sup>13</sup> over a half a century ago, a number of different regimes for international arbitration has been established: the Rules of the International Centre for the Settlement of Investment Disputes (ICSID) (under the authority of the World Bank in Washington);<sup>14</sup> the Commerce Arbitration Rules of the

10. The Law of the P.R.C. on Joint Ventures Using Chinese and Foreign Investment (hereinafter referred to as the Joint Venture Law) was adopted July 8, 1979. The law has been reprinted in several journals. See *Beijing Review*, July 20, 1979 at 24-6, for the first publication of the law. The Joint Venture Income Tax Law and the Individual Income Tax Law were adopted September 10, 1980. See "NPC Standing Committee Issues New Laws", Foreign Broadcast Information Service, PRC, Sept. 16, 1980, at L16-22. The individual income tax law has the practical effect of taxing foreigners. Very few Chinese will be taxed under the law.

11. Some recent regulations that concern foreign investors include: Regulations on the Registration of Joint Ventures Using Chinese and Foreign Investment; Regulations on Labour Management in Joint Ventures Using Chinese and Foreign Investment; and Regulations on Special Economic Zones in Guangdong Province. These regulations were approved by the State Council, Jul. 26, 1980.

12. *Kerr*, *supra* note 5, at 164.

13. The International Chamber of Commerce Rules of Conciliation and Arbitration were revised in June 1975. Conciliation is optional. A copy and summary of the revised rules are in 1 *YEARBOOK — COMMERCIAL ARBITRATION*, (P. Sanders, I.C.C.A. eds.), at 157-170 (1976).

14. The I.C.S.I.D. Regulations and Rules are effective as of Jan. 1, 1968.

American Arbitration Association (AAA);<sup>15</sup> the U.N. Commission on International Trade Law (UNCITRAL);<sup>16</sup> the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce;<sup>17</sup> the Council for Mutual Economic Assistance (COMECON)<sup>18</sup>; the Economic Commission for Asia and the Far East (ECAFE);<sup>19</sup> and the Council for Mutual Economic Assistance (EMEA).<sup>20</sup>

Communist and non-Communist countries alike have turned to arbitration. The Soviet Union and the East European Communist countries belong to COMECON. The Communist bloc, the United States and the majority of the world's leading trading nations have signed the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards.<sup>21</sup> Enforcement of awards is required by the Convention. Although the P.R.C. is not a signatory to the convention it has abided by arbitration awards involving its domestic corporations and nationals.<sup>22</sup>

---

15. The Commercial Arbitration Rules of the AAA were amended Jan. 1, 1980. Although the American Arbitration Association is one of the most important arbitration institutes, no site in the U.S. has assumed an influential position for arbitration.

16. The UNCITRAL Arbitration Rules and a commentary are in 2 YEARBOOK — COMMERCIAL ARBITRATION at 161–219 (1977). A revised draft of the UNCITRAL Conciliation Rules was made public at the 13th session of UNCITRAL in June 1980.

17. A copy of the Rules of the Arbitration Institute of Stockholm Chamber of Commerce can be found in 3 YEARBOOK — COMMERCIAL ARBITRATION, at 254 (1978).

18. The Arbitration Rules Under General Conditions of Delivery of Goods Between Organizations of the Member Countries of the Council for Mutual Economic Assistance is reproduced in 1 INTERNATIONAL COMMERCIAL ARBITRATION (C.M. Schmitthoff ed.), at 1–169 (1976).

19. The Economic Commission for Asia and the Far East (ECAFE) has been changed to the United Nations Economic and Social Commission for Asia and the Pacific. The ECAFE rules were adopted by the Economic Commission for Asia and the Far East during the twenty-second session held in New Delhi, India from March 22 to April 4, 1966. The Rules are reprinted in 1 YEARBOOK — COMMERCIAL ARBITRATION, at 1–161 (1976).

20. An introduction to arbitration in socialist countries and the rules of procedure in arbitration courts at the chambers of commerce of CMEA countries is in 1 YEARBOOK — COMMERCIAL ARBITRATION, at 4–17, 147–156 (1976).

21. The U.S. acceded to the Foreign Arbitral Awards Convention in 1970, 3 U.S.T. 2517 T.I.A.S. 6997, and Congress gave it practical effect by amendment to the Arbitration Act (9 U.S.C. 201 ff.).

22. As to the enforcement of a foreign arbitral award in China, although China is not a member of international conventional conventions for the enforcement of foreign arbitral awards, the Chinese corporations and enterprises will, in fact, execute foreign arbitral awards so long as they are fair and not in violation of Chinese laws and policies. In case of non-execution, the party requesting enforcement of the award may petition the relevant government departments of China or the CCPIT to push the enforcement or appeal to the Chinese court to enforce it in accordance with the law. Ren Tsien-Hsin [sic] and Lin Shao-Shan, "People's Republic of China," 3 YEARBOOK — COMMERCIAL ARBITRATION, at 160 (1978) (hereinafter cited as *Ren*).

