



From the SelectedWorks of Shahla F. Ali

September 2011

Governing China's Financial Disputes in the Aftermath of the Global Financial Crisis of 2008

Contact
Author

Start Your Own
SelectedWorks

Notify Me
of New Work

Available at: http://works.bepress.com/shahla_ali/12

Governing China's Financial Disputes in the Aftermath of the Global Financial Crisis of 2008

Hui Huang*, Shahla Ali[‡]

ABSTRACT: In light of the recent global financial crisis of 2008, this article critically compares how China's national arbitration commissions and local courts are responding to new challenges brought about by an increase in the number of banking related disputes. Drawing on comparative case analysis, the article examines the operation of CIETAC and the Shanghai Courts financial dispute resolution mechanisms in resolving financial disputes. Drawing on insights from selected case findings, the article provides insight into which institution is in the best position to handle financial-related cases, discusses prospects for coordination between the two and sets out proposals for further reform. Contrary to conventional wisdom indicating a general preference for arbitration over in-court litigation processes, initial findings suggest that given CIETAC's limited exposure to banking and financial-sector disputes, in the immediate term, parties are advised to seek resolution through reference to local financial division dispute resolution mechanisms such as the financial division of the Shanghai Courts. In the long term, prospects for greater strengthening of national mechanisms such as CIETAC and the Securities Dispute Resolution scheme will provide additional avenues of recourse.

Keywords: Financial Crisis; Dispute Resolution; Financial Regulation; Chinese Law; Comparative Study

* Associate Professor, Faculty of Law, Chinese University of Hong Kong (Conjoint Professor, Faculty of Law, University of New South Wales, Sydney, Australia). PhD, University of New South Wales; B. Eng., LLB, LLM, Tsinghua University (China). This paper draws on sections of a revised paper presented at the 6th Asian Law Institute Conference in Hong Kong in May 2009, and I thank the participants for their comments.

[‡] Assistant Professor and Deputy Director, LLM in Arbitration and Dispute Resolution, Faculty of Law, University of Hong Kong. B.A., Stanford University; M.A., Landegg International University, Switzerland; J.D., Boalt Hall School of Law, University of California at Berkeley; Ph.D, University of California at Berkeley. The authors thank the Government of Hong Kong's University Grants Committee for its kind support through its Public Policy Research Grant (HKU7001-PPR-10).

I. Introduction

The recent global financial crisis has called into question the adequacy of systems of financial regulation and dispute resolution at the national and supranational level. To date, while not immune to the fallout, China has fared relatively well in the global downturn which has steered all major Western economies into recession.¹ However, this suggests by no means that China's systems of financial governance is free of problems. Over the past quarter century, China's transition to a market-based economy has unleashed unprecedented economic growth, and the country's financial system has to develop fast to support that metamorphosis. But this transition has not been without limitations, nor is it complete. The healthy development and stability of the financial system is critical to the success of China's further economic and social transformation. As such, it is imperative that China's financial regulatory regime and mechanisms of financial dispute resolution be improved to meet the need of developing a more efficient financial system.

This article proceeds as follows. Part II traces the historical development of China's system of financial governance. This is followed by a more detailed discussion of the current Chinese financial governance framework including a review of recent CIETAC financial dispute resolution cases and cases handled by the Financial Division of the Shanghai Courts in Part III. The article then turns to the more important question of how China might consider reforming its financial governance regime in the future. Part IV contains a concluding remark.

¹ See generally: Hui Huang, 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis' (2010) 10(1) *The Journal of Corporate Law Studies* 219.

II. A Historical Overview

In order to truly appreciate how far China has advanced with respect to its systems of financial governance, it is essential to have a brief historical review of China's financial governance mechanisms.

A. Before 1978: Limited Financial Dispute Resolution Mechanisms

After the founding of the People's Republic of China (PRC) in 1949, the Communist Party of China gradually steered the nation towards a centrally planned economy modelled on that operating in the Soviet Union.² Under the so-called 'Socialist Transformation' policy, private businesses were turned into collective ownership and eventually state ownership. Thereafter, as the economy was centrally planned and comprised overwhelmingly of state-owned enterprises (SOE), there was little need for the existence of financial markets to fund businesses and allocate resources.

Hence, the financial markets established before the 'Socialist Transformation' policy were dismantled during this time. First, all stock exchanges ceased to operate in 1952, putting an end to the securities market.³ Second, the People's Insurance Company of China (PICC) was shut down in 1959, quickly followed by the closure of the insurance market altogether.⁴ Finally, in the banking sector, the People's Bank of China (PBC) became the only bank operating in China both as the central bank and a commercial bank. Although the PBC provided the traditional service of saving and lending, it functioned essentially as an instrument of the government rather than a real commercial bank as understood in Western economies.⁵ The PBC was used primarily as a conduit through which state money was channelled to fund SOEs under the direction of the government. In short, there was no financial regulation in the true sense of the term.

Prior to 1978, similar to the condition of financial regulation, formal legal institutions were largely dissolved. Prevailing thought was that, "justice should not be separated artificially from the masses of ordinary people by the barriers of lawyers, laws, and law courts."⁶ Rather, "the people in their masses could judge and decide questions of policy as well as the concrete disputes arising in everyday life."⁷ Systems of law were not viewed as "flexible enough to meet the needs of struggle under rapidly changing revolutionary conditions"⁸ but rather "an instrument for the oppression of antagonistic classes."⁹ During the 1949-1978 period, people's

² *Ibid.*

³ Hui Huang, *International Securities Markets: Insider Trading Law in China* (Kluwer Law International 2006) pp.7-8.

⁴ Linbo Fan, 'The Insurance Market System' in Joseph J Norton *et al* (eds), *Financial Regulation in the Greater China Area: Mainland China, Taiwan and Hong Kong SAR* (Kluwer Law International 2000), p.158.

⁵ P Leung *et al.*, *Banking Law in the People's Republic of China* (EMIS Professional 2004) p.6.

