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Internationella skiljedomar

En studie om verkställighet i Kina

Filosofie magisteruppsats inom Internationell Handelsrätt

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International Arbitral Awards

A Study of Enforcement in China

Master's thesis within International Commercial Law

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Title:	**International Arbitral Awards – A study of enforcement in China**
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Abstract

The increase in international trade creates a growing number of disputes between parties from different countries. International arbitration is the most preferred mechanism to solve disputes in international trade. If the failing party does not voluntarily comply with the award, the successful party must apply for recognition and enforcement of the award in order to obtain the remedies.

Since China is one of the major business markets in the world, several of the companies committed to arbitral procedures are likely to have assets in China. This means that, if a party fails to honour an award, an enforcement procedure may begin within a Chinese court. The enforcement procedures in China are said to be insufficient and not to comply with international standards.

International conventions and treaties provide for a high level of security in the recognition and enforcement procedure of the arbitral award. The most used and important instrument for recognition and enforcement is the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, to which China as well as Sweden are Contracting States. According to the Convention, an international arbitral award may only be refused under certain grounds laid down in the Convention.

An analysis of the legal situation in China confirms that there are problems associated with the enforcement of arbitral awards. These problems are not, however, connected with the concept of international arbitral awards, but rather with the entire judicial system in China. Even though an enforcing party can do little to overcome these problems, certain measures can be taken in order to ease the enforcement procedure.

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Sammanfattning

Ökningen av internationell handel leder till en ökning av konflikter mellan parter från olika länder. Inom internationell handel är internationellt skiljeförfarande den föredragna metoden att lösa konflikter. Om den förlorande parten inte frivilligt agerar i enlighet med domen måste den vinnande parten söka erkännande och verkställighet av domen för att erhålla ersättning.

Kina är ett av de största affärsområdena i världen. Detta medför att många parter verksamma inom internationell handel har tillgångar i Kina. Om en sådan part är en förlorande part i ett skiljeförfarande kan en verkställighetsprocess påbörjas vid en kinesisk domstol. Verkställighetsprocessen i Kina har kritiserats för att vara otillräcklig och inte uppnå internationell standard.

Internationella konventioner och förordningar möjliggör för en hög nivå av säkerhet i erkännande och verkställighetsprocess av en skiljedom. Det mest använda och viktiga instrumentet för erkännande och verkställighet är 1958 års New Yorkkonvention om erkännande och verkställighet av utländska skiljedomar, till vilken både Kina och Sverige är fördragsslutande stater. Enligt konventionen kan en internationell skiljedom vägras verkställighet endast i vissa begränsade fall.

En analys av rättsläget i Kina bekräftar att det finns problem med verkställigheten av skiljedomar. Dessa problem är dock inte kopplade till begreppet internationella skiljedomar som sådant, utan hänför sig till det hela rättsliga systemet i Kina. Även om en part som söker verkställighet kan göra litet för att överbygga dessa problem, kan parten genom vissa handlingar underlätta en verkställighetsprocess.

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ABBREVIATIONS

ARI	The Arbitration Research Institute of the China Chamber of Commerce.
CIETAC	China International Economic and Trade Arbitration Commission
CL	Contract Law of the People's Republic of China
CMAC	China Maritime Arbitration Commission
CPL	Civil Procedure Law of China
ICC	International Chamber of Commerce
IEOWP	Law on Industrial Enterprises Owned by the Whole People
SOE	State-owned Enterprise
UNCITRAL	United Nations Commission on International Trade Law
WTO	World Trade Organisation
YBCA	Yearbook Commercial Arbitration (published by Kluwer Law International)

1 Introduction

1.1 The Topic

International commerce with China has increased rapidly over the last few years and China has replaced Japan as the biggest Asian market for both Asian and EU exporters.[1] China has become a major international business partner and has now surpassed United States of America as the world's top destination for foreign direct investments.[2] There has been an increase in export and imports, as well as a growth of foreign establishments in China. Every now and then disputes arise between contracting parties and it is probably an unavoidable consequence of commercial trade. Disputes may appear more frequently in international trade where the parties come from different legal and social backgrounds and therefore are used to different behaviour in business. An increase in international communications has an effect on the economy but also on business relations. A growing number of international business relations will correspond with a growing number of disputes.

When a dispute arises, there are several ways to reach a settlement. The common practice of legally settling a dispute is to sue the opposite party in court.[3] This form of dispute resolution may not be, however, the most preferred way to reach a settlement connected with international trade. Other alternatives, besides litigation, include Alternative Dispute Resolution (ADR), specialized tribunals and arbitration. An ADR usually commences before, or in conjunction with, litigation. This includes for example mediation, mini-trials and conciliation. Normally a settlement by ADR is not legally binding[4]; it is a settlement where both parties agree on the outcome and reach a mutual understanding.[5] The backlash of this is that the parties afterwards are free to apply to a court to have the dispute settled and then obtain a legally binding award. Therefore, if the ADR is not successful, or one of the parties is not satisfied, a new dispute settlement may commence. This could explain the limited use of ADR in settlements of international commercial disputes.[6] There is, however, an increase in the use of ADR in commercial disputes.[7] In addition to litigation and ADR, there are also specialized tribunals and courts that handle disputes, for example maritime courts and labour courts.

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[1] WTO, International Trade Statistics 2004.

[2] Unkovic, p. 68.

[3] Chinese courts handle about 3 million civil cases every year, according to Wang Shengchang, Vice Chairman/ Secretary General of China International Economic and Trade Arbitration Commision (CIETAC), Beijing. The Swedish District courts handled 67, 080 civil cases during 2004, Court Statistics Official Statistics of Sweden 2004.

[4] There are exceptions to this. For example in Spain where a consumer dispute can be settled by a legally binding ADR, by the AUTOCONTROL. See http://europa.eu.int/comm/consumers/redress/out_of_court/commu/acce_just04_es_ccb2_en.html available 22-04-05.

[5] Bühring-Uhle, p. 346.

[6] See for a further discussion Bühring-Uhle, pp. 330–334.

[7] Bühring-Uhle, p. 328.

International arbitration is, however, the most preferred way to solve international commercial disputes.[8] If a dispute arises in relation to a contract with international elements, one party may feel uncomfortable with the legal system in the other party's domicile. Even more important may be the feeling of being in an inferior position if the dispute should be solved in one of the party's local court. To avoid these problems, parties can hold the dispute settlement in a neutral country and then choose arbitration as the procedure. That way they will enjoy a fair and comfortable proceeding. This is one reason in favour of settlement through arbitration in international commercial disputes, as opposed to court proceedings.[9] Other aspects are the flexibility and confidentiality of the proceeding, as the parties are free to work out the procedures which will best suit their contract. There is no detailed procedural legislation they will have to follow. The parties appoint the arbitrators and decide on the law that shall govern the dispute.

It is sometimes stressed in the doctrine that during a contract negotiation, an arbitration clause is chosen and signed merely because of lack of time or as standard procedure.[10] Too seldom, the parties draw attention to the consequences different dispute resolutions will have. In order to receive the best outcome from a future dispute, efforts should be made to regulate the following questions concerning the specific contract. Does the contract concern large amounts of money? Does it extend over a long period of time, or will the business dealings conclude in two weeks? These and more detailed questions should be discussed before the dispute resolution clause is signed. If the contract does not involve large amounts of money, a court proceeding may be a better solution, since an arbitration proceeding can be more expensive than a court proceeding.[11] On the other hand, an arbitration process is more likely to commence sooner than a court proceeding. For disputes involving smaller amounts of money, one option is to have an expedited arbitration proceeding. This kind of arbitration process is recommended for minor disputes, when the parties desire a speedy and inexpensive procedure.

There is not the same amount of scrutiny and control of arbitration settlements as compared to court proceedings, which may create a level of insecurity. Arbitration awards cannot be controlled or evaluated in the same way as court decisions. This confidentiality is up-held both by the parties and by the fact that an arbitration is not a public process. This also leads to a lack of case law. Different organisations and arbitration institutions do, however, report on some awards.[12] For the companies involved, this is normally not a problem, rather this is seen as an advantage. The dispute will not be known to the public, for example customers and media nor by the competitors.

In many countries a court proceeding is lengthy and burdensome, and appeals are common practice. This tends to make the proceedings last even longer. There is normally no right to file for an appeal, in respect to material matters, after an arbitration procedure has con-

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[8] Redfern & Hunter, p. 1.

[9] See Redfern & Hunter, p. 22, Seth, p. 58.

[10] Heuman, p. 28.

[11] *Ibid.*, p. 30.

[12] See, e.g. Yearbook Commercial Arbitration (published by Kluwer Law International), ICC International Court of Arbitration Bulletin.

cluded. The process is committed only at one level and the award shall act as *res judicata*.[13] Criticism can be held concerning this final award as it may create insecurity. For example, if one of the parties consider that a material mistake has been conducted in the arbitral award, no appeal can be made. If a dispute is resolved through a court system there are several instances for appeal.[14] This criticism, however, do not appear too frequently, as today's arbitrators normally are well-educated, and the arbitral institutions obtain high standards and professionalism. An arbitration process can be lengthy as well, especially if expert witnesses and well-known lawyers are involved. It may then be difficult to find a time that suits all involved.

By use of an international arbitration institution, the parties do not have to interfere with a foreign country's judicial system and can therefore concentrate on the actual dispute. It is important to remember that it is always the parties themselves that decide how a dispute shall be settled. International arbitration is the most common dispute settlement practice in international commercial trade. It is, therefore, of great importance that the parties involved are able to obtain what is settled in the arbitration award.[15] It is also of importance to determine what the chances are to have an international arbitration award enforced in China. This will help the involved parties to have an overview of their legal possibilities if a dispute arise. There has been some criticism concerning the ways Chinese courts enforce international arbitral awards.[16] Further, Swedish companies, in China, find government regulations complicated, conflicting or nontransparent.[17]

It is common practice to include an arbitration clause in a commercial contract. When the parties originate from two different countries they can either allocate the dispute settlement to either of their home countries or, more commonly in international arbitration, refer the settlement to a neutral well-known jurisdiction. It is an implied term of every arbitration agreement that the parties will enforce a future award.[18] This is, however, not always the case. Instead, the winning party may be forced to seek recognition and enforcement of the arbitral award. A party may also be interested in having the award recognised but not enforced. A recognised award works as a procedural hindrance, *res judicata*. The winning party may also face problems obtaining the remedy included in the award. Sometimes a cooperation needs to be established with the enforcement authority of the country where enforcement is sought, if such exists. If the venue of the arbitral procedure is located in a neutral country, or at the losing party's country, the party seeking enforcement must take action in an un-known jurisdiction in order to have the award recognised and enforced.

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[13] Latin phrase meaning "a matter that has been decided", see also Huleatt-James & Gould, p. 1. Seth, p. 58.

[14] In both the Swedish and Chinese judiciary a party can appeal to a higher court, and with special provision to the Supreme Court.

[15] Redfern & Hunter, p. 1.

[16] Andrén, pp. 73–77. Thomas Lagerqvist, Vinge Hong Kong and Marie Öhrström at the Arbitration Institute of the Stockholm Chamber of Commerce have also expressed this opinion.

[17] China Business Climate Report 2004, p. 1.

[18] Redfern & Hunter, p. 430.

The United Nation has issued a convention, United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958[19] (cited the Convention or the New York Convention), which simplifies the procedure for recognition and enforcement of international arbitration awards. Today, more than 130 States have succeeded to the New York Convention, which makes the Convention the most important international treaty relating to international commercial arbitration.[20] Both China and Sweden are Contracting States to the Convention.[21]

Imagine that a company, Sweden AB, has exported timber worth 5,000,000 USD to a Chinese company, China Corporation. The timber has reached the destination in Shanghai in accordance with the contract that was created. When payment is due, China Corporation does not pay the purchase sum. After three letters of demand, Sweden AB is forced to take legal action. In accordance with the arbitration agreement, Sweden AB commences an arbitration proceeding at the London Court of International Arbitration. In the final award, the court concluded that China Corporation should pay 5,000,000 USD plus interest to Sweden AB. However, the failing party does not pay voluntarily. Sweden AB has to take action in order to try to obtain the money. Sweden AB has to allocate the assets of China Corporation and apply for recognition of the award in that jurisdiction in order to have it enforced. What conditions must be fulfilled to have the award recognised and finally enforced in China? Will Chinese courts assist the applicant in order to reach an efficient and smoothly enforcement procedure?

1.2 Purpose and Delimitations

The purpose of this study is to investigate on what legal grounds an international arbitration award can be refused recognition and enforcement. A pre-condition for the enforcement of an arbitration award, as well as the refusal of the same award, is the existence of a valid arbitration agreement. The purpose is further specified trying to identify when, and on what grounds, an international arbitration award is refused in China. There is criticism among lawyers, foreign companies, and authors of the enforcement procedure in China, even though China adheres to the rules of the Convention. The study aims to see what the practical problems are and why they arise. The successful party normally expects the award to be performed voluntarily. This is not always the case and the successful party must apply to a national court in order to obtain the remedy. The party then applies for recognition and enforcement of the award. The problems that may arise will be investigated and discussed in this study. Part of the purpose is to examine what kind of legal problems a foreign company may encounter after an arbitration settlement, in terms of enforcement procedure.

This study will be of interest to people involved in international commercial trade with Chinese companies, whether they are in a position of a company that uses international arbitration clauses in their contracts, or in position of a lawyer representing a party in an international arbitration.

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[19] Convention on the Recognition and Enforcement of Foreign Arbitral Awards Done at New York, 10 June 1958 which entered into force 7 June 1959 United Nations.

[20] See http://untreaty.un.org/English/sample/EnglishInternetBible/partI/chapterXXII/treaty1.htm available 30-03-05.

[21] Accession by China 22 Jan 1987 and ratified by Sweden 28 Jan 1972.