In the United States the use of arbitration to settle international trade disputes, despite the availability of judicial remedies through the courts, has been well established. In *Scherk v. Alberto Culver*, 417 U.S. 506 (1974), the American plaintiff respondent had purchased three enterprises from a German citizen in a sales contract which provided that any claim arising out of a breach of the contract would be referred to arbitration before the ICC in Paris. Discovering that the trademark rights under the contract were subject to substantial encumbrances, the respondent sued in federal court for damages under the Securities Exchange Act.

Writing for the Court, Justice Stewart cited the U.S. Arbitration Act,<sup>23</sup> as "reversing centuries of judicial hostility to arbitration agreements"<sup>24</sup> and as being "designed to allow parties to avoid the costliness and delays of litigation and to place arbitration agreements 'upon the same footing as other contracts.'"<sup>25</sup> Respondent's resort to a federal court when both parties had agreed to arbitrate, Stewart emphasized, could not be judicially upheld:

A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages.<sup>26</sup>

Justice Stewart concluded that "the agreement of the parties in this case to arbitrate any dispute arising out of their international commercial transaction is to be respected and enforced by the federal courts" in accord with the Arbitration Act.<sup>27</sup>

International dispute settlement through arbitration is not just a means to avoid the rigors and risks of litigating in an opponents' national court system. The advantages of arbitration over litigation, even at the risk of a hearing set in a foreign country, and the use of foreign law and procedures, have become apparent to international businessmen, if not lawyers. Arbitration is generally quicker and more inexpensive. Its procedures, while formalized by any of the international sets of rules, are simple compared to the complex litigation rules and procedures of many court systems. Perhaps most importantly for the businessman who wants to maintain good relations with a foreign trading partner, or country, arbitration tends to avoid, or lessen, the often acrimonious confrontation of adversaries found in courtroom litigation.

---

23. 9 U.S.C. § 1 *et seq.* (U.S. Arbitration Act).

24. *Scherk v. Alberto Culver*, 417 U.S. 506 (1974).

25. *Id.* at 517.

26. *Id.* at 517.

27. *Id.* at 520-21.

## IV. CHINESE SETTLEMENT TECHNIQUES

A. *"Friendly Negotiations" and Conciliation*

Most Chinese standard form contracts contain clauses calling for "friendly negotiations" as the first stage in the settlement of a claim.<sup>28</sup> The next step, although it is often not spelled out as such, is normally conciliation, or joint conciliation. Finally, if these fail, contract clauses generally provide for arbitration.

Specific examples of the kinds of contracts containing arbitration clauses are: bilateral trade and shipping agreements between Chinese corporations and foreign firms; general conditions for delivery of goods, signed by the P.R.C. and foreign governments; and, general contracts between private foreign firms and Chinese enterprises and corporations. The new Joint Venture law explicitly calls for settlement of disputes through arbitration.<sup>29</sup>

"Friendly negotiations" is a Chinese term to describe what Westerners would consider simply discussions. Each party presents his views as to the correctness of his position and, in a non-confrontational way, both sides attempt to agree on a solution. No third party is involved.

If the parties fail to resolve their differences through discussions, they are encouraged, usually by the CCPIT, (whose role will be elaborated on) to consider conciliation. Conciliation can only be encouraged; it is not mandatory.

Conciliation has had a long tradition in China, chiefly as an instrument for solving domestic civil disputes. Shortly after the founding of the People's Republic, "The Provisional General Rules for the Organization of the People's Conciliation Committee"<sup>30</sup> were issued. These rules laid down the principles and organization for conciliation. People's Conciliation Committees were set

---

28. The following is an example of a standard purchase contract arbitration clause: "All disputes in connection with this Contract or the execution thereof shall be settled through friendly negotiations. In case no settlement can be reached, the case may then be submitted for arbitration to the Arbitration Committee of the China Committee for the Promotion of International Trade in accordance with the Provisional Rule of Procedures promulgated by the said Arbitration Committee. The arbitration shall take place in Peking and the decision of the Arbitration Committee shall take place in Peking and the decision of the Arbitration Committee shall seek recourse to a law court or other authorities to appeal for revision of the decision. Arbitration fee shall be borne by the losing party. LAW AND POLITICS IN CHINA'S FOREIGN TRADE, at 403 (Li ed. 1977). For complete examples of standard form contracts, see the appendices of LAW AND POLITICS.

29. Article 14 of the P.R.C. Joint Venture Law states: "Disputes arising between the parties to a joint venture which the Board of Directors fails to settle through consultation may be settled through conciliation or arbitration by an arbitral body of China or through arbitration by an arbitral body agreed upon by the parties."