⁶ Yan Wang, *Chinese Legal Reform: The Case of Foreign Investment Law* (Routledge 2002) p.22.

⁷ Ralph Haughwout Folsom and John H Minan, *Law in the People's Republic of China: commentary, readings, and materials* (Martinus Nijhoff 1989) p.12.

⁸ Carlos Winghung Lo, *China's Legal Awakening: Legal Theory and Criminal Justice in Deng's Era* (Hong Kong University Press 1995) p.10.

⁹ *Ibid.*, p.257.

mediation was encouraged as the preferred means of resolving civil and commercial disputes. Largely oriented toward the infusion of Socialist ideology and reaffirming class struggle,¹⁰ people's mediation was an informal avenue for promoting "correct thought" (si-xiang) in the context of civil dispute resolution.¹¹

B. 1978-1992: Market Regulation and Dispute Resolution

Regulatory Oversight

In 1978, the economic reform policy was introduced by the Third Plenary Session of the 11th National People's Congress, marking an important watershed in the development of China's financial markets and indeed the general economy.¹² First, the banking system was reformed to keep up with the transition to a market-oriented economy. As a starting point, the 'Big Four' state-owned banks were established or re-opened to provide specialized services, including the Agricultural Bank of China (ABC) in January 1979 for the agricultural sector, the Bank of China (BOC) in March 1979 for foreign exchange businesses, the Construction Bank of China (CBOC) in May 1983 for big construction projects, the Industrial and Commercial Bank of China (ICBC) in January 1984 taking over the commercial activities of the PBC.¹³

In order to increase market competition in the banking sector, more commercial banks were allowed to be set up at the national and local levels, most of which are jointly owned by the state and private investors, such as the Communication Bank in 1987. In 1994, three policy banks, i.e., the China Development Bank, the Agricultural Development Bank of China, and the Export-import Bank of China, were created to free the 'Big Four' banks from the provision of policy loans, enabling them to function as real commercial banks.

The other parts of the financial system also underwent significant reforms and developed rapidly. The securities market was brought back to life in the early 1980s, culminating in the establishment of Shanghai Stock Exchange and Shenzhen Stock Exchange in 1990 and 1991 respectively. Likewise, the insurance market was revived with the reopening of the PICC in 1980 and the formation of more insurance companies thereafter.

As a consequence of the reform, the PBC took on a dual role in financial regulation. It performed the major functions of the central bank while at the same time

¹⁰ Stanley Lubman, 'Mao and Mediation: Politics and Dispute Resolution in Communist China' (1967) 55(5) *California Law Review* 1284. Lubman, writing in 1967, at the peak of the Cultural Revolution, was one of the first to study the resolution of conflict in pre and post revolutionary China. His article, 'Mao and Mediation: Politics and Dispute Resolution in Communist China' examined how disputes on a community wide basis were resolved. His primary focus centered on the political/revolutionary function of mediation during the early years of Communist rule (see pp.1306-1309).

¹¹ *Ibid.*, pp.1306-1309. See further, Tsetung Mao, *Selected Works (Volume 3)* (Foreign Languages Press 1965) pp.117-122, where Mao stresses the importance of the propagation of correct ideas and the correction of mistaken viewpoints through rectification movements in Communist leadership.

¹² See Hui Huang 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis'.

¹³ Yangxin Huang, 'The Banking Market System' in Joseph J Norton *et al* (eds), *Financial Regulation in the Greater China Area: Mainland China, Taiwan and Hong Kong SAR* (Kluwer Law International 2000), pp.27-28.

supervising and regulating the whole financial system, including banking, securities and insurance. Thus, this effectively rendered the PBC the single financial regulator at that time.

With the emergence of China's market economy in 1978, formal and informal legal institutions, arbitral tribunals and professionalised mediation services proliferated. The Company Law, Laws on Economic Contracts, and Labor Laws were developed to keep pace with the development of China's consumer-oriented commodity market, privatization and the specialization of labor.¹⁴ In conjunction with the creation of a framework for direct foreign investment, agencies like the China International Economic and Trade Arbitration Commission (CIETAC)'s role was expanded.

From December 1978 (Third Plenum of the 11th Central Committee of the CCP) to September 1981, more than 200 laws were passed regulating economic and commercial activity.¹⁵ In light of economic reforms, Qiao Shi, the then Chairman of the Standing Committee of the National People's Congress, noted that laws were needed to "standardize the subject in the market, regulate the relationships among different subjects in the market and keep fair competition, and... improve, consolidate macro regulations... promot[ing] harmonious economic development."¹⁶ Privatization and open market reforms removed the centralization of economic authority, and thus the centralization of dispute-resolution authority. This could be seen at the local level with the transition from managerial dispute-resolution under a planned economy to increasingly decentralized, court-centered litigation in an open market system.¹⁷

With the growth of legal regulations, the demand for formal institutions to adjudicate a growing number of disputes likewise intensified. The number of civil disputes rose to 2.4 million cases in 1990, "with most of the increase attributable to the rise in contract and property disputes and in suits arising out of... claims for personal damages..."¹⁸ Indirectly, through transformations in the structure of the state, decision making power and authority became decentralized. Again, those working outside of the factory or work unit were no longer under the authority of the factory manager. Rather, external agencies were necessary to settle disputes. Regional arbitral bodies, such as CIETAC became increasingly active in the late 1970's in response to an increasing number of commercial and trade disputes both at the domestic and international levels.

Alongside the development of formal legal regulations, informal methods of dispute-resolution continued to receive continued support both within courts, arbitral bodies and informal dispute resolution structures. The renewed Chinese Civil Procedures Code of 1991 emphasized that mediation, if conducted, should be lawful.¹⁹ Chinese Legal Yearbook statistics indicated that mediation was used to

¹⁴ Spanogle and Baranski, 'Chinese Commercial Dispute Resolution Methods: The State Commercial and Industrial Administration Bureau' (1987) 35 *American Journal of Comparative Law* 761, p.133.