Particular interest is given to the legal situation in China. China is chosen because of its economical development and impact. The country is becoming increasingly open to foreigners. Furthermore, the author has committed part of her legal studies to Hong Kong and thereby gained an insight in the Chinese legal system. As trade between Chinese and foreign entities increases, and a rising number of Western companies start looking East for new business relations, a corresponding number of disputes will arise. Several Swedish companies already have a business relationship with Chinese companies or establishments in China, or aim to have one in the future.[22]

This study will focus on arbitration awards. Matters such as how enforceable arbitration agreements shall be conducted, or legal criteria for the composition and jurisdiction of the arbitral tribunal, will be deliberated only where it is needed for further discussion. A more in-depth study of these matters is beyond the scope of this study. China is bound by several conventions and treaties concerning arbitration[23], but this study will focus solely on the New York Convention of 1958 as it is the most important international treaty with regards to recognition and enforcement of arbitral awards. The national laws of China will also be discussed, as they play an important role in the enforcement procedure.

The scope is further limited as the thesis only concerns international arbitration awards. With this delimitation, the work will focus on arbitral awards made in another country from where enforcement is sought. According to Chinese terminology, an arbitration can be either domestic, *foreign-related*[24] or *foreign*[25]. In this study, only the arbitration type defined as foreign will be discussed.[26] A study of the differences in the enforcement procedure of these types of awards would be highly interesting since they are treated differently[27], but that is beyond the scope of this work.

1.3 Method and Materials

In this study, a problem-oriented method is used. China is bound to the Convention. How China's interpretation differs from the other Contracting States' interpretation of the re-

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[22] In 2003, trade with China represented 2.3 % of Sweden's total foreign trade. This was an increase by 19% since 2002. Facts from the Embassy of Sweden, http://www.swedenabroad.com/pages/general____20793.asp available on 12-04-05.

[23] Other conventions are *the International Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (The Washington Convention), established on October 1, 1966 and the *Convention on the Service Abroad of Judicial and Extra Judicial Documents in Civil or Commercial Matters*. China is also Contracting Party to a number of bilateral judicial assistance treaties with several countries, e.g., Belgium, Egypt, France, Italy and Thailand.

[24] Arbitration conducted within China that involves foreign elements, see Sec. 1.4.1.

[25] Arbitration conducted outside the territory of China, see Sec. 1.4.1.

[26] Domestic arbitration in China refers to the settlement of economic disputes among Chinese individuals and Chinese legal persons by means of arbitration. Foreign investment enterprises generally have the status of legal persons under Chinese law. Consequently, if these choose to arbitrate with other Chinese legal enterprises they may have to do so under the domestic arbitral rules.

[27] Art. 217 CPL allows a review on the merits in domestic awards. According to Wang Shengchang, interviewed in Stockholm, April 2005, enforcement problems can arise with awards made from CIETAC (foreign-related awards) as the courts believe that CIETAC has their own interests in the case, and do not cooperate.

fusal grounds set out in the Convention will be a main interest. In order to find these differences, a comparative method is used (see Chapter 3) where the refusal grounds set out in the Convention are discussed. There is mainly one article in the Convention that regulates applicable refusal grounds, Article V. The thesis aims to give the reader a comprehensive understanding and practical applicability of this article. In order to give the reader some background and understanding of the current legal situation in China, a descriptive part of the development of China's legal system and judiciary is presented in Chapter 4.

As one of the cornerstones of arbitration is the confidentiality of the process and the award, many of the awards are not published. The parties of the arbitration decide, whether to publish the award or not. Material is therefore scarce in comparison with the public publication of EU law cases or Swedish law cases. In China it is particularly hard to find published cases, as court judgements normally are not available to the public. This non-disclosure policy prevails for preparatory works as well. The arbitration cases which are commented on and referred to in this work are either published by various arbitration tribunals, or stems from information that the author has gained on a no-name basis from parties involved in the process. Such information has, for example, been provided by lawyers involved in arbitration processes.

To illustrate some problems associated with the recognition and enforcement of international arbitral awards, cases from other Convention States are selected to show the prevailing principles of the interpretation of the Convention. These are discussed to some extent in order to make a comparative study. These cases are derived from, for example, Italy, Sweden, and Germany. There is also some discussion of and comparison to the UNCITRAL[28] Arbitration Rules and Model Law. The Rules and Model Law has widely influenced the arbitral legislations in many countries and is therefore of interest as a comparative measure. Some comparisons are also made with the Swedish Law. Relevant doctrine concerning international arbitration and doctrine of Chinese law and judiciary is used in order to gain an understanding of the historical fundamental attitudes to the judiciary. Lawyers and others working with international arbitration are the ones who most frequently discuss the problems of enforcement of arbitral awards. Many articles from a range of legal journals are, therefore, used in addition to the doctrine. The author has been able to take part in and gain information about the situation in China today thanks to interviews with some very prominent lawyers working in China, both Chinese and Swedish.[29] These interviews have given this study a deeper and more accurate content.

1.4 Terminology

This section explains the concept international arbitration as well as the expressions recognition and enforcement of an international arbitral award, in order to facilitate the understanding of the following presentation. Within this study, the People's Republic of China is referred to as China.

[28] United Nations Commission for International Trade Law.

[29] For further details see Interviewees in the Reference list.

1.4.1 International Arbitration

International arbitration differs from domestic arbitrations. It implies that, to some extent, foreign elements are involved. Generally, the nature of the dispute and the parties determine whether the dispute is international. The nature of the dispute should concern international trade matters. When a classification is made to determine whether the arbitration is international, attention is normally given as to where the company has its seat of control and management.[30] Like other literature, this study gives a reference to the UNCITRAL Model Law to define which arbitrations are regarded as international. Article 1(3) states that an arbitration is international if

(a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States or

(b) one of the following places is situated outside the State in which the parties have their places of business:

(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected or

(c) the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country.

Usually, an international arbitration has no connection with the State where the process is held. Furthermore, the parties are mostly companies or State entities, rather than individuals. This allows the State, in which the place of arbitration is situated, to have a wider and more relaxed attitude toward such arbitration processes.[31]

In Chinese legislation, international arbitration is not used. Instead, the terms *foreign-related and foreign arbitration* are used. The concept of a foreign-related and a foreign case is not explained in the law, but Point 304 of the Supreme People's Court's *Several Questions Concerning the Applicability of the PRC Civil Procedural Law Opinion* specifies circumstances in which a case may be foreign-related:

- one or both parties are foreigners, stateless persons, foreign enterprises or foreign organizations or
- the legal fact of establishment, modification or termination of the civil legal relationship between the parties legally occurred in a foreign country or
- the object of the action is located in a foreign country.[32]

A *foreign-related* arbitration is an arbitration process that involves a foreign element and is conducted within China by any of the Chinese arbitration commissions.[33] A *foreign arbitra-*

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[30] See Redfern & Hunter, pp. 12–14.

[31] See, e.g. Section 51 of the Swedish Arbitration Act, where foreign parties may exclude a provision that is mandatory for parties in a national arbitration.

[32] Håkansson, p. 50.

[33] In China arbitration tribunals and institution are referred to as commissions, example CIETAC.

tion, then, refers to all arbitrations held outside of China.[34] Different rules regulates the enforcement of these two types of awards, but within this study only awards made outside of China are discussed, i.e. foreign arbitral awards. For the convenience of the reader, and to correspond with international doctrine, *international arbitral awards* will be used throughout the work with the same meaning as a foreign award in China.

1.4.2 Recognition and Enforcement

In order to understand the rationale of the Convention's enforcement rules, as well as the importance of *recognition* and *enforcement* of an arbitral award, definitions of the two terms are necessary. Although, an arbitral procedure is the result of a private arrangement, the award constitutes a binding decision on the dispute between the parties. If the failing party does not perform voluntarily, the award may be enforced by a court.

When the court recognizes an award, it declares the award to be valid and binding upon the parties. It can be seen as a mere declaration since it does not provide for any practical application of the ruling. Recognition may be sought in order to prevent a future claim which is contrary to the award, and it is a hindrance for a court proceeding of the same matter as ruled in the arbitral award, *res judicata*. Recognition of the award is not only of importance to prevent future claims, but also *e contrario* to allow the exercise of rights.[35] When a court is asked to enforce an arbitral award, it is not only asked to recognise the legal force and effect of the award, but also to ensure that the award is carried out by using available measures.[36]

The requirements as to when an award is enforceable differ from country to country. Under the Convention, an award may be refused enforcement if it has not yet become binding upon the parties, or set aside or suspended.[37] One understanding of the expression "binding", which is interpreted by the Contracting States, is that the award has obligatory force between the parties and is no longer open for appeal on the merits.

1.5 Outline

The overriding topic of this study is international arbitral awards and Chapter 2 provides the reader with the basic understanding of this concept. In Chapter 2, the different forms of international arbitration are discussed, as well as the methods for choosing the law for the arbitration. This Chapter also compares arbitration with court litigation. As the topic is limited to discuss enforcement procedure, this is investigated in the following Chapter. The New York Convention of 1958 is the most globally adopted and most successful instrument for uniting countries' enforcement procedure of international arbitral awards. This Convention will be accounted for in Chapter 3. The more specific topic of this study is to examine on what grounds, and how, international arbitral awards are refused enforcement in China. Chapter 3 deals more specifically with Article V of the Convention. This article regulates on what grounds an award may be refused under the Convention.

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[34] See Art. 257 of the CPL for foreign-related awards and Art. 269 CPL for foreign awards.

[35] Di Pietro & Platte, p. 22.

[36] Redfern & Hunter, p. 435.

[37] Art. V(1)(e).

Chapters 4 and 5 focuses on the legal situation in China. The first of these Chapters gives the reader an understanding of what the judiciary in China is like today. After this general view of the judiciary, Chapter 5 concentrates on the focus of this study, arbitration. This chapter investigates how international arbitral awards are enforced in China and where the problems rest. Chapter 6, finally contains conclusions on what the conditions have to be in order to have an international arbitral award enforced in China.

2 International Arbitral Awards

2.1 General Matters

The arbitration is a confidential proceeding where the public and the media is not allowed. It is a private process. The confidentiality of an arbitration process normally is not stipulated in any legislation, not in the Swedish law or the Model law or in the Chinese law. Some arbitral institutions have rules providing that the award shall be held confidential. The ICC has no specific rule of the confidentiality of the award, but the internal rules stress the "confidential character" of the work of the court. [38] When the arbitration is finished and a final award is given, the successful party expects the award to be performed without delay. As noted the failing party may in some circumstances fail to carry out the award and the winning party must take active measures to have the award recognised and enforced.

An international arbitral award, like a national arbitral award, normally includes one or several remedies, e.g. order for the payment of money, establishment of legal rights and obligations between parties, specific performance and punitive damages. These remedies differ in each case, and there are no universal rules establishing which remedy that shall be used in a specific case. A consideration has to be made in every case in accordance with the arbitration agreement and applicable law. The arbitration agreement hopefully includes, or give guidelines to, the rules to be applied during the arbitration. To an increasing extent, arbitral parties have greater possibilities to chose the rules to be applied in the proceeding in comparison with a court proceeding.[39]

2.2 Different Forms of Arbitration

There are two forms of arbitration proceedings: the party can choose to have an institutional proceeding or to have it *ad hoc*.[40] During institutional proceedings, an institution resolves the dispute. If this is the case, a specification is included in the arbitration agreement regulating where the arbitration process should take place, with reference to a named institution. Most arbitral institutions provide trained staff to administer the arbitration and ensure that the proceeding run as smoothly as possible. The rules of the different institutions tend to follow a similar pattern. Examples of arbitration institutions are the London Chamber of Arbitration, the Stockholm Chamber of Commerce, and Hong Kong Arbitration Centre. One of the best-known institutions is the International Court of Arbitration of the International Chamber of Commerce established in Paris.[41]

An *ad hoc* proceeding is conducted pursuant to rules agreed by the parties themselves, or laid down by the arbitral tribunal. These rules then suit their proceeding and establish the arbitral tribunal. The rules could, for instance, concern time limits for the arbitration proceeding, as well as restrictions with regard to the amount of evidence and number of witnesses. This form of proceeding may be useful when a dispute has arisen and the parties

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[38] Redfern & Hunter, pp. 30–31.

[39] See Sec. 2.3.

[40] Huleatt-James & Gould, p. 27.

[41] Redfern & Hunter, p. 52.

know the facts and circumstances. They are then able to create a proceeding in accordance with information given. One should remember, however, that once a dispute has arisen the parties may not be interested in establishing mutual agreements and they might have differing views of which rules and conditions are to be used. Another way of *ad hoc* arbitration is where the arbitration clause provide for the arbitration to be conducted according to established rules, such as UNCITRAL Arbitration Rules. It can be noted that domestic awards rendered from an *ad hoc* arbitration is not valid under Chinese law.[42]

It simplifies matters, when an international arbitration award is to be enforced if there is compliance between the national legislations from which the award was made and from which it is sought for enforcement. Every country has its own arbitration laws. One might, therefore, think that no uniformity applies in matters legislation in different parts of the world. This is not, however, altogether correct. Some uniformity can be seen among the arbitration laws. The UNCITRAL Arbitration Rules and Model Law has made this development possible. The Arbitration Rules were published in 1976 and were developed in cooperation with lawyers from different parts of the world.[43] These rules were made for *ad hoc* arbitration and, as they cover all the essential matters, parties can be ensured that the important matters are dealt with. The Model Law is an arbitration law which aims to further competence and to harmonise national laws of arbitration.[44] As opposed to a convention, countries may incorporate only parts of the Model Law, so that the law accommodates fundamental principles of their national law.[45] Neither Sweden nor China has based their arbitration laws on the Model Law.[46]

2.3 The Importance of the Choice of Law

For the most part, an arbitration is regulated first by the rules of procedure that have been agreed or adopted by the parties and the arbitral tribunal. Secondly, it is regulated by the law of the seat of arbitration.[47] Most modern laws of arbitration allows parties and arbitrators to decide upon their own detailed rules. This so long as it is done on equal grounds and not aligned with mandatory rules of the seat. This arrangement gives parties and arbitrators greater possibilities to dispose over the rules of procedure, compared with a court proceeding. It is important in light of this discussion, to define whether the applicable law shall govern the procedural or the material matters. All cases include both procedural and material matters. Then, the arbitrators are able to distinguish the substantive law applicable to the clause from the procedural law applicable to the procedure of the arbitration itself. If the parties have chosen a law to govern the arbitration agreement, this law will prevail in

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[42] Art. 18 of the Arbitration Law. China can refuse enforcement of an international arbitral *ad hoc* award in line with Art. V(1)(a) the New York Convention. Although, it is widely accepted that *ad hoc* awards made in other Contracting States will be recognized and enforced, due to the accession to the New York Convention (which includes *ad hoc* arbitrations).

