Dispute settlement with Chinese companies

With China's economy developing rapidly over the last two decades, many foreign enterprises have invested in the country and are now doing business with Chinese partners. But because the global economy is currently slowing down, which has also affected the Chinese market, the number of commercial disputes between foreign investors and their Chinese business partners has increased. This guideline tries to clarify some of the important points a foreign enterprise should know when settling a legal dispute in China.

When foreign elements are involved, the parties are basically free in their choice of applicable law and jurisdiction as well as in their choice of Arbitration Commission abroad. There are different ways for foreign companies to settle legal disputes with a Chinese business partner over commercial issues in China. The party bringing the dispute can either seek litigation or choose to arbitrate the dispute at one of the international Arbitration Commissions or local arbitration institutions in China in the case of having chosen such a method of dispute settlement or mediation to settle the dispute. There are different requirements for each procedure; the most appropriate option for the foreign party depends on the circumstances of the case and the interests of the foreign party. The prevention of any kind of litigation or arbitration procedure is of course the best way to avoid any unnecessary high costs and risks.

1. Legal framework

The Chinese legal system is not based on Case Law; it can be qualified as Continental Law. A legal dispute settlement in court is based on laws, regulations and the opinions and general principles of the Supreme Court. Unlike some other countries, Case Law jurisdiction does not play a major role when settling legal disputes in the People's Court in China, since there is no uniform body of jurisdiction. Although the Supreme Court and some of the People's Courts as well as certain Arbitration Commissions do publish rulings which are considered to be important, they are only regarded as examples for future rulings and therefore have almost no meaning, since they are in no respect legally

©2012 EU SME Centre

binding for other courts. Therefore, rulings that some of the foreign companies have experienced in certain courts can be ruled differently in other local courts or Arbitration Commissions. Furthermore, since some Chinese regulations are very vague and imprecise, judges are provided with a wide range of latitude of judgment. Therefore, even if cases show similar facts, court rulings or arbitration awards can sometimes vary significantly.

1.1 Limitation of action

Regardless of whether the foreign party chooses litigation, arbitration or mediation to settle their dispute, the following points are extremely important for all dispute settlements:

- A civil or commercial case or arbitration is of course always linked to the Chinese Civil Law. It is important to know that according to Paragraph 135 General Principles of the Civil Law of the People's Republic of China (GPPRC) the limitation of action for national legal disputes is two years. According to 129 Contract Law (CL) for legal disputes over **international trading issues** and **contract disputes over the import or export of technology** the limitation of action is four years from the date when the claimant obtains knowledge or should have known of the circumstances giving entitlement to claim. The limitation of action for any **infringement of patent rights** is two years counted from the date on which the patentee or any interested party obtains or should have obtained knowledge of the infringing act. However, the People's Court shall not protect his rights if 20 years have passed since the infringement.

Chinese sea and maritime law provides a special regulation for the limitation of action. Special sea and maritime courts are responsible for maritime law disputes. Since the legal procedure is very different from the normal Chinese civil procedure it will not be included in this guideline.

- For the foreign dispute parties it will also be important to know that the limitation of action can be suspended during the last six months of the limitation if the plaintiff cannot exercise his right of claim because of force majeure or other obstacles. In these cases, the limitation of action for the foreign related case shall resume on the day when the grounds for the suspension are eliminated. The limitation of action is discontinued if a suit is brought or if one party makes a claim for or agrees to fulfilment of obligations. A new limitation of action shall be counted from the time of the discontinuance.

- Foreign parties should also notice that Chinese law does not admit the private agreements of shortening, prolongation or waiver of periods of limitation.

1.2 'Commercial disputes that involve foreign elements'

Chinese Contract Law and Civil Procedure Law offer special regulations for legal disputes concerning 'foreign related contracts'. The *Opinion of the Supreme People's Court on Several Issues Concerning the Implementation of the General Principle of the Civil Law of the People's Republic of China* (1988) and the *Opinion on Several Questions Concerning the Application of the Civil Procedure Law of the People's Republic of China* (1992) have specified the definition of 'commercial disputes that involve foreign elements' as:

- Where either both parties or one party in a civil legal relationship is a foreigner, a stateless person or a foreign legal person;

- The subject matter of the civil legal relationship is within the territory of a foreign country; or

- Any other legal fact which gives rise to, modifies, or extinguishes civil rights or obligations taking place in a foreign country.

1.3 Legal consequences of a case that involves 'foreign elements'

If the case is qualified as involving 'foreign elements', the legal consequences for every foreign company involved in the case are particularly significant. First of all, foreign related cases are brought under a **centralised jurisdiction** (see below 2.2. jurisdiction when 'foreign elements are involved'). By doing so, the Chinese legal system tries to upgrade the adjudication of such cases as well as strengthen supervision over the guidance to the adjudication of foreign-related civil and commercial cases and admitting the demand for high level of legal knowledge for these cases. Another very important consequence of qualifying a case as a dispute that involves 'foreign elements' is that the dispute parties are actually free **in their choice of applicable law** (Paragraph 145 GPCLPRC), **in their choice of jurisdiction and in their choice of Arbitration Commission** (domestic and abroad). The choice of applicable law can be made orally or in writing. Parties are even allowed to choose or re-choose the applicable law after the conclusion of contract.

Nevertheless, it must be said that according to Chinese law **foreign invested companies in China are regarded as Chinese companies. If, for example, a foreign invested company signs a contract agreement with a Chinese company over the delivery of goods within China, from a legal point of view, the contract cannot be qualified as a foreign-related contract. In these cases the dispute parties can only apply Chinese law. Furthermore, only Chinese jurisdiction can be taken into consideration. Generally, both parties are also only permitted to choose from the domestic Arbitration Commissions.**

©2012 EU SME Centre

Any joint venture contract, any business of real estate in China and any Chinese-foreign cooperative exploration and development of natural resources in China, though, will not benefit from these special provisions regarding the jurisdiction for foreign related contracts, even if one of the contract partners is a foreign company. According to Paragraph 34 and 244 of Civil Procedure Law, disputes related to the above-mentioned issues shall fall under the jurisdiction of the People's Courts of the People's Republic of China (PRC). Foreign Arbitration Commissions, however, can be taken into consideration for joint venture contracts.