¹⁵ *Ibid.*

¹⁶ 'To Establish the Legal Framework of Socialist Market Economy' (1994) 12 *China Law*.

¹⁷ Mingxin Pei, 'Citizens v. Mandarins: Administrative Litigation in China' (1997) 152 *The China Quarterly* 862.

¹⁸ Stanley Lubman, *Sino-American Relations and China's Struggle for the Rule of Law* (Columbia University: East Asian Institute 1997) p.15.

¹⁹ Hualing Fu and Richard Cullen, 'From Mediatory to Adjudicatory Justice: The Limits of Civil Justice Reform in China' (26 November 2008). Available at SSRN-id1306800.

resolve more than 90 per cent of all civil cases during the mid 1980s²⁰ and nearly 60 per cent of civil cases in the late 1990s.²¹

C. 1992-present: Multiple Sectors-based Regulators & Emergence of CIETAC

With the rapid development of the financial markets since the early 1990s, China has been moving steadily towards a sectors-based financial regulatory model²² with separate regulators for banking, securities and insurance.²³ First, in October 1992, responsibility for securities regulation was spined off from the PBC to the State Council Securities Commission (SCSC) and the China Securities Regulatory Commission (CSRC). These two securities regulators were merged and the surviving CSRC was vested with the exclusive authority to regulate the securities market in April 1998.²⁴ Second, in keeping with the booming insurance market, the China Insurance Regulatory Commission (CIRC) was established in November 1998. Finally, in April 2003, the China Banking Regulatory Commission (CBRC) was set up to take over the function of direct banking regulation from the PBC.

Together with the PBC as the central bank, the above three highly specialized and mutually independent regulatory commissions make up China's financial regulatory framework, collectively referred to as '*Yihang Sanhui*' (one bank, three commissions). Different regulatory commissions are responsible for the administration and supervision of different financial sectors, namely banking, securities and insurance. This sectors-based regulatory model corresponds to the segmentation of financial services and markets in China, a policy commonly known as '*Fenye Jingying, Fenye Jianguan*' (separate operation, separate regulation).²⁵ The adoption of this regulatory regime has been heavily influenced by overseas experience, particularly the US.

In addition to an acceleration in court use, since 1992, arbitral institutions such as the China International Economic and Trade Arbitration Commission (CIETAC) have continued to see a growing case load in managing and resolving financial disputes. Since it was founded in 1956, CIETAC has administered more than 10,000 international arbitration cases. Approximately 700 cases are filed with CIETAC each year, most of which are international.²⁶ In addition to litigation through the courts and arbitration through CIETAC, financial disputes are resolved through provincial arbitral bodies such as the Beijing Arbitration Commission (BAC) and local mediation services which will be discussed in greater detail below.

²⁰ *Ibid.*, p.223.

²¹ *Zhongguo Falu Nianjian* [Law Yearbook of China] (Zhongguo Falu Nianjian She 1983-1995).

²² Hui Huang, 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis'.

²³ For fuller discussion of the development of China's financial reform after its WTO accession, see e.g., J Barth *et al.* (eds), *Financial Restructuring and Reform in Post-WTO China* (Kluwer 2006).

²⁴ Hui Huang, *International Securities Markets: Insider Trading Law in China* (Kluwer Law International 2006) p.18-19.

²⁵ See Hui Huang, 'Financial Regulatory Modernization: Experiences and Lessons from Common Law Jurisdictions' (2009) 1 *Guangdong Shehui Kexue* [Guangdong Social Science] 181, p.185.

²⁶ See CIETAC at http://www.cietac.org.cn/english/introduction/intro_1.htm.

III. The Current Structure of Financial Governance in China

Financial Regulatory Oversight

As discussed above, the current financial regulatory structure in China has the defining feature of being sectors-based.²⁷ As the central bank, the PBC assumes responsibility for monetary policy and the stability of the financial system generally. The CBRC, the CSRC and the CIRC are the authorities responsible for regulating the banking, securities and insurance sectors respectively. These four regulatory bodies will be examined below in detail.²⁸

First, the PBC is the central bank in China, a role legally confirmed by the Law of PRC on the People's Bank of China (PBC Law).²⁹ Pursuant to the PBC Law, the PBC must formulate and implement monetary policies, guard against financial risks and maintain financial stability under the leadership of the State Council.³⁰ As with most central banks in the world, the PBC performs a threefold role: as the currency-issuing bank; as the bank of banks; and as the government bank.³¹ More specifically, the PBC issues the Chinese currency, namely Renminbi, and serves as a bankers' bank for other banks and financial institutions. It seeks to stabilize the currency and the financial system by indirect, macro-economic means rather than through a direct, interventionist approach as it did in the planned economy era. It therefore exercises macro-economic control over the financial markets primarily through monetary tools such as deposit reserves, rediscount rate, interest rate and open market operations.³²

Second, in 2003, the CBRC came into existence as the banking 'watch dog', taking over the role previously performed by the PBC. The legal and regulatory framework for banking regulation comprises the Law of the PRC on Commercial Banks,³³ and the Law of the PRC on Banking Regulation and Supervision.³⁴ Like its peers in the securities and insurance markets, the CBRC is a ministry rank unit under the direct leadership of the State Council.

Third, against the backdrop of the fast-growing insurance market, the CIRC was set up in 1998 to assume regulatory responsibility for the insurance industry in China

²⁷ Hui Huang, 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis'.

²⁸ *Ibid.*

²⁹ Zhonghua Renmin Gongheguo Zhongguo Renmin Yinhang Fa [The Law of PRC on the People's Bank of China] (adopted at the 3rd session of the Standing Committee of the 8th National People's Congress of the PRC on 18 March 1995, amended on 27 December 2003), art.2.

³⁰ PBC Law, art.2.

³¹ PBC Law, art.4. It should be noted that the State Administration of Foreign Exchange is a government agency under the leadership of the PBC, and it acts as the implementation branch of the PBC in relation to foreign exchange administration and supervision. See State Administration of Foreign Exchange at http://www.safe.gov.cn/model_safe/whjjs/whjjs_detail.jsp?id=1&ID=160200000000000000.