[43] Huleatt-James & Gould, p. 23.

[44] *Ibid.*, p. 25.

[45] UNCITRAL Model Law *F. Adoption of the Model Law*. Huleatt-James, Mark & Gould, Nicholas, p. 25.

[46] See Appendix 2 in Huleatt-James & Gould, for a list of countries which have based their arbitration laws on the Model Law.

[47] Redfern & Hunter, p. 77.

line with the doctrine of separability. The doctrine of separability is an expression of the independence of the arbitration clause from the rest of the contract. If no choice is made, one practice in arbitration is that the procedural law is the same law as the one chosen to govern the underlying contract.[48] Another option, even though a law is chosen to govern the underlying contract, is to determine the applicable law in accordance with the conflict of law rules of the seat of arbitration.[49]

Where the parties have not chosen a law for the underlying contract, the arbitral tribunal is faced with the problem of choosing a system of law to govern the contract. There is no universal rule to identify the applicable law. Rather, the methods used to determine this law will differ from tribunal to tribunal. One solution is to follow the rules of conflict of the seat of the arbitration, another is to allow the arbitral tribunal to decide for itself what law it considers appropriate. A third alternative is in line with the conflict rule adopted in the Rome Convention[50], the law of the country with which the contract is most closely connected.[51] It is worth pointing out that Article 1(2)(d) of this Convention expressly excludes arbitral agreements from its scope. However, the discussion in the present section is about contracts as a whole and not about a separate arbitration agreement. If no arbitration seat is chosen, the determination of law will be even more difficult. One solution is to apply the law to which the specific conflict has its strongest legal connection.[52]

This carries the consequence that *lex arbitri* (the law governing the arbitration) in most cases is the law of the seat of the arbitration, *lex loci arbitri*.[53] Exceptions from this sometimes occur, for example in arbitrations where institutional rules such as the ICC Rules of Arbitration are used. In modern international arbitration, the law used on the arbitration proceeding will be the same as the law of the seat.[54] This concept is referred to as the seat theory and is well-established in international arbitrations.[55] This standpoint is adopted in Sweden and has been discussed and stated by the government.[56] It has been established that parties generally cannot agree to use a foreign law to govern the procedure of the arbitration.

It is common that a foreign law (compared with the national law of the seat of arbitration) is applicable on material matters. This is an outcome since international arbitration usually takes place in a "neutral" country to which the parties have no connections. This country is normally chosen because it does not have any connections to the parties or the dispute.[57] This choice does not necessarily mean that the parties intend to choose this country's law to govern the material matters. The parties may choose a substantive law which is not the

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[48] Hill, p. 621, Huleatt-James & Gould, p. 36, van den Berg, p. 293.

[49] van den Berg, p. 293, Bogdan, ed. 6, p. 272.

[50] The Convention on the Law applicable to Contractual Obligations of 19 June 1980.

[51] Art. 4 the Rome Convntion.

[52] Bogdan, ed. 5, p. 312.

[53] Petrochilos, p. 31.

[54] Petrochilos, p. 64.

[55] Redfern & Hunter, p. 83.

[56] SOU 1994:81 p. 304 and prop 1998/99:35 p. 244.

[57] Redfern & Hunter, p. 78.

law of the seat. This freedom of the parties is known as party autonomy, and is a guiding principle to be followed in the arbitration proceeding. This principle is endorsed in both national laws as well as in the regulations used by international arbitral institutions.[58] There is nothing in the Swedish Arbitration Act concerning applicable law, but it is well known that party autonomy is a basic concept in Swedish legislation.[59]

A source, relevant to party autonomy, is the UNCITRAL Model Law. The Model Law can be of interest to compare with, as it has been widely used as a model for the arbitration laws of several countries, such as Australia, Germany, the Russian Federation, and by the independent jurisdictions of California and Texas (parts of the United States of America).[60] It is stipulated in Article 28(1) that party autonomy takes precedence:

(1) The arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of laws rules.

An enforcement process is handled in accordance with the law of the country in which enforcement is sought. The national law determines whether the arbitration award is international.[61] The international arbitration concept is discussed in Article 1 of UNCITRAL's Model Law. Many authors writing about international arbitration refer to the internationality description in the Model Law, in order to describe the meaning of the expression.[62] It is, therefore, of interest to again look to the Model law for guidance.[63]

2.4 Enforcement of Court Judgements and Arbitral Awards

In arbitration, the tribunal is established to solve issues arising from a specific contract. The tribunal is dissolved when the final award has been given and is *functus officio*[64], i.e. it has discharged its duty. This is the main difference when compared to enforcement of court judgements.[65] Tribunals do not have the same control and independence as courts and a special system is needed for enforcement of awards from an arbitration tribunal. Countries, where enforcement is sought for an arbitration award, must have national legislation that provides for recognition and enforcement by the courts in that country. In order to sim-

[58] The principle of party autonomy is also accepted in the Convention, Art. V(1)(d) "…if the arbitral procedure was not in accordance with the agreement of the parties."

[59] Heuman, p. 692.

[60] Huleatt-James & Gould, p. 123.

[61] Di Pietro& Platte, p. 14. Heuman, p. 676.

[62] See Huleatt-James & Gould, p. 8, Redfern & Hunter, p. 16, Petrochilos, p. 3.

[63] See Sec. 1.4.1 for Art. 1(3) of the Model Law.

[64] Latin phrase meaning "no longer having power or jurisdiction" "free from further obligations".

[65] Di Pietro& Platte, p.14.

plify and harmonize this process, several international conventions and bilateral treaties have been adopted.[66]

China is a Contracting State to the New York Convention and, consequently arbitral awards are to be recognised and enforced in accordance with the Convention. It provides for an uncomplicated and effective method when a party seeks recognition and enforcement of an award. Enforcement may only be refused on specific grounds set out in the Convention. China made two reservations upon their accession to the Convention. China will apply the Convention based on reciprocity, meaning that only recognition and enforcement of arbitral awards made in the territory of another Contracting State will be applied in China.[67] The second reservation concerns the classification of arbitral awards. China will only recognize and enforce awards under the Convention which arise from commercial relationships according to the definitions in the national law of China.

In China, there is no general rule with regards to enforceability of court awards. A party or a foreign court may apply to a competent intermediate people's court to enforce a foreign judgement, but there must be an obligation based on an international treaty or relation under the reciprocity principle.[68] A Japanese court judgement was, for example denied enforcement in China in 1994 because no international treaty or relationship under the reciprocity principle existed.[69] In this case, a debtor owned property in China and enforcement, therefore, was sought in China.

2.5 Consequences of Refusal of Arbitral Awards

An important consequence when a country refuses to enforce an arbitral award, may be less willingness to do business with the country, or a decline in the use of international arbitration in general. If it becomes known among businesspersons that a certain country is less interested in enforcing international arbitration awards, a natural result is to use other forms of dispute settlement. However, if a country is hostile to international arbitration awards, one might wonder how this country treats a foreign party in another form of dispute settlement. At some point, a party applying for legal rights must do so through the judicial system. It might be easier to do business with a party from a country where the legal system is well known. Switching to a trade partner from another country is, of course, not as easy as it may sound. The country where awards may be refused is probably chosen for some reason, and the party is not willing to change to a new business partner in another country merely for this reason.

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[66] For example the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the Convention), the International Convention on the Settlement of Investment Disputes between States and Nationals of Other States (The Washington Convention).

[67] The expression *reciprocity* can be confusing as it is commonly used in international law to denote that in relations between States, each State gives the subjects of the other State certain privileges on the condition that its own subjects shall enjoy similar privileges in the other State. This is not the way the reciprocity principle shall be understood in the Convention. In the Convention, the reciprocity reservation means that country A applies the Convention to awards made in country B because B adheres to the Convention and applies the Convention to awards made in A.

[68] Art. 267 the CPL, see n. 67 for a description of reciprocity principle.

[69] The Bulletin of the Supreme People's Court, Issue 1 of 1996, at 29.

The parties involved in an arbitration procedure are not interested in the public light that might be drawn to the enforcement proceeding. This conclusion can be drawn since one of the concepts of arbitration is that it is a closed procedure. The confidentiality of the arbitration, however, is threatened when the arbitral award is filed for enforcement in a court. The successful party is rather interested in obtaining what is lawfully theirs (money or other rights) according to the award. The refusal of an arbitration award prohibits this. Such a failure may have far-reaching consequences and the award may be of great monetary value. This may have such a negative effect on a smaller company's finances that liquidation or other negative economical sanctions must be exercised.

A country's refusal to enforce an arbitration award is, of course, only a refusal within that jurisdiction. The arbitral award is still legally binding. The winning party can seek recognition and enforcement in other countries after, or at the same time as, an award has been denied enforcement in one country. However, the failing party must have assets in, or by other terms have connections to, this country. There are otherwise no possibilities for a court to perform any sanctions against the failing party in this country. There are different terms in different jurisdictions concerning the legal grounds on which a person can be bound to a court's decision. These grounds are defined in each countries' national legislation, and for the enforcement of arbitral awards there are definitions in the Convention as well.

2.6 A State as a Party to the Arbitration Agreement

State entities are often increasingly participating in international trade. In many socialist countries and developing countries, a State monopoly on foreign trade is part of the national economic and legal system. The State can even be the largest actor on the market.[70] As this is especially true in socialist and former socialist countries, China, therefore, plays an important role in the following discussion. These entities may be an exclusive instrument for the participation of those States in international trade. Commercial agreements with these entities often include arbitration clauses, just as with any other company.

State entities from industrialized private economy countries participate in international commerce as well.[71] As noted, one of the consequences of increased international trade has been the use of international arbitration for dispute resolution. Nowadays, it is common that a State is one of the parties to a contract where an arbitration clause is included. A State purchases, or supplies goods and services, as any other private company to a contract would do. A State can be party to a contract in several ways. For instance, directly through a ministry or agency of the State. However, the State can also have special companies for this purpose which they control, either directly or indirectly. If the State owns these companies, the profit, if any, belongs to the State. On the other hand, the State is liable for its losses. Even in situations where the company is legally independent of the State it can still be controlled by the State in the sense that the State appoints the senior officers and controls its finances and business activities.

As a State normally is rather unwilling to appear in a foreign court, it is common practice to include an arbitration clause in the contract, particularly if the other party is foreign. This is

[70] Lew, Mistelis & Kröll, p. 733.

[71] *Ibid.*, p. 277.

usually the wish made by the other party as well, since it does not feel tempting to appear in court in a foreign country against the State of that country. Fear of unfair treatment would not be unrealistic.

Private parties are normally free to decide the way of dispute resolution in relation to their contract. This is, however, not always the case for a State party. There may be some special rules in the national law that precludes certain forums. Such rules could limit the availability of having a dispute resolved by arbitration. For example the State, or State companies, in Sweden, Saudi Arabia, and Iran must obtain approval from the relevant authorities before they can enter into an arbitration agreement with a foreign party.[72] Many of these restrictions are due to old concepts which state that it goes against sovereign dignity of the State to submit to a dispute resolution where the State cannot control the process. Such distrust is normally found in countries, which historically consider parties from industrialised countries to be favoured in international arbitrations.[73]

If a party lacks arbitrability[74], the arbitration agreement will be void. Therefore, a party conducting business with a State must be aware of, and pay attention to, the national law of the other party. It must be verified that no such restrictions are at hand. A recommendation is to include a reference in the arbitration agreement that the State party has complied with all necessary procedures.[75] Another question to keep in mind is whether the person signing the arbitration agreement on behalf of the State has the power to do so. Contracts, to which a State is one of the parties, normally require approval from the government. According to this, does a contract, which includes an arbitration clause, bind the State when it has not signed it? This question sometimes arises when a person of lower rank signs the agreement and then acts without authority. In general, it is accepted that as long as the person who signed the agreement had apparent authority to do so, the agreement is valid. If a State company makes the State party to an arbitration agreement, without the approval by the State, the arbitration agreement will not be valid.

This is in line with the principle that a State company has no power to bind the State in any way, and is normally its own legal entity. This is important to keep in mind as it sometimes happens that parties doing business with a State company try to include the State itself in the arbitration proceeding. This is often a consequence in cases where the State company has insufficient funds to meet the claim, or when it will be hard to get a hold of the assets, as these belong to the State. It is not a sufficient argument that the State is the owner of the company, and that it has some control over it to include the State in the arbitration agreement. The State company must be seen as separate from the State. If the State itself has not signed the arbitration agreement, it will not be a party to it. The State company alone should be seen as party to the agreement.[76]

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[72] *Ibid.*, p. 735.

[73] *Ibid.*, p. 735.

[74] Arbitrability determines which types of dispute may be resolved by arbitration and which belong exclusively to the field of the courts. The Convention is limited to disputes that are "capable of settlement by arbitration", Art. II(1) and V(2)(a).

[75] Lew, Mistelis & Kröll, p. 735.

[76] *Ibid.*, pp. 739–740.

Traditionally, sovereignty of a State meant that a court had no jurisdiction over the conduct of another State. The sovereign immunity protected a State from the burden of defending litigation abroad.[77] The absolute immunity has, however, been dissolved to some extent in accordance with the involvement of States in international commerce. Nowadays, a distinction is made between acts of private and commercial nature, *acta jure gestionis*, versus public activities by the State, *acta jure imperii*. This division has lead to the thinking that when a State acts in commercial matters, no immunity should be considered. The State has to follow the same rules as all other private parties. There are, however, great exceptions to this generally accepted principle in several countries' national legislations.[78]

[77] Redfern & Hunter, p. 463.

[78] Lew, Mistelis & Kröll, p. 745.