2. Litigation

If a foreign company does not succeed in solving the dispute in a friendly way, as a last resort this foreign company can seek litigation. However, foreign enterprises often fear that they are likely to lose the case in court since local jurisdictions might favour local companies. Foreign companies also fear that cases in China take too long, which prevents many of them from taking the final step to file a lawsuit. Furthermore, many foreign companies believe that the corruption of Chinese courts plays a major role in terms of fair trials. And last but not least, foreign companies doubt the effectiveness of the court's ruling when it comes to the enforcement of the award.

On the other hand, China's desire for a positive international reputation as well as its interest in keeping and supporting further investment of foreign enterprises in the country can prevent the Chinese courts from favouring domestic companies over foreign enterprises. Additionally, the People's Court system has installed an online compliance hotline where dispute parties are able to report complaints over legal discrimination in court (http://jubao.court.gov.cn). When it comes to the effectiveness of enforcement awards, the Chinese legal system is no different from other international standards. **Only if the Chinese company has assets which can be frozen should a foreign company think about filing a lawsuit.** Therefore, accurate preparation and investigation is often the key to a successful outcome of the case.

2.1 Court system and instances

2.1.1 Four-tier court system

The PRC judiciary is a four-tier system composed of the basic court, the intermediate court, the superior court and the Supreme People's Court. The basic court is the lowest level of the judicial system, established at the county level, city districts directly under provincial leadership, autonomous regions, or municipality districts directly under the central government. Tribunals may also be set up in accordance with local conditions affiliated to the basic court.

©2012 EU SME Centre

The intermediate court is established at the level of a city directly under provincial leadership or autonomous regions, or between the basic court and the superior court in terms of municipalities directly under the central government. Most of the foreign related cases are conducted by intermediate courts.

The superior court is established at the provincial level, autonomous regions or municipalities directly under the central government.

The Supreme People's Court, situated in Beijing, sits atop the judicial system of the PRC and supervises the administration of justice by courts at various levels and by the specialised courts. The Supreme People's Court is responsible to the National People's Congress and its Standing Committee. There are subdivisions in the court according to subject matter or nature of the claim.

2.1.2 Two instances for final adjudication

The PRC follows the principle of two instances of trials for final adjudication; one is first instance (trial) and the other one is second instance (appeal). A foreign party may appeal the case to the trial court by initiating the second instance procedure within 30 days (for foreign party) upon receipt of the judgment. Failing to appeal the case within this time limit will result into the judgment taking effect.

The intermediate court hears appeals from the basic court. The superior court hears appeals from the intermediate court. The Supreme People's Court hears appeals from the superior court. All the cases are governed by the ordinary procedure except that simple cases are governed by summary procedure at the basic court. Nevertheless, when the dispute party chooses mediation by the court for dispute settlement, an appeal of the first instance trial is not possible, since the mediation agreement becomes legally binding on the date following the day it is signed by the parties.

Only in exceptional cases can a procedure for trial supervision be considered after an appeal has been unsuccessful. Trial supervision means that if a party to an action considers there to be an error in a legally effective judgment or written order, he may apply to the People's Court at the next higher level for a retrial; however, execution of the judgment or written order shall not be suspended. The contract parties shall apply for trial supervision within 2 years after the judgment is legally binding. The court which has released the ruling or a higher level of court can also initiate trial supervision on its own.

Therefore, this can be considered a third instance trial. But according to Paragraph 179 Civil Procedure Law, trial supervision is only granted under strict requirements, for example when there is new evidence which is sufficient to set aside the original judgment or written order; there is a lack of evidence for establishing the basic facts ascertained in the original judgment or written order; the main evidence for the facts ascertained in the original judgment or written order is falsified or not cross-examined; or there is a definite error in the application of law in the making of the original judgment or written order.

©2012 EU SME Centre

With respect to a legally effective mediation agreement, if evidence furnished by a party proves that the mediation violates the principle of voluntariness or that the content of the mediation agreement violates the law, the party may apply for a retrial.

The People's Court shall retry a case where violation of the statutory procedure may prevent the correct judgment or written order from being made or the adjudicator, in the course of the trial, commits embezzlement, accepts bribes, engages in malpractice for personal gain, or perverts the law in making the judgment or written order.

2.2 Jurisdiction when 'foreign elements are involved'

2.2.1 Jurisdiction

Foreign companies that consider going to court must know that the jurisdiction system for 'foreign related dispute' cases is slightly different. The Supreme People's Court of the PRC issued in 2001 the *Rules on Certain Issues Relating to Jurisdiction over Proceedings of Foreign Related Civil and Commercial Cases* to regulate the jurisdiction for foreign related disputes.

Foreign related disputes are special:

- Cases of disputes over foreign related contracts or rights infringements;

- Cases of disputes over letters of credit;

- Cases of application for the cancellation, recognition or enforcement of international arbitral decision;

- Cases of application for verifying the binding force of foreign related civil and commercial arbitration clauses; and

- Cases of application for the recognition or enforcement of civil or commercial judgments or rulings given by foreign courts.

These cases shall be governed by the:

a) People's Courts in the Economic and Technological Development Areas approved by the State Council (basic court);

b) Intermediate People's Courts in the provincial capital cities, the capital cities of autonomous regions and municipalities directly under the Central Government;

©2012 EU SME Centre

c) Intermediate People's Courts in the Special Economic Zones and cities directly under the State planning;

d) Other Intermediate People's Courts designated by the Supreme People's Courts; and

e) Superior People's Courts

Nevertheless, these provisions shall not be applicable to foreign related businesses disputes which are qualified as border trade dispute cases occurring in border provinces adjoining foreign countries, real estate cases or intellectual property cases involving foreign elements. A first instance patent dispute case shall be under the jurisdiction of an intermediate People's Court at the place where the government of the province, the autonomous region or the municipality directly under the Central Government is located or at an intermediate People's Court designated by the Supreme People's Court.