³² PBC Law, art.23.

³³ Zhonghua Renmin Gongheguo Shangye Yinhang Fa [The Law of the PRC on Commercial Banks] (adopted at the 13th session of the Standing Committee of the 8th National People's Congress of the PRC on 10 May 1995, amended on 27 December 2003).

³⁴ Zhonghua Renmin Gongheguo Yinhangye Jiandu Guanli Fa [The Law of the PRC on Banking Regulation and Supervision] (adopted at the 6th session of the Standing Committee of the 10th National People's Congress of the PRC on 27 December 2003, amended on 31 October 2006).

under the Insurance Law of the PRC.³⁵ Like the CBRC, the CIRC is charged with both market conduct regulation and prudential regulation in relation to insurance companies.

Finally, the legal and regulatory framework for the securities market in China is largely based on the Securities Law of the PRC (Securities Law).³⁶ As noted before, established in 1992 and upgraded in 1998, the CSRC is the oldest of the three industry-specific regulatory bodies in the financial markets and has assumed responsibility for securities regulation in China. It should be noted that the coverage of the Securities Law and therefore the authority of the CSRC is so broad as to include the regulation of shares, corporate bonds, treasury bonds, securities investment funds, and derivative products such as futures contracts, options and warrants.³⁷

Resolution of Financial Disputes

Within the various sectors described above, both CIETAC and provincial and local courts, including the Shanghai Courts have developed dedicated dispute resolution scheme to resolve commercial and financial disputes³⁸. Following a description of these two schemes, this section will analyse the number and types of cases brought to each of these institutions.

A. Institutional Arbitration - CIETAC

Arbitration is among the more preferred methods of financial and commercial dispute resolution in China³⁹. Because ad hoc arbitration is not recognized under Chinese law if it takes place within China, arbitration must be conducted by an officially recognized arbitral institution. As a consequence, parties selecting China as their arbitration location will be constrained in their choice of applicable procedural and substantive rules, and, if an arbitration is necessary, will be required to choose arbitrators from lists maintained by the arbitration institution they select.

Chinese Arbitration Commissions

There are a number of arbitration commissions located throughout China. The most well known is the China International Economic and Trade Arbitration Commission (CIETAC). CIETAC deals with disputes arising from economic transactions. In 2003, CIETAC adopted Financial Dispute Arbitration Rules, which specifically applies to disputes arising from, or in connection with financial

³⁵ Zhonghua Renmin Gongheguo Baoxian Fa [Insurance Law of the PRC] (adopted at the 14th session of the Standing Committee of the 8th National People's Congress of the People's Republic of China on 30 June 1995, amended 28 October 2002 and 28 February 2009), art.9.

³⁶ Zhonghua Renmin Gongheguo Zhengquanfa [Securities Law of the PRC] (promulgated by the 6th session of the Standing Committee of the 9th National People's Congress of the PRC on 29 December 1998 and effective from 1 July 1999, amended in 2004 and 2005).

³⁷ *Ibid.*, art.2.

³⁸ US Government Export Portal, 'Dispute Avoidance and Resolution' (*China Business Information Centre*, [export.gov](http://www.export.gov), _____23 January 2011) (http://www.export.gov/china/exporting_to_china/disputeavoidanceandresolution.pdf).

³⁹ Shoushuang Li, 'Insight into Commercial Dispute Resolution in China' (2007) *Hong Kong Lawyer*.

transactions⁴⁰ between parties⁴¹. While, as yet, there are no special programs set up after the financial crisis, nevertheless CIETAC has indicated an intention to carry out further amendments to the CIETAC Arbitration Rules in accordance with developments in the PRC markets by requesting submission of proposals in late 2009⁴².

CIETAC was founded in April 1956 by the China Council for the Promotion of International Trade (CCPIT) to meet the needs of the continuing development of China's economic and trade relations with foreign countries after adopting its "open door" policy.⁴³ CIETAC's main headquarters are located in Beijing with three sub-commissions in Shanghai, Shenzhen and Tianjin respectively known as the CIETAC Shanghai Sub-Commission, the CIETAC South China Sub-Commission and CIETAC Financial Arbitration Center in Tianjin.⁴⁴ CIETAC also successively established 21 liaison offices in different regions and specific business sectors. Within each of CIETAC's headquarters and each of its sub-commissions is a secretariat established to handle logistical matters and daily affairs under the leadership of their respective secretaries-general.⁴⁵

In addition to CIETAC, there are over 140 local arbitration commissions that have been established in most major cities, including Beijing, Shanghai, Guangzhou and Shenzhen⁴⁶. Many local arbitration commissions have established specialized financial arbitration divisions in recognition of the growing demand for financial dispute settlement. The first specialized financial arbitration commission was set up in Shanghai in December 2007, followed by Guangdong, Chongqing, Wuhan and Hangzhou⁴⁷. The spokesperson for Chongqing Financial Arbitration Commission envisaged that PRC citizens may seek the assistance of these financial arbitration commissions when faced with abusive bank practice⁴⁸. It is also expected that the Shenzhen Arbitration Commission will follow suit this year⁴⁹.

The CIETC Financial Dispute Resolution System

Besides making prominent contributions to the legislation of the Chinese Arbitration Law and the development of the arbitration practice in China, CIETAC has also set up a financial dispute resolution system to deal with financial disputes

⁴⁰ Article 3 of the CIETAC Financial Dispute Arbitration Rules.

⁴¹ Sanzhu Zhu, *Securities Dispute Resolution in China* (Ashgate 2007) p.229.

⁴² See CIETAC at <http://cn.cietac.org/NewsFiles/NewsDetail.asp?NewsID=896> [Chinese] accessed 26 August 2011.

⁴³ *Ibid.*

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*

⁴⁶ See note 1.

