The Laws of the People's Republic of China: An Introduction for International Investors

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I. INTRODUCTION

China’s growth is well documented. Much of this growth has been fueled by seemingly unceasing investment from the developed world, particularly the United States and Western European nations.

As a practitioner based in China and advising foreign investors, I have observed a trend resulting from China’s growth: the increasing use of Chinese law and Chinese dispute resolution organs to govern investments. The euphoria and after-glow experienced by foreign investors at the close of a deal is often quickly replaced by the realization that the relative certainty of law and judicial processes prevailing in the investors’ home states may not exactly be replicated in the People’s Republic of China ("PRC").

The purpose of this Article is to provide foreign investors with a basic understanding of the laws and institutions that are most likely to have an impact on their investments in China. It does not attempt to be academic in its approach, as I believe that a useful introduction to the legal regime requires a blend of a textual understanding of the law as well as lessons learned from practical experience.

As China’s economy continues to integrate with the rest of the world, and as Chinese law increasingly gains recognition, it seems inevitable that an understanding of Chinese business law will become a basic requirement for international lawyers. In this Article, I will focus on the following topics that I believe are “live” issues, both for the Chinese government and foreign investors: the Chinese judicial system and its reform, alternative dispute resolution

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mechanisms, the protection of intellectual property rights, employment law, and bankruptcy reform.

II. THE JUDICIAL SYSTEM OF THE PRC AND JUDICIAL REFORM

China is in transition from a state-controlled system of administrative fiat to one that respects the rule of law. The Chinese judicial system is being reformed slowly, which often makes foreign investors resort to alternative dispute resolution procedures to solve disputes. Since the early 1990s, China has put into effect measures both to reform its judicial system and to increase transparency. This Section aims to provide an understanding of the Chinese judicial system, particularly the aspects that affect the settlement and outcome of commercial disputes.

A. THE HIERARCHY OF THE CHINESE COURTS

Chinese courts are established pursuant to the Constitution of the PRC and the People’s Courts Law of the PRC, and exercise judicial power on behalf of the state.

There are four levels in the judicial hierarchy—the Supreme People’s Court and the following three levels found in each province, autonomous region, or municipality directly under the central government: the Higher People’s Courts, the Intermediate People’s Courts, and the Basic People’s Courts. These are the courts that are most likely to have impact on daily or business life. In addition to these courts, there are also courts with jurisdiction over specialized matters, such as maritime and railway transportation issues.

The Supreme People’s Court is the highest judicial organ in China, and it is responsible for interpretation of the law, administration of the judicial system beneath it, and the hearing of cases (although, as with appellate bodies in other countries, it hears only a limited number of cases). The Higher People’s Courts and the Intermediate People’s Courts are, in essence, appellate courts in the provinces, though they also have first-instance jurisdiction over matters that meet certain substantive requirements, such as when the amount in dispute is

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1 PRC Const, art 123.
2 People’s Courts Law of the PRC, National People’s Congress (July 1, 1979, amended Sept 2, 1983).
3 China has twenty-three provinces, five autonomous regions, four municipalities directly under the central government, and two special administrative regions. See Chinaview About China, Xinhua News Agency (2003), available online at <http://news.xinhuanet.com/english/2003-02/19/content_815536.htm> (visited May 7, 2006).
The amount that will confer original jurisdiction is decided by both the Supreme People's Court as well as the Higher People's Courts of each province and can differ from province to province.

B. COURT INSTITUTIONS

At first instance, most cases in China are heard by a collegial panel of three judges—a presiding judge and two other judges or "judicial assessors." Appeals are also heard by a panel of judges.

Administratively, all courts (for instance, the Basic People's Court of a particular district) will have an adjudicative committee comprising the president of the court, the chief judge, and senior judges. The role of the adjudicative committee is to exercise collective leadership over the court's judicial activities. It can also assist and may provide its views to the presiding judge of a collegial panel where there are difficult issues and complex cases. The collegial panel will usually follow the views of the adjudicative committee. The Supreme People's Court also has an adjudicative committee; one of the committee's responsibilities is the issuance of "judicial interpretations" that seek to clarify unclear or ambiguous legislation.

C. TRIAL PROCEDURE

The Chinese People's Courts employ a system which is known in China as "two trials for a final decision." This means a decision of a first instance trial court is always subject to appeal, with the ability to appeal being "as of right." As long as any party appeals within a certain period of time, the case must be transferred to the higher level court for an appeal. However, the decision of the second-instance court is final and legally binding upon the parties; there is no opportunity for appeal to the next level court.

Under certain limited circumstances and with the court's leave, a party can apply to have a first-instance or second-instance judgment retried. Upon receipt of an application for retrial, the court will retry the case only when one of the following requirements is met: there is new evidence that is sufficient to overturn the original judgment or ruling; the main evidence on which findings of

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4 Judicial assessors, who may not be lawyers by training, have the same rights and obligations as judges and are appointed by the Standing Committee of the People's Congress. See the Civil Procedure Law of the PRC, 7th National People's Congress, 4th Sess, art 40 (April 9, 1991) (hereinafter Civil Procedure Law). See also Decision of the Standing Committee of the National People's Congress Regarding Perfecting the System of People's Assessors, passed by the Standing Committee of the National People's Congress (August 28, 2004) (effective May 1, 2005).

5 Civil Procedure Law, art 41 (cited in note 4).

6 Id at art 158.
facts were made in the original judgment or ruling was insufficient; an error was made in the application of the law in the original judgment or ruling; the People’s Court violated statutory procedure, and the judgment was so influenced; or in trying the case, the adjudication personnel accepted bribes or committed embezzlement.\textsuperscript{7} The higher level court or the president of the court has the right to propose the retrial of a case when it believes a judgment contains mistakes.\textsuperscript{8} The People’s Procuratorates can also lodge a protest against a legally binding decision.\textsuperscript{9}

A frequent criticism of the Chinese judicial process is that traditionally written judgments have been brief with little analysis or legal reasoning. These short judgments are a sharp contrast to the typically more lengthy opinions given in most developed judicial systems and can come as a surprise to sophisticated investors who take lengthy written legal decisions for granted. Nevertheless, this practice is changing slowly, and more recently, judgments for cases involving foreign parties (or foreign subject matter) and judgments issued by the higher level courts now provide analysis of the legal principles applied and the reasons for the decision.\textsuperscript{10} Although there is no system of binding case precedent in China, such written decisions can at least provide guidance to the public and legal practitioners.

\textsuperscript{7} Id at art 179.

\textsuperscript{8} If the president of a People’s Court at any level discovers an error in a legally effective judgment or written order of his court and deems it necessary to have the case retried, he shall refer it to the judicial committee for discussion and decision. If the Supreme People’s Court discovers an error in a legally effective judgment or written order of a local People’s Court at any level, or if a People’s Court at a higher level discovers some definite error in a legally effective judgment or written order of a People’s Court at a lower level, it shall respectively have the power to bring the case up for trial by itself or direct the People’s Court at a lower level to conduct a retrial. Id at art 177.

\textsuperscript{9} The People’s Procuratorates are State organs for legal supervision; they are tasked with performing legal supervision and protecting the unified and proper enforcement of State laws. If the Supreme People’s Procuratorate finds that a legally effective judgment or written order made by a People’s Court at any level involves any of the circumstances discussed around note 7, or if a People’s Procuratorate at a given judicial level finds that a legally effective judgment or written order made by a People’s Court at a lower level involves any of those circumstances, they may lodge a protest. Id at art 185. With respect to a legally effective conciliation statement, if evidence furnished by a party proves that the conciliation violates the principle of voluntariness or that the content of the conciliation agreement violates the law, the party may apply for a retrial. Id at art 180.

\textsuperscript{10} For example, the judgments published on the website of Chinese Commercial and Maritime Trial Involving Foreign Elements, available online at <http://www.ccmt.org.cn/english/case/index.php> (visited May 7, 2006), which are for foreign related cases, all include detailed reasoning.
D. Reform: The 1999 Five-Year People’s Courts Reform Plan

The implementation of the 1999 Five-Year People’s Court Reform Plan ("First Reform Plan")\textsuperscript{11} involved a wholesale amendment of laws, an increase in the issuance of judicial interpretations, and the adoption of an internal supervision system.

One of the significant achievements of the First Reform Plan involved improving the qualifications of judges. Prior to the First Reform Plan it was common to find judges who were not legally qualified or who lacked experience in commercial transactions. In 2001, the Judges Law of the PRC was amended to impose stringent qualification requirements. In addition to holding a university degree, judges appointed after January 1, 2002 have to pass a national judicial examination, the same bar examination taken by private practitioners.\textsuperscript{12} On January 1, 2001, the Supreme People’s Court’s Judge Training Regulation came into effect, which requires courts to provide continuing legal education to judges, regardless of seniority.