30. *Ren, supra* note 22, at 155.



up to resolve civil disputes. Conciliation became a characteristically Chinese form of settlement in the "new China":

Conciliation (not only) solves civil disputes in a simple and timely way but also help(s) to propagate and educate the masses with government policies and decrees, to familiarize them with such policies and decrees, to promote their political consciousness and law-abiding concept and to prevent and minimize the occurrence of civil disputes.<sup>31</sup>

Foreign arbitration institutions, such as the AAA, have recognized the Chinese preference for conciliation. It has been reported by the AAA that in recent years the Chinese have settled over 90% of all foreign trade disputes by conciliation.<sup>32</sup> Recognizing the P.R.C. preference for conciliation, the AAA has held discussions with the CCPIT Legal Affairs Office with a view to establishing procedures for conciliation. In October 1976, it was announced that joint conciliation of disputes could be arranged one conciliator being appointed by each of the parties<sup>33</sup> between the CCPIT and the AAA. No formal agreement was entered into, however, and according to one expert in the field, Howard Holtzmann, the two organizations are proceeding on a pragmatic basis, "developing mutual experience and refining procedures."<sup>34</sup>

Approximately two years ago, joint conciliation was used when a company from the United States and a corporation in the P.R.C. had a disagreement. The AAA appointed a conciliator for the U.S. side and the CCPIT appointed a conciliator for the Chinese side. An agreement was reached and formal arbitration was not used.<sup>35</sup>

---

31. *Id.*

32. The American Arbitration Association mission to China in 1975 was told that although the Chinese do not keep detailed statistics on cases handled, temporary statistics for 1974 indicate that more than 100 cases were settled through friendly negotiations. See H. HOLTZMANN, *LEGAL ASPECTS OF DOING BUSINESS WITH CHINA* 83 (1976) (hereinafter cited as *Legal Aspects*). The AAA was told that over 90% of all disputes in foreign trade have been resolved by conciliation without need of recourse to arbitration. Holtzmann, *Dispute Resolution Procedures in East-West Trade*, 2 *INTL. LAWYER* 233-251 (1979) (hereinafter cited as *Holtzmann*).

33. American companies having disputes are invited to seek AAA help in initiating conciliation and Chinese trading organizations have been informed by the CCPIT of the availability of the joint service. *Id.* at 249.

34. *Id.*

35. The "Cotton Case" is the first example of joint conciliation by an American company in the P.R.C. The case was discussed by Robert Meade of the American Arbitration Association at an international business law seminar held in New York December 4-5, 1980.

The actual work of conciliation can be carried on by the working arm of the two arbitration commissions of the CCPIT — the Legal Affairs Office.<sup>36</sup> Conciliation may be conducted either through correspondence or face-to-face. The conciliators base their examination of the facts and issues on the prerequisite of a clear demarcation of right and wrong, and ascertained liabilities.<sup>37</sup> They then make recommendations to the parties for settlement. A "conciliatory statement" is often drawn up, provided that both parties are in agreement about the settlement. If, however, one or both parties reject the conciliators' recommendations, they may proceed with arbitration.

Chinese confidence in conciliation as a settlement technique is reflected in the fact that most trade disputes are resolved by its use, rather than by arbitration. Conciliation does not stand in isolation, however, from arbitration. As the head of CCPIT's Legal Affairs Office, Ren Jianxin has stated: "To combine arbitration with conciliation is one of the striking characteristics of China's arbitration work."<sup>38</sup> While conciliation can be pursued as an intermediary step between friendly negotiations and arbitration, it can also be used in conjunction with, and simultaneously with, arbitration, as "an organic combination interrelating and complementary to each other."<sup>39</sup> So long as the parties agree, conciliators can act on their behalf and conduct discussions even during the proceedings before an arbitration tribunal.

Conciliation, arbitration and friendly "consultations" are all called for in the 1979 Trade Agreement between China and the United States.<sup>40</sup> Article VIII provides that each side shall encourage the settlement of disputes between its firms, trading organizations, etc. "through friendly consultations, conciliation or other mutually acceptable means." Failure to settle through

---

36. An introduction to the functions of the CCPIT are outlined by Tseng Chun-wei, a Research Fellow at CCPIT. See *CHINA'S FOREIGN TRADE AND ITS MANAGEMENT*, at 113-28 (1978).

37. *Id.* Conciliation is usually thought of as a pre-arbitration step but it can also

37. Ren, "Legal Aspects of China's Technology Import and Utilization of Foreign Investment," *ECONOMIC REPORTER*, Sept. 1980, at 8.

38. *Id.* Conciliation is usually thought of as a pre-arbitration step but it can also be combined with arbitration. The steps that are usually followed, according to Ren Jianxin, are: "First, combining mediation with arbitration . . . Second, joint mediation: If there are disputes, the Chinese investors take the disputes to the China Arbitration Commission and the foreign investor takes the dispute to their own country's arbitration commission separately, and the two commission then mediate. Third, investigation and study: making an on-the-spot investigation of the bilateral agreements or inviting both Chinese and foreign arbitrators to join in the work." *TA KUNG PAO*, "Forum on China's Foreign Trade Arbitration," at 15 (Oct. 2, 1980).