⁴⁷ Yaya Jiang, Ying Liu and Yibo Lu, 'Establishment of the Shanghai Financial Arbitration Commission' (Shanghai Arbitration Research Centre, 19 December 2007) (http://www.arsh.sjtu.edu.cn/view_news.jsp?newsid=77) [Chinese] accessed 26 August 2011.

⁴⁸ Chongqing Daily, 'Yu Chengli Xibu Shoujia Jinrong Zhongcaiyuan, Shu Guonei Di'er Zhuanmen Jigou [The Establishment of the First Arbitration Institution in the West of China, Chongqing, the Second Largest Specialized Institution in the Country]' (www.cq.xinhuanet.com, 29 July 2010) (http://www.cq.xinhuanet.com/business/2010-07/29/content_20471602.htm) [Chinese] accessed 26 August 2011.

⁴⁹ Shenzhen Arbitration Commission, 'Introduction of the Shenzhen Financial Arbitration Commission' (www.fabao365.net, 12 January 2010) (<http://www.fabao365.com/news/657785.html>) [Chinese] accessed 26 August 2011.

across the nation. CIETAC has issued a set of Financial Disputes Arbitration Rules which serve as an expeditious and professional method for resolving financial disputes.

A Closer Look at the Rules

On 17 March 2005, CIETAC issued the “China International Economic and Trade Arbitration Commission Financial Disputes Arbitration Rules” (hereafter “the Rules”) which were revised and Adopted by the China Council for the Promotion of International Trade/China Chamber of International Commerce and became effective starting from 1 May 2005. According to art.1 of the Rules, these rules were formulated “for the purpose of impartial and prompt resolution of disputes arising from financial transactions between the parties.” These rules apply to the arbitrations of disputes “arising from, or in connection with, financial transactions between the parties”. Article 2 of the Rules then goes on to define “financial transaction” as

“transactions arising between financial institutions inter se, or arising between financial institutions and other natural or legal persons in the currency, capital, foreign exchange, gold and insurance markets that relate to financing in both domestic and foreign currencies, and the assignment and sale of financial instruments and documents denominated in both domestic and foreign currencies, including but not limited to: loans, deposit certificates, guarantees, letters of credit, negotiable instruments, fund transactions and fund trusts, bonds, collection and remittance of foreign currencies, factoring, reimbursement agreements between banks, and securities and futures.

The parties to a transaction are encouraged to specify their intended dispute resolution method expressly in their agreement. However, in cases where the parties agree to refer their disputes to arbitration under the Rules without providing the name of an arbitration institution, according to art.4, they shall “be deemed to have agreed to refer the dispute to arbitration by CIETAC”. This makes CIETAC one of the most commonly used means of arbitrating financial transactions.

Besides allowing parties to state expressly their intention to have their financial disputes resolved by a particular body, the Rules also allow parties to appoint any arbitrator, at their discretion, from a Panel of Arbitrators in the Financial Industry of CIETAC, or from such Panel of Arbitrators as may be designated by CIETAC. However, the appointment of arbitrators by the parties is not final as it is subject to the confirmation by the CIETAC Chairman, who makes the final decision. CIETAC has engaged over 100 experts and distinguished personnel in the field of finance as arbitrators. These experts have diverse cultural backgrounds. While most of them are from mainland China, a small number of them are from HKSAR, Macau SAR, as well

as from other parts of the world such as Canada, the United Kingdom, the United States and some EU countries such as France and the Netherlands. They usually are experts in the fields of Contract Law, Banking Law, Arbitration Law, Company Law, Trade Law, and Commercial Law, as shown in the list of arbitrators. Article 12 of the Rules provides that the arbitral tribunal shall be composed of either one or three arbitrators. Where the parties have not agreed upon the number of arbitrators in advance, the final decision power will rest in the CIETAC Chairman.

According to art.12, unless otherwise agreed by the parties, the arbitral tribunal shall render an arbitral award within 45 working days from the date on which the arbitral tribunal is constituted. At the request of the arbitral tribunal, the Secretary-General of CIETAC may extend the time period as needed. However, the extension may not exceed 20 working days.

In deciding a case, the arbitration tribunal will take into account the terms of the contract, the general usages and standard practices of specific business sectors, and abide by the principles of fairness and reasonableness. If the parties in a case involve a foreign-related element, the parties may, subject to the mandatory provisions of law, choose the law to be applied to the merits of the dispute. In cases of lack of such agreement, the tribunal will then apply the law as it deems appropriate in the situation.

It is however worth noting that the Rules here do not necessarily cover all situations. In cases which are not covered by the Rules, the Arbitration Rules of CIETAC shall apply as a fall back.

First case accepted by CIETAC Tianjin International Economic and Financial Arbitration Center

On 10 December 2008, the Tianjin International Economic and Financial Arbitration Center of CIETAC accepted its first case.⁵⁰ The case was about a dispute over a sale of goods contract which involved nearly 9 million Yuan. This was the first case handled by the Tianjin office after its establishment in May in the same year. The Tianjin office was set up to cater to the strategic development of the new Bohai district of Tianjin, to provide a legal framework for the newly developed Binhai New District as an international financial center, and to allow CIETAC to play more important role for China so as to enable local and foreign enterprises to have their disputes resolved by a fair and convenient commercial dispute resolution mechanism.

⁵⁰ ‘Maozhong Tianjin Guoji Jinji Jinrong Songcai Zhongxin Shouli Diyi’an [The First Case accepted by Tianjin International Economic and Financial Arbitration Center]’ (Tianjin International Economic and Financial Arbitration Center of the China International Economic and Trade Arbitration Commission, 10 December 2008) (<http://www.cietac-tj.org/newsfiles/NewsDetail.asp?NewsID=45>) [Chinese] accessed 26 August 2011.

Recent CIETAC Financial and Commercial Dispute Resolution Cases

Below is a selection of CIETAC's recent financial and commercial cases. What can be observed from these cases is the following: Most all of the cases involve issues relating to the sale of goods, capital contributions, lease contracts etc. As a result, CIETAC has had limited exposure to banking related cases. Nevertheless, for the cases it has handle it has achieved a relatively uniform process of case handling through reference to commercial agreements, existing law and trade practice.

