

## The Enforcement of Foreign Arbitration Awards in China

Article contributed by: Henry (Litong) Chen, MWE China Law Offices and B. Ted Howes, McDermott, Will & Emery

When cross-border business transactions lead to cross-border controversies, arbitration before an international panel of arbitrators—as opposed to litigation in the courts of a particular country—is usually the contracting parties' dispute-resolution mechanism of choice. Neutrality is a key reason for this. Both the venue for an international arbitration (normally, a third-party country from which neither of the parties in dispute is a citizen) and, more importantly perhaps, the decision makers in the arbitration (normally, a three-member panel of arbitrators where the Chairman is from a third-party country) are considered "neutral" to both sides of the dispute. However, enforceability is at least as important a reason as neutrality. Typically, arbitration awards are far easier to enforce across national boundaries than are the judgments of national courts. This is because more than 140 countries that have ratified the New York Convention on Recognition and Enforcement of International Arbitration Awards (the New York Convention), are treaty-bound to enforce foreign arbitral awards. There is no comparable international treaty for the enforcement of foreign court judgments.

In 1986, the People's Republic of China ratified the New York Convention. Over the more than 20 years that have transpired since China ratified the treaty, Chinese companies have become regular participants in proceedings before the International Chamber of Commerce, the Stockholm Chamber of Commerce, the Hong Kong International Arbitration Centre and similar international arbitral bodies. For many, however, the question remains whether the Chinese courts are faithful to the New York Convention in enforcing foreign arbitral awards, particularly when the awards go against local Chinese companies.

### *Validity of Arbitration in China*

If it can be said that arbitration is generally the preferred method of dispute resolution for international commercial transactions, it can also be said that arbitration is the *vastly* preferred method of dispute resolution for non-Chinese businesses doing business in China.

There are good reasons for this, including the relative weakness of the Chinese court system and the difficulty (if not impossibility) of enforcing foreign court judgments in China.

Chinese law certainly recognises the validity of arbitration. However, while most of the requirements for a valid arbitration under Chinese law are similar to those found in the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Arbitration, Chinese arbitration law differs from arbitration laws of most other countries in two critical respects:

- under Chinese law, domestic disputes with no foreign element, including a dispute between a Chinese party and the Chinese subsidiary of a foreign party, must have their seat of arbitration inside mainland China; and
- when the place of arbitration is within mainland China, Chinese law requires that the arbitration be administered by a Chinese arbitration institution rather than an international arbitration institution.

As a result of the limitations that Chinese law imposes on arbitration, Chinese courts have considerably more discretion to "set aside" (or refuse to enforce) arbitral awards rendered inside mainland China. Unlike foreign arbitral awards rendered outside mainland China, which can only be set aside on very limited grounds set forth in the New York Convention, domestic arbitral awards can be set aside by the Chinese courts on the ground that the evidence for ascertaining facts was insufficient or that there was a clear error in the application of the law. Arbitral awards rendered inside mainland China can, in other words, be reversed by the Chinese courts much like a normal court appeal. This, in turn, makes any arbitration inside mainland China ultimately reliant on the views of the Chinese courts if the losing party chooses to challenge the concerned arbitral award.

The fact that the local Chinese courts have less discretion to vacate a foreign arbitral award is a critical point for non-Chinese companies doing business in China. The local courts in China are still mostly financed by the local governments, and certain local Chinese governments have proved all too willing to interfere improperly in the judicial process with a view to obstructing enforcement. Thus, by agreeing that any dispute with a Chinese business will be arbitrated outside mainland China, a non-Chinese business should, in theory, be able to avoid a Chinese court "re-deciding" a case already decided against the Chinese business.

### *China's Enforcement and "Public Policy"*

As mentioned above, even the New York Convention permits the courts of the signatory states to refuse to enforce foreign arbitral awards in certain limited circumstances. Most significantly, the New York Convention permits the courts of the signatory states to refuse to enforce a foreign arbitral award that violates the "public policy" of the state. In practice, this "public policy" exception has been interpreted very narrowly by western courts, allowing a foreign arbitral award to be vacated on public policy grounds only when there is clear evidence that the arbitration violated the due process rights of the participants (*e.g.*, evidence that an arbitrator took a bribe from one of the parties).

Legal practitioners outside China tend to believe that the Chinese courts are quite loose in invoking "public policy" as a reason to reject the enforcement of arbitral awards that are rendered outside China. This belief, however, is somewhat of a misconception. On 17 April 2000, the Supreme People's Court of China (SPC) issued a notice mandating that no foreign arbitral awards could be vacated or refused for enforcement unless approved by the SPC. Therefore, since at least 2000, any decisions by the lower Chinese courts vacating a foreign arbitral award are subject to automatic review by the SPC. In turn, the SPC has been able to monitor efforts by parties and lower courts to prevent the enforcement of foreign arbitral awards since 2000.