Another objective of the First Reform Plan has been the enforcement of anti-corruption regulations. One example of this effort was the issuance of guidelines regulating interaction between judges and lawyers, the breach of which will give rise to disciplinary sanctions, and, in more serious cases, criminal liability.\textsuperscript{13}

The Supreme People’s Court has also commenced reform to allow a more adversarial common law system of proceedings (as opposed to the existing inquisitorial system). For instance, laws regulating evidence in court proceedings were passed in 2001 to introduce a limited form of discovery, a concept hitherto unknown in China.\textsuperscript{14}

Finally, an ongoing objective of the First Reform Plan is to improve efficiency in the enforcement of judgments. In furtherance of this objective, more judges have been assigned to the enforcement divisions of the courts. In addition, courts of different provinces are now required to liaise with each other.

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\textsuperscript{11} 1999 Five-Year People’s Court Reform Plan, Supreme People’s Court (Oct 20, 1999) (hereinafter First Reform Plan).

\textsuperscript{12} The Judges Law of the PRC, National People’s Congress (July 1, 1995, amended June 30, 2001). The 2001 amendments to articles 9 and 12, which came into effect on January 1, 2002, increased the qualification requirements on initially appointed judges.

\textsuperscript{13} Certain Provisions of the Supreme People’s Court and the Ministry of Justice on Regulating the Relationship between Judges and Lawyers and Maintaining Judicial Justice, Supreme People’s Court (Mar 19, 2004).

\textsuperscript{14} Certain Provisions on Evidence in Civil Litigation Procedure, Supreme People’s Court (Apr 1, 2002).
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in relation to the enforcement of judgments involving assets located in different provinces which is no small task bearing in mind China's population (1.3 billion) and geographical reach.\(^ {15} \)


Late in 2005, the Supreme People's Court issued the Second Five-Year People's Courts Reform Plan (2004–2008) ("Second Reform Plan").\(^ {16} \) The Second Reform Plan attempts to guarantee the financial independence of the courts, adopt a system of using significant cases as guidelines for legal interpretation, and coordinate a consistent understanding of the law across China.

F. EXISTING CHALLENGES

The nature of the reforms implemented thus far suggest that China still has some way to go before it acquires a judiciary consistent in both quality and professionalism across the whole of China. It therefore faces a number of challenges before it can be recognized as a jurisdiction on par with other more established legal systems.

There are anecdotes of corruption, bribery, and protectionism in favor of Chinese parties, and interference from the executive branch of the government still occur—these are challenges recognized by the Supreme People's Court.\(^ {17} \) The judiciary, as with all significant organs of the Chinese government, is still subject to the supervision of the Chinese Communist Party, which wields influence in the appointment and promotion of senior judges. Although China has made significant progress in improving and reforming its judicial system, the challenges identified above can mean that relying on the Chinese judicial system to vindicate one's position is an uncertain exercise. Many foreign parties have therefore preferred alternative dispute resolution procedures to resolve commercial disputes in China.

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\(^ {16} \) Second Five-Year Reform Plan (2004–2008), Supreme People's Court (Oct 26, 2005).

\(^ {17} \) The Supreme People's Court reported 461 cases of judicial corruption occurred in 2004. See the Supreme People's Court Working Report to the 3d Conference of the National People's Congress, 10th Sess (Mar 9, 2005).
III. ALTERNATIVE DISPUTE RESOLUTION IN THE PRC

Among the various ways of settling disputes between Chinese and foreign parties, arbitration remains the most popular. Notably, the China International Economic and Trade Arbitration Commission ("CIETAC") has emerged in recent years as a world heavyweight in terms of numbers of cases heard each year. Arbitration also possesses a clear advantage over litigation as a result of the ability to enforce arbitration awards under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"), of which China is a member.¹⁸

A. CHINESE ARBITRATION LAW 1995 AND ARBITRATION AGREEMENTS

The main legislation in China governing arbitration is the Arbitration Law 1995 ("Arbitration Law").¹⁹ Article 16 of the Arbitration Law provides that, for an arbitration agreement to be valid, it must express the parties' intention to apply for arbitration, list the matters eligible for arbitration, and designate an arbitration institution.

In addition, Article 18 of the Arbitration Law specifically provides that if parties do not select or name the arbitration commission in their agreement, the agreement will be void unless the commission is specified in a "supplementary agreement." While an arbitration agreement must be in writing,²⁰ exchanges of letters, telexes, telegrams, or electronic documents constitute valid supplementary agreements.²¹

Once a dispute arises, however, it may be difficult for the parties to agree to any supplemental agreement. Thus, in order for the parties' original intention of resolving disputes through arbitration not to be frustrated, it is important for the parties to select the arbitral commission in order to ensure that the arbitration clause in their contract complies with Article 16 of the Arbitration Law.²²


²⁰ Id at art 16.


B. Effect of Arbitration Agreement

A valid arbitration agreement between two parties should prevent one party from commencing court proceedings under Chinese law. Article 5 of the Arbitration Law provides that if the parties have concluded an arbitration agreement, and one party institutes proceedings in a People's Court, the People's Court shall not accept the case unless the arbitration agreement is void.23

In addition, Article 26 of the Arbitration Law provides that if there is an arbitration agreement, but one party nonetheless commences litigation in a People's Court, the People's Court will dismiss the case where the other party challenges the jurisdiction of the Court by submitting the arbitration agreement before the first hearing.

In general, therefore, the existence of an arbitration agreement should prevent the parties to the contract from circumventing that agreement and instituting proceedings in the courts. However, Article 26 of the Arbitration Law provides a caveat to this: when a claimant has commenced proceedings in the People's Court (in circumstances where the parties have executed an arbitration agreement), and the defendant does not raise an objection to the People's Court prior to the first hearing, the defendant shall be deemed to have renounced the arbitration agreement, and the People's Court shall continue to try the case. Furthermore, Article 148 of the Opinion of the Supreme People's Court on Certain Questions Concerning the Implementation of the PRC Civil Procedure Law also provides that if a party commences proceedings before the court and

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23 Civil Procedure Law, art 257 (cited in note 4); Arbitration Law, art 5 (cited in note 19).
does not declare the existence of an arbitration agreement, and the other party submits a defense, the court is deemed to have jurisdiction over the case.\(^{24}\)

Thus, in circumstances where an arbitration agreement does exist, and where the claimant has commenced court proceedings, a defendant should be careful not to submit a defense to the court, but instead should challenge the jurisdiction of the court on the basis of the arbitration agreement. In such circumstances, the court should dismiss the case and refer the parties to arbitration pursuant to the arbitration agreement.

C. AD HOC ARBITRATION

The Arbitration Law does not contain any reference to, or provision for, ad hoc arbitration. Therefore, although not expressly forbidden by the Arbitration Law, no clear legal basis exists for ad hoc arbitration in China, and as a result, arbitration in China is essentially institutional. In other words, it is administered by an arbitral commission such as CIETAC.

Further, as mentioned, under Article 18 of the Arbitration Law, if an arbitration agreement does not specify an arbitration commission, the arbitration agreement will be void under Chinese law. Case law has also confirmed that ad hoc arbitrations are not permitted in mainland China.\(^{25}\) Thus, it seems clear that at present, arbitrations conducted in China, whether or not governed by Chinese law, should be institutional.

The SPC Draft Provisions appear to place further restrictions on ad hoc arbitration,\(^{26}\) and it remains to be seen how the issue of ad hoc arbitration, common in international jurisdictions, will be resolved in China in the future, particularly when the SPC Draft Provisions are implemented in their final form.

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\(^{24}\) Opinion of the Supreme People's Court on Certain Questions Concerning the Implementation of the PRC Civil Procedure Law, Supreme People's Court (July 14, 1992).

\(^{25}\) People's Ins Co of China, Guangzhou Branch v Guangdong Guanghe Power Co Ltd, 2003 Min Si Zhong Zi No 29 (China).

\(^{26}\) Article 27 of the SPC Draft Provisions provides that:

An arbitration agreement between the parties that provides for ad hoc arbitration shall be invalid, except where the relevant parties are all nationals of countries that are members of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 and the laws of such countries do not prohibit ad hoc arbitration.

Because ad hoc arbitrations are not permitted in China, and because there is no provision for ad hoc arbitration in the Arbitration Law, Article 27 appears to be directed at ad hoc arbitrations outside China. However, by the same token, because Chinese law does not allow ad hoc arbitration, an arbitration agreement entered into outside of China is invalid inside of China, and Chinese courts may refuse to enforce such awards even if the agreement is valid under its governing law.
D. Chinese Arbitration Institutions and Commissions

The main Chinese arbitration commission that deals with foreign-related arbitration is CIETAC (unless the dispute is of a maritime nature, in which case the dispute will most likely be dealt with by the China Maritime Arbitration Commission). China also has various domestic arbitration commissions.\(^{27}\) Because of changes to the jurisdictional scope of these domestic arbitration commissions in 1996, and subsequent changes to CIETAC's jurisdictional scope in 1998 and 2000,\(^{28}\) the distinction between foreign-related arbitration and domestic arbitration has become blurred. Domestic commissions can now hear foreign-related cases, and CIETAC can now hear most domestic disputes.