2.2.2 Territorial jurisdiction

Basically, the plaintiff is allowed to bring legal proceedings either to the place of performance or where the defendant is domiciled. Regarding a lawsuit brought against a dispute party who has no domicile in the PRC concerning a contract dispute or other disputes over property rights and interests, if the contract is signed or performed within the territory of the PRC, or the object of the action is within the territory of the PRC, or the defendant has detainable property within the territory of the PRC, or the defendant has its representative agency, branch, or business agent within the territory of the PRC, it may fall under the jurisdiction of the People's Court located in the place where the contract is signed or performed, the subject of the action is located, the defendant's detainable property is located, the infringing act takes place, or the representative agency, branch or business agent is located.

2.3 Requirements for litigation (procedure)

The following information shall give the reader a basic overview of the actual litigation procedure at court. However, it should be noted that the court's language is Chinese. Generally, contracts can be drafted in foreign languages if there are no special requirements about the contract language, but since the official language remains Chinese, a foreign interpreter service is necessary for the translation of the contracts. The cost must be paid by the foreign dispute party.

Also, dispute parties should notice that mediation during litigation in the People's Court is very common. Chinese judges very much prefer to mediate, since the Chinese legal system provides no procedure to appeal a mediation award or mediation agreement. They can be considered as the most important method for mediation besides the ones explained later on. Procedure for trial supervision against a legally effective mediation agreement remains possible under certain circumstances, but must be applied by the parties.

2.3.1 Filing case

The dispute party shall first file a complaint with the People's Court having jurisdiction over the case to start the legal procedure. The more detailed and disclosed the complaint is the better the chances are for the defendant to learn more about the plaintiff's strategy and to be better prepared. So technically, the complaint could be as simple as possible, but it shall specify at least the information about the defendant, clear claims, factors and grounds as well as the basic evidence.

Dispute parties should also notice that the People's Court, unlike many international jurisdictions, does not verify which particular claim is being brought to court. Therefore, dispute parties are especially advised to pay careful attention when preparing their head of claims. They should be drafted as specific as possible.

2.3.2 Hearing

After receipt of the complaint, the People's Court will decide whether to accept the case or not. The hearing of a civil case by the court of first instance is usually performed by a collegiate bench composed of judges and jurors or a collegiate bench composed of judges alone. A cross-examination of evidence is the next step in court. The court will hear and get both parties to fully state the facts and its grounds.

2.3.3 Evidence submission and cross-examination

Within the court-designated time limit for producing evidence, both plaintiff and defendant shall produce and submit all evidence to the court. Generally, the evidence which is submitted after this time limit will not be accepted and examined by the court, unless the producer has enough reasons for late submission which will also be subject to court approval. Therefore, it is notable that if foreign investors cannot submit evidence within the time limit specified by the court, an application with the court for late submission of evidence with reasonable grounds shall be filed. Generally, the court will organise both parties to cross-examine the evidence after both plaintiff and defendant have submitted all evidence.

2.3.4 Preparation of evidence

For foreign companies it is not always easy to meet the strict standards of evidence of Chinese courts. The burden of proving all necessary evidence lies with the complainant. If the complainant fails to provide the evidence he will bear the adverse consequences. For example, in litigations related to intellectual property, it is very difficult for the foreign companies to prove to the court the actual damage created due to the infringement of intellectual property, therefore the court often fixes much lower damage compensation than the foreign company has filed for in their lawsuit.

©2012 EU SME Centre

Generally speaking, the Civil Procedure Law does not allow procuring evidence through a discovery process (the evidence collection on a self-initiative inquiry by the court is only permitted if the matter concerns the interests of the country, public or if a third party is affected). When insufficient evidence is collected, a private investigator should be hired to assist the company to find valuable evidence, but this of course presents another additional cost, which the company has to take into consideration when calculating the costs. Also, cases have recently been reported where law firms have used illegal investigation methods to provide the court with the necessary evidence. This method is of course not recommended.

Chinese courts are also strict with the form of the evidence. To foreign companies in particular, this can create a heavy burden; any evidence created outside the People's Republic of China must be notarised by a local public notary, and then authenticated (legalised) by the Chinese Embassy or Consulate in that jurisdiction. Charges for notarisation and legalisation vary from jurisdiction to jurisdiction, but when a lot of evidence must undergo this treatment, the costs can become considerable.

Under certain circumstances foreign enterprises find it very important that evidence is preserved. The Chinese Civil Procedure Law (Art. 74) allows evidence to be preserved when there is a likelihood that evidence may cease to exist or be lost or difficult to obtain later on. The People’s Court can also take measures to preserve such evidence on its own initiative. The preservation is a necessary tool for the plaintiff to collect evidence and at the same time it decreases the plaintiff’s burden of proof.

2.3.5 Servicing litigation documents

Litigation documents shall be sent or delivered directly to the person to whom they are to be served. In addition to the relatively strict procedure for legalising evidence for the court as well as other procedural documents, servicing litigation documents to foreign companies which are not domiciled in China is often very arduous and time-consuming. For example, servicing through diplomatic channels can take six months or even more. Should a foreign company have already established a subsidiary or hired a lawyer in the PRC, servicing litigation procedure will become much easier. If none of the other servicing methods regulated by the Civil Procedure Law can be employed, the service shall be considered complete six months after the date when the public announcement was issued.

Former foreign related cases have shown that sometimes these formalities can become a huge challenge for the courts’ organisation skills. Cases have also been reported in which disputes over the proper service of litigation documents has become an issue.

2.4 Timetable

The trial court will decide whether to accept the lawsuit within 7 days of receiving the filing by the plaintiff. The trial court will serve the claim form to the defendant within 5 days of accepting the filing. The defendant may submit a defence to the trial court within 15 days of receiving the service of the claim form. The court will then serve the defence to the plaintiff within 5 days of receiving the defence. The trial court shall conclude the trial case governed by the general proceedings within 6 months of accepting the filing. This time limit can be extended by 6 months subject to the approval of the President of the Court. Any additional extension shall be subject to the approval of its Superior Court. The trial court shall conclude the trial case governed by the summary procedure within 3 months of accepting the filing.