1. *Dispute over capital contribution in a Joint Venture*⁵¹ (Published 2009)

This case involved a dispute between two parties who signed an agreement to establish a limited liability entertainment company. The contract required both parties to contribute capital, including a one-time payment of registered capital made within five months of acquiring the necessary license to conduct business. The claimant alleged that the respondent was unable to fulfill its obligations because the property it intended to provide as capital belonged to the government of the district where the joint venture was located and the government had already mortgaged it to a bank. The respondent counter argued that the claimant had not fully contributed the amount of capital required by the contract: the foreign exchange that it had originally promised to contribute was not paid and the equipment provided fell short of the required amount.

According to the terms of the contract, the Claimant referred the matter to CIETAC for arbitration.

The arbitral tribunal found that the respondent did not have legal rights to the property as its capital contribution and hence did not carry its investment obligations. The claimant also did not completely execute its investment obligations under the terms of the contract. Therefore, the tribunal determined that the joint venture contract should be terminated and the claimant's requests for compensation should be rejected.

Here the subject matter of the dispute, a capital contribution agreement, is more commercial, rather than financial in nature. The case determination was made primarily on the basis of the terms of the contract. Therefore, parties are advised to consider such terms carefully, in light of future adjudication.

2. *Dispute over a Contract for the Sale of Goods—Contract Revision and Reserving the Right to Seek Compensation for Damages*⁵² (Published 2009)

This case involved a dispute between a claimant and a respondent (French company) who signed a contract for the sale of glass production equipment which the claimant intended for resale to its partner companies in China in February

⁵¹ 'Dispute Over Capital Contribution in a Joint Venture' (*Case Studies, References, CIETAC*, 15 July 2009) ([HYPERLINK "http://www.cietac.org/index.cms"](http://www.cietac.org/index.cms) <http://www.cietac.org/index.cms>) accessed 26 August 2011.

⁵² 'Dispute Over a Contract for the Sale of Goods—Contract Revision and Reserving the Right to Seek Compensation for Damages' (*Case Studies, References, CIETAC*, 15 July 2009) (<http://www.cietac.org/index.cms>) accessed 26 August 2011.

1996. The contract required the claimant buyer open an irrevocable letter of credit for the full contract price with the respondent seller 60 days before the loading. The claimant opened a letter of credit as required by the contract but the respondent failed to deliver the equipment according to schedule. When the respondent finally delivered the equipment one and a half months later, the claimant demanded that the respondent pay penalties according to the contract for late delivery of goods and sought additional compensation on the basis that the respondent's late delivery had caused the claimant to violate its resale contracts with its partner companies and the cost of altering the letter of credit. The claimant argued that revision of the letter of credit was independent of the main contract therefore it did not amount to revision of the contract while the respondent argued that the revision of the letter of credit extended the original date of delivery in the contract.

The arbitral tribunal found that although the letter of credit exists independently of the main body of the contract, it still originates from the contract. Generally speaking, revision of the major articles of the contract such as the date of delivery of goods, should be viewed as equivalent to the revision of the contract itself. A party may agree to revise a letter of credit with or without conditions, it should protect its right to seek compensation by expressly reserving its right to seek compensation later based on the provisions of the contract. If a party seeks to revise a letter of credit without reservation it abandons its right to seek compensation in the future. Therefore the claimant lost its contractual right to seek compensation from respondent based on late delivery of goods as the respondent delivered the equipment within the time limit set by the revised letter of credit.

Here CIETAC primarily considered the parties initial and subsequent revisions to its contract and reasoned that revision to the LOC without conditions amounted to a change in the underlying contract itself and therefore the claimant was not entitled to damages.

3. *Lease Contract Dispute—Obvious Loss of Fairness and the Exercise of the Right to Revoke a Contract (Published 2009)*⁵³

The claimant, a Hong Kong citizen, and the respondent, a Beijing-based real estate company, signed a contract in 1996 where the claimant agreed to lease the respondent its property in Beijing. Before the contract was signed, the respondent agreed to sublet the property to a department store. According to the contract, if the rent obtained by the respondent from subletting the property exceeded a certain minimum amount, the respondent could claim the remainder, if the rent fell under the minimum amount, the respondent was required to pay the remainder to the claimant. In 1999, the claimant applied to CIETAC for arbitration on the basis that the respondent failed to pay the required amount of rent. The respondent argued that the sum it was required to pay by the contract far exceeded the amount of rent it obtained from the sublease, therefore the contract had lost its fairness under art.5 of the Contract Law of PRC and should be revoked.

⁵³ 'Lease Contract Dispute—Obvious Loss of Fairness and the Exercise of the Right to Revoke a Contract' (*Case Studies, References, CIETAC*, 15 July 2009) (<http://www.cietac.org/index.cms>) accessed 26 August 2011.

The arbitral tribunal found that as the contract contained explicit provisions regarding the calculation and payment of rent, the respondent still had the obligation to pay the minimum required rent to the claimant regardless of how much rent the respondent obtained from the sublease. When the respondent signed the lease contract with the claimant, it had already agreed to sublet the property for a third party for an amount less than the rent it would have to pay to the claimant so the respondent was clearly aware of the price differential. Also according to arts.54 and 55 of the Contract Law, if a contract loses equality, a party has the right to request that the court or arbitral tribunal permit modification or revocation of the contract within one year of when it knew or should have known that it had cause to do so. As the respondent did not attempt to exercise its right until 3 years after signing the contract, the respondent had lost its right to seek revocation even if the contract had actually become unfair.

This case, which primarily involves a lease and sublease agreement, primarily revolved around the running of a limitations time period. Because the respondent waited until 3 years after signing the contract, he lost his right to seek revocation.