CIETAC has been criticized for failing, among other things, to offer a fully transparent arbitral regime.\(^ {29}\) Other domestic arbitration institutions are slowly showing themselves to be more sensitive to ethical considerations in a bid to compete with CIETAC.\(^ {30}\) There are over 180 domestic arbitration commissions in the PRC. Most, however, are still in the relatively early stages of institutional development and are not yet equipped to handle a large volume of cases, let alone cases that involve international elements. There are, however, a few exceptions, the main one being the Beijing Arbitration Commission. Foreign

\(^{27}\) Currently, China has around 180 domestic arbitration commissions. The Beijing Arbitration Commission and the Shanghai Arbitration Commission are among the most popular domestic arbitration commissions.

\(^{28}\) On June 28, 1996, the State Council of the People's Republic of China issued the Notice on Clarification of Certain Questions Arising from Implementing Arbitration Law of the People's Republic of China (Guo Ban Fa (1996) No 22). The third paragraph of this notice permits the domestic arbitration commissions to accept foreign related disputes if the parties so agreed. In 1998, CIETAC amended its arbitration rules to broaden the scope of cases to include disputes arising between foreign-invested enterprises in China as well as between foreign-invested enterprises and other legal or physical persons and/or economic organizations. In 2000, CIETAC amended its arbitration rules, to permit CIETAC to accept domestic disputes.

\(^{29}\) CIETAC's implementation of its 2005 Rules is partly in response to recent criticisms. For example, Article 25 of the 2005 Rules requires arbitrators to disclose in writing to CIETAC any matters which may give rise to reasonable doubts as to their independence and impartiality, whether such matters arise before or during the arbitral proceedings, and CIETAC is then required to disclose this information to the parties. See 2005 Rules, art 25 (cited in note 22).

investors should therefore ensure that the arbitral commission of their election has the experience to administer the resolution of their disputes.

CIETAC remains, however, the predominant Chinese arbitral institute for foreign-related and international disputes. In the future, however, domestic arbitral institutions will no doubt equip themselves to handle more of such cases as they strive to compete.

E. CHOICE OF ARBITRATION VENUE

Under Article 128 of the Contract Law, parties to a contract with a “foreign element” can opt for arbitration before a Chinese arbitral institution or a foreign arbitral institution. Conversely, parties to a contract without a “foreign element” will have no choice other than arbitration at a Chinese arbitral institution. For this purpose, foreign investment enterprises (“FIEs”)—contractual and equity joint venture companies and wholly-owned foreign enterprises incorporated in China with foreign investment—are deemed to be “domestic” entities under PRC law. Therefore, in order for FIEs and other domestic Chinese enterprises to have the ability to opt for arbitration before either a foreign arbitral institution or a Chinese arbitral institution, there must be a foreign party to the contract, or another “foreign element” must be present.

Despite the choice open to parties to contracts with a foreign element, many foreign companies still find themselves with CIETAC (or another Chinese arbitral commissions) as the seat of the arbitration where the other party to the contract is a Chinese entity. Although such choice is often a matter of negotiation, one reason that CIETAC is selected more often than foreign arbitral commissions is the fact that Chinese parties generally prefer arbitration in China; this is probably because they are more comfortable with having arbitration in their own jurisdiction.

Under the old CIETAC Rules, parties were not permitted to choose a venue for CIETAC arbitration outside China (it is not entirely clear for these purposes whether Hong Kong was deemed to be part of China). The 2005

31 Article 178 of the Supreme People’s Court Opinion on Certain Issues Relating to the Full Implementation of the PRC General Principles of Civil Law (hereinafter GPCL SPC Opinion) provides that a contract will have a foreign element when: (a) one or both parties to the contract are foreign or stateless parties; (b) the subject matter of the contract is located in a foreign country; or (c) the act which gives rise to, modifies, or extinguishes the rights and obligations under the contract occurs in a foreign country. Under Article 126 of the PRC Contract Law, parties to a contract with a “foreign element” may also choose the governing law of the contract unless Chinese law provides otherwise; exceptions include Sino-foreign joint venture contracts and natural resources contracts.

Rules, however, allow parties to choose CIETAC arbitration, but with the venue outside China, provided the parties pay the travel and accommodations expenses of the CIETAC panel. This revolutionizes the concept of CIETAC arbitration, allowing CIETAC to administer arbitrations anywhere in the world.

A CIETAC-administered arbitration at a venue outside the PRC would not appear to run afoul of Article 128 of the PRC Contract Law if chosen as the forum for dispute resolution by two “domestic” parties to resolve disputes arising out of a contract that does not otherwise have a “foreign element,” on the basis that the arbitration institution selected is still a Chinese arbitral institution. Article 20(7) of the SPC Draft Provisions provides, however, that an arbitration agreement providing for domestic parties to conduct foreign arbitration in relation to a dispute that does not otherwise contain a foreign element will be invalid. A CIETAC arbitration outside China would no doubt be considered by the Chinese courts as being arbitration in a foreign country. It is not clear whether “foreign arbitrations” under the SPC Draft Provisions include an arbitration administered by a Chinese arbitral institution in a foreign country. Hopefully this will be clarified in the future when the SPC Draft Provisions are finally implemented. Until then, a “domestic” dispute should continue to be arbitrated in China, even if under the auspices of CIETAC and in accordance with the 2005 Rules. The 2005 Rules specifically provide that the award is deemed to be issued from the seat of arbitration. It is not yet clear how a CIETAC-administered award heard abroad will be treated by the Chinese courts. Will a CIETAC award heard in London, for example, be treated as a London award enforceable under the New York Convention, or as a foreign-related, domestic CIETAC award? The answer to this remains unclear.

F. CHOICE AND APPOINTMENT OF ARBITRATORS

The old CIETAC Rules stipulate that arbitrators in CIETAC administered proceedings must be appointed from CIETAC’s own panel of arbitrators which comprises both Chinese and “foreign” arbitrators, with Chinese arbitrators outnumbering their “foreign” counterparts. The 2005 Rules now allow the parties to agree that qualified arbitrators can be selected from outside CIETAC’s panel, if CIETAC endorses the appointment “in accordance with the law.” Where the arbitrator is a foreign national, Article 67 of the Arbitration Law provides that a foreign arbitration commission may appoint foreign arbitrators having special knowledge in “fields of law, economic relations and trade, science

This opens up the scope of choice, as CIETAC's panel predominantly consists of Chinese nationals. Most foreign-related CIETAC arbitrations involve a panel of three arbitrators, with each party to the contract having a choice of one arbitrator and either a jointly-appointed third arbitrator, or one appointed by CIETAC as authorized by the parties. The third, jointly or impartially selected arbitrator acts as presiding arbitrator.

In practice, parties are usually unable to agree on the presiding arbitrator. The 2005 Rules set out a procedure wherein the parties each give CIETAC a list of three names (if CIETAC agrees, the names need not be from CIETAC's panel). If one of the three names from one party matches a name from the other party, that person will be appointed as the presiding arbitrator. If two or more names match, CIETAC will decide the appointment from these matched names based on the circumstances of the case. If no names match, the parties do not make an appointment, or they fail to provide CIETAC with a list of three names, CIETAC will make the appointment from its panel (which may result in an appointee being other than any of the names provided by the parties).

In the interest of impartiality, a provision should be inserted into the arbitration agreement providing that the nationality of the third arbitrator not be of the nationality of either of the parties to the contract. This is because a Chinese contractual party will invariably appoint a Chinese arbitrator, and a Western contractual party will invariably appoint a non-Chinese arbitrator. If, as is usually the case, the parties are unable to agree on the appointment of the third arbitrator, such that CIETAC makes the appointment pursuant to the 2005 Rules (which remains the default mechanism), it is more likely than not that CIETAC will appoint a Chinese national as the third and presiding arbitrator. Unfortunately this could give rise to a perceived two-to-one advantage in favor of the Chinese party, particularly if the latter is believed to wield local influence.

Such a perceived difficulty can be avoided by providing in the contract that the nationality of the third arbitrator cannot be the same nationality as either of the two parties to the contract. From experience, CIETAC has accepted and respected such a provision. It has been observed that many foreign arbitrators may be reluctant to accept a CIETAC appointment because remuneration is

36 Arbitration Law, art 67 (cited in note19).
38 The reason for this is arguably that there are many more Chinese arbitrators on CIETAC's panel than non-Chinese arbitrators. In 2005, the CIETAC panel has 1025 arbitrators, 228 of them are come from Hong Kong, Taiwan, and foreign countries. Notably, and perhaps responding to criticisms levied against it, CIETAC has, in some recent cases, appointed a non-Chinese national to be the third arbitrator, although the prevalence of this practice is uncertain.
This is something to bear in mind before deciding on CIETAC arbitration as the venue for dispute resolution. This issue has not been addressed in the 2005 Rules.