However, for foreign related cases it is important to notice that according to article 248 (CPLPRC) the time period for handling a civil case involving foreign elements by the People's Court shall not be limited by the provisions mentioned above. In foreign related cases, the evidence procedure and servicing litigation documents are normally very time-consuming. As there is no legal regulation about the time limit of the foreign related procedure, it might take years in practice.

2.5 Enforcement

For foreign parties, the enforcement of an award is of course the main interest when filing a lawsuit. The purpose of an enforcement guarantee is to protect the lawful interests of the award debtor while at the same time ensuring the enforcement of the contents of the arbitral award. If, however, the award debtor is completely and fundamentally unable to perform its debt obligations, then the court will suspend or terminate the enforcement. For this reason, preparation before filling a lawsuit is highly important. Therefore, to determine if the award debtor is able to repay his debts is essential for a successful outcome of litigation. A private investigation might be necessary.

Enforcement of acts: foreign parties should also keep in mind that, like in many other international jurisdictions, actions/acts (which can only be fulfilled by the defendant) cannot be enforced in a People's Court. If, therefore, a claim is being prepared where one of the head claims includes the defendant taking certain action, the plaintiff shall also include damage compensation head claim in case the defendant is not willing to take the action. A claim which includes an action by stages can therefore help to reach a successful jurisdiction.

©2012 EU SME Centre

2.6 Court and preservation fees

Court fees for property disputes amount to 0.5-2.5% of the claim amount on an accumulative basis:

If the amount of claim is less than RMB 10,000	the court fee will be RMB 50
For the portion exceeding RMB 10,000 but less than RMB 100,000	the court fee will be 2.5% of the exceeding amount
For the portion exceeding RMB 100,000 but less than RMB 200,000	the court fee will be 2% of the exceeding amount
For the portion exceeding RMB 200,000 but less than RMB 500,000	the court fee will be 1.5% of the exceeding amount
For the portion exceeding RMB 500,000 but less than RMB 1,000,000	the court fee will be 1% of the exceeding amount
For the portion exceeding RMB 1,000,000 but less than RMB 2,000,000	the court fee will be 0.9% of the exceeding amount of claim
For the portion exceeding RMB 2,000,000 but less than RMB 5,000,000	the court fee will be 0.8% of the exceeding amount
For the portion exceeding RMB 5,000,000 but less than RMB 10,000,000	the court fee will be 0.7% of the exceeding amount
For the portion exceeding RMB 10,000,000 but less than RMB 20,000,000	the court fee will be 0.6% of the exceeding amount
For the portion exceeding RMB 20,000,000	the court fee will be 0.5% of the exceeding amount

These fees are not necessarily expensive, and often cheaper than arbitration fees. However, it is important for foreign enterprises to know that these fees are collected separately for first instance and second instance trials. Furthermore, if the other dispute party refuses to accept the enforceable judgment, then the applicant must additionally apply for enforcement – which produces a further cost. These points must be taken into account before failing a lawsuit.

Court fees and preservation fees must be pre-paid by the claimant. If, however, the plaintiff reaches a favourable jurisdiction legal costs are reimbursed.

2.7 Preservation of the opponent’s property

To ensure that a judgment can be enforced against the other dispute party, the foreign party should apply for preservation of the opponent's property. However, this also produces additional costs. First, an investigation into the opponent's assets may be necessary. The preservation fee itself depends on the amount preserved, but a deposit will have to be paid to the court to guarantee any damages resulting from wrongful preservation. The deposit is decided by the court.

©2012 EU SME Centre

2.8 Preliminary injunction

Preliminary injunction has become another important legal tool for foreign companies, especially in terms of patent and trademark infringements. For instance, the PRC Patent Law permits courts to issue injunctions before or during infringement proceedings. According to Paragraph 66 of the Chinese Patent Law, the People's Court shall make a ruling within 48 hours from the time of its acceptance of the application. If an extension is needed under special circumstances, an additional 48-hour extension can be provided. If a ruling is made in order to have the relevant act ceased, it shall be enforced immediately. The party that is dissatisfied with the ruling can file for a review, and the enforcement shall not be suspended during the period of review.

According to Paragraph 57 Trademark Law, a preliminary injunction is also possible when it comes to trademark infringements. The court must also make a ruling within 48 hours from the time of its acceptance of the application.

However, it is very difficult to clearly prove infringement and irreparable damages to support a grant of preliminary injunction. If patent and trademark infringements are found during exhibitions in P.R. China, it is advisable to get the evidence of infringements notarised during the exhibitions so that sufficient evidence can be provided in the litigation later on.

2.9 Lawyer fees

Lawyer fees vary depending on the case and the law firm of choice. For foreign enterprises it may be important to know that all foreign law firms - without exception - do not have the right to litigate in China's People's Courts. Only Chinese lawyers working for Chinese law firms are allowed to appear in court. Therefore, foreign law firms work together with local Chinese law firms when foreign law firms are involved in Chinese litigation.

Almost all foreign law firms and most Chinese law firms dealing with foreign related cases charge on time basis. Some Chinese law firms will agree to contingency arrangements for civil disputes. In practice, it is common to ask for advance estimates of time to be spent to control the costs.

When calculating the amount of litigation costs, foreign enterprises should also note that unlike many other international jurisdictions, lawyer fees are usually not awarded. This might be an important issue for smaller companies. Exceptions are only made for those cases where the parties have expressly agreed on the lawyer fees in a contract between the parties. However, courts may check if lawyer fees are reasonable. Generally, lawyer fees of foreign law firms are higher than the standard rate issued by the local bar association and may be unreasonable. In practice, lawyer fees often become an expensive investment which cannot be recovered. This should be evaluated by the foreign companies before taking the step to litigate.

©2012 EU SME Centre

3. Arbitration

Arbitration can also be considered if contract or pecuniary disputes arise between the parties. **But only if the contract between the foreign and the Chinese company includes a well-drafted arbitration clause can arbitration become a mandatory stage of dispute settlement.** An arbitration agreement shall contain the following particulars: an expression of intention to apply for arbitration; matters for arbitration; and a designated arbitration commission. If an arbitration agreement contains no provisions concerning the matters for arbitration or the arbitration commission, or those provisions are unclear, the parties may reach a supplementary agreement. If no such supplementary agreement can be reached, the arbitration agreement shall be null and void.