3 The New York Convention of 1958

The New York Convention regulates the enforcement of international arbitration awards and aims to standardize the enforcement procedures of all Contracting States.[79] It has been described as a Convention which "perhaps could lay claim to be the most effective instance of international legislation in the entire history of commercial law".[80]

3.1 Grounds for Refusal in General

Countries that have adopted the Convention can only refuse to enforce arbitral awards in accordance with the Convention. States, which have ratified the Convention on the basis of the reciprocity principle, are only obligated to follow the Convention in relation to awards made in other Contracting States.[81] China has made this reciprocity exception.[82] The Convention has been successful since it has given commercial parties freedom to develop and adopt autonomous business relationships outside the boundaries of their respective country.[83] To a certain extent, elements of international trade need to be left outside the rules normally applied in national trade. In order to maintain this freedom, and to provide an efficient and practical dispute resolution system, the Contracting States must follow the rules set out in the Convention. If national courts abandon the important principles stipulated in the Convention, the whole idea will have been wasted. It is, therefore, of importance to investigate the refusal grounds in the Convention, and to examine under which conditions problems may arise, as well as how contracting States have solved these problems. To be able to study the criticized enforcement procedure in China, an investigation of the general enforcement status of the Convention is required. It must be studied just how accurate this criticism is, as China has developed to become one of the most important commercial areas in the world.

There is one article in the Convention that countries can rely on regarding refusal to enforce an award, Article V.[84] Certain main aspects of the grounds for refusal can be observed in this article.

The first aspect implies that *the respondent has the burden to prove the existence* of one of the criteria in Article V(1). This aspect constitutes an arbitration award friendly attitude as it maximizes the successful party's chances to have the award recognised and enforced. It also minimizes the power of the court, as the court will not on its own initiative investigate if any of the grounds in Article V(1) exists. The second aspect implies that the Convention does *not permit that any review on the merits* of the arbitral award shall be made. This is the outcome of Article V, as it does not include grounds for refusal based on a mistake in fact or

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[79] Di Pietro & Platte, p.11.

[80] See Redfern & Hunter, p. 441.

[81] Art. I(3) Convention on the Recognition and Enforcement of Foreign Arbitral Awards Done at New York, 10 June 1958 which entered into force, 7 June 1959 United Nations.

[82] See n. 67.

[83] Di Pietro& Platte, p.11.

[84] See Appendix 1.

law by the arbitrator.[85] This is a very important interpretation of the Convention, and one which is generally accepted. One of the main principles of international arbitration is that national courts are not to be involved in the substance of the arbitration.[86] This is one reason to choose arbitration instead of court proceedings. The fact that the Convention does not allow any review on the merits can be seen *e contrario* since Article V is *exhaustive*, which means that no other refusal grounds exist in the Convention other then those stipulated in Article V. It is a general rule that there can be no review of the merits, even if the arbitrator has erred on questions of fact or law.

Another main aspect is the fact that the enforcing court is *not obliged* to refuse enforcement. It is stated in the first sentence of Article V that "*Recognition and enforcement of the award* **may** *be refused…*" [emphasis added by the author]. This wording gives the judge freedom to overlook a ground for refusal, and enforce the arbitral award, even though such grounds exist. This may be appropriate if, for example, enforcement of an award would be in line with Article V(2)(b) and violate public policy[87], but not to the degree that the violation would hinder international relations. Lastly, the refusal grounds set out in the Convention shall be interpreted *narrowly*. This means that the refusal grounds should be accepted in severe cases only. Several decisions made by courts in Contracting States support this narrow interpretation.[88]

Paragraph one of Article V sets the grounds for when the party, against whom the award is invoked, may prove certain criteria to have enforcement of the award refused. Article V(1) is divided into five parts. In the other paragraph, Article V(2), a competent authority in the country in which enforcement is sought may also refuse to enforce the award if they discover certain criteria stipulated in the article. The second paragraph is to be dealt with *ex officio*, meaning that the court may investigate if such criteria exist, without a request of a party.

The different articles in the Convention do not have any titles, and neither do the five subparagraphs in Article V(1). For a more convenient overview, the different parts of Article V(1) deals with:

- Article V(1)(a) *Invalidity of the Arbitration Agreement*.
- Article V(1)(b) *Violation of Due Process*.
- Article V(1)(c) *Excess by Arbitrator of his Authority*.
- Article V(1)(d) *Irregularity in the Composition of the Arbitral Tribunal or the Arbitral Procedure*.
- Article V(1)(e) *Award Not Binding or Set Aside*.

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[85] In a case from the Swedish Supreme Court, NJA 1979 p. 527 *Götaverken v. GNMTC*, the court declined to review the merits of the case, even when the arbitrators had made a decision of matter which they were not authorized to do, on the ground that it would be contrary to the Convention.

[86] van den Berg, p. 269.

[87] See Sec. 3.7.

[88] See van den Berg, p. 268, Redfern & Hunter, pp. 444–445.

The two grounds where the court *ex officio* can deny enforcement concerns:

- Article V(2)(a) *Non-arbitrable Subject Matter*.
- Article V(2)(b) *Other Grounds of Public Policy*.

A judge shall, when a question of refusal in the enforcement procedure arises, verify whether circumstances given either by the respondent, or *ex officio*, are justified in accordance with Article V. As noted, no review on the merits is allowed. The refusal grounds will be further analysed and discussed in the following Chapters. A distinction is made between the two paragraphs, since one deals with refusal grounds invoked by the party, and the other deals refusal grounds invoked by the court on its own.

Many arbitration laws allow the arbitrator to give a provisional ruling, based on his competence, in order not to delay the arbitration. It does also work as a means to alleviate attempts from an obstructive respondent trying to complicate the process. This power is known as the expression of *Kompetenz-Kompetenz*.[89] If an institution finds that it has jurisdiction, it can continue with the arbitration. There is no rule stating this authority in the Convention, but as this is a prevailing principle of national arbitration laws, the Convention would have contained express provisions for such derivation in order to make that effect clear.[90] However, as arbitration excludes the competence of the courts, which is considered a far-reaching effect, the courts retain the last word and can overrule a competence decision made by arbitrators.

3.2 Invalidity of the Arbitration Agreement

The first ground for refusal of recognition and enforcement under the Convention is as follows:

"(a) *The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made…*"

The first ground for refusal, V(1)(a), provides for two diverse arguments against enforcement. On the hand, the defence can be the incapacity of a party and, on the other hand, an invalidity of the arbitration agreement. Nothing is mentioned expressly in the article, or in the Convention as a whole, concerning which law shall determine the incapacity of a party. This, then, must be solved by the conflict of law rules of the country where enforcement is sought.[91] These conflict rules vary from country to country. Questions that must be sorted out in accordance with the country's law, where enforcement is sought, relate to the rules governing the nationality of a physical person and domicile, and a legal person's place of business or place of incorporation. Such an interpretation is not in line with the aim to

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[89] The Kompetenz-Kompetenz principle originated from a ruling rendered by a High Court in the former West Germany in 1955. This determined that arbitrators shall have the power to rule on the scope of arbitration agreements on which the authority of arbitrators is based, see Duan&Duan Law Firm http://www.duanduan.com/lslt-e-2004-2-10-2.htm available 05-05-05. The UNCITRAL Arbitration Rules has adopted the Kompetenz-Kompetenz principle, Art. 21, Section 1. See also von Houtte, p. 387, Huleatt-James & Gould, p. 67.

[90] van den Berg, p. 312.

[91] *Ibid.*, p. 276.

have a uniform interpretation of the Convention and, thereby, obtain similar enforcement rules in all Contracting States. These matters are not necessarily to be determined under the same law as the law applicable to the arbitration agreement. Look to Article V(1)(a), which contains uniform conflict rules, to find the law applicable to the arbitration agreement.

The main situation in which a party can be said to be incapable will be if the party is a State.[92] The issue of capacity for a State to enter an arbitration agreement has already been discussed in Section 2.6. It is commonly understood that the Convention includes arbitral agreements and awards, with regards to a State's participation and that the expression "*differences between persons, whether physical or legal*" in Article I(1) symbolises this.[93]

This may invoke a situation where sovereign immunity can be questioned. There is one case worth mentioning in relation to the discussion of a State's status in international arbitration. It involved Contracting States to the Convention and it is therefore of interest to see the arguments of the Italian Supreme Court where enforcement was sought in 1996. [94] The court stated that State parties should share the same conditions as applied to all parties participating in modern international commerce. This view is supported in all parts of the world, and State parties may be successful in resisting enforcement by invoking the lack of capacity to enter into an arbitration agreement.[95]

If an arbitration clause is to be written into a contract which a State is party to, it is of great importance to determine if the State has capacity to agree to arbitration. To determine this, an investigation must be carried out with regards to the national law of the State concerned, as well as the law of the forum of arbitration. It is also well advised to pay attention to possible conventions that the State could have adhered to.

The prevailing opinion with regards to the interpretation of the second part of Article V(1)(a), is that the agreement shall comply with standards set out in Article II. If it does not comply, there is no valid arbitration agreement and hence enforcement can be denied. An invalidity of the arbitration agreement under the law applicable to it pursuant to Article V(1)(a) has never been successfully invoked.[96] It appears that it is Article II(2)[97] that is invoked, rather then the law applicable in Article V(1)(a), when requests for refusal of awards regarding an incapable arbitration agreement is sought. This is not surprising since the criteria in Article II are quite severe. The matter that remains of interest in Article V(1)(a), regarding the invalidity of the agreement, is mainly *the lack of consent*, including misrepresentation, fraud and undue influence. These defences can hardly be successful, however, if the agreement is in order with Article II(2). If both parties have signed the agreement, is it hard to claim fraud or misrepresentation. [98]

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[92] For example as a State trading agency or another body of public law.

[93] van den Berg, p. 277, Böckstiegel, p. 11.

[94] Corte di cassazione, 9 March 1996, no 4342, XXII YBCA 737 (1997) 742.

[95] Lew, Mistelis & Kröll, p. 708.

[96] According to van den Berg, p.282.

[97] See Appendix 1.

[98] van den Berg, pp. 282–283.

There are, however, authors who are of an opposite opinion with regards to the above described interpretation of Article V(1)(a). Di Pietro and Platte finds it hard to see the merits of the prevailing opinions, such as those of van den Berg. Di Pietro and Platte argues that Article V(1)(a) is a very clear-cut provision which, by the wording, only provides for two possibilities when the invalidation of an agreement is to be found. Namely, the law chosen by the parties, or if none is chosen, the law of the place where the award was made. They find that references to Article II are made for other reasons, which merely are the demand for a written arbitration clause and the peremptory recognition of arbitration agreements by States.[99] If the prevailing opinion is to be adhered to, further options will be made available to the resisting party. Then, a chance to have the award set aside at the place of arbitration is opened, which is not the intention of Article V. A more reasonable approach would be to separate the enforcement of an arbitration agreement from enforcement of an arbitration award. In the enforcement stage of an agreement, the criteria stated in Article II should be taken into consideration, while in the enforcement stage of an award, only the criteria stated in Article V should be considered to deny enforcement.

The second part of Article V(1)(a) consists of two uniform conflict of law rules which supersede the relevant conflict rule of the forum. The first one is party autonomy and the second one concerns the rules at the seat of the arbitration (where the award is made). Usually, a contract contains provisions stating that "this contract is subject to the law of X". If such contract contains an arbitration agreement, which does not have a separate choice of law clause, problems arise in defining under which applicable law the agreement shall be invalid. Either the provision governs the whole contract, including the arbitration agreement, or the arbitration agreement is seen as a separate contract. If it is seen as a separate contract, then the relevant law will be "the law of the country where the award was made", *lex loci arbitri*, in accordance with Article V(1)(a). This view is in line with the doctrine of separability, which is the prevailing notion in many countries.[100] The doctrine of separability is mainly important when a question is raised as to whether the main contract is invalid. It would be to take the discussion too far if this doctrine should totally separate the arbitration clause from the rest of the contract. When a contract contains a choice of law clause, but no specific law choices for an arbitration procedure; one opinion is that this law governs the arbitration agreement as well. Another opinion is that it is the law of the seat of the arbitration that shall govern the arbitration agreement.[101]

If the arbitrators have made a ruling stating the agreement to be valid in accordance with the principle of *Kompetenz-Kompetenz*[102], a court can prove this to be invalid and then refuse enforcement under Article V(1)(a). The applicable law to determine the competence of the arbitrators, concerning the invalid arbitration agreement, will then be the law applicable to the agreement. This law is determined by the conflict rules earlier discussed in this Chapter.

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[99] Di Pietro & Platte, p. 84.

[100] See Swedish Arbitration Act Section 3, English Arbitration Act 1996 Section7, Art. 1053 Netherlands Arbitration Act 1986, ICC Rules Art. 6(4).

[101] For a further discussion of choice of law and *lex arbitri* see Sec. 2.3.

[102] See Sec. 3.1.

3.3 Violation of Due Process

The second ground for refusal of recognition and enforcement under the Convention is as follows:

"(b) *The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case…*"

A fundamental requirement of a process is the right to a fair hearing and adversary proceedings, also referred to as *audio et alteram partem*. These rights are protected in Article V(1)(b) which is about due process. Most irregularities that can arise in arbitration proceedings are covered within the scope of due process. It covers, for example, improper notice of the proceedings, inability to present a case, and a denial of the right to be heard. This article ensures that the arbitration institution observes certain standards of fairness. This article is probably the most important ground for refusal under the Convention, and is necessary for ensuring the future of international arbitrations. When the parties are from different countries, and in many cases proceed in a foreign jurisdiction, they must have confidence in the way the process is conducted.

What falls under the concept due process may differ significantly from the country of arbitration to the country of enforcement. This can lead to uncertainty and, additionally, to an unforeseeable outcome of the arbitration. This constitutes a problem, as it is a widespread concept that international arbitration should be more freely compared to national arbitration.[103] The court, and the law in the State where the arbitral process is conducted, will naturally have its own concept of requirements for a due process, but that does not mean that the matters should be dealt with exactly as they are done before this national court. Generally, this court should be satisfied if the process is done in accordance with the agreements of the parties, in accordance with the principles of equality of treatment, and the right to present a case. The court at the place of enforcement has a more limited role. Its function is merely to decide if due process has been maintained.[104]

Once again, the question of applicable law arises. According to which law is a violation of due process to be adjudicated? Authors discussing international arbitration stress the importance of viewing a violation of due process as an "international rule", and not relate it to any national law. Such a standpoint is based on a connection between Article V(1)(b) and Article V(1)(d). The latter states that if the parties have agreed on the composition of the arbitral authority and the arbitral procedure, the law governing these matters is not to be taken into account. Such freedom must however be limited by the fundamentals of due process, and as Article V(1)(d) is regarded to be a matter of international standards, and beyond the reach of national law, so can Article V(1)(b) be seen as an international rule. In doing so, a provincial and narrow rule does not interfere with the orderly procedure of an international award. This argument is, so far, merely a discussion in the literature. Courts today rule in the opposite direction by making due process fall under the law of the court in question. This division may seem troublesome but, in fact, the result of the judgements and the conclusions from the authors are more or less the same. This is possible since the court hold that what may be a violation of due process under its own law, is not necessarily

[103] Di Pietro & Platte, pp. 148–149.