39. *Id.*

40. Trade Relations Treaty of 1979, T.I.A.S. 9630 (hereinafter cited as *Treaty*).

these means may result in the parties seeking arbitration "in accordance with provisions specified in their contracts." Specifically, arbitration

may be conducted by an arbitration institution in the P.R.C., the United States of America, or a third country. The arbitration rules of the procedure of the relevant arbitration institution are applicable, and the arbitration rules of the United Nations Commission on International Trade Law recommended by the United Nations, or other international arbitration rules, may also be used where acceptable to the parties to the dispute and to the arbitration institution. (Paragraph 2).<sup>41</sup>

### B. *Arbitration*

When discussing arbitration in China, one is really only discussing the two arbitration commissions which form part of the CCPIT: the Foreign Economic Trade Arbitration Commission (FETAC) and the Maritime Arbitration Commission (MAC).<sup>42</sup> In addition, most cases taken to arbitration are conducted in private, and the results left unpublished. Discussion of arbitration is therefore to arbitration hearings before these two institutions. Compared to the current crop of economic and commercial laws, these two bodies may be considered venerable legal institutions in the P.R.C. In 1954 the decision was made to establish a "Foreign Trade Arbitration Commission" within the CCPIT. Two years later both commissions were set up and Provisional Rules of Procedure were published for the Foreign Trade body.<sup>43</sup>

Both FETAC and MAC are responsible for all arbitration cases arising from "foreign economic exchange under the auspices of the CCPIT." MAC takes cognizance of disputes arising out of maritime contracts, collisions between sea-going vessels, and the like. FETAC exercises jurisdiction over disputes arising out of the following:<sup>44</sup>

- joint ventures between foreign companies and Chinese corporations and enterprises;

41. *Id.*, at Article VIII para. 2.

42. The charter and rules of procedure for both the FETAC and the MAC are published in 3 YEARBOOK — COMMERCIAL ARBITRATION P. Sanders, ed.), at 243-49 (1978). The scope of disputes handled by the FTAC was expanded and the Commission was renamed the Foreign Economic and Trade Arbitration Commission (FETAC) in February 1980.

43. The "provisional rules" for both Commissions are still in effect. Conversation between Sally Lord Ellis and Li Wei, First Secretary of the P.R.C. Embassy in Washington, D. C., Mar. 13, 1981.

44. Since the focus of this paper is on foreign trade disputes rather than on maritime disputes, FETAC will be the frame of reference.

- the building of factories and facilities in China;
- credits extended to the P.R.C. by foreign countries and institutions;
- the introduction of foreign technology;
- co-production by the P.R.C. and foreign firms;
- cooperative production;
- processing businesses with materials supplied by foreign firms; and
- compensation trade.

FETAC is composed of 15–21 members (arbitrators)<sup>45</sup> selected and appointed by the CCPIT on the basis of their knowledge and experience in foreign trade, industry, agriculture, transportation, insurance, and other related areas, as well as in law. They are appointed for one year terms.

There are three guiding principles under which both commissions operate:

- (1) equality and mutual benefit;
- (2) independence and initiative;
- (3) consideration of international practice.<sup>46</sup>

"Equality and mutual benefit" have been interpreted as requiring that the treatment of all countries, regardless of size or influence, be on an equal basis.<sup>47</sup> This particular principle, or policy, has political meaning to the Chinese, who view arbitration, as they do other aspects of their law, in a political context:

The Chinese Commissions are opposed to despotic hegemonism in international trade and marine transport through deceit and blackmail, the big bullying the small and the strong domineering the weak; they are equally opposed to great-power chauvinism and national egoism in making use of arbitration to favour the party of their own nationality.<sup>48</sup>

The policies of giving due regard to international practice, and yet maintaining independence and initiative may seem in conflict. They are, however, part of a balancing that the Chinese seek, between the demands of

---

45. Although the Chinese expect that the number of arbitrators will be increased, they have not done so as of this writing.

46. China Council for Promotion of International Trade — *CCPIT Legal Affairs* booklet (1980), at 18.

47. *Id.*

48. Chiang Chi, "Arbitration Cadres Planed [sic] to Set Up in China's Coastal Cities," *ECONOMIC REPORTER*, Sept. 1980, at 29 (hereinafter cited as *Chiang*).

their own domestic interests and the requirements of international arbitration practices, to which they must conform if they are to develop their foreign trade. Howard Holtzmann has pointed out that the opposing nature of the policies actually adheres to the Maoist dialectic theory, whereby a thesis is opposed by an antithesis, with the result of a synthesis, representing the correct approach.<sup>49</sup>

Arbitration can arise out of two kinds of agreements: either an agreement signed before the dispute arises, usually in a contract, or in one signed after the dispute has arisen — "an agreement of submission for arbitration." Application is made to FETAC, and must contain the following information: the names and addresses of both parties; the claim of the plaintiff and the facts and evidence on which the claim is based; the name of the arbitrator chosen by the plaintiff from among FETAC members, or a statement authorizing the chairman of FETAC to appoint an arbitrator, and original copies or certified duplicates of all relevant documents.<sup>50</sup>

After the application is received, the parties may be urged by FETAC, unless they have already taken the steps, to engage in friendly discussions or conciliation.

The plaintiff must deposit a sum equivalent to 0.5 percent of the amount of his claim. The defendant must then respond within 15 days. In his response, the defendant may raise objections to the claim, or make a counterclaim (which cannot exceed the scope of the arbitration agreement). In addition, in his response, the defendant should indicate a preference for an arbitrator selected from the Commission.<sup>51</sup>

There may be either one or three arbitrators. In the case of each side choosing one, the arbitrators so selected can jointly choose a presiding arbitrator from the commission. The disputing parties can also choose a sole arbitrator. In the event that either or both parties do not know whom to select from the commissions, they may request that the chairman of the commission appoint an arbitrator on their behalf. It is within the authority of the commission to change an arbitrator if the opposing party challenges him with good reason.