However, marital, hereditary or labour disputes cannot become a subject-matter of the arbitration. Arbitration in the PRC is more than just an alternative to the country's litigation system, since an arbitration agreement is legally binding for the dispute parties and therefore can be enforced. Also, dispute parties should notice that mediation during arbitration procedures is very common. If mediation during arbitration procedures leads to a settlement agreement, the arbitration tribunal shall make a written mediation statement or make an arbitration award in accordance with the result of the settlement agreement. Such written mediation statements and arbitration awards should be binding on the dispute parties.

In an arbitration dispute the parties are free to choose from the different Chinese arbitration institutions (China International Economic and Trade Arbitration Commission, Beijing Arbitration Commission, Shanghai Arbitration Commission) or foreign arbitration institutions such as the Hong Kong International Arbitration Centre, Singapore International Arbitration Centre, International Chamber of Commerce, Stockholm International Chamber of Commerce Arbitration Centre and London Court of International Arbitration.

With over 1,200 cases a year and over 100 employees, China International Economic and Trade Arbitration Commission (CIETAC - http://www.sccietac.org/main/en/) has for many years been the leading international arbitration commission for foreign related arbitration in the PRC and its cases have been increasing constantly. Its employees have many years of professional experience with foreign-related disputes and its arbitrators are experts in their specific fields. Furthermore, CIETAC provides over 200 non-Chinese arbitrators, which illustrates the effort of CIETAC to reach international standards. To further meet the demands and to improve the level of ruling CIETAC has revised its arbitration rules which came into force on May 1st 2012.

©2012 EU SME Centre

3.1 Specific improvements of the CIETAC

The most important change after the revision is that before, rulings only needed to meet the "principle of fairness and common sense" and "international business practices" which made almost every case very unpredictable. This is no longer the case since the revised CIETAC now proposes that every ruling must be according to Chinese law as well as the contract itself. **Furthermore, foreign parties will benefit from the revised regulation of the CIETAC since Chinese language in court will not be mandatory anymore. The parties are free to choose the official language. It is expected that most of the international legal dispute parties will choose English as the official language.** Before the revision the head of the arbitration tribunal had to be a Chinese person, this is not the case anymore. Nationality, applicable law and language of the proceeding can now be taken into account. And last but not least, on request of a dispute party an interlocutory arbitration award can be requested. Under certain circumstances the Commission, though, might request that the party puts down a security. How effective these new measures will prove to be for foreign related disputes must be determined by the next few years.

3.2 Arbitration procedure at CIETAC

The following information shall give the reader a basic overview of the actual arbitration procedure. The information will be given based on the process of CIETAC, since it has been the leading Arbitration Commission in the PRC. The arbitration procedure of CIETAC is representative for all other Arbitration Commissions in the PRC.

3.2.1 Application, defence and counterclaim

When applying for arbitration, foreign companies shall submit a request for arbitration in writing to the Secretariat of CIETAC, including all facts and evidences on which its claim is based. Foreign companies should notice that after applying for arbitration, a request for amendment is possible. However, the arbitral tribunal might refuse such a request if it considers that it is too late to raise the request and the amendment may delay the arbitration proceedings. It is therefore a discretionary decision of the arbitration tribunal. Good preparation before finalising the request for arbitration once again is a key factor for a favourable judgment.

The CIETAC Secretariat then will send the Notice of Arbitration to the respondent. The respondent must respond to the Notice and let the CIETAC Secretariat know if the party is willing to defend itself in written form within 45 days (in foreign related arbitration) from the date of receipt of the Notice of Arbitration. The written defence should also include all documentary evidence relevant to the case. The respondent may represent its counterclaim during the arbitration procedure. The counterclaim must be submitted to CIETAC within 45 days (in foreign related cases), from the respondent's receipt of the Notice of Arbitration.

©2012 EU SME Centre

3.2.2 Hearing

The arbitral tribunal will hold an oral hearing when examining the case. The arbitral tribunal may hold deliberation at any place or in any manner that it considers appropriate. The parties shall send their representative(s) to attend the hearing. If the respondent fails to appear at any oral hearing without showing sufficient cause for such failure, the arbitral tribunal may proceed with the arbitration and make a default award. If the claimant fails to appear at an oral hearing without showing sufficient cause for such failure, the claimant may be deemed to have withdrawn its request for arbitration.

3.2.3 Evidence

The claimant and the respondent shall assume the burden of proving the facts on which their claim, defence or counterclaim is based. The arbitral tribunal may undertake investigation and collect evidence on its own initiative where it deems it necessary. Should one party or both parties fail to be present, the investigation and collection of evidence shall by no means be affected.

The arbitral tribunal may consult an expert or appoint an appraiser for the clarification of special issues relating to a case. In this situation, the parties are obliged to submit or produce to the expert or appraiser any materials, documents, properties or goods related to the case for check-up, inspection or appraisal. The parties may engage their own experts to testify at the hearing. The admission of any evidence, including the evidence submitted by the parties, the expert's report, and the appraiser's report, shall be decided upon by the arbitral tribunal after examination thereof. The arbitral tribunal has the right to determine the relevance, weight and validity of the evidence.

3.2.4 Award

In an ordinary procedure case, the arbitral tribunal shall render an arbitral award within 6 months (in foreign related cases) from the date on which the arbitral tribunal is formed. In a summary procedure case, the arbitral tribunal shall make an award within 3 months from the date on which the arbitral tribunal is formed. At the request of the arbitral tribunal and with the approval of the Secretary General of the CIETAC, the time period of rendering an arbitral award may be extended. According to the CIETAC Arbitration Rules, the arbitral tribunal shall submit its draft arbitral award to the CIETAC for scrutiny before signing it and the CIETAC may remind the tribunal of issues in the award on the condition that the tribunal's independence in rendering the award is not affected. The scrutiny of arbitral awards may assist in ensuring high quality of CIETAC arbitration and the enforceability of its arbitral awards. The date on which the arbitral award is made is the date on which the arbitral award comes into effect.