[104] Redfern & Hunter, pp. 448–449.

a violation of due process under the Convention. The authors further add that courts will find inspiration to the intention of due process in the their own law.[105]

Aside from the question under which law the standards of due process are to be judged, there are other problems as well. One problem is the fact that due process normally is viewed in conjunction with public policy[106], which is regulated in another article, namely Article V(2)(b). This raises the question whether the regulation in Article V(1)(b) excludes due process from application under Article V(2)(b). If this is true, a court would not be able to refuse enforcement of an award on its own motion, if it finds that a violation of due process exists. This is the outcome since it is the respondent alone who can ask that the award be refused under the grounds set out in Article V(1). There has never been a court decision in support of this narrow interpretation, and the prevailing opinion is that a violation of due process can fall under either Article V(1)(b) or Article V(2)(b).[107] This should be viewed as a precautionary measure where the court has mandate to refuse enforcement when the respondent does not invoke this. It can also be seen as a statement that it is the respondent, and not the claimant, who should furnish proof to support this allegation.

Another important consideration is how a court should behave in relation to the violation of due process, and the actual impact on the decision in question. van den Berg believes that only if it is beyond any doubt that the decision would have been the same, is a court allowed to enforce the award in opposition of due process.[108]

Courts tend to refuse enforcement of awards based on Article V(1)(b) in very severe cases only.[109] One case, therefore, is worth mentioning. In a decision by the Court of Appeal of Cologne[110], an award made according to the Arbitration Rules of the Copenhagen Arbitration Committee for Grain and Feed Stuff Trade was refused enforcement. Because of certain understandable concerns by the Copenhagen Arbitration Committee, did the parties not know the names of the arbitrators (the arbitrators were experts and as the numbers of experts in this field was limited, the arbitration committee did not include the names of the arbitrators). The Court ruled this contrary to the rights implied in Article V(1)(b) and stated that they could not enforce the award.

In general, courts have followed the principle of Article V, that grounds for refusal of enforcement shall be interpreted narrowly when a defence of due process has arisen.[111] This is despite the fact that Article V(1)(b) can be interpreted very broadly. It has been shown that arbitrators and arbitration institutions give attention to due process in the proceedings, but that the respondents use due process for chicanery purposes.[112]

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[105] van den Berg, p. 298.

[106] For further discussion of public policy see Sec. 3.7.

[107] van den Berg, p. 300.

[108] *Ibid.*, p. 302.

[109] van den Berg, p. 297.

[110] Oberlandesgericht of Munich, June 20, 1978 (F.R. Germ. No. 14).

[111] For a further discussion of the general interpretation of Art. V see Sec. 3.1.

[112] van den Berg, p. 310.

3.4 Excess by Arbitrator of his Authority

The third ground for refusal of recognition and enforcement under the Convention is as follows:

"(c) *The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced…*"

Under this article, a presumption is made that the parties have a valid arbitration agreement, but at the time of the arbitration process the institution exceeded its mandate. Article V(1)(c) handles two conditions in which arbitrators exceed their power. The first part of the article concerns on the one hand awards made by the institution outside their jurisdiction, or without jurisdiction, *extra petita*. The arbitrators have then performed outside of the mandate given by the parties in the agreement. The question of the arbitrability of the matter does not depend on the applicable law. This law may, or may not, allow arbitration of a certain dispute, but that is not what is of importance under this article. It is rather the agreement made by the parties that is of importance when one determines whether the institution has exceeded its mandate.

Additionally, the first part of Article V(1)(c) concerns problems of *ultra petita*, where the institution has exceeded its jurisdiction. This means that the institution has dealt with a dispute that was not submitted to it. In these cases, the arbitration institution begins the process within their power, but then goes beyond what was originally allowed. Since in those cases part of the process has been properly conducted a non-enforcement of that part of the award would not be logical as it would be a waste of time and money. Therefore, a provision has been made for these occasions in the second part of the article. This relates to the possibility of a partial enforcement of an award, which contains both decisions within and outside the institution's authority. On most occasions, neither of these defences has successfully been invoked.[113]

One case, *Götaverken v. GNMTC*[114], contained to some extent the excess by arbitrator. In this case, the arbitrator awarded something which was not claimed by the parties. The Svea Court of Appeal[115] in Stockholm, however, enforced the award anyway. The Court stated that the respondent had not been able to show that the arbitrator's decision in any part was invalid, and the Court had no power to review the merits of the case.

If the arbitrators have ruled that certain matters fall within their mandate, in accordance with the principle of *Kompetenz-Kompetenz*[116], a court can prove that they have exceeded their authority and enforcement may be refused under Article V(1)(c). Should this situation arise,

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[113] See Lew, Mistelis & Kröll., p. 714 and Redfern & Hunter, p. 450.

[114] NJA 1979 s. 527, also discussed in n. 85.

[115] Which is the second instance in Swedish court hierarcy.

[116] See Sec. 3.1.

there will not be any questions of applicable law in most cases, as the excess of authority is largely a question of fact.[117]

3.5 Irregularity in the Composition of the Arbitral Tribunal or the Arbitral Procedure

The fourth ground for refusal of recognition and enforcement under the Convention is as follows:

"(d) *The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place…*"

If the parties have made an agreement that regulates the composition of the arbitral institution or the arbitral procedure, an alleged irregularity is to be judged under this agreement only. This provision clearly establishes the supremacy of party autonomy, since the law of the country where the arbitration took place can only be applicable if the agreement is lacking, or does not regulate the specific matters. This is the defence stipulated in Article V(1)(d) and it is deemed that the purpose of this article is to minimize the role of *lex loci arbitri* in the enforcement process.

Therefore, the respondent cannot make a defence on the ground that the award does not comply with the law governing these matters, when the composition of the arbitral institution and the arbitral process comply with the agreement. These matters must, of course comply with the requirements of due process and public policy.[118]

This refusal ground is rarely relied upon when cases, where enforcement is sought, are brought before courts.[119] There is one case, however, worth mentioning, in which the grounds spelled out in Article V(1)(d) were fulfilled, but the court in Hong Kong still enforced the award.[120] The respondent held that the arbitrators appointed were on the Shenzhen CIETAC list, but the agreement of the parties stipulated that the arbitrators should be appointed by the Beijing CIETAC list. The court enforced the award anyway and rejected the defence. It held that albeit the arbitrators were from the "wrong" list, they were, according to the parties' agreement, on a CIETAC list.

3.6 Award not Binding or Set Aside

The fifth ground for refusal of recognition and enforcement under the Convention is as follows:

"(e) *The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made*."

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[117] van den Berg, p. 312.

[118] For a further discussion of public policy see Sec. 3.7.

[119] See Di Pietro & Platte, p. 163 and van den Berg, p. 323.

[120] *China Nanhai Oil Joint Service Cpn v Gee Tai Holdings Co. Ltd*, Volume XX(1995) YBCA, p. 671.

The last ground under Article V(1) concerns matters where the award has not become binding or has been suspended or set aside in the State where it was made. A distinction is made, on the one hand, of awards not yet binding and, on the other hand, of awards which are suspended or have been set aside. Questions arise as to whether 'binding' is an autonomous term or whether it is subject to national law determination. As the Convention aims to depart from national considerations and legislation, an autonomous interpretation must be made. This is not stated specifically in the Convention, but it is in line with the aims of the Convention. A general opinion is that an award can be binding even if some additional formalities are required to make it enforceable where it was made, or formal time limits in the law of the place where it was made have not yet expired.[121]

In Article VI of the Convention, a right to postpone its decision is given to the Court where enforcement is sought, if the resisting party successfully has applied for suspension or setting aside of the award at the place where it was made. Despite this, the Court can enforce an award which has been successfully challenged. The opinions among authors on this subject vary greatly.[122] Nothing is stated in the Convention of a prerequisite that an arbitral award must be confirmed at the place of rendition, but it is a general presumption that the Convention is to be interpreted only on valid awards.[123] This may, however, give rise to another problem, namely that the validity of international arbitral awards are exclusively determined by the courts in the forum State. An outcome of this sort is probably contrary to one of the reasons the parties chose arbitration instead of a court proceeding, as they wanted to exclude this jurisdiction.

3.7 Ex Officio Grounds

The last grounds where recognition and enforcement may be refused are as follows:

"*…if the competent authority in the country where recognition and enforcement is sought finds that:*
(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
(b) The recognition or enforcement of the award would be contrary to the public policy of that country."

The concept of public policy may have effect on most areas of law. Both sub-paragraphs of Article V(2) fall under the public policy defence and the court may use these *ex officio*, i.e. no request has to be made by a party and the court may investigate if a defence based on public policy grounds exists. It is very hard to define in one or two sentences what international public policy is, and it is very unusual to see an explanation of it made by a court. It may be illogical to divide Article V(2) into two parts, as both parts relate to public policy. This is, however, done for historical reasons as these were separate grounds for refusal in the Geneva Convention of 1927, but does not affect the applicability of the article.[124] Public policy is a term which also is known as *ordre public*. This alternative expression is used mainly in civil law countries and is believed to be broader.[125] The two expressions have

[121] Lew, Mistelis & Kröll, p. 717.

[122] See Lew, Mistelis & Kröll., p. 719.

[123] Di Pietro & Platte, p. 337.

[124] The Geneva Convention of 1927, Art. I(2)(b), which was replaced by the New York Convention of 1958.

[125] Bogdan, ed. 6, p. 74, Collier, p. 359.

gradually developed to have the same meaning. [126] The limits on this study, however, do not allow for extended research of the issue.

The first public policy defence, V(2)(a), relates to whether the subject matter of the dispute can be settled by arbitration in the enforcing State. The article refers explicitly to the law of the country where the enforcement of the award is sought. No question, therefore, should arise as to which law is applicable to the arbitrability of the subject matter. Examples of matters that generally are seen as non-arbitrability matters are anti-trust, the validity of intellectual property rights, and family law.[127] The non-arbitrability matters may also be broadened by the reservation stated in Article I(3), according to which a State can choose to only apply the Convention to matters that are commercial under their national law. China has used this possibility of reservation. The concept of arbitrability varies from country to country and has been developed through the years. This development, along with the overall attitude of favouring arbitration, has lead to that the concept of arbitrability has expanded significantly over the last years.

Under Article V(2)(b) a country may refuse recognition and enforcement of an award if the award is in opposition of public policy of that State. This right is understandable since it relates to a country's fundamental principles. It is difficult to describe the concept of public policy, and a description of a violation of it is even harder. Each State has its own definition of public policy, which means that there is a risk that one State may deny an award that another State regards as valid. To prevent this from happening, an international public policy concept has been developed.[128] It is put forth in the literature that only a violation of a country's public policy in relation to international relations shall be of interest.[129] An established description of a violation of international public policy is an action that would "*violate the forum state's most basic notions of morality and justice*".[130] An international public policy limits judicial interference with international arbitral awards. This opinion is recognised by courts in the Convention States. The courts, then, provide an international dimension, as opposed to a domestic one, to the concept of public policy when applying Convention awards. One must, however, remember that even if public policy is recognized as international, its basis is national, as it can only be dealt with by a national judge.

The International Law Association Committee on International Commercial Arbitration published in 2000 and 2002 a report titled *Public Policy as a Bar to the Enforcement of International Arbitral Awards*.[131] This report gives some guidance for the classification of public policy grounds, and divides them into procedural and material matters. According to this report, a procedural public policy ground includes fraud in the composition of the tribunal, lack of reasons in the award, and lack of impartiality. The concept of the material matters of the public policy ground includes fundamental principles of law and actions contrary to

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[126] Di Pietro & Platte, p. 179.

[127] van den Berg, p. 370.

[128] The concept is for example embodied in French law, the French Decree Law no. 81-500 of May 12, 1981, Art. 1502.5 and in Portuguese law, the Code of Civil Procedure (1986), Art. 1096(f).

[129] Lew, Mistelis & Kröll, p. 721.

[130] Berger, p. 671.

[131] See http:/ / www.ila-hq.org/ available 12-04-05. The report was published in the Report of the seventieth Conference, New Delhi.

good morals.[132] The distinction between international and domestic public policy is justified by the differing purposes of domestic and international relations. As a result, matters which fall under international public policy are fewer then those in domestic cases.[133]

The development in the Convention of the public policy concept has resulted in a narrow interpretation and application of Article V(2) by Contracting States. This has raised the question whether the courts have gone too far in limiting public policy to considerations of "*the forum State's most notions of morality and justice*."[134] States tend to comply with international standards to such a great extent, that it is alleged that it has lead to a useless definition of public policy. It is even suggested that public policy no longer has a meaningful definition, especially in the United States of America where the courts have interpreted the concept very narrowly.[135] A development like this can be a hindrance to international arbitration. Parties could, at least in earlier times, rely on the protection embodied by the public policy concept in the country where the award was to be recognized and enforced. If the enforcing country does not use its own definition of public policy with regards to international awards, but rather interprets it in accordance with international influences, this protection no longer exists. If the public policy ground becomes nonexistent, parties may refrain from using arbitration, as the public policy ground can be seen as a "catch-all" rule.

An overall conclusion, based on the outcomes of enforcement cases of international arbitral awards around the world, is that it is very unusual for a court to rule in line with a public policy defence. A defence regarding violation of public policy is however commonly used by parties in the enforcement proceeding. In general, an award will only be refused if the international public policy principle is violated. The distinction between national and international public policy is broad. A far more restrictive view is taken concerning a violation of international public policy. For example, an award issued by the Istanbul Chamber of Commerce was enforced in Germany even though the award did not expressly state the reasoning for the judgement in the award.[136] The German court stated that this would be contrary to German internal *ordre public*, but distinguished this from *international ordre public*, which would only be violated if the foreign decision was contrary to the German procedural law to such an extent that it would violate the constitution. In Germany, as well as in many other countries, the reasoning for a judgement must be clear and apparent, but this was not considered to have the same importance for the enforcement of an international arbitral award.