The Provisional Rules for FETAC stipulate that the case should be heard in open session. Upon the request of either party, however, the hearing may be held in closed session. Both parties must produce evidence. The

---

49. Holtzmann, *supra* note 32, at 86-88.

50. Yuan Li-wu, *China's Foreign Trade Arbitration*, CHINA HANDBOOK, at 69 (1973).

51. *Id.*

examination, verification and evaluation of evidence shall be handled at the discretion of the tribunal.<sup>52</sup>

When it is necessary or appropriate, the tribunal may notify witnesses to provide testimony. The tribunal also has the authority to take the initiative to consult experts, conduct investigative research and to collect evidence and material. Protective measures<sup>53</sup> related to the property in dispute may also be taken — called “Provisional measures” — such as in the case of perishable goods which may be held in custody in order to protect the interest of the parties in the goods, and to prevent one party from jeopardizing the arbitration proceeding by selling off or removing the property. The chairman of FETAC, pursuant to the Provisional Rules, may prescribe provisional measures concerning property rights, materials.<sup>54</sup>

Both sides may be represented by counsel before the tribunal. Attorneys may be either Chinese citizens or of foreign citizenship. The CCPIT Legal Affairs Office has a list of part-time lawyers which it will make available to foreign businesses which seek to be represented by Chinese counsel. It is also possible to hire one of the full-time lawyers on the Legal Affairs staff, as the Chinese legal profession does not operate under the same conflict of interest strictures as do American lawyers.<sup>55</sup>

Hearings are generally held in Beijing, but may be conducted in other cities approval of the Chairman of FETAC.<sup>56</sup>

FETAC has been using its own rules since its inception in 1956, but although the Chinese prefer to follow their own rules, UNCITRAL Rules may be used in ad hoc arbitration., or upon agreement by the parties and the arbitration institution.<sup>57</sup> There are no known cases where FETAC has used procedural rules other than its own.<sup>58</sup>

In the case of a three-man tribunal, a majority vote decides the case, and reasons are given for the decision. The decision is given in Chinese, with

---

52. Provisional Rules of FETAC.

53. *Id.* (no. 15).

54. *Id.*

55. Interview by Sally Lord Ellis with Shao Xunji, an official of CCPIT in Beijing, November 21, 1980 (hereinafter cited as Shao Interview).

56. 1978 YEARBOOK, at 158.

57. *See Treaty, supra* note 40.

58. Ren Jianxin pointed out how the FETAC handles cases in a speech entitled “Some Legal Aspects of Our Import of Technology and Utilization of Foreign Investment” given at a meeting sponsored by the Chinese General Chamber of Commerce in Hong Kong, September 29, 1980. While he did mention examples of new developments in arbitration agreements such as the increasingly popular use of a third country as a forum for arbitration and the joint conciliation procedure that has been applied, he did not make mention of any cases where UNCITRAL rules have been used in ad hoc arbitration.

translations into the appropriate foreign language. (The proceeding is to be conducted in Chinese, but if a foreign party needs and does not have an interpreter, the tribunal may designate one for him.)

The principal part of the arbitration award must be read to the parties; the full award, together with the reasons for the decision, should be put in written form. An award is final. It may not be appealed to a court of law or any other institution.<sup>59</sup> In the case of a dispute between American and Chinese parties, enforcement of the award is recognized and enforced by the Trade Agreement.<sup>60</sup> China is not a signatory to the Convention on the enforcement of awards, but there have been no known cases where the Chinese have refused to enforce an award. There has also never been a case where a petition has been made to a people's court because of a Chinese corporation's failure to execute an award, although this procedure is provided for.<sup>61</sup>

The arbitration fee shall be written into the award and shall not exceed one percent of the claim under FETAC (for MAC the figure is two percent.)<sup>62</sup>

### C. *The Economic Courts*

Within the last year courts in at least three cities have begun handling cases involving economic relations with foreign investors. The economic section under the Tianjin, Guangzhou and Beijing Intermediate People's Courts are authorized to hear cases involving foreign trade, maritime affairs, insurance, Chinese-foreign joint ventures, and a number of other economic-related subjects.<sup>63</sup> Thus far, most cases have involved domestic economic issues, or issues concerning overseas Chinese businessmen.

The courts are more likely to be fora for disputes between a joint venture company (between a Chinese corporation and a foreign company) and a third party. Past practice of setting disputes arising between two Chinese companies has been to submit the problem to the highest level in the organization where the issue is resolved through negotiations. This has been practical in the past because both entities have been state-owned. This may not be a workable method if one of the party's opponents is a foreigner.

---

59. Provisional Rules of FETAC.

60. *See Treaty, supra* note 40.

61. *Ren, supra* note 22, at 72.

62. Provisional Regulations (FETAC).

63. "Tianjin Ribao: Courts Set up for Economic Cases," *FBIS Daily Report PRC*, 5 Nov. 1979, at R 4.; Beijing Court to Handle Economic Disputes," *FBIS Daily Report PRC*, 16 Jan. 1980, at L3; Guangzhou Court Begins Handling Cases Involving Foreign Economic Relations," *China Economic News*, at 4 (24 March 1980).