G. RULES AND PROCEDURE IN CIETAC PROCEEDINGS

In the absence of an agreement stating otherwise, the 2005 Rules govern CIETAC proceedings. The 2005 Rules provide that deviations from the Rules (provided for by the parties, for example, in their arbitration agreement) should be respected and allowed, so long as such amendments can be implemented and do not violate mandatory provisions of the law of the seat of the arbitration. This is an amendment to the old Rules, which provided that CIETAC first give its approval to any deviations. The removal of the requirement that CIETAC’s approval be obtained provides greater autonomy to the parties to decide how they want the arbitration to be conducted, and is in line with international practice on the conduct of arbitration proceedings.

The 2005 Rules also make it clear that the parties can select other arbitral rules—subject to the same restrictions mentioned above—to govern their arbitration. This reflects CIETAC’s evolving willingness to administer arbitrations under rules other than its own.

In addition, the 2005 Rules provide that unless the parties agree otherwise, the arbitrators can conduct either inquisitorial or adversarial proceedings. The proposed change from an inquisitorial system to an adversarial one addresses one of the most frequent criticisms of CIETAC arbitrations today by foreign parties from common law jurisdictions. The tribunal can also convene pre-hearing conferences, issue procedural directions and define issues that need to be determined at “trial,” bringing CIETAC more in line with other jurisdictions.

A shorter time period has also been stipulated in the 2005 Rules for concluding an arbitration matter: for foreign-related arbitrations the time for issuing an award has been shortened from nine months to six months from the establishment of the tribunal; for domestic arbitrations from six months to four. In practice, this timeframe appears to be followed in more simple

43 Id.
44 Id at arts 42, 65.
domestic cases only. Experience of CIETAC arbitrations involving foreign-related disputes indicates that they are no quicker than an international arbitration in other jurisdictions.

H. INTERIM RELIEF

Like litigation proceedings, the same interim relief is also available for arbitration proceedings once they have been commenced—the People’s Court presiding over the matter rules on whether to grant or deny an application for preservative relief. In practice, a party should submit an application to the arbitration commission, which will forward the application to the people’s court.

I. EVIDENCE

The Chinese Government has yet to enact comprehensive legislation with rules of evidence for legal proceedings. The Arbitration Law and the 2005 Rules address this subject only in general terms, giving a high degree of discretion to the arbitration tribunal.

All evidence should be exhibited at the hearing for examination by the parties. The parties are permitted to carry out debate in the course of the hearing, as well as to present witnesses and, in some cases, experts, although the right of one party to adduce expert evidence is not set out in the 2005 Rules. The arbitration tribunal is empowered to decide upon the admission of any evidence or statements that are produced after the date that has been stipulated for the production of evidence.

The Arbitration Law permits the arbitration tribunal to initiate its own investigations, collect evidence, and appoint experts or appraisers as it deems necessary. Where this takes place, the parties are obliged to deliver or produce to the expert or appraiser any relevant materials, documents, property, or goods if the arbitration tribunal so requires.

The parties should be given an opportunity to question and debate the resulting evidence or report at an oral hearing, if they so request. The 2005 Rules address the parties’ rights in slightly more detail, requiring the tribunal to promptly notify the parties where it will initiate such efforts, as well as to permit the parties to attend any independent investigation and to comment on the resulting evidence or report.

45 Id at art 39.
46 A party which is in default of filing evidence within the prescribed time limit ordered by the tribunal will be liable for any adverse consequences that may flow from such default (for example, the costs of any adjournment). See id at art 36.
47 Id at art 38.
48 Id at arts 37–38.
J. COMBINATION OF MEDIATION WITH ARBITRATION

The opportunity to combine conciliation and arbitration in the same proceedings is one of the unique features of Chinese arbitration. As pioneers in the application of combined techniques, arbitrators in China have gained positive recognition for their flexible use of the two dispute resolution techniques in a single procedure.

At present, China has no national legislation governing mediation. While the Arbitration Law does not specifically prescribe the combination of mediation with arbitration, it imposes no restriction or limitation on such combination of techniques.

CIETAC has been most instrumental in developing this aspect of Chinese arbitration, and has long practiced the combined technique approach, while tirelessly promoting the combination of mediation with arbitration. Article 40 of the 2005 Rules sets forth the procedures for the combination of mediation and arbitration and serves as a model for other arbitral institutions in China.

The 2005 Rules do not prescribe any particular structure or approach for mediation, leaving it to the arbitral tribunal to determine what is appropriate. Under Article 40, the arbitral tribunal may conciliate the case “in the manner it considers appropriate” and, if all parties agree, it may do so at any stage of the arbitration proceedings. In practice, it is common for the arbitral tribunal to ask the parties at least once in the course of the arbitration proceedings whether they would like to try mediation techniques to resolve their dispute. Mediation may also be initiated at the request of the parties.49

The use of mediation within an arbitration proceeding is not obligatory—it depends entirely upon whether all parties agree to such a procedure. If any party disagrees, mediation will not be used. Likewise, if any party requests the termination of a mediation proceeding after it has begun, the arbitral tribunal is required to stop the mediation process. The arbitral tribunal is also empowered to cease the mediation process on its own, where it believes that further efforts to conciliate will not be productive in reaching a resolution of the case.50

In contrast to countries where arbitration and mediation are regarded as separate procedures that should not be combined (usually due to concerns as to how the independence of the arbitrator will be preserved should the mediation efforts not be successful), the 2005 Rules openly contemplate that either all members or the presiding member of the arbitral tribunal will actively participate in the mediation proceedings. However, given the flexible approach under the 2005 Rules, parties may also choose to carry out mediation without the

49 Id at art 40.
50 Id.
involvement of the arbitral tribunal. So long as the parties agree to have the arbitration continue with the tribunal monitoring the progress of the mediation (whether actively or without active, direct involvement), the case may be regarded as a combination of mediation and arbitration.

One alternative where parties prefer not to combine the two procedures is where the parties apply to the tribunal to suspend the arbitration proceedings for a stipulated period while they attempt to conciliate without any involvement of the arbitral tribunal. The tribunal then decides whether to accept the application to suspend. Where such application is accepted, a time limit normally is set, whereupon the arbitration shall resume if no settlement is reached through the mediation.

K. Costs

Under Article 46 of the 2005 Rules the tribunal has the power to determine in the award that the losing party must compensate the winning party for the expenses reasonably incurred by it in pursuing the case, which include the fees paid to CIETAC at the outset of the case. Costs are assessed by the tribunal according to various factors, including the complexity of the case, the expenses incurred by the winning party, the disputed amount, and the reasonableness of the expenses, in line with international practice. \(^{51}\)

L. Remarks on Arbitration in China

Given the relative uncertainty of engaging the Chinese judiciary, foreign investors have sought to use arbitration as the preferred means of dispute resolution in China. Chinese arbitral institutions such as CIETAC continue to display the desire to improve and provide a viable alternative to relying on the Chinese courts or even arbitral institutions outside China.

IV. The Protection of Intellectual Property Rights in China

Many foreign investors bring valuable trademarks, designs, or business processes into China with the hope of applying the same in conjunction with a lower-cost business proposition. Nevertheless, the protection of intellectual property rights is an issue that remains to be resolved satisfactorily, particularly as infringements continue to be widespread.

It has been several years since China’s accession to the World Trade Organization in 2001 and reform has been implemented. The reform of

\(^{51}\) Id at art 46.
intellectual property laws in China has continued following the promulgation of the new Patent, Trademark, and Copyright Laws in early 2000.\textsuperscript{52} Numerous judicial interpretations, regulations, and measures have been introduced in the intervening years to combat piracy, counterfeiting and infringement problems.

China is also a party to several important international conventions relating to intellectual property, including the Paris Convention for the Protection of Industrial Property; the Madrid Agreement for the International Registration of Marks, the Protocol Relating to the Madrid Agreement, the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Geneva Phonograms Convention, the Patent Cooperation Treaty and the Trademark Law Treaty.

\section*{A. TRADEMARKS}

The basic legal framework for the protection of trademarks in China is set out in the Trademark Law and its implementing regulations.\textsuperscript{53} Trademark registrations are valid for ten years and may be renewed for further ten-year periods.\textsuperscript{54} China has adopted a “first to file” trademark system: in the event of a conflict between competing applications for registration for similar or identical marks, the person who filed the first application will generally be entitled to register the mark.\textsuperscript{55} A registered mark may be cancelled on various grounds, including that the mark has not been used for three consecutive years, that registration was obtained through deceptive or improper means, or that the mark is non-distinctive.\textsuperscript{56} For trademarks that have not been registered in China (because registration is not available), the Trademark Law also gives protection to well known trademarks. A mark is not registrable if it is indistinctive or is descriptive of the products or services in an existing application, or if it is the same or confusingly similar to a prior trademark application or registration or a well known trademark.\textsuperscript{57} A mark which contains the name, the national flag and emblem of a country is also not registrable.