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[132] Lew, Mistelis & Kröll, p. 723.

[133] van den Berg, Albert, p. 360.

[134] van den Berg, p. 367.

[135] van den Berg, p. 368.

[136] Unreported case, Oberlandesgericht Bremen, available in Lew, Mistelis & Kröll, pp. 728–729.

4 An Introduction to the Chinese Law

In order to understand and realize the problems a party may encounter participating in a legal process in China, a brief description of the legal history and of the current legal situation is necessary.

4.1 Development of Chinese Law

The traditional Chinese law started to develop more than 4000 years ago during the Qin Dynasty and is distinct from common law and civil law traditions of Western countries. It is constructed in a feudal system based on a patriarchal tradition. Within this system, equality before law was never officially accepted as a legal principle, and the system was not founded on democratic principles but on totalitarian ones. The traditional law was very similar in nature to criminal law, as it depended on criminal punishments (including torture), carrying the consequence that all litigations were subject to criminal procedures.[137]

No concept of private law existed in this traditional legal system. It did not have a separate judicial branch. The judicial officials, therefore, exercised both the power of administration and the power of adjudication. They acted as prosecutors and judges. These methods created a distrust of the legal system as a whole, which forced people to put their trust in individual officials and to find personal connections outside of the formal procedure. This legal system aimed to protect governmental and social interests, rather protecting individuals. This historical structure may partly explain the deep-rooted distrust of the legal system in the Chinese culture, which still exists.[138]

Since the end of the Cultural Revolution[139], China has developed a legal system founded on modern Western legal systems. Ever since the opening up of China to the outside world, the class struggle has been replaced by economic construction. Private ownership is allowed and protected, and trade with foreigners is promoted. These rapid changes have created a gap between the written law and the law in practice, since the traditional Chinese legal culture has persisted despite legal reforms.

The rule of law is not a formally adopted conception in China, instead the term "legal system" is used in official documents. Both terms have the same pronunciation in Chinese "*fa zhi*." The literal meaning of them, however, is different.[140] The long history of the traditional Chinese law and the old socialist system, which concentrates on the supremacy of the Party and the rule of man[141], do not guarantee the supremacy of law in society. The legislative explosion during the last 25 years has, to some extent, created confusion since the

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[137] Chenguang & Xianchu, pp. 4–6.

[138] *Ibid.*, pp. 4–6.

[139] The *Great Proletarian Cultural Revolution* lasted during 1966 to 1976. Under this ten year period China's legal system was destroyed and lawlessness was praised. The *Great Proletarian Cultural Revolution* ended with the death of Mao Zedong and the overthrow of the *Gang of Four*. For more information see Chenguang & Xianchu, p.11 f, Håkansson, p. 20.

[140] Chenguang & Xianchu, p. 14.

[141] A society governed solely by the decisions of those in power, i.e. the rule of only one man, namely the emperor.

rules are both contradictory and inconsistent. This is due to the constant changes promoted by reform and social transition, and the fact that governmental organs get more legal power (see Section 4.3). It is recognised by many legal scholars that one of the major problems is the implementation of laws.[142]

4.2 Sources of Law

The National People's Congress (NPC) constitutes the unitary legislative power of the entire nation and delegates certain legislative powers to local people's congresses and the central and local governments.[143] Today, China is a civil law country, in the sense that statute law is the source of legal rules. With focus put on the rules regulating business activities, a distinction can be made between published legislation and internal regulation. The published materials can be divided into four categories: a) *basic statutes* b) *decrees, decisions and instructions based on existing laws* c) *administrative regulations* and d) *local laws and administrative regulations*.[144] These published sources constitute one part of the legal framework, as the internal regulations also play an important role in China. These are administrative rules made by State agencies.

Adjacent to the published regulations and the internal regulations, a system for interpretation of laws exists. The Supreme People's Court develops most of the interpretive material, *judicial interpretation*. This has lead to a powerful role of the Supreme People's Court as a law-making institution. Many lower courts have been forced to try complex lawsuits in areas where relevant regulation has been insufficient or even absent. As a result, the Supreme People's Court has been forced to issue interpretations in order to help the lower courts. This is a demonstration of the failure of the judiciary and legislation to follow the rapid economical and social changes in China. Some issues have been raised concerning the judicial interpretation. These include the none-requirement to publish a judiciary interpretation and the lack of a review system for these interpretations.[145]

4.3 Judicial Structure

Courts, procuratorates and public security organs create the judicial structure in China. The courts are the most important in terms of settling legal disputes. The people's court have four levels, the Supreme People's Court at the national level, high courts at the provincial level, intermediates courts at the prefectural level (the level in-between the province and county levels) and basic courts at the county and city levels.

The courts are created by, and responsible for, people's congress. Their financial resources are provided and by central and local government.[146] Judges enjoy no tenure of office. They are to a great extent appointed, promoted and removed, not by the Supreme People's Court or Ministry of Justice, but by the local party and government elite.[147] The independ-

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[142] Chenguang & Xianchu, pp. 8, 12–13.

[143] Chenguang & Xianchu, p. 18.

[144] Håkansson, pp. 22–23.

[145] Håkansson, pp. 25–26.

[146] Chenguang & Xianchu, p. 25.

[147] Cohen, p. 71.

ence of courts and judges is limited by these arrangements. Consequently, rulings could be executed under pressure from local governments to favour local interests and economy.

Another problem is the rather low status of judges in China. As noted, court resolution in civil cases is a fairly new mechanism, and many people still associate courts with distrust and injustice. The status is further kept low as judges' salaries in mainland China are at a low level. For example, in Shenzhen (a city in southern China, close to the Hong Kong border), judges earn RMB[148] 2,000 – 3,000 Yuan per month.[149] The salaries here are among the highest in mainland China. This should be compared to a normal salary for a lawyer which, at the time, was RMB 10,000 - 30,000 Yuan per month.[150]

4.4 Legislation relevant to International Arbitration

China has quite an extensive legislation in the area of international arbitrations. These rules are mainly to be found in the 1991 Civil Procedural Law[151] (CPL) and in the 1994 Arbitration Law. The Arbitration Law codifies both domestic and international arbitration. The most important international treaty, regarding international arbitration, is the New York Convention of 1958 to which China acceded in 1987.[152] Before this accession, no foreign arbitral awards were enforced in China.[153] When an application for enforcement of an international arbitral award is filed in a court, Article 269 of the CPL states "*the People's court shall act according to the international treaties which China has conduded or to which China is a party or in accordance with the principle of mutual reciprocity*". The fact that international treaties shall take precedence over Chinese law, if there are differences, is stated in Article 238 of the same law.

Aside from the statutes, several documents issued by the Supreme People's Court give guidelines as to how the courts should handle international arbitral matters. As noted earlier, these documents are as important as the statutes. Two of the most important are the "*Notice on Court's Handling of Issues in Relation to Matters of Foreign- Related Arbitration and Foreign Arbitration*" (1995 Notice), and the "*Notice on the Implementation of China's Accession to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*" (1987 Notice).

In a historical perspective, it is worth mentioning that prior to the enactment of the Arbitration law in 1994 there existed fourteen laws, eighty administrative regulations and nearly two hundred local regulations that contained clauses on arbitration. Many of these contradicted each other.[154] Since July 1, 1997, Hong Kong became a Special Administrative Region of Mainland China. Hong Kong is also a party to the Convention. After the handover the Convention does not fit to the current relationship between Hong Kong and mainland China. Therefore, a reciprocity agreement between Hong Kong and mainland China was

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[148] RMB is the Chinese currency. 100 RMB = 82 SEK or 100RMB = 11.50 USD, as of 28-04-05.

[149] As of October 1996, see Håkansson, p. 195.

[150] Håkansson, p. 195.

[151] Provisions governing international arbitrations are found in Arts. 257–261, 266 and 269.

[152] See n. 23 for other treaties China has acceded.

[153] Cohen, p. 71.

[154] Cohen, p. 71.

signed.[155] This agreement permits the High Court of Hong Kong to enforce mainland Chinese awards made pursuant to the Arbitration Law of the People's Republic of China, and the Intermediate People's Court in China, to enforce awards made in Hong Kong pursuant to Hong Kong's Arbitration Ordinance. A press release states that the Convention no longer applies to the enforcement of arbitral awards between Hong Kong and mainland China.[156] Awards from either party are henceforth to be considered domestic.

It is important to note that there are Chinese provisions which expressly restrict the use of foreign laws and stipulate that the application of Chinese law is mandatory. An example is Article 126 of the Contract Law, which concerns Chinese-foreign equity joint ventures and exploration of natural resources. If a foreign law is written into these types of contracts, the contract will be in violation of Chinese law and deemed invalid.

4.5 Case law

Chinese law follows the legal tradition in which the main sources of law are statutes and written legal documents, and where judicial decisions are not legally binding in future cases. These decisions do, however, affect the judges and may have an effect on the outcome of other cases. It has been discussed whether the judicial decisions may have a more important position in the future, as the publication of cases by the Supreme People's Court has increased.[157]

4.6 Options for Commercial Dispute Resolution

In China, as well as in most other countries, options for solving commercial disputes exist. Negative attitudes toward the judiciary stem from Chinese history and have resulted in the development of alternative dispute resolutions. In many contracts with Chinese parties, a clause providing for friendly negotiations as a first step in settling a dispute is included. Other means for dispute settlement that are common in China are conciliation and mediation. These are non-binding and cannot be enforced, except as private contracts between the parties.[158] Although actions have been taken in recent years to improve the legal system in China, its judiciary tends not to be independent from the government, the Party, or other local interests. Another obstacle is that a foreign lawyer is not allowed to appear before a court of law in China.[159] In addition, many law practitioners fear the domestic court system of China as it lacks commercial expertise, as well as involving procedures that are slow and complex.[160] Arbitration, therefore, seems to be a far better option for a foreign party. If arbitration is chosen, the parties enjoy three alternatives in deciding where the arbitration is to be held. One option is to hold the arbitration proceeding in mainland China. It is, then, most likely to be held at one of the more than 100 arbitration commissions es-

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[155] The Arrangement Regarding the Mutual Recognition and Enforcement of Arbitral Awards between the Hong Kong Special Administration Region and Mainland China.

[156] Claver-Carone, pp. 369–404.

[157] Håkansson, p. 26.

[158] Håkansson, p. 34.

[159] Art. 241, the Civil Procedural Law.

[160] Unkovic, pp. 68–73, Claver-Carone, pp. 369–404.

tablished under the auspices of the CIETAC or the CMAC.[161] Another option is to hold the arbitration proceeding in Hong Kong since there is an agreement on mutual recognition and enforcement of arbitral awards between Hong Kong and mainland China.[162] Under this agreement, awards from either place are to be considered domestic, and not stipulated by the Convention. The third option available to parties choosing a venue for the arbitration settlement is to hold it abroad, i.e. outside the territories of China and Hong Kong. The award, then, will be treated as an international arbitral award in China.

[161] Claver-Carone, pp. 369–404.

[162] The 1999 Agreement on the Mutual Recognition and Enforcement of Arbitral Awards, effective on February 1, 2000. However it has retroactive effect to the date of the handover, July 1, 1997.

5 The Enforcement Procedure in China

5.1 Procedural Requirements

For enforcement of an international arbitral award, a proper application made within the time limits for commencement of such action is essential. A proper application should meet the standards set out in the "*Stipulations on Several Issues in respect of Enforcement Work of the People's Court*" that was issued by the Supreme People's Court in June 1998. According to it, a filing for an action to enforce an arbitral award must satisfy several conditions. The arbitration award should be final and binding upon the parties, the applicant is a party or successor to the award, and the subject matter for enforcement and the party against whom enforcement is made must be unambiguous. Furthermore, the party against whom enforcement is sought must have failed to execute the award within the time limit. The filing must also be made within the statutory time limit and made to the People's court.[163]

The application must include a written application for enforcement in Chinese, in which the status of assets of the party against whom enforcement is sought is stated. The application must also include the arbitral award, along with its Chinese translation certified by the Chinese embassy or consulate or a Chinese notary public. Additionally, the arbitration agreement or the contract containing the arbitration clause must also be submitted. As no foreign lawyers are allowed to appear before a court of law in China, a Chinese counsel must be consulted to file the enforcement action. A written power of attorney must be submitted in favour of the counsel, and it must be in Chinese. If the power of attorney is executed from outside of China, it has to be notarized and authenticated by a Chinese embassy or consulate.[164]

As noted, an application must be filed within certain time limits. The 1987 Notice states that the application shall be filed within the time limit regulated by the Civil Procedural Law. It is stipulated in Article 219 of this law that when either party is a natural person, an application must be filed within one year. If both parties are legal persons, an application must be filed within six months. Both time limits begin at the last day of the periods specified in the award for voluntary performance. If a party fails to file an application for enforcement within the time limit, the right to apply for enforcement is waived in China (for that award).

Another obstacle to accepting the application, which rightfully can be argued by the court, is that the court does not have jurisdiction over the action. A party shall apply to the Intermediate People's Court in one of the following localities:

1. if the respondent is a natural person, the place of his registered domicile or where he actually resides,
2. if the respondent is a legal entity, the place where its principal business office is located, or

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[163] Shengchang, *Observations to Magnus Andrén's Artide*, p. 82.

[164] *Ibid*. p. 82, Lin, p. 53.

