Managing New Risks: Time to Revise Arbitration Clauses

For many foreign companies and their Chinese subsidiaries dealing with Chinese counterparts, arbitration is the preferred choice to resolve disputes. Perhaps the single most important reason for the popularity of arbitration in China, is that it avoids the risk of having to litigate in the home court of the Chinese party (local protectionism).

By Maarten Roos & Kathleen Cao

Arbitration also has some drawbacks, and recently a new disadvantage has come to the fore. The CIETAC (China International Economic and Trade Arbitration Commission), headquartered in Beijing but with important sub-commissions in Shanghai and Shenzhen, has always been the most popular of arbitration institutions in China for foreigners. But over the twelve months, a very public dispute has arisen between the Beijing CIETAC and its branches. In the end, the Shanghai CIETAC and the Shenzhen CIETAC pronounced themselves independent, and changed their names to the SHIAC and the SCIA respectively.

For convenience, the new arbitration commissions are called:

- SHIAC: Shanghai International Arbitration Commission (or Shanghai Arbitration Center).
- SCIA: South China International Economic and Trade Arbitration Commission (or Shenzhen Court of International Arbitration)

Unfortunately, this has not completely resolved the problem. While the SHIAC and SCIA are established with the approval and support of the local governments in Shanghai and Shenzhen, the CIETAC in Beijing continues to dispute their authority. To build its case, the CIETAC has established offices in Shanghai and Shenzhen respectively where it can hold arbitration hearings. Two questions are frequently asked;

1. If parties choose to refer disputes to the SHIAC or the SCIA, can their awards be enforced in other parts of China and internationally?

2. If parties have agreed to refer to the Shanghai CIETAC and the South-China CIETAC, then which commission should take the case to ensure enforceability?

Choosing the SHIAC or SCIA

Chinese arbitration law determines that for an arbitration institute to have jurisdiction, the parties must agree to refer the dispute to that specific arbitration institute. Thus referring to a place only is not sufficient, especially where that place has more than one institute (as is, and was already the case in both Shanghai and Shenzhen). Usually the parties will include an arbitration clause in their contract, stipulating that any disputes will be submitted to [xxx] arbitration institute, and that its award will be binding upon the parties.

After announcing their independence, the SHIAC and SCIA have continued to deal with the disputes in their hands, and have accepted new disputes that are referred to them. Where there is no ambiguity on the intention of the parties, then the risk is minimal that a court in China or abroad will refuse to enforce such an award - even as the CIETAC in Beijing continues to challenge the authority of the two defectors. Thus where parties want to take advantage of the long history and strong reputation of the SHIAC in Shanghai or the SCIA in Shenzhen, they can include an arbitration

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clause in their contracts that refers specifically to one of these institutes.

Choosing the CIETAC Shanghai Sub-commission or the CIETAC South China Sub-commission

For existing contracts with arbitration clauses, however, there is much more uncertainty. To give an example, a typical arbitration clause used to refer disputes to the CIETAC in Shanghai. The rules of the SHIAC state that it may continue accepting cases under its former name. However the Beijing CIETAC, either in Beijing or in its Shanghai office, also wants to take on disputes in this name. Thus the following issue arises:

- Where it is unclear which institute is referred to, then where should the claims be submitted? And will this choice have an impact on the enforceability of the final award?

A recent case illustrates these issues, and the picture is not pretty.

A dispute between Suzhou Canadian Solar Inc. and LDK Solar Co., Ltd. was referred to the CIETAC Shanghai (now the SHIAC) in July 2010, as per their arbitration agreement which referred to CIETAC, place of arbitration Shanghai. As is not unusual, it took some time to complete the case, and the award was issued in December 2012.

To enforce the award, the respondent applied to the Suzhou Intermediate Court. This court however issued a decision of non-enforcement (i.e. refusing the enforcement). In its arguments, it explained that the CIETAC Shanghai indeed had jurisdiction to take the case; but that when it declared itself independent, it should have given the parties the option to transfer the case back to the CIETAC in Beijing. By continuing to deal with this case and render an award, the SHIAC violated the principle of party autonomy. In other words, when it changed into the SHIAC, it was no longer the arbitration institute originally chosen by the parties.

The decision of the Suzhou court is not without controversy; commentators have raised the possibility that the court may have wanted to protect local industry. In another case, an award issued by the SCIA under similar circumstances was duly enforced by the Shenzhen Intermediate Court. But whatever the reasoning behind its decision, the Suzhou case shows a fundamental weakness in the current system, creating a precedent that other courts may follow.

R&P Comments

The most important conclusion of the past year is that when parties sign new contracts with arbitration clauses, the decision on the arbitration institute should leave no ambiguity on the parties' preferences. A relatively standard and simple example of an arbitration clause which sends disputes to the SHIAC, could be:

- Any dispute arising from or in connection with this Agreement shall be submitted to Shanghai International Economic and Trade Arbitration Commission ("SHIAC") for arbitration in accordance with the SHIAC Arbitration Rules as then in force. The number of arbitrators shall be three, one appointed by each of the parties, who will then appoint the third (who will be of a different nationality from the parties). The arbitration proceedings shall be conducted in English, and the final award shall cover arbitration costs as well as lawyer fees).

A much more difficult challenge for many companies, is whether existing contracts should be amended, including framework contracts that establish a legal framework (including dispute resolution forum) for subsequent purchase orders. Where possible, reaching some kind of agreement with the Chinese counterpart would be preferable. The best solution would be to execute an amended framework agreement or a supplementary agreement to clarify the intentions of the parties. If this is not realistic, then an email exchange may be helpful.

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What would be helpful as well, is if the Supreme People's Court steps in and resolves this controversy, by recognizing the authorities of the "new" arbitration institutes, and by determining which institute may take jurisdiction in which circumstances. Rumors suggest that this could happen before the end of the year, though it remains to be seen what such a ruling would be.

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