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\textsuperscript{54} Trademark Law, arts 37–38.
\textsuperscript{55} Id at art 29.
\textsuperscript{56} Id at art 41.
\textsuperscript{57} Id at arts 10–13, 29.
\end{flushright}
The trademark owner’s exclusive right to use the mark is infringed by anyone who uses the mark or a similar mark without the owner’s permission on the same or similar goods or services for which the infringed mark is registered, who sells goods bearing an infringing mark, or who actually replaces the original trademark on a product with his or her own.\(^{58}\) Those who sell without knowledge of the infringement, who can prove that their goods were acquired legally, and also reveal the source of the infringing goods, may be exempted from liability to pay damages.\(^{59}\)

B. PATENTS

The Patent Law and its implementing regulations govern the protection of inventions, utility models, and designs.\(^{60}\) An invention or utility model must be novel, inventive, and of practical applicability to be registrable as a patent.\(^{61}\) In this context, novelty means that no identical invention or utility model has been disclosed in China or anywhere in the world or publicly used or made known to the public in the country before the filing date.\(^{62}\) For registrability of designs, only the novelty requirement applies.\(^{63}\) China has a “first-to-file” rather than a “first-to-use” system of entitlement to patent protection.\(^{64}\) The term of inventive patent protection lasts for a period of twenty years, whereas the protection period for utility model and design patents is ten years.\(^{65}\) The patentee must pay an annual fee beginning with the year in which the patent right was granted, failing which the patent right will cease before the expiration of its duration.\(^{66}\)

Following the grant of a patent for an invention, generally, and except in the case of compulsory licensing, no one else may make, use, or sell the patented product, or use the patented process, or use or sell the product of that process, without the patentee’s permission. Similarly, without the design patentee’s authority no one may make or sell a product incorporating the patented design for production or business purposes.\(^{67}\) The patentee also has the right to prevent unauthorized imports of infringing products and to prohibit unauthorized

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\(^{58}\) Id at art 52.

\(^{59}\) Id at art 56.

\(^{60}\) Patent Law, art 2 (cited in note 52).

\(^{61}\) Id at art 22.

\(^{62}\) Id.

\(^{63}\) Id.

\(^{64}\) Id at art 9.

\(^{65}\) Id at art 42.

\(^{66}\) Id at arts 43–44.

\(^{67}\) Id at art 11.
However, a person who uses or sells a product without knowledge that the product is patented and who can prove that the product comes from a lawful source will not be liable for damages. \(^{69}\) Compulsory licenses will be granted only in situations such as national emergencies. \(^{70}\) To date China has never granted a compulsory license.

C. COPYRIGHT

The Copyright Law protects literary works, oral works, musical, operatic, dramatic and acrobatic works, fine art, architectural works, photographic works, cinematographic works (and other works created in a similar method), engineering drawings, design drawings, graphic works (such as maps, sketches and models), computer software, and other works as provided by law. \(^{71}\) The term of protection of most copyrights is generally fifty years beginning from the first production or publication of the works. \(^{72}\)

Copyrights may be infringed by various restricted acts such as copying, publishing, exploiting or broadcasting a work without the permission of the copyright owner. \(^{73}\) However, despite the law reform in early 2001, the prevention of three-dimensional copying of a two-dimensional work, or vice versa, remains a controversial and uncertain area. While the 2001 law reform removes the express provision which excludes any possibility of preventing three-dimensional copying of two-dimensional work or vice versa, academics and the courts—instead of viewing this amendment to the law as confirmation or encouragement of the Courts to prevent such cross dimensional copying—continue to adopt a very conservative interpretation of the law.

D. ANTI-UNFAIR COMPETITION

Unlike its name suggests, the Anti-Unfair Competition Law \(^{74}\) has nothing to do with antitrust or competition law. Its purpose is to fill a significant gap in China’s intellectual property protection regime. Previously, there had been no specific protection for unregistered trademarks or the get-up or trade dress of well-known products. The unauthorized use of “the characteristic name,
The packaging or get-up of a well-known commodity is now prohibited. Also, the Trademark Law now specifically extends protection to unregistered, well-known trademarks by prohibiting parties from applying for or using another confusingly similar mark in relation to identical or similar commodities (when confusion is likely to be caused).

The Anti-Unfair Competition Law also protects trade secrets. Trade secrets are defined as "technological information and business information not in the public domain, which brings economic benefits to the party entitled thereto, which is of practical use, and which is kept confidential by the party entitled thereto." It prohibits general business operators or any person from: obtaining commercial secrets by unfair means; disclosing, using, or permitting others to use commercial secrets belonging to others; and breaching confidentiality agreements.

E. LEGAL REMEDIES

In most cases, intellectual property owners have the option of suing the infringer in the People's Courts or bringing actions through administrative authorities if their intellectual property rights have been infringed. The latter route may be unfamiliar to many foreign investors, but it proves to be a more popular option when there is blatant counterfeiting and when the main goal is to stop infringement. It is also possible for an intellectual property owner to involve customs authorities if the owner is aware of an export or import of infringing products. If the seriousness of the infringement so justifies, a criminal action may be brought against the infringer.

If there is evidence that others are committing infringement or will soon commit infringement resulting in damage to the trademark or patent owner that is difficult to remedy, application may be made at the People's Court for injunctive and preservation measures. Furthermore, an interested party may apply to the People's Court for preservation of evidence before instituting proceedings if the evidence is likely to be destroyed or will be difficult to obtain later. The applicant will be required to give a sufficient bond or undertaking to

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75 Id at art 5.
76 Trademark Law, art 13 (cited in note 52).
77 Anti-Unfair Competition Law, art 10 (cited in note 74).
78 Patent Law, art 57 (cited in note 52); Trademark Law, art 53 (cited in note 52).
80 Patent Law, art 61 (cited in note 52); Trademark Law, art 57 (cited in note 52).
81 Civil Procedure Law, art 74 (cited in note 4).
the Court. For design patent cases, intermediate courts require the provision of an official search report issued by the patent administration authority which shows the utility model was novel at the time of filing.

The amount of compensation is to be calculated according to the profits made by the infringer or the losses suffered by the intellectual property right owners, including reasonable expenses incurred for stopping the infringing acts. If the amount of damages cannot be ascertained, the People’s Court may order discretionary damages not exceeding RMB 500,000. In practice, unless a plaintiff can show very strong evidence to establish its damages, the damages ordered by the People’s Court tend to be very low.

**F. RECENT REFORM**

The PRC Criminal Law requires a certain threshold to be met before a criminal action can be brought against an infringer of certain intellectual property rights. In order to increase the deterrent effect, the Supreme People’s Court and the Supreme Procuratorate issued a joint judicial interpretation towards the end of 2004 to lower the threshold for criminal punishment for crimes of counterfeiting trademarks, selling goods using counterfeit registered trademarks, or producing or selling fake registered trademarks. Criminal punishment is now possible for individuals whose illegal activities result in revenues exceeding RMB 50,000 or profits exceeding RMB 30,000. For legal entities, the threshold is RMB 150,000 in revenue or RMB 90,000 in profit. The value of illegal revenues is calculated based on the value of the infringing goods, rather than the value of the genuine goods.

It is a common strategy in patent cases for the defendant to seek to stay an infringement action by filing an invalidation action with the PRC Patent Re-examination Board to challenge the validity of the patent at issue—usually on

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82 Patent Law, art 61 (cited in note 52); Trademark Law, art 57 (cited in note 52); Civil Procedure Law, art 93 (cited in note 4); Supreme People’s Court’s Certain Provisions on Application of Law in Stopping the Patent Infringing Activities Before the Commencement of Litigation, art 6 (June 7, 2001).
84 Id at art 21; Trademark Law, art 56 (cited in note 52).
85 Criminal Law, arts 213–19.
86 Interpretation of the Supreme People’s Court and the Supreme People’s Procuratorate Concerning Some Issues on the Specific Application of Law for Handling Criminal Cases Infringement upon Intellectual Property Rights (Dec 8, 2004).
87 Id.
the ground of lack of novelty or inventiveness, and particularly in design and utility model cases. Recent developments in the law show that an infringer may also be able to use this strategy in trademark infringement actions.\(^8\) If allowed, a stay on this basis will be very prejudicial to trademark owners. Unfortunately, there are insufficient rules and regulations to prevent abuse by such means at this time. In fact, the Supreme People’s Court is actually seeking to introduce a new judicial interpretation which may further encourage the use of this delaying strategy. The Supreme People’s Court is currently consulting the public on this new judicial interpretation by hosting discussions with academics, practitioners, and judges and by making the draft judicial interpretation available on the Internet for public opinions. If the judicial interpretation is passed in its current form, infringement actions may be stayed pending the final determination of simultaneous opposition\(^9\) or cancellation actions,\(^9\) which would actually be a major setback to the progress made in the trademark enforcement system. Unless the Trademark Office and the Review Board are able to expedite cancellation and opposition proceedings (currently it takes three to five years on average to obtain a first-instance decision in an opposition or cancellation action), this would allow an infringer to easily delay a trademark infringement action for three to five years.

G. REMARKS ON INTELLECTUAL PROPERTY IN CHINA

Significant steps have been taken in China to protect intellectual property rights. Often, the difficulty has not been the lack of laws, but rather, both the ability to enforce these laws consistently and public noncompliance in a country where such rights were traditionally nonexistent. As China’s economy develops and many of its business enterprises create their own intellectual property that require protection, there will be an increasing desire and impetus to ensure that all intellectual property rights—regardless of their origin—are protected.