©2012 EU SME Centre

3.3 Enforcement of the arbitral award

The arbitral award is final and binding upon both parties. Neither party may bring a lawsuit before a court of law on the same dispute resolved by the previous arbitration or make a request to any other organisation for revising the arbitral award. If, however, a party fails to comply with an award of an arbitral organ established according to the law, according to Paragraph 213 Civil Procedure Law the other party may apply for execution to the People's Court which has jurisdiction over the case. The People's Court applied to shall enforce the award.

If the party against whom the application is made furnishes proof that the arbitral award involves any of the following circumstances, the People's Court shall, after examination and verification by a collegial panel, make a written order not to allow the enforcement:

a) The parties have had no arbitration clause in their contract, nor have subsequently reached a written agreement on arbitration;

b) The matters dealt with by the award fall outside the scope of the arbitration agreement or are matters which the arbitral organ has no power to arbitrate;

c) The composition of the arbitration tribunal or the procedure for arbitration contradicts the procedure prescribed by the law;

d) The main evidence for ascertaining the facts is insufficient;

e) There is definite error in the application of the law; or

f) The arbitrators have committed embezzlement, accepted bribes or done malpractice for personal benefits or perverted the law in the arbitration of the case.

If the People's Court determines that the execution of the arbitral award is against the social and public interest, it shall make an order not to allow the execution. The above-mentioned written order shall be served on both parties and the arbitral organ. If the execution of an arbitral award is disallowed by a written order of the People's Court, the parties may, in accordance with a written agreement on arbitration reached between them, apply for arbitration again; they may also bring an action in a People's Court.

©2012 EU SME Centre

3.4 Arbitration fee schedule for international or foreign-related cases

Because arbitration law does not provide any specific regulation concerning arbitration fees (except that the price control authority will examine and approve the charging fees) each arbitration institute is basically free to determine the amount of charge, which is approved by the local government. The arbitration fee of CIETAC is representative for all other arbitration centres in the PRC:

If the amount of claim does not exceed RMB 1,000,000	the arbitration fee will be 4% of the claimed amount but not less than RMB 10,000
If the amount of claim is between RMB 1,000,000 and RMB 2,000,000	the arbitration fee will be RMB 40,000 plus 3.5% of the amount exceeding RMB 1,000,000
If the amount of claim is between RMB 2,000,000 and RMB 5,000,000	the arbitration fee will be RMB 75,000 plus 2.5% of the amount exceeding RMB 2,000,000
If the amount of claim is between RMB 5,000,000 and RMB 10,000,000	the arbitration fee will be RMB 150,000 plus 1.5% of the amount exceeding RMB 5,000,000
If the amount of claim is between RMB 10,000,000 and RMB 50,000,000	the arbitration fee will be RMB 225,000 plus 1% of the amount exceeding RMB 10,000,000
If the amount of claim is between RMB 50,000,000 and RMB 100,000,000	the arbitration fee will be RMB 625,000 plus 0.5% of the amount exceeding RMB 50,000,000
If the amount of claim is between RMB 100,000,000 and RMB 500,000,000	the arbitration fee will be RMB 875,000 plus 0.48% of the amount exceeding RMB 100,000,000
If the amount of claim is between RMB 500,000,000 and RMB 1,000,000,000	the arbitration fee will be RMB 2,795,000 plus 0.47% of the amount exceeding RMB 500,000,000
If the amount of claim is between RMB 1,000,000,000 and RMB 2,000,000,000	the arbitration fee will be RMB 5,145,000 plus 0.46% of the amount exceeding RMB 1,000,000,000
If the amount of claim is more than RMB 2,000,000,000	the arbitration fee will be RMB 9,745,000 plus 0.45% of the amount exceeding RMB 2,000,000,000, the total amount shall not exceed RMB 15,000,000

Each case, when being accepted, shall be charged an additional amount of RMB 10,000 as a registration fee which includes the expenses for examining the application for arbitration, initiating the arbitration proceedings, computerising management and filing the documents.

3.5 The recognition and enforcement of foreign arbitral awards by the Chinese courts

For foreign related disputes it may also be important to know that foreign arbitration awards are often faced with some difficulties when it comes to enforcement of the award. For instant the Civil Procedure Law does not permit foreign courts or arbitral institutions to apply directly to the Chinese courts for the enforcement of arbitral awards.

©2012 EU SME Centre

If, however, the party is seeking to enforce a foreign arbitral award they must apply to the courts in the following locations for the acceptance and hearing of its case: where the award debtor is an individual, the application for enforcement should be submitted to the court located in the place of that person's registered permanent residence or that person's place of actual residence; where the award debtor is a legal person, the application for enforcement should be submitted to the court located in the place of the legal person's principal place of business; where the award debtor does not have any place of residence, domicile or chief office in the PRC, but owns property in the PRC, the application for enforcement should be submitted to the court where such property is located.

When applying for the enforcement and recognition of a foreign arbitral award, the applicant must also pay an application fee, which will ultimately be borne by the award debtor. Where the applicant applies for the recognition and enforcement of a foreign arbitral award, the standards for the payment of application fees are as follows:

Where the enforcement does not involve a monetary amount or anything of monetary value	the application fee shall be between RMB 50 and RMB 500
Where the monetary amount or monetary value of the assets forming the subject of the enforcement order does not exceed RMB 10,000	the application fee shall be RMB 50
Where the relevant amount or value does exceed RMB 10,000 but less than RMB 500,000	a further 1.5% must be paid on such portion of the monetary amount or value which is in excess of RMB10,000
Where the relevant amount or value does exceed RMB 500,000 but is less than RMB 5 million	a further 1% of the amount exceeding RMB 500,000 shall be paid
Where the portion of the monetary amount or value does exceed RMB 5 million but is less than RMB 10 million	a further 0.5% of the amount exceeding RMB 5 million shall be paid
Where the relevant amount or value is more than RMB 10 million	a further 0.1% of the amount exceeding RMB 10 million shall be paid

4. Mediation

Mediation is another way to encourage parties to voluntarily reach an agreement to resolve their dispute. Mediation in China can be divided into four categories. In addition to the above-mentioned mediation conducted by the People's Court and mediation conducted by an arbitral tribunal, there are also administrative mediation and non-governmental mediation.