The procedure for hearing a case in court requires that the dispute first be arbitrated at two levels. If a party does not accept, he may appeal to the intermediate People's Court within ten days after arbitration.<sup>64</sup> The fact that arbitration awards of the FETAC and the MAC are not appealable to the courts indicates that for the moment at least, the new courts will be used primarily for *local* economic-related cases.

The new Lawyer Regulations require Chinese nationality for a lawyer practicing in Chinese courts. Thus, litigation in the economic courts, unlike arbitration, would require the hiring of Chinese counsel.<sup>65</sup>

China's trade agreement with the United States — in which the P.R.C. agrees to use UNCITRAL rules, and to allow a third country arbitration site — is but one indication of increased willingness to conform to international practice. Informally, China has agreed on several foreign cities as natural territory, including Toronto (in 1974), Stockholm, London and Switzerland.<sup>66</sup> The Schindler Joint Venture Company agreement, for example, stipulated that arbitration would be held in Stockholm, using British law.<sup>67</sup> A recent case, reported in the *All England Law Reports*, used London as the forum for arbitration, and also applied British law.<sup>68</sup> In that case, the China National

---

64. Following the Party Central Committee guidelines, "[D]isputes arising in implementing economic contracts must be first arbitrated by the economic committees at all levels, the departments in charge of economics and the industry and commerce administrative departments. After arbitration is conducted at two levels, if a party does not accept, he can appeal to the intermediate People's Court within 10 days after the arbitration. See 'Tianjin Ribao': Courts Set up for Economic Cases," *FBIS Daily Report PRC*, 5 Nov. 1979, at R 4.

65. Article 8 of Provisional Regulations on Lawyers, which were adopted at the 26 August 1980 meeting of the NPC Standing Committee stipulates: "Those citizens who cherish the PRC, support the socialist system and have the right to elect and be elected are eligible to be lawyers after passing an examination and if they have the following qualifications . . ." No. 18 of the Provisional Regulations on arbitration states, "A disputing party may confer with the Arbitration Commission on matters relating to the proceedings in person or by attorney. Such attorneys may be citizens of the People's Republic of China or foreign citizens." See *supra*, note 4.

66. "Arbitration case ends in UK House of Lords," *CHINA BUSINESS REPORT* (May 1980), at 10 (hereinafter cited as *China Report*).

67. The original arbitration clause in the agreement for the Schindler Joint Venture Company stipulated that arbitration would be held in London in accordance with the arbitration rules of the International Chamber of Commerce. The change was required by the Foreign Investment Commission. The ICC is not acceptable because Taiwan uses those rules. For more information on the Schindler Joint Venture see P. Loong, *Schindler's Ups and Downs*, *FAR EASTERN ECONOMIC REVIEW*, Jul. 11, 1980; see also *China Economic News*, Jul. 14, 1980, at 8.

68. The case, reported in the *ALL ENGLAND LAW REPORTS* 2 All ER, (1979), at 1044, was between the China National Foreign Trade Transportation Corporation and Evlo-



Foreign Trade Transportation Corporation had hired a vessel on a "time charter" from Greek ship owners. When the Chinese company claimed certain deductions in their payment, the Greeks withdrew the ship, forcing the Chinese to hire another and incur additional expenses. The London arbitrators held in favor of the Chinese. The case was then appealed to the Commercial Court, the Appeals Court, and finally, to the House of Lords, which confirmed the arbitrator's judgment in favor of the ship owners.<sup>69</sup>

As well as allowing alternative sites to Beijing, the P.R.C. is increasingly open to the use of other arbitration rules,<sup>70</sup> notably UNCITRAL rules.

The UNCITRAL rules are a model set of rules which are made available to businessmen, regardless of nationality, throughout the world. They require no ratification by any government, and they only carry the force of "law" when they are agreed upon for use by parties. The U.N. General Assembly merely recommends their use in commercial relations. Unlike the rules drafted by arbitration bodies and chambers of commerce, the UNCITRAL rules are unique in that they were drafted by both Communist and non-Communist members and are the only rules emanating from an international body.

China is not a member of UNCITRAL and did not participate in the drafting of the Rules.<sup>71</sup> There are a number of similarities between the Rules and China's Provisional Regulations for FETAC and MAC. For example, both rules allow witnesses,<sup>72</sup> and the arbitral tribunal to present evidence. However, the arbitration tribunal retains the power to determine how evidence will be examined.<sup>73</sup>

gia Shipping Co. SA of Panama. For a summary of the case see *Arbitration Case Ends in UK*, at 11 (hereinafter cited as *Arbitration in UK*). London Rules of Arbitration no longer stipulate that an arbitration decision may be appealed to English Courts. Arbitration awards in England are now final and binding. See ARBITRATION ACT OF 1979.

69. *Arbitration in UK*, *supra* note 68.

70. The International Chamber of Commerce Rules are not used by the P.R.C. because Taiwan is one of the sites for I.C.C. arbitration. *Shao interview*, *supra* note 55.