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\(^8\) Discussion draft of the Guiding Opinion of the Supreme People’s Court on Certain Issues Relating to the Hearing of Intellectual Property Dispute Cases Involving Conflict of Interest (Trial); The Supreme People’s Court Reply Regarding the Trademark Right Conflicts Concerning Registered Trademark Authorization Disputes.

\(^9\) An administrative proceeding conducted at the Trademark Office which allows a claimant to object to and challenge the registration of a mark which has been examined, passed, and published in the Trademark Gazette, but not yet registered.

\(^9\) An administrative proceeding conducted at the Trademarks Review and Appeal Board which allows a claimant to object to and challenge the registration of a registered trademark.
V. THE RESOLUTION OF EMPLOYMENT DISPUTES IN CHINA

Many foreign investors establish entities in China that require local staffing (sometimes in conjunction with expatriate staff). Given China’s population of around 1.3 billion—one-fifth of the world’s population—it is probably fair to say that the Labour Law of the PRC (“Labour Law”)92 is the predominant law governing employment relationships in the world. Nevertheless, there is often a lack of understanding on the basics of Chinese labour law which this section seeks to address.

In China, laws governing the resolution of employment disputes (or “labour disputes,” to adopt a wording that is more commonly used in Chinese legislation) are mainly issued by the National People’s Congress—the highest legislative body in the land—and the executive branch of government. Also, the Supreme People’s Court issues judicial interpretations which guide Chinese courts applying the laws of labour dispute resolution. The salient instruments include: the Labour Law; PRC Regulations on Resolution of Enterprise Labour Disputes;93 Rules on the Handling of Cases by Labour Dispute Arbitration Commission;94 and Supreme People’s Court Interpretation on Several Issues relating to the Application of Law in the Hearing of Labour Disputes.95

In addition, various provinces in China also issue rules concerning the resolution of labour disputes applicable within their own territories. These provincial rules are not supposed to conflict with laws issued by the central level authorities (such as the laws enumerated above).96 However, in practice, these provincial rules are accorded considerable weight by Chinese courts, because they are regarded as more relevant to the level of economic and social development of the particular province, which may vary substantially across China’s many provinces.

A. METHODS OF RESOLVING LABOUR DISPUTES

Under Chinese law, a labour dispute may be settled through consultation, mediation, arbitration, or litigation.97 Each of these methods is discussed in turn.

92 National People’s Congress (July 5, 1994) (hereinafter Labour Law).
93 Issued by the State Council (Aug 1, 1993) (hereinafter Labour Regulations).
95 Issued by the Supreme People’s Court (Apr 16, 2001).
97 Labour Law, art 77 (cited in note 92).
1. Consultation

In most cases, parties to a labour dispute would engage in consultation and seek a settlement of their dispute. As a matter of practice, consultation may provide an opportunity to the parties to arrive at an amicable resolution early and therefore avoid the need of involving a third neutral party. It should be noted, however, that consultation is not a legal requirement under Chinese law.

2. Mediation

Mediation of labour disputes is carried out on a voluntary basis. Chinese law recommends that enterprises in China set up a “Labour Dispute Mediation Commission” (“LDMC”) to mediate labour disputes between any such enterprise and its employees.98 LDMC shall contain representatives of the employees of such enterprise and representatives from both the enterprise and the trade union of such enterprise.99 Chinese law also requires that the representatives from the enterprise shall not exceed one-third of the members of the LDMC100; and an LDMC must be chaired by a representative of the trade union.101

If no settlement agreement is reached by the parties within thirty days from the day when a party applies for such mediation, the mediation is considered unsuccessful. On the other hand, if a settlement agreement is signed by the parties within the above-mentioned timeline, both parties must “voluntarily” comply with such settlement agreement.102

3. Arbitration

In the event that the parties elect not to mediate or mediation has failed, any party may apply to a “Labour Dispute Arbitration Commission” (“LDAC”) for a “labour arbitration.” Under Chinese law, an LDAC may be established at either county or municipal level. An LDAC must be composed of representatives from labour authorities of the government, trade unions, and employers, and it must be chaired by a representative of the labour authorities.103

An application for arbitration must be filed with the LDAC within sixty days from when the labour dispute arises.104 An LDAC will not extend such

98 Id at art 80.
99 Labour Regulations, art 7 (cited in note 93).
100 Id.
101 Id art 8.
102 Id art 11.
103 Labour Law, art 81 (cited in note 92).
104 Id at art 82.
period of limitation unless there are force majeure events or other justified reasons that delayed the application.\(^{105}\) A party must submit its application for labour arbitration in writing together with evidence. The application for arbitration must set out the details of the identity of both the claimant and the respondent and the facts and reasons for the application.\(^{106}\)

The LDAC must decide whether to accept the application for arbitration within seven days from when the LDAC receives the application. For the purpose of making such a decision, the LDAC would examine: whether the claimant has a direct interest; whether the dispute in question is a “labour dispute;” whether the LDAC is authorized to hear the labour dispute in question; whether the labour dispute in question falls within the jurisdiction of the LDAC; whether the application of the claimant and the related materials are adequate; and whether the period of limitation has expired.\(^{107}\)

The LDAC, within seven days from when a claim is accepted, shall appoint arbitrators to establish an arbitration tribunal. The tribunal should usually contain three members. However, the LDAC has the discretion to appoint only one arbitrator if the claim in question is relatively simple.\(^{108}\)

In the event that complex issues are involved in the claim or the claim is substantial, the arbitration tribunal may submit such matter to the LDAC for discussion. If the tribunal elects to do so, it must comply with any decision that the LDAC may make.\(^{109}\)

Chinese law requires that when hearing a labour dispute, the labour arbitration tribunal should first attempt to mediate the dispute. If the parties arrive at a settlement agreement, the tribunal would issue a “mediation award” based on the settlement agreement. Such mediation awards, once served on both parties, are binding on both parties. Thus, if any party refuses to comply with a mediation award, the other party may apply for enforcement to a Chinese court rather than resorting to another arbitration or court litigation.\(^{110}\)

If the mediation is not successful, the tribunal may proceed with the arbitration and enter an award within sixty days from when the tribunal was

\(^{105}\) Labour Regulations, art 23 (cited in note 93).

\(^{106}\) Id at art 24.

\(^{107}\) Labour Arbitration Rules, art 12 (cited in note 94).

\(^{108}\) Labour Regulations, art 16 (cited in note 93); Labour Arbitration Rules, arts 15–16 (cited in note 94).

\(^{109}\) Labour Regulations, art 16 (cited in note 93).

\(^{110}\) Id at arts 27–28.
established. This sixty-day limit can be extended upon the approval of the LDAC, but such extensions generally will not exceed thirty days.

If a party is dissatisfied with the award of the labour arbitration tribunal, it may commence a lawsuit before a Chinese court within fifteen days from when such party receives the award, failing which the award shall become effective.

From the preceding, albeit brief, description of Chinese labour arbitration, one would note that the Chinese "labour arbitration" is indeed not arbitration in any real sense because it departs from some basic features of a real arbitration. There are several reasons for this. First, labour arbitration is initiated on an involuntary basis: the plaintiff of a labour dispute has no choice but to first go through a labour arbitration before it may seek remedies from a Chinese court.

In other words, court litigation on labour disputes in China must be preceded by a labour arbitration. Also, the arbitrators of a labour arbitration are appointed by the LDAC rather than the parties themselves. Second, the award of a labour arbitration is not final. As discussed above, the award of a labour arbitration is subject to appeal to a Chinese court.

B. COURT LITIGATION

If court litigation is commenced by a party that is dissatisfied with the labour arbitration award, the court will examine the same matter afresh and enter its own judgment. Unlike many western jurisdictions, there is currently no special tribunal in charge of employment matters within the Chinese court system. The hearing of labour disputes is conducted by civil tribunals and governed by general Chinese civil procedure laws.

It is important to note that the court proceedings may be interwoven with mediation—if possible, a Chinese court may mediate the dispute and attempt to broker a settlement agreement between the parties.

C. REMARKS ON EMPLOYMENT DISPUTES IN CHINA

The Labour Law and other relevant regulations discussed above were once praised as heralding a new era in employment matters in China. The Labour Law itself was a result of fifteen years of work and thirty drafts, and was intended to lay a foundation for the reform of employment systems in China's state-owned enterprises.