4.1 Administrative mediation

There is no particular definition of administrative mediation, which generally refers to mediation activities hosted by administrative organisations. The scope of administrative mediation is very wide. In practice, however, administrative mediation is not chosen very often to settle a dispute. One of the main reasons might be that dealing with administrative organisations is a big burden for foreign companies and often there is a lack of trust in these organisations when it comes to fair trials. Additionally, an administrative mediation agreement is not legally binding and therefore not enforceable, since it is considered only as a contract.

4.2 Non-governmental mediation

Non-governmental mediation refers to mediation activities hosted by non-governmental organisations or natural persons including the people’s mediation, commercial mediation and other unofficial mediation, such as lawyer mediation, neighbourhood mediation and so on. The non-governmental mediation organisations in the PRC have made great progress in recent years.

4.2.1 People’s mediation

People's mediation, which is carried out by People's Mediation Committees to help parties voluntarily reach settlement agreements through consultation by persuasion, guidance and other methods, is widely-used and distinctive in the PRC. Property and personal disputes can be resolved through people’s mediation. It is worth noting that the People's Mediation process does not charge parties for the trial of confirmation cases.

However, civil or commercial disputes between legal persons cannot be settled by the People’s Mediation. Therefore, the People’s Mediation does not play a major role when it comes to dispute settlements where foreign elements are involved, since most of the foreign related legal disputes are between companies and furthermore the People’s Mediator is not familiar with international business.

4.2.2 Mediation via mediation institutions

Currently there is no specific law regarding mediation through mediation institutions, and the mediation institutions themselves make their own rules. In China, there are two main kinds of mediation institutions: one is derived from arbitration institutions, such as the Beijing and the Guangzhou Arbitration Commissions which both provide independent mediation services. The other kinds are independently established mediation institutions, e.g. the China Council for the Promotion of International Trade (CCPIT - http://adr.ccpit.org). Any commercial dispute can be submitted to mediation via mediation institutions. The settlement agreement is like a civil contract, which cannot be enforced as easily as a court order.

©2012 EU SME Centre

Furthermore, there are no regulations concerning specific requirements for the mediators and mediation procedure. Each mediation centre is therefore free to choose the process of procedure. A standard of quality consequently cannot be guaranteed. Also, mediation agreements are only considered as contracts and thus they cannot be enforced. Therefore mediation via mediation institutions is not recommended.

4.3 Mediation fee (CIETAC – South China Mediation Centre)

Since the Chinese mediation system does not provide any regulation concerning mediation fees, each mediation institute is basically free to determine the amount of charge. The CIETAC – South Mediation Centre is a well-known mediation centre and their mediation fees are representative for all other mediation centres in China:

If the dispute amount does not exceed RMB 100,000	the mediation fee shall be 4% to 6% of the dispute amount but not less than RMB 1,500
If the dispute amount is between RMB 100,000 and RMB 500,000	the mediation fee shall be 2% to 4 % of the dispute amount
If the dispute amount is between RBM 500,000 and RMB 1,000,000	If the dispute amount is between RBM 500,000 and RMB 1,000,000
If the dispute amount is between RMB 1,000,000 and RMB 5,000,000	the mediation fee shall be between 0.55% and 1.75 % of the dispute amount
If the dispute amount is between RMB 5,000,000 and RMB 10,000,000	the mediation fee shall be 0.325% and 0.55% of the dispute amount
If the dispute amount is between RBM 10,000,000 and RMB 50,000,000	the mediation fee shall be 0.125% to 0.325% of the dispute amount
Any dispute amount over RMB 50,000,000	will produce a mediation fee of 0.125% of the dispute amount

5. Conclusion

5.1 Advantages and disadvantages of each type of dispute settlement

Due to the lack of regulations concerning mediation procedures in China, in practice foreign companies do not choose mediation in case of a legal dispute. Therefore, only the advantages and disadvantages of litigation and arbitration will be specifically analysed.

The ultimate choice between litigation and arbitration depends on various factors such as the party's personal preferences, the legal culture and the judicial circumstances of the country they reside in. The parties are free to choose between litigation and arbitration. Both are recognised by Chinese law as

©2012 EU SME Centre

methods for international commercial dispute settlements. An arbitration clause in the contract can make the arbitration mandatory when a dispute arises. **Often though these valuable clauses are not part of the contract or they are poorly drafted.** The parties should make it especially clear whether or not the contract parties want to choose litigation or arbitration. In any case they should avoid leaving both options available, since such clauses are legally void.

The major differences (advantages and disadvantages) between litigation and arbitration settlement can be described as the following:

a) It can be said that arbitration is highly flexible. While litigation has very strict provisions for servicing litigation documents in case of foreign related disputes, arbitration provides much less strict regulations on this matter.

b) While the litigation judges are appointed by the state and therefore cannot be designated by the parties, the parties of arbitration have the right to appoint an arbitrator from the selected list.

c) The parties of arbitration have the right to choose the arbitration body, the arbitration rules and the arbitration location. However, in the litigation, the choice of the jurisdiction of court, the procedure rules and the location of the hearing must comply with the Civil Procedure Law and other related laws and regulations.

d) Arbitration hearings as well as the decisions are not made publicly available. Civil cases are usually open to the public, except for the cases mentioned above.

e) Normally, arbitration is slightly quicker than the litigation procedure.

f) While the Chinese court follows a two-instance trial system, arbitration only provides a single ruling system. The single ruling system can be an advantage as well as a disadvantage. Especially when the arbitration award does not protect the civil claims of the foreign company, the legal system provides almost no further action which can be taken against this kind of award.

g) Choosing to arbitrate the dispute gives the parties the benefit to choose from several Chinese arbitration institutions and therefore they are able to avoid local protectionism. If the party chooses to file a case to the People's Court they must follow the provisions of the Civil Procedure Law in the jurisdiction by forum level and on exclusive jurisdiction.

h) Another advantage of some Arbitration Commissions (for example CIETAC and Shanghai Arbitration Commission) is that they now allow foreign attorneys to represent their foreign clients, while this is still forbidden in the litigation procedure. However, any statement as well as any interpretations of Chinese laws and regulations by foreign lawyers will still not be accepted by the Arbitration Commission.

