PUBLICATION

Drafting Arbitration Clauses in Chinese/American Commercial Contracts for Arbitration in China

January 27, 2016

American companies doing business with Chinese companies in China are often concerned about the credibility, neutrality and quality of the arbitration institutions in China. As a result, American companies generally try to avoid arbitration in China and, instead, try to persuade the Chinese party to agree to what they believe is a more neutral jurisdiction, like Hong Kong or Singapore. However, many large Chinese companies, including state-owned enterprises or Chinese conglomerates, often insist that their commercial contracts with foreign parties provide for disputes to be resolved by arbitration in Mainland China. In addition, many Chinese courts located outside the first tier cities still refuse to enforce arbitration awards rendered outside of Mainland China. Plus, due to the type of likely disputes under the commercial contracts and/or the location of assets to satisfy any judgment, it may make more sense to arbitrate any dispute in China. Where arbitration in China is either required or otherwise makes sense, here are some important considerations when drafting the arbitration clause.

1. Arbitration Institutions and Location

Unlike U.S. or other Western nations, ad hoc arbitrations are not permitted in Mainland China. As a result, arbitration proceedings in China are required to be administered by institutions pursuant to China Arbitration Law. There are approximately 240 designated arbitration institutions in Mainland China and, in 2014, these arbitration institutions administered 113,660 cases. The China International Economic and Trade Arbitration Commission (CIETAC) is the oldest and largest arbitration institution in China. In 2012, a rift developed between CIETAC and its Shanghai and Shenzen-based branches. CIETAC has since restructured, and its former Shanghai branch is now an independent institution, the Shanghai International Arbitration Centre (SHIAC), and its former Shenzhen branch is now an independent institution operating as South China International Economic and Trade Arbitration Commission (SCIA). CIETAC, SHIAC, and SCIA are specifically set up for foreign-related disputes in China and are located in the major business and arbitration-friendly centers--Shanghai, Beijing, and Shenzhen.

When deciding on which institution to designate in the commercial contract, the parties should consider:

location of the business (whether it is close to Beijing, Shanghai or Shenzhen);

the number of foreign arbitrators and nationalities (SHIA approximately 255, CIETAC approximately 333, and SCIA approximately180);

cost and efficiency;

the nature of the dispute and specialties of each institution

- SHIAC: corporate law, foreign investment, M&A, IP, finance, securities, IT;
- CIETAC: corporate law, foreign investment, M&A, trade;
- SCIA: corporate law, foreign investment, M&A

2. Language

The parties should identify in the arbitration clause included in the commercial contract the language (e.g.,

English or Chinese) for conducting the arbitration proceedings. In the absence of such agreement, the language of the arbitration likely will be conducted in Chinese or a language designated by the arbitration institution.

3. Applicable Law

In an arbitration proceeding, there are two areas where different governing law may apply: 1) the merits of the case, and 2) the validity and scope of the arbitration clause.

In accordance with Article 126 of China Contract Law, parties to a foreign-related contract are free to choose the substantive law applicable to the contract except for Sino-foreign equity joint venture enterprise contracts, Sino-foreign cooperative joint venture contracts, and Sino-foreign joint exploration and development of natural resources contracts performed in China. In each of these cases, the parties are required to use Chinese law. Otherwise, in the absence of any express choice of law by the parties to a foreign-related arbitration, the tribunal may apply such law as it determines appropriate.

Parties also may agree upon the law that will govern the arbitration clause under Chinese law. Where the parties have made no such choice, laws of the domicile of the arbitration institution, or laws of the place of arbitration shall apply.

4. Evidence Rules

Similar to litigation proceedings in a court, arbitration proceedings in China are more inquisitorial than adversarial, which means the tribunal is actively involved in investigating the facts of the case. So parties are only required to produce evidence to prove their allegations or defenses. The tribunal can collect its own evidence when it deems it necessary. For U.S. parties who are not familiar with the inquisitorial system, they should try to include the use of adversarial-approach evidence rules in the arbitration clause, including document production, discovery, and cross-examination. In addition, China Arbitration Law permits the parties to a commercial contract to determine the scope of disclosure in arbitration. In this regard, the U.S. company may wish to include the International Bar Association's Rules on the Taking of Evidence in International Arbitration or other desirable evidence rules in the arbitration clause in the commercial contract.