71. Although the P.R.C. is not a member of UNCITRAL, it does not oppose the action in recommending them. Article 8 of the Trade Relations Treaty between the United States and the P.R.C. specifically mentions the UNCITRAL Rules for Arbitration. An article illustrating the advantages of arbitration under UNCITRAL is *Holtzmann supra* note 32, at 239.

72. UNCITRAL Rules, Article 15.2.

73. The FETAC Rules refer to the use of witnesses to present evidence. Number 22 of the Rules states: "The Arbitration Tribunal may require the parties or their attorneys, witnesses or other persons to sign their names on the records for purpose of evidence." Number 26 states: "The Examination and appraisal of evidence shall be performed by the Arbitration Tribunal at its discretion." FETAC Rules of Procedure.

Arbitration in China — despite the age and experience of the two arbitration commissions — is still not widely used, or trusted, by foreign businessmen. The acceptance of a non-Chinese forum and non-Chinese arbitration rules may lessen foreign uncertainty or mistrust, but problems remain with the arbitration procedures as they are. The Provisional Rules require that arbitrators are to be chosen from the members of the commissions. It is unclear if only *Chinese* arbitrators are allowed to sit on the tribunal. Foreigners are not expressly forbidden, and there have been reports that in 1978 an English official of the Chartered Institute of Arbitrators was asked to arbitrate in a number of shipping disputes.<sup>74</sup> The requirement that the Chinese language must be used in the proceedings is seen as another difficulty. The Rules do not specify whether Chinese law must be the substantive law applied. The most serious drawback, according to a recent report, is the lack of experienced arbitrators.<sup>75</sup> Although each commission has between 15–21 members, there are now less than 100 arbitrators as a pool from which the commissions can draw to act as arbitrators.<sup>76</sup>

The Chinese, however, appear confident that the future of arbitration in China is bright. Ren Jianxin has announced that China will continue to strengthen her cooperation with other arbitration organizations.<sup>77</sup> As well as adopting UNCITRAL rules in agreements such as that with the U.S., China has established ties with the International Maritime Arbitration Association and the International Maritime Commission. Bilateral agreements exist with the United Kingdom, France, Switzerland and Japan (the Maritime Arbitration Commission of the Japan Shipping Exchange Ltd., and the Japan International Commercial Arbitration Association).<sup>78</sup>

Mr. Ren has already announced that the arbitration staff of the CCPIT will be increased in order to deal with disputes arising out of bilateral agreements<sup>79</sup> and that the number of arbitrators will be increased.<sup>80</sup> Arbitration centers, as of September 1980, have been set up in Shanghai, Tianjin, Lush and Dalian, as well as in Beijing. CCPIT announced that several more centers would be set up in the coastal cities of China (apparently under the control of FETAC).

---

74. Pauline Loong, *Arguing for Arbitration*, FAR EASTERN ECONOMIC REVIEW, September 19, 1980, at 144–45.

75. *Id.*

76. *South China Morning Post*, Jan. 10, 1980, at 10. (hereinafter cited as SOUTH CHINA).

77. Ren, "Forum on China's Foreign Trade Arbitration," TA KUNG PAO, Oct. 2, 1980, at 15.

78. *Id.*

79. *Id.*

80. SOUTH CHINA, *supra* note 76.

Business and government leaders in Hong Kong have pushed to establish that territory as an arbitration forum. Hong Kong has several advantages: if a joint venture has been carried out primarily in the P.R.C., Hong Kong is an attractive forum because it is both geographically close to the "subject" being arbitrated, and because it is also a neutral forum.

Several contracts between Hong Kong firms and Chinese enterprises have stipulated that arbitration be performed in Hong Kong.<sup>81</sup> Although the Chinese appear to have accepted Hong Kong as a arbitral forum, it is not an official center yet. Proposals for it to become a center have been drafted<sup>82</sup> but no formal plan has been approved by the Chinese.<sup>83</sup>

### III. SUGGESTIONS FOR AN ARBITRATION CLAUSE

Because of their preference for non-adversarial settlement of disputes, the Chinese will often pursue pre-arbitration steps even after a dispute has been referred to FETAC. In one case where a European seller tried to invoke an arbitration clause, the Chinese buyers ignored his efforts and continued to correspond on all matters other than arbitration. In spite of these acts, the claim was eventually settled.<sup>84</sup>

Before advising U.S. businessmen on the particular requirements of an arbitration clause, counsel should point out that no matter how carefully drafted the contract and arbitration clause, the Chinese will almost certainly attempt to negotiate or invoke conciliation if a dispute arises, and only if these pre-arbitration techniques fail will they resort to arbitration. Arbitration in China presents a contradiction — at the same time it is the most formal and established legal system, while also being a system of last resort for the settlement of disputes. Once businessmen realize that pre-arbitration is almost a certainty in the first instance, then attention must be paid to careful drafting of the contract and arbitration clause.<sup>85</sup>

---

81. U.S. Consulate Paper: *Hong Kong as an Arbitration Center*, Jul. 11, 1980.

82. The American Chamber of Commerce in Hong Kong and the Hong Kong branch of the Chartered Institute of Arbitrators are both formulating proposals for an arbitration center in Hong Kong.