3. if the respondent has no registered domicile, place of residence or principal business office, but has property situated within the territory of China, the place where that property is situated.[165]

In order to file a complete application, the party must also be aware of the fees to be submitted. First, there is a fee in the amount of 500 RMB[166] which is charged for a request for recognition of a foreign arbitral award. In this case, recognition means that the Intermediates People's Court only examines whether the validity of the arbitration award shall be confirmed. If an application is filed for both recognition and enforcement of the award, an additional fee must be paid. If the court decides to recognise the award, but not to enforce it, this latter fee will be refunded.[167] For recognition and enforcement, the fees will be charged in accordance with Article 8 of the "*Methods for Collecting Litigation Fees by the People's Court*" issued in June of 1989. These fees are much lower than the fees charged in a standard civil litigation case.[168] The fees can be examined in the table below:

Amount Sought for Enforcement	**Amount of Fees**
Below 10,000 RMB	50 RMB
10,000 to 500,000 RMB	0.5%
The part exceeding 500,000 RMB	0.1%

The court which has accepted the application for the enforcement shall issue a Notice of Enforcement within three days, ordering the respondent to fulfil the obligations ascertained by the award within the given time limit. If the respondent still does not comply, the court shall issue a ruling to take compulsory enforcement measures.[169]

5.2 Practical Issues

As noted, an arbitration is not a public proceeding. It is a confidential process. This means that there are no publications reporting the number of awards that are voluntarily performed. There is no system in China for collecting information on how many applications are sought for enforcement, and consequently no system for collecting information on the number of enforced or refused cases. The main source for information is the lawyers working in China, or the experiences encountered by businesspersons. In the late 1990's, two surveys of the enforcement situation in China were conducted, with differing results.[170] One of the surveys was conducted by Randall Peerenboom[171], the other one by the Arbitra-

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[165] Art. 3 of the 1987 Notice and Art. 269 CPL.

[166] RMB is the Chinese currency. 100 RMB = 82 SEK or 100RMB = 11.50 USD, as of 28-04-05.

[167] See the "*Stipulations on the Questions with respect to the Charging Fees and the Time Limit for Examination in Recognition and enforcement of Foreign Arbitral Awards*" issued in October 1998.

[168] Shengchang, *Observations to Magnus Andrén's Artide*, p. 83.

[169] Shengchang, *Observations to Magnus Andrén's Artide*, p. 83.

[170] See Peerenboom, pp. 8–13, Shengchang, *The Practical Application of Multilateral Conventions*, pp. 461–504.

[171] Randall Peerenboom holds, for example, a JD and a MA in Chinese Religion from Columbia Law School. He practiced law with a major international law firm in Beijing from 1995 to 1998. He currently teaches PRC law at the UCLA School of Law.

tion Research Institute (ARI) of the China Chamber of Commerce. Lawyers who handled the cases, press reports, academic articles and the Supreme People's Court Gazette supplied the information used in the Peerenboom survey. The ARI obtained information through interviews with judges at different courts. Only a small portion of the courts questioned by the ARI responded to the survey. It should be noted that the statistics merely are of potentially practical use, and that the statistics are incomplete. None of the surveys claim to be complete, nor do they provide a comprehensive description of the enforcement situation. Both surveys include international arbitral awards and awards rendered from CIETAC, and it is not possible to separate these statistics.

The data in the Peerenboom survey consist of 72 cases dating from 1995 to 1998. Forty-five of these cases were enforced. Peerenboom found that an applicant had a 17 percent chance of recovering 100 percent of the award, and in about one-third of the cases, the applicant was able to obtain 75-100 percent of the award. In the ARI survey, courts were asked about applications filed from 1990 to mid-1997. The responding courts held that 14 cases were filed for enforcement during this period and that 10 awards were recognized and enforced. These statistics, however, only account for a limited number of cases. Furthermore, very few reports on enforcement have been published.

The problems connected with the application procedure are not just related to whether the parties make a correct application. There may also be problems associated with the court's handling of the applications. Local protectionism[172] is one of the problems. Another relates to the uncertainty and lack of experience among the judicial officials handling the applications. There are reports showing that courts have treated applications as domestic awards. This is a very serious failure as the enforcement procedure in domestic cases allows review of the merits.[173] In several reported cases, the judges were unfamiliar with the rules regarding enforcement and they encountered an application for enforcement of a foreign award for the first time.[174] In another case reported in the Peerenboom survey, the court did not know which chamber of the court should make a ruling of whether to recognize the award, and what documents were required. It took 18 months to get the application accepted. In another case, this application process took 13 months. In other cases, the courts applied the wrong standards as they used the wrong law.

This neglectful attitude toward applications filed for enforcement is brought forth from several lawyers working in China as one of the main problems in the enforcement procedure today.[175] A fairly common practice is that the court does not do anything. Either it does not accept the application, or it waits for a very long time before it accepts it. A case could be pending for many years. A suggestion is that the court expects that the party eventually will forget the application. The problem, then, is solved without interference from the court. It costs a lot of money and energy to process, and in the end the party stops pursuing the case. Mr Xing Xiusong revealed one case in which he represented a Japanese company in an arbitral proceeding against a Chinese company at the Arbitration Institute of the Stockholm Chamber of Commerce. The Japanese party won and they sought enforcement of the award in China in late January, 2001. They are still waiting for a response

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[172] See Sec. 5.4.

[173] Art. 217 CPL allows a review on the merits in domestic awards.

[174] Peerenboom, pp. 8–13.

[175] Interviews with Xing Xiusong, Stockholm, April 2005; Thomas Lagerqvist, April 2005.

as to whether the case will be enforced or not. Mr Xiusong supplied another example of a case filed in 1994, in which there still has not been a final judging granted. In several cases, observers report that the courts refuse to accept an application for enforcement. If no application exists, no problems exist, and there is nothing to report to a higher court.

As noted, not many judgements are made public, and the judgements are issued in simplified form. A simplified judgement means that the judgements are made unreasoned, which further makes the transparency of the judiciary more difficult. No other judges or the public are able to understand the judgement or predict the outcome in a similar case. As the courts do not exchange documents and judgements on a regular basis, the uncertainty and lack of competence of the judicial officials will continue to exist.

5.3 Internal Review

In 1995, the Supreme People's Court issued the 1995 Notice in which an internal review system or, a pre-reporting system, was developed. The stipulations in this Notice were further specified in 1998 through the earlier noted "*Stipulations on the Questions with Respect to the Charging Fees and the Time Limit for Examination in Recognition and Enforcement of Foreign Arbitral Awards*", to which time limits were added. According to these two regulations, an Intermediates People's Court handling an enforcement application shall make its ruling within two months from the date it accepted the application. If the court decides to enforce the award, it shall be completed within six months of the date of the ruling.

If the court has valid reasons not to enforce the award, it shall report to its higher People's court within the area for examination. If this higher People's court agrees to refuse the enforcement, it shall report its opinion to the Supreme People's Court. Only after receiving the reply from the Supreme People's Court, the Intermediate People's Court can deny enforcement or recognition and enforcement. The report to the Supreme People's Court shall be made within the two month limit.

The introduction of this mechanism can be seen as a sign that the Supreme People's Court is aware of some of the problems connected with the enforcement procedure of international arbitral awards and is eager to prevent them. There is, however, criticism of this system among lawyers and scholars working in China.[176] The pre-reporting system does not give the enforcing party any right to review the report of the Intermediates Peoples Court or the higher courts and make submissions to it. Nor is there a right to appear before the higher courts or the Supreme People's Court. Furthermore, there is no time limit stating when the Supreme People's Court must submit their ruling.

The critics hold that the system is not efficient or fair. They claim that it is not fair that the parties are not allowed to be involved, and that it is far too time consuming. To overcome these problems, some people has suggested replacing the pre-reporting system with a right to make a normal appeal.[177] This would increase the chances of the party seeking enforcement to win the case, and provide for more fairness in the proceeding.[178] This opinion, however, is not shared by everyone working with international arbitration in China. The

[176] Interview with Xing Xiusong, Stockholm, April 2005.

[177] Interviews with Xing Xiusong, Stockholm, April 2005 and Wang Shengchang, Stockholm, April 2005.

[178] Interview with Xing Xiusong, Stockholm, April 2005.

vice chairman of CIETAC believes that the pre-reporting system works well and stresses that it has existed for a mere 10 years. He agrees that there is a lack of transparency, but he does not think that it is too much of a problem. He further emphasized that as the Supreme People's Court is an exclusive forum, the problem of local protectionism[179] is solved. Should the system change to involve normal appeal procedures, these would be at a local level, even if it would be to another court higher than the Intermediates People's Court. This solution, therefore, is not perfect either, and the existing system is better. The suggested system would decentralize the process, which would be a step back. Additionally, this would be more time consuming and costly since the parties would have to consult a lawyer for a longer time period.[180]

5.4 Local Protectionism

As noted, Chinese legislation requires a filing for enforcement of arbitral awards to be brought before the Intermediates People's Court at the venue where the party against which enforcement is sought either maintains its domicile or owns property. This legislation forces the applicant to deal with the non-performer's local court. If the latter party has economical or political connections, these connections are likely to be found where the party's local court is situated. At these places, the local court is under the supervision of the local government, which in turn has an interest in regional forces. The local government is involved in local enterprises and controls the personnel and financial affairs.[181] There is no clear separation between law and politics in China, which give rise to a widespread use of personal relationships (guanxi). These relationships are of high value among some officials of the courts. An outcome of this can be that judicial decisions are subjective to these external influences. There are measures, like party and governmental discipline and even criminal sanctions, against court and governmental personnel who repeatedly support local protectionism.[182] It is however unclear whether all courts are aware of these prohibitions and the possible sanctions against them.

It is important to have an understanding of the mechanism of local protectionism, in order to understand how and why it exists. Since 1985, the central government has gradually granted local governments more power and authority. Its revenue stems mainly from local taxation, fees and charges collected from activities of local businesses. In order to develop the local economy, the local governments consider the protection of local interests and sources of finance very important. Consequently, if the local court enforces an award against a local company, in favour of a foreign party, the local economy will be harmed. This could carry far-reaching consequences should the local company be forced to close down and the employees lose their jobs. As the employer generally provides housing, the employees would also lose their homes.[183] This would be a social and economical burden to the local government.

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[179] See Sec. 5.4.

[180] Opinions of Wang Shengchang, interviewed in Stockholm, April 2005.

[181] Hu, *Enforcement of the International Commercial Arbitration* Award, p. 20.

[182] Håkansson, p. 199, interview with Wang Shengchang, Stockholm, April 2005.

[183] Håkansson, p. 198.

One case in particular, the Revpower Ltd. case, has demonstrated the problems associated with local protectionism in China[184]. In July 1991, the arbitration proceeding commenced at the Arbitral Institute of the Stockholm Chamber of Commerce. Two years later, the arbitral panel entered an award of $4.9 million, plus interest, in favour of Revpower. The losing party did not pay voluntarily and Revpower filed an enforcement action in December 1993 at the party's local court in Shanghai. The court refused to accept the application. It did not even accept the filing fee from Revpower. The refusal to enforce the award constituted a clear violation of the Convention and Chinese law. Revpower gained the support of US governmental officials who brought this unlawful behaviour to the attention of the chief judge of the court, the Shanghai city officials, and the central governmental authorities, in an effort to commence the enforcement process. These attempts were fruitless. At the same time, Revpower began receiving reports that SFAIC was divesting its assets to another company. Revpower won strong support in Washington. Al Gore, the Vice-President during 1993 to 2000, and the Secretary of Commerce, Ron Brown, raised the issue with Chinese officials. Moreover, an amendment to an existing trade law was introduced which would compel the US to oppose China's accession to the WTO for so long as it was in violation of the Convention. These measures had the intended effect and in mid-1995, Chinese court officials invited Revpower to reapply for enforcement of the arbitration award.[185]

The problems with local protectionism are not, however, as big as they used to be, as efforts have been undertaken by the Chinese judicial authorities to come across and minimize the problems.[186] The pre-reporting system is one measure undertaken to abolish local protectionism as well as other judicial interpretations from the Supreme People's Court, alongside with more education of judicial officials. A representative from CIETAC agrees on the existence of local protectionism, but says the criticism is overstated.[187] He said that the main reason for its existence is the lack of independence of the court personnel and the local government. Mr Shengchang agrees that efforts have been undertaken to eliminate the problems with local protectionism and that this is particularly true after the Revpower case. Judges and courts have learned a lesson and now try harder to comply with the Convention. A suggestion for further improvement is to centralize the jurisdiction for enforcement of arbitral awards. More experienced judges would be handling the cases and the problem with local judges and local protectionism would disappear.

5.5 Public Policy

In Chinese law neither of the expressions *public policy* nor *ordre public* are used: instead the expression *social and public interests* is used.[188] No definition of this expression exists, but it is a general understanding that under the Chinese legal system *social and public interest* is interpreted differently from *public policy* or *ordre public*.[189] An interpretation of an action against *so-*

[184] Revpower Ltd. versus the Shanghai Far East Aero-Technology Import and Export Corporation (SFAIC).

[185] Information about the Revpower case obtained from Håkansson, p. 196 f, Mora, pp. 2–4.

[186] Hu, *Enforcement of Foreign Arbitral Awards*, p. 176.

[187] Interview with Wang Shengchang, Stockholm, April 2005.

[188] See, e.g. Art. 260 and 262 of the CPL and Art. 126 of the CL.

[189] Hu, *Enforcement of the International Commercial Arbitration Award*, p. 11.

cial and public interests include for example harm to the State sovereignty, deterioration and corruption of Chinese moral values, destruction of China's natural resources, heavy pollution of the environment etc.[190] An example where an award could be contrary to Chinese public policy is if the contract involves the import and dissemination of pornographic books, periodicals and materials.[191]

In one case, the Zhenzhou Intermediates People's Court refused enforcement on the ground that "…*according to current State policies and regulations enforcement…would seriously harm the economic influences of the State and public interest of society…*".[192] This ruling also illustrated some of the problems associated with local protectionism, as the defendant was a major local company. However, the Supreme People's Court overruled the decision and stated that the Intermediate People's Court had made an incorrect interpretation.[193] Although the ruling made by the Intermediates People's Court was overturned, it gives a glimpse of how some of the Intermediates People's Courts work and argue.

It seems that Westerners often believe that public policy is a big problem when applying for enforcement in China. This does not, however, seem to be correct. According to several observers, almost no cases are refused on the grounds of violation of public policy.[194] In a survey of enforcement rates of 72 foreign and CIETAC awards made between 1995 and 1998, there were only two cases refused on the grounds to the violation of public policy.[195]

5.6 State Entity as a Party

State-owned enterprises (SOEs) are often involved in commerce in China and thus parties to arbitration agreements. No special provisions prevail for State companies to be part of such agreements. SOEs are their own legal entities under the Chinese law where the State is the owner. A State entity is similar to a private company in the legal sense. It bears civil liability with the property conferred upon by the State. The Law on Industrial Enterprises Owned by the Whole People (the IEOWP) specifies the nature, rights and duties of State-owned enterprises. In these State-owned enterprises, there shall be complete separation between ownership and management, and the State does not bear unlimited liability for their debts.[196] Article 19 of the IEOWP stipulates that a State-owned company may be declared bankrupt in accordance with the law, or other matters. The Bankruptcy Law[197] applies to State-owned enterprises only, but it is not always strictly enforced.[198] As will be demon-

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[190] Chenguang & Xianchu, p. 257.