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111 Labour Regulations, art 27 (cited in note 93); Labour Arbitration Rules, art 26 (cited in note 94).
112 Labour Regulations, art 32 (cited in note 93).
113 Labour Law, art 83 (cited in note 92); Labour Regulations, art 30 (cited in note 93).
114 Labour Law, art 79 (cited in note 92).
115 Id.
However, the current labour dispute resolution mechanisms in China are widely criticised as lagging behind China's burgeoning market economy and unable to provide adequate protection for employees. There are two changes necessary within the framework of the current labour dispute mechanisms. First, there should be no requirement that a labour arbitration must precede court litigation—this merely prolongs the settlement process of labour disputes. In many cases, this has resulted in a disadvantage to employees who commence claims against their employers, because employees lack the deep pockets of employers to contest a drawn-out legal battle. In addition, such a requirement has also led to waste of judicial resources, because if a party is dissatisfied with the award of a labour arbitration and commences a lawsuit, the Chinese court will have to examine the case afresh and basically repeat the process already carried out at the level of the labour arbitration tribunal. Second, the sixty-day limit—whereby an arbitration tribunal must enter an award within sixty days from when it is established—is too short to preserve the claim of an employee. This limitation period is much shorter than the two year period that provided for general claims under Chinese civil procedure law. As employees are more likely to be the plaintiffs in labour disputes, the sixty-day limit is widely perceived in China as unfavourable to employees.

In response to such criticisms, the National People's Congress has placed a PRC Law on labour dispute resolution on its agenda for legislation. Although no details of the draft of this law have been released as yet, it is widely expected to address, among other things, the issues set out above and to be promulgated by the end of the current year. Consequently, foreign investors should keep their eyes peeled for ongoing developments in this area of the law.

VI. BANKRUPTCY REFORM IN CHINA

It has been ten years in the making, but it appears that China intends to introduce a bankruptcy regime to rival that of other developed economies—at least on paper. In June 2004 a new draft bankruptcy law (the "Eighth Draft")


was submitted to the Standing Committee of the highest legislative body in China: the National People’s Congress.\footnote{Enterprise Bankruptcy Law of the People’s Republic of China (Draft) proposed to National People’s Congress Standing Commission Chairman Meeting, 19th Sess (on file with author).} In late 2004 and early 2005, the Legal Committee of the National People’s Congress revised the Eighth Draft (resulting in the “Ninth Draft”).\footnote{Enterprise Bankruptcy Law of the People’s Republic of China (Draft) proposed to the 24th Session National People’s Congress Standing Commission Chairman Meeting, 24th Sess (on file with author) (hereinafter Ninth Draft).} Neither the Eighth Draft nor Ninth Draft has been made public but a limited number of copies have been circulated to key organizations, including the firm where the author practices, as part of a pre-enactment consultation process.

Whenever passed, as with all Chinese legislation, the proof of the bankruptcy law’s effectiveness will be in its implementation and enforcement at a provincial level. Despite reasonably modern mechanisms for corporate rescue and liquidation, the Ninth Draft contains a number of procedural idiosyncrasies and ambiguities which may, at least for the private creditor, render it toothless in reining in debt-laden state-owned (or related) enterprises. This section summarizes and comments on some of the key features of the Ninth Draft.

**A. SCOPE OF THE NINTH DRAFT**

Unlike the current regime (or regimes), the Ninth Draft's bankruptcy procedures are applicable to both state-owned and privately held companies with legal person status (including those with foreign investment). The Eighth Draft did extend to partnerships and sole proprietorships with the intention of creating a level playing field for all economic entities, but it appears that concerns over the availability of judicial resources and an immature credit-based economy have resulted in the exclusion of partnerships and sole proprietorships from the ambit of the Ninth Draft.

The Ninth Draft provides a carve-out (as is the case in some other jurisdictions) for financial institutions and certain state-owned enterprises (“SOEs”). The Ninth Draft now clarifies the extent to which China’s SOEs will be able to avail themselves of the carve-out by stipulating that the State Council will determine the time period and the types of SOEs that will be exempted from the Ninth Draft.

**B. COMMENCING BANKRUPTCY PROCEEDINGS**

Both the Eighth Draft and Ninth Draft contemplate three different procedures: liquidation, reorganization, and conciliation. These procedures are
commenced upon the “acceptance” by the court (not mere submission by the applicant) of an applicant’s petition. The acceptance by the court of the petition gives rise to a moratorium against litigation and enforcement proceedings.\textsuperscript{120}

In practice, the fact that acceptance of the petition is left to the discretion of the court may lead to significant delay in the commencement of insolvency proceedings. This is because the court may, for one reason or another (for example, their overriding concern about unemployment and social instability following the liquidation), fail to accept or reject the petition promptly. Our experience with the current bankruptcy regime is that this is not uncommon, particularly in the courts located away from the major business centers of China.

A liquidation or reorganization can be petitioned for by either the debtor or its creditors. Further, only a debtor can apply for conciliation.\textsuperscript{1} The petition for reorganization or conciliation can be applied for at any time prior to the court’s declaration of an order to liquidate the debtor.\textsuperscript{2} This may provide an opportunity for debtors to buy time and it remains to be seen whether some degree of tactical litigation will emerge.

\textbf{C. INSOLVENCY TEST}

The test for insolvency is a critical element in any bankruptcy regime. It is the basis on which a court can decide whether a business is to be saved or brought to an end. Consequently, the test must be clear and of practical application.

In most jurisdictions, the test for insolvency is based either on establishing that the debtor’s assets are insufficient to satisfy its liabilities (“balance-sheet” insolvency) or where the debtor is unable to pay its debts as they fall due (“cash-flow” insolvency). The Ninth Draft, however, requires either: (a) that the debtor is unable to pay off its debts when due and its assets are insufficient to cover its liabilities; or (b) that the debtor is unable to pay off its debts when due and it is obvious that the debtor lacks the ability to discharge its liabilities.\textsuperscript{3}

Test (a) is a combination of both a “balance-sheet” and “cash-flow” insolvency test. It would appear that this test will be relied upon in an application from the debtor itself (as it would have the requisite information) and not a creditor. More often than not, a creditor is in no position to obtain information on the latter, and it would seem to place an onerous burden on a creditor to have to satisfy balance-sheet insolvency. It is questionable whether it

\textsuperscript{120} Ninth Draft, arts 30–31 (cited in note 119).
\textsuperscript{121} Id at art 93.
\textsuperscript{122} Id at arts 65, 95.
\textsuperscript{123} Id at art 2.
is unnecessary to have to prove "cash-flow" insolvency in addition to "balance-sheet" insolvency in the case of an application from a debtor.

Under test (b) it would seem that, for a creditor, the language in the latter half of the test—where insolvency is declared when "it is obvious that the debtor lacks the ability to discharge its liabilities"—lacks clear guidance. In most cases, a creditor can rely only on the fact of non-payment of debts when they fall due, so it is unclear if the language in the latter half of test (b) provides any further assistance. Indeed, it is ambiguous and is likely to lead to litigation and give debtors a further opportunity to delay.

Article 2 of the Ninth Draft also appears to suggest that reorganization is available so long as the lesser criteria—where the debtor is "likely incapable to pay its debts when they fall due"—is satisfied. However, although the less onerous requirement for reorganization can be attributed to a desire to assist viable businesses before it is too late, it would seem that there is a need for the Ninth Draft to clarify what evidentiary burdens have to be surmounted in deciding whether the threshold requirements for the different procedures are satisfied. Some guidance should also be given to the courts as to the nature of evidence they should take under consideration in deciding whether a matter is suitable for one or other of the procedures in the Ninth Draft. It may be better for such guidance to take the form of interpretative opinions of the Supreme People's Court or implementing regulations.

D. ADMINISTRATOR

Having no doubt observed the ongoing debate about the relative merits of "debtor-in-possession" bankruptcy regimes versus those which replace management with a court appointed administrator, the Central Government has come down firmly on the side of the latter. The administrator is appointed by the court upon the acceptance of the bankruptcy petition. To ensure the impartiality of administrators, the Ninth Draft provides that only the courts have the power to appoint administrators and also to determine their fees.

Essentially, the administrator replaces management in either operating (and running down) the activities of the debtor company in liquidation and realising its assets for the benefit of its stakeholders or in managing or supervising a debtor in reorganization. The administrator's performance falls under the purview of the court, as does the supervision of the creditors' meeting and the creditors' committee. The introduction of the administrator into China's bankruptcy regime appears to afford opportunities for professional services firms. Article 21 of the Ninth Draft requires administrators to be members of

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124 Id at arts 19, 20, 27.
legal, accounting, or specialist bankruptcy firms or to otherwise possess "relevant professional expertise and practice qualification." It is, however, unclear to what extent a petitioner (or other stakeholder in the debtor) may propose a nominee for appointment, although it seems evident that the intention is to appoint an independent professional to protect the debtor's assets and facilitate a conciliation, reorganization, or liquidation—a most welcome development.

A word of caution for insolvency practitioners: there is no return without risk, and although the Ninth Draft provides that the administrators' fees rank as "bankruptcy costs" (and thus rank first), it also provides that the administrator owes duties to both creditors and the debtor, the breach of which may result in civil and criminal sanctions.

E. Reorganization

Another innovation of the Eighth Draft and the Ninth Draft is the introduction of a corporate reorganization or rehabilitation regime. Akin to procedures such as US Chapter 11 Bankruptcy and English administration, reorganization is aimed at viable businesses that need temporary protection from creditors.