83. Much debate has been stimulated by proposals of an international arbitration center in Hong Kong. See J. Leung, *Hong Kong to Become Arbitration Center*, *ASIA WALL STREET JOURNAL*, Aug. 16, 1980, at 1, 10; and P. Loong, *Arguing for Arbitration*, *FAR EASTERN ECONOMIC REVIEW*, 19 Sept. 1980, at 144-45.

84. Lubman, *Contracts, Practice and Law in Trade with China: Some Observations*, in *Chinese Economy Post-Mao: A Compendium of Papers* (1978), at 778-79.

85. *Kerr*, *supra* note 5, at 174.

A. Suggestions for a "Model" Arbitration Clause:

The following points should be considered in framing the arbitration clause:

"Friendly negotiations" and conciliation should be included as steps to arbitration, even if the businessman is not experienced in their use. It should be emphasized that most problems with the Chinese are resolved through these two methods. It is also worthwhile to point out that these steps carry two important advantages: they are cheaper and faster than arbitration (or litigation) and they do not bear the same risks of destroying good relations between the parties.

The place of arbitration is often crucial. Many standard form contracts place arbitration in the country of the defendant. This may be practically difficult because both parties may jockey to be put in the position of defendant, in order to have the law of their own forum.

When considering the law of the forum, it is important, from an American perspective, to obtain a common law forum, rather than a civil law jurisdiction. Consideration should also be given to making both the procedural as well as the substantive law of the forum applicable to the proceeding, as that will affect such matters as cross-examination of witnesses, preventing disclosure of evidence, etc.<sup>86</sup> The arbitration clause should stipulate that the Chinese party will assist the foreign party in obtaining a visa to negotiate a settlement.

The language in which the proceedings will be carried on should also be specified.

The arbitral decision should be final, binding, and non-appealable.

The number of arbitrators, as in Chinese practice, is normally either one or three. Unless the case is very complex, one arbitrator is usually enough. The number of arbitrators and the method of selecting them should be set out in the clause.

There should be some definition of the kinds of disputes that can be taken to arbitration.

Whether some form of international rules, such as UNCITRAL, will be followed should be stipulated, as well.

---

86. Although the U.S. law originating from RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 187 (1971), limits the autonomy the contracting parties have in the choice of substantive law and forum, U.S. courts have allowed choice of neutral forum and substantive law in international contracts. Section 188 of the RESTATEMENT (SECOND) gives factors for the court to consider in determining which law is to be applied when the parties do not make an effective choice of substantive law in their contract.

### B. Problems of Interpretation in Chinese contracts

Careful attention should be paid to the legal terms used in contracts as certain terms have a different connotation in Chinese than in English. One such term is *force majeure*. The common law concept covers events such as "acts of God" including natural disasters, disease, and "acts of man" such as wars, strikes and labor unrest.

There is uncertainty as to what constitutes *force majeure* under Chinese law — for example it is not clear whether, because of ideological reasons, the Chinese recognize strikes as *force majeure* events.<sup>87</sup>

Chinese sales contracts are usually vague on the point and sometimes excuse Chinese sellers for either late delivery or non-delivery due to *force majeure* causes if they "inform the buyer in due time."<sup>88</sup> Foreign sellers, however, are often required to notify the Chinese buyer immediately upon such an event, and to document the *force majeure* cause.

### CONCLUSION

China's recent actions, domestically and internationally, augur well for the future of foreign trade dispute resolution. The P.R.C.'s arbitration institutions, and pre-arbitration methods, will be used with greater frequency as foreign trade continues to grow, and as foreign businessmen become more knowledgeable about and familiar with their operations. The resurgence of the legal profession in China, combined with a growing number of U.S. lawyers with expertise in the China trade area, will give U.S. businessmen increased confidence in their dealings with Chinese corporations and enterprises. China's commitment to develop and expand the functions of its two domestic arbitration institutions has been matched by its willingness to use third countries as fora for arbitration, and by the growing number of contacts with international, and national, arbitration organizations.

---

87. Hsiao says that China, like other socialist countries, has reportedly refused to accept strikes as a *force majeure* cause. However, since the 1978 Constitution (Article 45) allows the freedom to strike, it may be included in the definition of *force majeure*. See Hsiao, *THE FOREIGN TRADE OF CHINA* 153 (1977).

88. The Chinese government trade manual, *FOREIGN TRADE PRACTICE*, gives the following definition of *force majeure*:

In general *force majeure* includes two categories of factors: (1) natural factors, e.g., earthquake, typhoon (or hurricane), lightning, colossal floods, and drought, epidemics, contagious disease and any others that cannot be prevented or predicted by humans, or controlled by any reasonable measures; and (2) man-made factors, such as those caused by circumstances of war which influences time of delivery.

As for the economic courts, it is too early to predict whether they will provide a feasible alternative to the arbitration institutions. A number of indications portend that they will not: the arbitration institutions are already well established, with published rules and procedures which have been in use for over two decades; there are no signs that the Chinese have changed their traditional view of courts and litigations; the preclusion of foreign lawyers from the economic courts will tend to deter foreign businessmen from litigating in them; and the courts, despite their "economic" orientation, remain primarily domestic, not international, in nature.