This process has apparently had some positive results for the enforcement of arbitration awards against Chinese companies. According to a 2008 speech by Wan E'xiang, a deputy Chief Justice of the SPC, the lower courts of China refused to enforce foreign arbitral awards on public policy grounds seven to eight times between 2000 and 2008.<sup>1</sup> However, the SPC did not uphold *any* of these lower court decisions.<sup>2</sup>

As a result, and according to the deputy Chief Justice, "public policy" has actually not been invoked by the Chinese courts to vacate a single foreign arbitral award, at least, in the 2000-2008 time period. This is because, to quote the deputy Chief Justice, "public policy must be dealt with in a very precautious and prudent way [in respect of the enforcement of a non-Chinese arbitral award]."<sup>3</sup>

Due to the lack of available statistics on judicial decisions in China, the deputy Chief Justice's remarks cannot be independently verified. That said, there seems little reason to doubt his official representation. Indeed, on 11 August 2008, just a few months after the deputy Chief Justice's speech, the SPC upheld a decision<sup>4</sup> by an intermediate court in Shandong province that refused to enforce an arbitral award issued by a Paris arbitration tribunal on the ground that the award violated the public policy of China. This case was

hailed by the Chinese media as "the *first* case" to "refuse to recognize a foreign arbitral award on the grounds of the public policy."<sup>5</sup>

### *Defining "Public Policy"*

All signatories to the New York Convention pledge to honour foreign arbitral awards, by a process in which the enforcing party may present a copy of the foreign arbitral award to the appropriate judicial body in the chosen country for enforcement. However, as discussed above, the New York Convention allows national courts to overturn a foreign arbitral award if the award violates the "public policy" of that country. Hence, China, like almost all of the other states that have signed on to the New York Convention, can refuse to enforce foreign arbitral awards by invoking public policy.

The problem is that the term "public policy" is not defined under Chinese law. Under some Chinese protocols, the concept of "public policy" has been equated with the social public interests, which is a concept also not defined under Chinese law. For example, according to the Agreement Between Mainland China and Hong Kong SAR Concerning the Mutual Recognition and Enforcement of Arbitration Awards<sup>6</sup>, if a court in the mainland decides that it is against the social public interests of the mainland to enforce an arbitral award that is rendered in Hong Kong, the court of mainland China may refuse to enforce the arbitral award. According to the Deputy Director of the Enforcement Bureau of the SPC, "'social public interests' is a concept that falls within the political domain rather than a term of law... For a foreign-related or foreign arbitral award, social public interests are the same as the State's sovereign interests."<sup>7</sup>

### *Three Case Studies*

In order to better understand how Chinese courts understand and apply the concept of "public policy" to foreign arbitration awards, it is instructive to consider three specific case studies.

#### *Case Study 1: Refusal to Enforce a Foreign-Related Award on Public Policy Grounds*

As mentioned above, the SPC has not, at least between 2000 and 2008, refused to enforce a single "foreign" arbitral award on the ground of public policy. A "foreign arbitral" award, however, should not be confused with a "foreign-related" arbitral award. Under Chinese law, a "foreign" arbitral award refers to an arbitral award issued by an arbitration body located *outside* China. A "foreign-related" arbitral award, on the other hand, refers to an award issued by a Chinese arbitration body inside mainland China (e.g., the China International

Economic and Trade Arbitration Commission or CIETAC, the Shanghai Arbitration Commission, etc.) with respect to a foreign-related dispute (*e.g.*, where at least one of the parties to the arbitration is not Chinese).<sup>8</sup>

The provisions of the Civil Procedural Law in China do not directly define the terms "foreign arbitral award" and "foreign-related arbitral award." However, as a matter of practice, arbitral awards rendered by arbitration bodies located inside mainland China which have a foreign element are referred as "foreign-related" arbitral awards; arbitral awards rendered by the arbitration bodies outside of China are referred as "foreign" arbitral awards.<sup>9</sup>

This first case study concerns a "foreign-related" CIETAC arbitration dating from 1977. In this case,<sup>10</sup> a U.S. musical group entered into a contract to perform a concert in China, but the concert was suspended due to what authorities considered to be the objectionable content of the performance.<sup>11</sup> Specifically, the Chinese authorities asserted that the U.S. performers had breached the contract by performing "heavy metal music," which was not approved by the Ministry of Culture of China and that was otherwise "not suitable" for China.

After not being paid for their concert, the U.S. musical performers commenced an arbitration in mainland China pursuant to the CIETAC arbitration clause in the contract. The CIETAC arbitration tribunal, in turn, awarded damages to the U.S. performers.