4. *Execution of Duties in a Contract for the International Sale of Goods*⁵⁴

The claimant seller and the respondent buyer signed a contract under which the claimant agreed to supply the respondent with five thousand tons of peanuts. The contract required the buyer to open an irrevocable, transferable letter of credit with the seller as beneficiary 15 days before the loading date. The respondent failed to open a letter of credit and cancelled the contract on the ground that there was insufficient time to arrange the loading of the ship. The claimant sought compensation for damages. The respondent's failure to open the letter of credit and arrange shipping forced the claimant to convert product into peanut oil resulting in financial losses. The respondent counter argued that examination of the goods before the loading period indicted that the product did not meet the required standard and hence it did not open a letter of credit.

The arbitral tribunal confirmed the claimant's request for compensation resulting from the respondent's fundamental breach of contract from failing to open the letter of credit. Regardless of the usual practice with the claimant where the letter of credit will only be opened after the parties examined the product together and determined the required standard was met, contractual obligations always supersede implicit understanding.

Here CIETAC is relying first on the contract as stated as opposed to industry practice. Because the opening of a letter of credit was not contingent on product quality, the respondent was contractually bound to open the letter of credit. As he failed to do so, he was in breach of the contract.

Assessment of Cases

⁵⁴ 'Problem in the Sequence of the Execution of Duties in a Contract for the International Sale of Goods' (*Case Studies, References, CIETAC*, 16 July 2009) (<http://www.cietac.org/index.cms>) accessed 26 August 2011.

As can be seen from the above sample of CIETAC cases, the majority of those cited deal with some variation of a contractual dispute whether it be sale of goods, the opening of a letter of credit, subleasing agreements or product quality. None of the cases reviewed above directly involve banking or financing related disputes. While CIETAC maintains a list of highly qualified and well established financial dispute resolution practitioners, given the limited number of finance related cases thus far having been referred to CIETAC, a question arises as to the preparation of CIETAC on the whole to handle financial and banking related matters.

Why might the number of financial dispute resolution cases brought to CIETAC be low? In general, CIETAC is amongst the most well known arbitral institutions in China and the first to introduce a financial dispute resolution system. Therefore, it is not due to lack of awareness or the absence of a specialized program that has deterred users. One reason might be that CIETAC case handling fees are less expensive when compared with other international arbitration venues, but relative to general income levels in China, CIETAC fees can be high. As a result, case fees may be a deterrent to mid-size businesses and sole proprietorships.

B. Shanghai Courts Financial Division

In relation to CIETAC, the number of financial disputes brought to the Shanghai Courts is far greater and more varied. This has provided the Shanghai Courts with greater exposure to a diverse array of financial and corporate claims.

Background

On 12 April 2011, the Shanghai High Court issued a series of white papers on trials of financial cases in 2010⁵⁵.

According to the white paper, the Shanghai Courts handled a total of 22,278 financial and commercial dispute cases (of those 22,234 were closed), an increase of 29.64 per cent from the previous year. The cases involved a total amount of 6.465 billion RMB. Of these cases, 359 were heard on appeal, an increase of 13.97 per cent over the previous year. Most involved disputes concerning credit cards, loan agreements, bank deposits, insurance contracts, bills, securities, financial leasing arrangements and management of trust funds⁵⁶.

The Courts also handled a total of 1,165 financial criminal cases in 2010, of which 1,153 were closed. This represented an increase of 38.3 per cent over the previous year. The cases involved crimes of credit card fraud, bill fraud, sales, purchase and transportation of counterfeit money, illegal operations, holding and using counterfeit money, illegal absorption of public deposits and interference with credit card management.

⁵⁵ 'Press Conference on the Issue of White Papers' (*Shanghai No.2 Intermediate People's Court*), (<http://www.shezfz.com/view.html?id=55150>) [Chinese] accessed 26 August 2011.

⁵⁶ Shanghai Shangbao, 'Xinyongka Zhapian Cheng Jinrong Fanzui Zhongzaiqu [Credit Card Fraud Becomes the Most Common Financial Crime]' (<http://www.sina.com.cn>, 11 March 2011) (<http://finance.sina.com.cn/roll/20110311/11109512831.shtml>) [Chinese] accessed 26 August 2011.

Relevant Cases

Below is a sample of relevant cases handled by the Financial Division of the Shanghai Courts. The sample illustrates the growing depth and breadth of experience in handling financial related issues and the use of mediation in some cases.

*1. Abuse of majority shareholder power (Published 2008)*⁵⁷

This case involved a plaintiff and defendant who were originally the only two shareholders in a company with registered capital of 21 million RMB, holding 15 per cent and 85 per cent stakes respectively. Under the pretext of addressing company liquidity problems, the defendant who was also the majority shareholder held several shareholder meetings between April and September 2005 to approve the injection of capital by itself and a third party “strategic partner” company. The capital injection allowed the defendant to increase his stake in the company to 73.7 per cent and the third party “strategic partner” company obtained 20 per cent while the minority shareholder stake was reduced to 6.3 per cent. The plaintiff sued the defendant for abuse of the position of majority shareholder.

The appeal court, in consideration of the deteriorated relationship between the two parties, persuaded them to reach a mediation agreement where the defendant agreed to purchase the plaintiff’s entire equity interest and pay the plaintiff a one-off compensation of 6.1 million RMB.

*2. Request for winding up of company (Published 2006)*⁵⁸

This case involved a claim by Plaintiff subsidiary company against its parent company (the defendant). The plaintiffs claimed that the defendant parent company refused to hold shareholder and director meetings resulting in severe difficulties in the management and normal operation of the company.

After a review of the facts, the court held for the defendant, indicating that the plaintiffs should also bear responsibility for the unfavourable management state of the company which was partly attributed to their breach of contract.

*3. Fraudulent shareholder investment*⁵⁹

⁵⁷ ‘Appeal on Dispute over Compensation for the Abuse of Majority Shareholder Power [(2008) Shanghai No.2 Intermediate People’s Court, Third Civil Division (Commercial Case), Final Ruling, Case No.238] [3 September 2008]’ (*The Selected Case List, Shanghai No.2 Intermediate People’s Court*), (<http://www.shezfz.com/view/jpa/detail.html?id=175>) [Chinese] accessed 26 August 2011..