©2012 EU SME Centre

i) Arbitration Commissions such as CIETAC and Shanghai Arbitration Commission also have the distinct advantage that the language to settle a legal dispute can be chosen. This is not the case in a People's Court, since Chinese is the official court language.

In conclusion, it can be said that arbitration in the PRC has many strong advantages to settle legal disputes where foreign elements are involved. If contract partners agree on a contract where foreign elements are included, the parties are basically free in their choice of applicable law and jurisdiction as well as in their choice of Arbitration Commission abroad. Therefore, foreign companies will want to choose the jurisdiction and Mediation Commission as well as applicable law of their own country. Nevertheless, Chinese contract partners are often not willing to go along with these contract clauses. Furthermore, foreign companies are advised to check if foreign awards over the matter of their dispute would be recognised for enforcement in case of a hearing at the People's Court in the PRC. Currently, China has a treaty on judicial assistance with countries such as France (civil and commercial), Italy (civil), Belgium (civil), Greece (civil and criminal), Spain (civil and commercial), Cyprus (civil and commercial as well as criminal), Bulgaria (civil and criminal) and Hungary (civil and commercial). Germany and England have no treaty with China. Therefore, only on the principle of reciprocity can foreign awards be enforced in each country. So far there are no cases recorded where German or English court rulings were enforced in the PRC.

To avoid these legal complications, foreign parties are advised to choose an international Arbitration Commission, since these kinds of clauses have become an international standard when drafting a contract with foreign elements involved. Foreign companies are advised to choose an Arbitration Commission in a neutral third land since there is a good possibility that these commissions will be accepted by the Chinese contract partners. Also important to know is that a commission located in one of the countries that is a member of the New York UN Convention should be chosen, since their awards can be accepted and enforced by China's People's Court under certain conditions, since China joined the New York UN Convention in 1987. Nevertheless this can sometimes not be the best choice for the party, since offshore arbitration has inconveniences such as preservation of property and evidence. Furthermore, there is still potential risk that the award of an internationally recognized Arbitration Commission might not be recognized and enforced by the Chinese courts.

Of course the main question will be whether the Chinese contract partner will want to agree to these choices of contract agreements. A Chinese Arbitration Commission can be chosen to settle possible legal disputes as well. It also can be agreed upon that foreign law shall be the applicable law. But since the Chinese Arbitration Commissions have almost no experience with foreign laws it is advised to agree on choosing Chinese law as the applicable law.

©2012 EU SME Centre

5.2 Proper preparation

Foreign parties in China often prefer to settle a dispute rather than to file a lawsuit, but if a satisfying compromise cannot be achieved, then the only way to settle the dispute may be to litigate. Common risks of litigating in China (and to a certain extent, arbitration in the PRC) are local protectionism, strict evidentiary rules, and enforcement challenges, but just as important in many smaller disputes is the cost of litigation. Companies should carefully consider whether the legal costs are worth the potential benefits, especially since not all these costs are recoverable.

Whatever path the foreign party chooses, it cannot be emphasised enough that to win a case, proper preparation of all evidence and assurance of the compliance of the preparation with Chinese law are very important. Contracts between the parties should be as specific as possible. It is advised to let professional lawyers draft these contracts. Therefore, agreements over liabilities, specific method of damage compensation calculation, applicable law and clauses to dispute settlements are advised to only be drafted with the support of a lawyer.

If a dispute needs to be settled in a litigation or arbitration procedure it is also important to know that a professional lawyer should be hired as soon as possible and the right choice of law firm is another important step for a favourable jurisdiction. Since foreign related cases are often very complex and most of the time many of the relevant documents are in foreign languages, it is very important for the foreign companies to hire a law firm which has experience in handling similar foreign disputes and can communicate effectively in both Chinese and the language of the foreign party. Most importantly, such law firms shall know not only the international practice but also the Chinese court practice.

The prevention of any kind of litigation procedure is of course the best way to avoid any unnecessary high costs. Preparation is the main key to success. For example, the contract should have accurate payment terms (such as prepayment or letter of credit clauses). The quality of the products should be checked in China before shipment is arranged. If any kind of problems occur, early communication with the Chinese contract partner will become very important. Traditionally, Chinese companies avoid going to court. Most of the companies are willing to settle the dispute by finding an amicable solution. But in most cases, these settlements only have a chance of succeeding if both contract partners are willing to make compromises. Litigation or arbitration is always the end of the business relationship. From this point of view, compromises are more valuable than justice.

A Chinese proverb says: “harmony is the most important thing.”

©2012 EU SME Centre

Contact the Centre at:

Room 910, Sunflower Tower
37 Maizidian West Street
Chaoyang District
Beijing, 100125

T: +86 10 8527 5300
F: +86 10 8527 5093

www.eusmecentre.org.cn
enquiries@eusmecentre.org.cn

The EU SME Centre assists European SMEs to export to China by providing a comprehensive range of free, hands-on support services including the provision of information, confidential advice, networking events and training. The Centre also acts as a platform facilitating coordination amongst Member State and European public and private sector service providers to SMEs.

The Centre's range of free services cover:
• Business Development – provision of market information, business and marketing advice
• Legal – legal information, 'ask the expert' initial consultations and practical manuals
• Standards – standards and conformity requirements when exporting to China
• HR and Training – industry and horizontal training programmes
• Access to a service providers directory and information databases
• Hot-desking – free, temporary office space in the EU SME Centre to explore local business opportunities
• Any other practical support services to EU SMEs wishing to export to or invest in China.

Disclaimer

This document is provided for general information purposes only and does not constitute legal, investment or other professional advice on any subject matter. Whereas every effort has been made to ensure that the information given in this document is accurate, the EU SME Centre accepts no liability for any errors, omissions or misleading statements, and no warranty is given or responsibility accepted as to the standing of any individual, firm, company or other organisation mentioned. Publication as well as commercial and non-commercial transmission to a third party is prohibited unless prior permission is obtained from the EU SME Centre. The views expressed in this publication do not necessarily reflect the views of the European Commission.

Date: July, 2012

The EU SME Centre is a project funded by the European Union.

©2012 EU SME Centre