The SPC, upon review of the decision issued by the lower court, concluded that the musical performance had in fact violated the social public interest of China, and as such, the Ministry of Culture's suspension of performance was caused by the breach of contract of the performing party. As a result, the SPC held that the CIETAC arbitral award could not be enforced without causing damage to the social public interests of China. Therefore, pursuant to Paragraph 2 of Article 260 of the Civil Procedure Law of the People's Republic of China (1991), the SPC refused to enforce the award.<sup>12</sup>

#### *Case Study 2: Refusal to Vacate a Foreign Arbitral Award on Public Policy Grounds*

In this case, dating from March 1999, a Japanese company commenced an arbitration against a Chinese state-owned enterprise (SOE) under the rules of the Arbitration Institute of the Stockholm Chamber of Commerce.<sup>13</sup> In its arbitration demand, the Japanese company alleged that the SOE had, by contract, assumed the obligation to pay back certain debt owed to the Japanese company by a Hong Kong company, and that the SOE was delinquent in repaying this debt.

After the Stockholm arbitration tribunal ruled in favour of the Japanese company, ordering the SOE to repay the debt, the SOE challenged the arbitration award in China's Haikou Intermediary Court. Specifically, the SOE argued that the arbitral award violated the "public policy" of China because the repayment of the foreign debt to the Japanese company had not been approved by the State Administration on Foreign Exchange (or SAFE), and that SAFE approval was compulsory.<sup>14</sup> SAFE is an agency of the Chinese government that is in charge, among other things, of approving the flow of foreign currency into and out of China.

The Haikou Intermediary Court, which had original jurisdiction over the enforcement of the proceeding, agreed with the SOE and found against enforcement of the arbitral award. The Hainan High People's Court thereafter affirmed the decision of the Intermediary Court, and sent it to the SPC for approval.

The SPC agreed with the lower courts that the SOE had in fact violated the laws and regulations of China regarding the approval and registration of foreign debt and China's policies on foreign exchange administration. However, the SPC went on to rule that "violation of compulsory provisions in the administrative regulations and departmental regulations *will not naturally constitute* a violation of the public policy of China"<sup>15</sup> (italics added). Therefore, the SPC reversed the lower courts, ruling that the foreign arbitral award was enforceable and could not be vacated on the ground that it violated the public policy of China.<sup>16</sup>

*Case Study 3: Recent SPC Decision Refusing to Enforce Foreign Arbitral Award on Public Policy Grounds*<sup>17</sup>

On 22 December 1995, one Chinese company, Jinan Yongning Pharmaceutical Co., Ltd. (Yongning Company), and three non-Chinese companies signed a contract to set up a joint venture. The joint venture contract provided that any disputes arising under the contract would be submitted to arbitration under the rules of the International Chamber of Commerce (ICC) in Paris. Subsequently, a leasing dispute occurred between the Yongning Company and the joint venture entity. A Chinese court, accepting jurisdiction over the dispute, ruled in favour of the Yongning Company, and ordered that the assets of the joint venture be impounded. As a result of this impounding, the operation of the joint venture was suspended and the joint venture was eventually closed.

In July 2005, the three non-Chinese parties to the underlying joint venture contract, invoking the arbitration clause in the contract, commenced an ICC arbitration in Paris against the Yongning Company. After hearing both sides, the ICC arbitration tribunal ruled

that the Yongning Company had breached the joint venture contract by petitioning a Chinese court to impound the assets of the joint venture. As a result, the ICC tribunal ordered the Yongning Company to pay US\$6,458,708.40 as damages.

Because the Yongning Company did not pay the money mandated by the ICC arbitration award, the three non-Chinese companies lodged a lawsuit in Jinan Intermediate People's Court on 10 September 2007, seeking the court's recognition and enforcement of the foreign arbitral award. The Court, however, held that the arbitration clause in the joint venture contract only bound the disputes between the contracting parties, and therefore did not bind the leasing disputes between the Yongning Company and the joint venture. As a result, the Chinese court ruled that the ICC arbitration award, by purporting to resolve a dispute that was subject to the jurisdiction of the Chinese courts, violated China's judicial sovereignty and, with it, Chinese public policy. Accordingly, the Jinan Intermediate People's Court held that the arbitral award should not be enforced, which decision was affirmed by the SPC.

#### *Conclusion: An Evolving Judiciary*

The above three case studies provide at least some parameters about what constitutes "public policy" under Chinese law with respect to the enforcement of foreign arbitral awards. As can be seen from Case Study 2, it appears that administrative regulations, such as the SAFE regulations, do not constitute public policy. In fact, even a violation of a compulsory provision in an administrative regulation does not lead to violation of public policy.

To the contrary, a violation of public policy seems to require proof of an affront to the higher "social public interest" of China as a whole, whether it relates to the moral order of the country (Case Study 1) or the sovereignty of the Chinese courts (Case Study 3). This difficult level of proof may explain why the SPC has apparently vacated only one foreign arbitral award on public policy grounds since (at least) 2000.