[191] Paragraph 10 of *the 1987 Supreme People's Court Response.*

[192] *Dongfeng Garments Factory of Kai Feng City and Tai Chu International Trade* (HK) *Company Ltd.* v. *Henan Garments Import and Export* (Group) *Company* (China).

[193] Hu, *Enforcement of the International Commercial Arbitration Award*, p. 11.

[194] Hu, *Enforcement of the International Commercial Arbitration Award*, p.11, interview with Wang Shengchang, Stockholm, April 2005.

[195] Peerenboom, pp. 8–13.

[196] Chenguang & Xianchu, p. 359.

[197] Law on Enterprise Bankruptcy of 1986.

[198] Chenguang & Xianchu, p. 360.

strated, the main problem having a State entity being the opposite party in an arbitration settlement arises when this party does not pay the award voluntarily.

A State entity cannot be declared bankrupt in the same way a private company can, according to present legislation. It is a requirement that a reorganization is performed first. If, after the reorganization, nothing can be done to save the company, it may be ordered to declare bankruptcy. The reverse procedure is performed at a private company. There, the debtor may go to court to obtain the money. Obtaining money from a private company, as opposed to from a State company in the enforcement procedure of an arbitral award is, therefore, faster. If State companies could declare bankruptcy the same way private ones do, many people would lose their jobs and make complaints to the government. This would not be acceptable in China.[199]

During the month of March 2005 however, the State Administration of State Owned Assets published a report on how to make the bankruptcy procedure more efficient. This report states that within four years time, State owned companies shall have the same position as private companies concerning the bankruptcy procedure. In the future, then, there will be a uniform system for both types of companies, which will facilitate the enforcement procedure of international arbitration awards.

An example will be used to illustrate a problem which can arise if the respondent is a State entity. An arbitration award was made in a New York Convention State, where the losing party was a Chinese State Company. [200] The award was, according to observers, correct and should be enforced in China in accordance with the Convention. Chinese courts, however, refused to enforce the award. As the court was not co-operative, the successful party agreed on a settlement, in order to obtain part of the remedies included in the award. The winning party did not, however, obtain any money. Since the respondent was a State Company, its assets were not to be used to pay settlements due to special rules regarding State Companies. There was a chance that the State Company would declare bankruptcy. This, however, was not allowed. Therefore, no money was paid to the successful party, even after the parties had agreed on a settlement worth less than the amount spelled out in the award.

5.7 Obtaining Remedies included in the Award

The main reason for non-enforcement of an award is the respondents' lack of assets. In the survey[201] conducted by Randall Peerenboom, the respondents' lacks of assets were reported to be the cause for failure to enforce the award in 43 percent of the non-enforcement cases. According to figures from 1996, approximately 20-30 percent of the enforcement of arbitral awards fail because of the respondent lacking sufficient assets.[202] In a number of cases, the respondents transferred its assets to another company, leaving no funds to comply with the award.[203] By doing so, the respondent was insolvent.

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[199] Interview with Wang Shengchang, Stockholm, April 2005.

[200] Information obtained in an interview with Thomas Lagerqvist, April 2005.

[201] See Sec. 5.2.

[202] Håkansson, p. 194.

[203] Håkansson, p. 193, Peerenboom, pp. 8–13.

Chinese law is still in some parts insufficient of ensuring that the enforcing party will recover the assets due. Some of the above discussed judicial provisions promulgated during recent years have improved the situation, however. The court is able to use several measures in order to affect the enforcement. These are, for example, sealing up, detaining, freezing, auctioning off, or selling off the property of the failing party. It can further freeze, or transfer bank deposits, of the failing party, compel the party to conduct specific performance, or transfer shares from one party to the other.[204]

The enforcing party should be aware that even if a court order for enforcement has been granted, the local legal community may be reluctant to liquidate a debtor because of the social and economic costs of such action. The Civil Procedure Law gives executive officers responsibilities to pursue property of the party against whom a judgement is to be executed.[205] This executive officer may favour local parties who are likely to be economically harmed by a judgement against them. This is another example of the problems of local protectionism, as the executive officers are dependent of the local government. The circle of local companies as the important mechanisms in the local economy is closed, in conjunction with the continued existence of the company and the executive officers.

[204] The execution measures are provided for in Arts. 221 to 233 the CPL.

[205] Art. 216 the CPL.

6 Conclusions

Currently, the most common way to resolve international commercial disputes is through international arbitration. This success would not be possible without efficient and reliable national laws and international treaties. These regulations must cover and protect the arbitration procedure, as well as the recognition and enforcement of the award. One, and probably the most important international instrument for recognition and enforcement, is the New York Convention. The Convention stipulates five grounds where the resisting party to an arbitral award may request that the court shall refuse to enforce the award. The court may also, on its own motion, refuse enforcement on two additional grounds.

These international standards are not always maintained in China. This is put forth by both foreign companies involved in enforcement procedures in China and by lawyers working in China. It may be a prejudiced opinion among people not directly working in or with China that the legislation is insufficient. This is not correct. It should be pointed out that the existing legislation could guarantee that international arbitral awards are recognized and enforced effectively and smoothly in China. This is not, however, the way it works today and businesspersons often complain about the situation. If the legislations exist, and China is bound to the New York Convention, the problem must lie within the administrative routines. Other problems are the interpretation and adjudication of these existing rules. This is also one of the conclusions of this study. This conclusion, however, is not new or revealing. Lawyers working in China are well aware of these problems.

This study further illustrates that the criticism of the enforcement procedure, put forth mainly by Westerners, corresponds to the general problems of the judicial system in China. In several cases, the criticism concerned undue delay extending for several years. It has also been shown that this delay in many cases was connected with uncertainty and lack of knowledge how to interpret the Convention. The lack of knowledge about the Convention among enforcing judges is not evidence of a negative view of the Convention as such. This insufficiency may be seen in the interpretation and use of other international conventions that China is bound to as well. Rather, it should probably be viewed as lack of continuous education and training of judges and judicial personnel. After the legal education at the University, the courts must continue to further educate its judges to be up-to-date with China's present international legal commitments.

In order to make the enforcement procedure more efficient, the enforcing parties themselves must be aware of the requirements laid down in different legislations which are discussed in this study. If the court is unsure of the necessary requirements, the party might save some time, and gain some credibility, if all documents are in order from the beginning. It is always very important to file the correct documents in a proper way, since an incomplete application is a legitimate reason to refuse enforcement of the arbitral award. To be able to file a proper application, the party must start the preparations early. This is especially true for documents to be translated into Chinese. As the time limits are relatively narrow, six months if both parties are legal persons and one year if one of them is a natural person, it is recommended that the party applying for enforcement start the process immediately after the voluntarily performance period has ended. It is also advisable to keep in mind that *ad hoc* arbitration awards may be refused in China. In order to diminish the possible problems that may arise in an enforcement procedure, it might be well advised to choose to solve the dispute at an arbitration institution.

The enforcing party must also be aware of the importance of personal relationships (*guanxi*) in the Chinese social and political life, which might influence the court as well. The party should not only be aware of *guanxi*, but also try to use this networking method. The enforcing party could, for instance, hire lawyers with *guanxi*, or establish relationships with the local government or other ministries. A party should not hesitate to contact the media in order to attract attention to their case. Another possible, and sometimes effective measure, is to make a complaint to the trade representative or Chinese embassy in their home country. This was shown to be effective in the previously mentioned Revpower case. The most important relationship, however, is that of the judge and other court personnel handling the case. Several cases have demonstrated this relationship to be the deciding factor on whether the case was handled efficiently or not.

In several cases, the cause for non-enforcement is the respondents' lack of assets. The enforcing party has limited possibilities to act in cases where this is due to an illegal transfer of assets. In some situations, however, the enforcing party themselves may be blamed to be put in a situation where the respondent lacks assets. This can be seen as a failure of an adequate due diligence. If this had been done at right time, a possibility is that the contract never had been signed between the parties. A satisfactory due diligence should either have been committed at the time of contracting with the respondent, or at the time when deciding whether to seek arbitration and then apply for enforcement. Several of the cases involves State companies, where the respondent is not able to commit the payment. The unsatisfactory situation that may arise when the State company cannot be bankrupt will hopefully vanish in the following years. This will optimistically be the outcome of the new report published by the State Administration of State Owned Assets. In the future, then, there will be no special provisions regarding State companies. These companies shall have the same position as private companies concerning the bankruptcy procedure. This will have positive influences on the enforcement situation of international arbitral awards in China.

A solution to the problems of both local protectionism, and poorly continuous educated judges and judicial officials, would be to develop some exclusive forums for arbitration enforcement procedures. Under the current system, the enforcing party must apply for enforcement at the local court of the non-performer. Even if this system does not encourage local protectionism, it does facilitate its existence. A further measure to shorten the time period within which the Supreme People's Court has to render their final judgement, would be to state a time limit of this ruling. Today no such time limit exists, and the parties may have to wait for many years.

A presumption is that international arbitral awards are treated in a rather fine way in China, compared to domestic court awards or domestic arbitral awards. As many of the reasons for refusals to enforce international arbitral awards or undue delays under the enforcement proceeding correspond to the judicial system, it is feasible to believe that problems of the same nature exist in domestic cases as well. China wants to establish and maintain good relations with the outside world. It can also be suggested that the local government, as well as the central government, wants to facilitate business relations between foreign and domestic companies. This aim might be even stronger today with the recent succession of China to the WTO.

The crucial point, at which the enforcement system is unsatisfactory, is the lack of knowledge among the ones working within it. This does not, however, imply that legal education is at an insufficient level. Every individual in China with law training needs to submit to a lawyers' exam in order to work within the law profession (e.g., as a judge or lawyer). This

exam is very difficult to pass. According to observers, the knowledge and education of the law students of today is at a satisfactory level. The lack of knowledge, then, is connected with the problems of transparency in the judicial system. When the Supreme People's Court issue new regulations, the courts which are to implement them must understand how these new regulations should be applied. There must also be a higher level of awareness of the international treaties and conventions China is bound to. If the judges are aware of these international instruments, they will be confident in approaching an action made according to these instruments. Another importance is the unsatisfactory lack of exchange of judgements between the courts. If the courts work separately from each other, and judges do not know how their colleagues rule, great uncertainty will be the outcome. This uncertainty will also affect the parties in an enforcement procedure, as they cannot predict the outcome.

The 4th division of the Intermediates People's Court, which handles foreign related matters and intellectual property, publishes a journal every two months containing cases and other information from the court. This is step in the right direction, as it improves the judicial system. Such publications create transparency providing for more openness in the court system. This is very much needed in China. Hopefully, additional divisions adopt this procedure.

It is not only important to improve the knowledge among people working within the courts, but also among businesspersons. It must be made clear that everyone should obey the law, and what the long-term consequences of not obeying the laws would be. When these principal notions are upheld, a more precise understanding of matters like international arbitration can be achieved. Companies must be convinced of the importance of establishing a connection between internationalization and a good environment for international dispute resolution. Arbitration is only one part of this. People engaged in international trade must first see the overall importance, in order to later understand and value an efficient and correct enforcement system. It must be made clear that the foreign investors and businesspersons are important to the economy of China. One way to attract them is to have a well working and accepted arbitration system as well as enforcement mechanisms. To achieve this, it is important to educate and inform businesspersons on these matters. Information must be provided in Chinese, and articles must be published in sources were the public can take part of them. It must be easier to get access to information about arbitration.

It is important that there is co-operation between the courts and the local interests, but not local protectionism. Rather, the focus should be on developing a system where the local area attracts foreign businesses. In order to realize this, judges, with people involved in local business and local government, must recognize the importance of the courts to carry out their responsibilities properly. This may affect interest in the area in the short-term, but the achievements obtained over the long-term must be stressed. Assistance is needed to commence such a co-operation, but it must be in the interest of the central government to discover the problems associated with the local enforcement procedures and assist the local authorities in establishing this joint effort.

At the present time, it is difficult to determine how often the failing party voluntarily complies with awards. Nevertheless, it is a problem, maybe not as large as some suggest, but this obstacle may interfere with the future development of international trade with China. Maybe one of the most important initiatives is to find measures to minimize the situations where a party must apply to a court for enforcement at all. It is of great importance to convey to the parties the importance of a voluntarily enforcement of the award. An awareness

of these matters could have a significant impact on future international business relations. The enforcing party should always try to remind the resisting party of his business reputation. If the resisting party realises that a negligence to comply with the award could hinder business deals in the future, he might choose to voluntarily comply with it.

Unfortunately, there are some problems in the administrative system in the Chinese courts, as well as other institutional problems, which will not be solved overnight. These weaknesses and problems, such as lack of transparency and lack of independence to the government, have consistent negative effects on the enforcement procedure of international arbitral awards. The actions and regulations stipulated by the Supreme People's Court do, however, confirm that China tries to improve in response to the criticism. What can be seen today is that measures to comply with international standards are taken at the central level, i.e. through the above-mentioned regulations and other actions. However, these measures for complying with international standards must also be taken at the local level. Today, local interests control the national interests of China. This is the main problem, and it is at the local level where measures and efforts to establish an efficient enforcement system must be introduced. The problems will no doubt vanish at the local level as well, as the importance of a well-organized enforcement system prevails at the central level. An improvement of the enforcement system can be expected in the future – hopefully this future is not too far away.

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Appendix 1

Excerpt from:

Convention on the Recognition and Enforcement of Foreign Arbitral Awards Done at New York, 10 June 1958; entered into force, 7 June 1959 United Nations, Treaty Series, vol. 330, p. 38, No. 4739 (1959)

Article II

1. Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.

2. The term "agreement in writing" shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.

3. The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

Article V

1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

(a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or

(c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

(d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition or enforcement of the award would be contrary to the public policy of that country.