Essentially, reorganization is a court-supervised, three-stage procedure. The first stage commences with the petition of a debtor, creditor(s), or shareholders of the debtor (who hold one third or more of its registered capital) to the court. Upon the court's decision to permit reorganization (and bearing in mind the lack of clarity as to the thresholds to be satisfied), the second stage, the "reorganization period," commences.

Usually, the administrator will assume management of the debtor, although Article 69 of the Ninth Draft permits the debtor's management to apply to the court to continue management of the debtor, under the supervision of the administrator.125 It is unclear under what circumstances the debtor's management will be allowed to remain in office. However, it does appear that this is intended to be the exception rather than the rule.

Within six months of the commencement of the reorganization period, the administrator (or the debtor's management if it is still in office) is to prepare a reorganization plan aimed at improving its financial status and business performance, including repayment plans and the restructuring of its debt. Upon receipt of the reorganization plan, the court convenes a meeting of the creditors to vote on the plan, the beginning of the third stage.126

125 Id at art 69.
126 Id at arts 77, 81.
Similar to voting procedures in other jurisdictions, the creditors must be divided into different classes (for instance, secured creditors, unsecured creditors, and employees). Approval of each class must be obtained, and approval of each class is determined by the affirmative vote of a majority of the creditors in that class present and voting, and comprising two-thirds in value of the debt held in that class. If approval is secured, a further application is made to the court for its sanction of the reorganization plan before it is implemented. If the creditors reject the plan, the debtor or administrator may nevertheless apply to court for approval provided certain conditions are met.\textsuperscript{127}

Perhaps of greatest interest to creditors is the fact that secured creditors are subject to the moratorium during the reorganization period. Although the right of the secured creditor is generally considered paramount, the reorganization procedure seeks to redress the imbalance that can be caused when secured creditors foreclose on the most valuable or productive assets of the debtor. However, a secured creditor is entitled to seek the court's permission to enforce on its security rights, provided there is a likelihood that the security will either suffer damage or diminution in its value.\textsuperscript{128}

\section*{F. Conciliation}

Under the Ninth Draft, the debtor may petition for a court order for the commencement of a conciliation procedure, whereby the debtor has the opportunity to propose a settlement of its debts with its creditors. A settlement agreement must be accepted by a simple majority of the creditors who attend the meeting and together hold no less than two-thirds in value of the unsecured debts.\textsuperscript{129} If the creditors' meeting fails to pass a settlement agreement, the court should issue a liquidation order.\textsuperscript{130} However, there is no time limit in which to hold the meeting and, if it fails, there appears to be nothing preventing the court from giving the debtor multiple chances. The potential for tactical filings is obvious. It is also noteworthy that, as far as secured creditors are concerned, the moratorium is lifted once a stay order permitting the conciliation procedure is issued, thereby affording the debtor only limited protection.\textsuperscript{131}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{127} Id at art 85.
\item \textsuperscript{128} Id at art 71.
\item \textsuperscript{129} Id at art 96.
\item \textsuperscript{130} Id at art 97.
\item \textsuperscript{131} Id at art 94.
\end{itemize}
\end{footnotesize}
G. AVOIDANCE PROVISIONS

The Ninth Draft sets out certain circumstances under which a transaction entered into by the company before winding up will be either voidable at the insistence of the administrator or void. Such transactions include the sale of assets below value, granting security while insolvent, anticipatory debt repayment, waiver of creditor’s rights, and unfair preference.\textsuperscript{132} In addition, concealing or diverting the insolvent company’s assets and acknowledging “untrue debts” will cause a transaction to be considered void.

In line with the practice in many other jurisdictions, these avoidance provisions aim to prevent the insolvent company from acting beyond its ordinary course of business to diminish still further the value of its assets available to its unsecured creditors.

H. SET-OFF

Article 123 provides that where a creditor incurs a debt to the debtor before announcement of bankruptcy, the creditor may apply to the administrator for a set-off before the bankruptcy distribution plan is announced to the public.

To avoid abuse, Article 124 prohibits set-off where the creditor: acquired its claim after the court accepts the bankruptcy petition; incurred a debt to the debtor in the knowledge that the entity has ceased payment or petitioned for bankruptcy, unless the debt was incurred by operation of law or more than one year before the bankruptcy petition; or acquired its claim with prior knowledge of the types events listed above in Section VI.G.

I. PRIORITY OF LABOUR-RELATED CLAIMS

Labour-related claims, including employees’ wages, basic social insurance premiums, and other similar compensation, are treated as preferential claims in the distribution of bankruptcy assets.

Although the Eighth Draft effectively ranks such claims behind bankruptcy costs and the rights of secured creditors, the Ninth Draft cuts back on the rights of secured creditors: even though Article 113 reiterates the general rule that secured claims enjoy priority, Article 127 subordinates such secured claims to labour-related claims and provides that when the debtor’s assets are insufficient to pay for all labour-related claims, the assets subject to a security interest can be resorted to repay such labour-related claims.

It is axiomatic that a country’s bankruptcy regime can reflect the importance of certain social values, for instance, the rights of employees of an

\textsuperscript{132} Id at arts 33–34.
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insolvent enterprise. However, it is also important to recognize the role security plays in the financing of the enterprise and respecting the agreement made between borrower and lender. There is also the danger that labour-related claims can easily exceed the value of the security, thereby negating the value of the security provided to a lender.

It seems apparent that this is an issue that needs to be carefully considered, not least taking on board the views of the lending community before the Ninth Draft becomes law. It may be that Article 127 could prompt a reevaluation by lenders as to both lending criteria and the price of loans.

J. CROSS-BORDER INSOLVENCY

China’s increased participation in the global economy finds expression in Article 7 of the Ninth Draft. First, Article 7 purports to extend the effect of Chinese bankruptcy procedures on debtors’ assets located overseas. This, of course, is dependent on the cooperation of foreign courts. Second, the Ninth Draft states that foreign bankruptcy proceedings could be binding within China on the China-based assets of a debtor.

However, Article 7 is to a large extent rendered illusory since foreign proceedings will not be binding when: there is no reciprocity in the recognition of bankruptcy proceedings (either by way of treaty or practice); the foreign bankruptcy proceedings contravene Chinese public interest; or the foreign proceedings impair the legal interests of a Chinese creditor.

There are presently around forty treaties for reciprocal enforcement of judgments between China and other jurisdictions. None, so far as we are aware, specifically refer to bankruptcy proceedings, and few, if any, of these treaties involve China’s major trading partners. Similar requirements apply to enforcement of foreign judgments in China, and the nebulous concepts of “Chinese public interest” and “impairment of legal interests” have been utilized to refuse recognition of the most meritorious of cases. Nevertheless, the fact that the Ninth Draft includes a section on cross-border insolvency at all is perhaps a significant development in itself.

K. DIRECTOR’S LIABILITY

The Ninth Draft appears to incorporate the concepts of directorial liability and disqualification for trading during insolvency found in other jurisdictions. In particular, Chapter 10 of the Ninth Draft imposes on the debtors, directors, and officers: civil liability where the bankruptcy of the debtor is a result of a breach of their duties of loyalty and diligence to the debtor; a criminal penalty if such
action constitutes a crime; and if guilty of any of the above, the debtor, director, or officer cannot assume directorial or managerial positions in a company for a period of five years from the date of the conclusion of the bankruptcy. Such express penalties for misfeasance by directors is new to Chinese bankruptcy law and should, if enforced, improve the standard of corporate governance in China.

L. REMARKS ON BANKRUPTCY IN CHINA

It is doubtless encouraging that China’s central government, after many years of prevarication, is grasping the nettle of bankruptcy law reform. However, its efforts will be criticized as nothing more than window-dressing if, as is so often the case under the present bankruptcy regime, it is unable to coerce provincial courts into accepting bankruptcy petitions against important or politically well-connected enterprises. This will be difficult to achieve while the courts retain discretion as to whether or not to accept a bankruptcy petition. Further, as the floods of foreign investment into China continue, the lack of any real recognition of foreign bankruptcy proceedings appears set to remain a key frustration for foreign lenders. Nevertheless, if properly implemented, the Ninth Draft should establish a modern bankruptcy regime based on the pari passu principle, administered by independent and experienced professionals.

VII. CONCLUSION

The Chinese economy has grown at a faster pace than legal reform. There are various aspects of Chinese law that are of significance to foreign investors and most of them (as discussed in this article) are undergoing significant changes. Foreign investors should be mindful of the fact that laws in China may not be similar to their home jurisdictions and that ongoing reform must necessarily mean that they keep up-to-date with changes in the law. What should be of comfort is that Chinese legal reform appears aimed at achieving internationally acceptable standards.

133 Article 162 of the Criminal Law provides:

where, in the process of its liquidation, a company or enterprise conceals its assets, records false information in its balance sheet or inventory of assets, or distributes the company or enterprise assets prior to full payment of its debts, thus causing serious harm to the interests of the creditors or others, the persons who are directly in charge and the other persons who are directly responsible for the crime shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention and shall also, or shall only, be fined not less than 20,000 yuan but not more than 200,000 yuan.

134 Ninth Draft, art 139 (cited in note 119).