It is likely that China's judicial policy toward foreign arbitral awards will continue to evolve in a positive way. This evolution is inseparable from China's business, cultural and economic environment; privatization and rapid economic growth will surely, over time, create the changes that require a more sophisticated and "internationalist" judiciary. China already has travelled far in transforming itself from a closed society to one that is governed by transparency and rule of law. The likelihood is that enforcement of foreign arbitral awards will follow a similar path of integration into the global legal and business system.

*Henry (Litong) Chen, the Commissioner of the Economic Committee of All China Lawyers' Association, is a partner of MWE China Law Offices, a leading Chinese law firm based in Shanghai. Mr. Chen is licensed in the PRC and the State of New York. Mr. Chen's practicing areas include international arbitration, domestic litigation, compliance with the Chinese Anti-Monopoly Law, anti-trust filings, Foreign Corrupt Practices Act (FCPA) investigations and auditing, risk management under anti-commercial bribery laws and other corporate services. Email: HenryChen@mwechinalaw.com.*

*Mr. Howes is a partner in the New York office of McDermott Will & Emery LLP, an international law firm that has a strategic alliance with MWE China Law Offices. Mr. Howes specializes in international arbitration and complex commercial litigation, with a special focus on international dispute resolution. Mr. Howes is also the head of the Firm's Chinese Litigation and Dispute Resolution Group and the Firm's Chinese Products Practice Group, and has significant experience regarding the resolution of disputes with Chinese entities. Email: bhowes@mwe.com. His biography can be found at [www.mwe.com](http://www.mwe.com).*

*The views expressed in this article are those of the author and are not to be attributed to Bloomberg Finance L.P.*

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<sup>1</sup> Speech by Wan E'xiang, Deputy Chief Justice of the Supreme People's Court of China, on 6 June 2008 at the 50th Anniversary Symposium of the New York Convention (available at <http://www.rucil.com.cn/article/default.asp?id=798>).

<sup>2</sup> According to the deputy Chief Justice (available at <http://www.rucil.com.cn/article/default.asp?id=798>), from the beginning of 2000 to the end of 2007, a total of 12 foreign arbitral awards were not recognized and enforced by the SPC. Of these twelve awards: four were refused because the statute of limitations for application for enforcement had expired; five were refused because the concerned parties had not reached an arbitral agreement or the arbitration clause had been invalid; one was refused because the concerned party against which the arbitral award was enforced did not have any enforceable assets within China; and the remaining award was refused because the concerned party against which the arbitral award was enforced had not received the notice for appointment of arbitrators and arbitration procedure. The deputy Chief Justice did not mention how many foreign arbitral awards were vacated before 2000, or whether public policy was invoked by the Chinese courts to vacate any pre-2000 foreign arbitral awards.

<sup>3</sup> See Endnote 1.

<sup>4</sup> The SPC did not officially publish its decision on the case. The contents of the decision were provided in news reports — see Endnote 5.

<sup>5</sup> See <http://www.chinanews.com.cn/cj/cyzh/news/2008/07-16/1314096.shtml> (last visited 9 March 2009).

<sup>6</sup> See [http://www.law-lib.com/law/law\\_view.asp?id=13](http://www.law-lib.com/law/law_view.asp?id=13) (last visited 29 October 2009).

<sup>7</sup> Available at: <http://cn.cietac.org/TheoryResearch/readbookcontent.asp?cgid=124> (last visited 24 October 2009).

<sup>8</sup> The Civil Procedural Law of the People's Republic of China (2007), Article 267 and Chapter 27.

- <sup>9</sup> The Civil Procedural Law of the People's Republic of China (2007), Article 258.2.
- <sup>10</sup> See <http://cn.cietac.org/TheoryResearch/readbookcontent.asp?cgid=124> (last visited 24 October 2009).
- <sup>11</sup> Reply Letter of the Supreme People's Court Regarding the Request of Beijing First Intermediary People's Court for Refusal to Enforce the Arbitral Award [1997] Ta No.35.
- <sup>12</sup> The reader should note that this case was decided in 1977, before China adopted its reform and open door policy. The performance of heavy metal music would almost certainly not rise to the level of public policy in China today.
- <sup>13</sup> See <http://www.cninfo.net/news/200710/17022900.htm> (last visited on 24 October 2009).
- <sup>14</sup> Available at <http://www.cninfo.net/news/200710/17022900.htm> (last visited on 24 October 2009).
- <sup>15</sup> See Endnote 15.
- <sup>16</sup> Reply Letter of the Supreme People's Court Regarding the Request of Haikou Intermediary Court for Refusal to Admit and Enforce the Arbitral Award of the Arbitration Inst. of Stockholm Chamber of Commerce (13 July 2005) [2001] Min Si Ta Zi No.12.
- <sup>17</sup> The SPC has not officially published this case yet. The facts of this case are taken from the media.