⁵⁸ ‘Request for Winding up of Company [(2006) Shanghai No.2 Intermediate People’s Court, Third Civil Division (Commercial Division), Initial Ruling, Case No.76] [8 September 2006]’ (*The Selected Case List, Shanghai No.2 Intermediate People’s Court*), (<http://www.shezfz.com/view/jpa/detail.html?id=111>) [Chinese]) accessed 26 August 2011.

⁵⁹ Eight typical cases on financial and investment risks realized by the Shanghai High Court on 19 September 2010. Extracted from http://www.sh.xinhuanet.com/2010-09/16/content_20922_657.htm and <http://www.zwjkey.com/oneas.asp?Id=7074>.

This case involved a joint venture agreement entered into by two defendants in June 1999. Although the official registration records indicated that the company had registered capital of 5 million RMB, the two defendant shareholders had in fact paid nothing. In 2004, the company increased its registered investment capital to 10 million RMB, with the two shareholder's funding obligations still unfulfilled. A debt crisis hit the company and the suppliers, bank and other debtors sued the company and its two shareholders.

The court held that shareholders were required to pay the full contribution in order to set up a company. As the company's actual capital was below that of the legal minimum, its corporate status was not established and the defendant shareholders were, as a result, jointly and severally liable for the company's debts.

4. *Breach of fiduciary duty by management*⁶⁰

This case involved a dispute between a defendant manager for a foreign company responsible for the company's sales in the South China region and the foreign company. In the course of his employment, the defendant obtained profits for himself through side dealing and fraudulent means. The company dismissed the defendant and sued him for compensation of losses suffered by the company.

The court held that the defendant owed duties of loyalty (including a prohibition against self-dealing) to the company. As a result of the defendant's breach, the court ordered him to disgorge any profits and compensate the company for the losses it suffered.

5. *Company refusal to award shareholder dividends*

This case involved a dispute between a shareholder (the plaintiff) and his company (the defendant). In Jan 2008, the plaintiff was arrested and held under custody for a crime that he was subsequently acquitted of. During the period of custody, the defendant company distributed shareholder dividends for the year of 2007 to all shareholders except the plaintiff. The plaintiff sought a payment of his dividends after his release.

The court held that shareholder rights are not affected even when a shareholder is under custody by the police. The defendant was ordered to pay the plaintiff his dividends accordingly.

6. *Company deregistration prior to liquidation*

This case involved a plaintiff real estate company which was set up in 1999 and de-registered in March 2006. During the period when the company was in operation, it purchased 0.5 million RMB worth of construction materials from the defendant, which remained unpaid at the time of deregistration.

The court held that even after a company is deregistered and wound up, the shareholders are still under the responsibility to liquidate the company according

⁶⁰ *Ibid.*

to law. The court ordered the shareholders to compensate the defendant for any losses suffered due to the non-payment for the materials.⁶¹

Summary

The Financial Division of the Shanghai Courts has handled a wide range of banking, corporate and financial cases. In addition to the above-cited sample, the court has handled an additional 242,686 civil disputes including financial cases.⁶² Case handling fees are lower than CIETAC arbitration filing fees. Comparing the case type and volume with CIETAC, one can readily observe that the financial division of the Shanghai Courts has clearly had greater exposure, experience and familiarity with financial disputes. Therefore, the authors are of the view that given CIETAC's limited exposure to banking and financial-sector disputes, in the immediate term, parties are advised to seek resolution through reference to local financial division dispute resolution mechanisms such as the financial division of the Shanghai Courts. In the long term, prospects for greater strengthening of national mechanisms such as CIETAC and the Securities Dispute Resolution scheme will provide additional avenues of recourse.

⁶¹ Guoji Jinrongbao, 'Weijixia Shanghai Jirong An'jian Jizeng [Surge in Financial Litigation as Financial Crisis hits Shanghai]' (www.people.com.cn, 21 May 2009) (http://paper.people.com.cn/gjjrb/html/2009-05/21/content_257709.htm) [Chinese] accessed 26 August 2011.

⁶² See Shanghai Fayuan Falu Wenshu Jiansuo Zhongxin at <http://www.hshfy.sh.cn:8081/flws/list.jsp#>.

IV. Lessons from the global financial crisis

What lessons can be learned from the global financial crisis? How can such lessons be applied to the development of China's financial governance systems in the future? Although China's financial markets and institutions have been affected by the global financial crisis, the impact appears less direct and less severe than is the case with overseas markets.⁶³ The Chinese financial system as a whole has survived the crisis in relatively good shape: no major financial institutions have fallen and no major scandals over transactions of complex financial products have occurred. The losses suffered by Chinese financial institutions are essentially the consequence of their ill-fated investment in overseas markets rather than in domestic markets. Further, the overall risk exposure of China's financial institutions and listed companies in overseas markets is quite limited and manageable.

However, one would be wrong to believe, judging from the relatively good health of the Chinese financial markets following the financial crisis, that China's financial regulatory system is problem-free. Rather, a closer examination reveals the irony that the good fortune of China's financial system in this financial crisis is largely attributable to the relative simplicity of its financial products and isolation from the global economy.

To begin with, the Chinese financial markets continue to have much room for development. At present, the financial products traded on the Chinese financial markets are limited and the technology of securitization is yet to be widely used. There are some traditional financial derivatives in China such as options and warrants, but they are far fewer than those found in overseas markets and far less sophisticated than their overseas counterparts, including collateralized debt obligations (CDOs), collateralised loan obligations (CLOs) and synthetic CDOs. As securitization and complex financial instruments have now been identified as one of the core causes of the current financial crisis,⁶⁴ it is not hard to understand why China's financial system has not suffered any home-grown problems.

On the other hand, the isolation of the Chinese financial system from the outside world has helped to stop the flow-on effect of the financial crisis in China. Although China has worked to open up its financial markets since its accession to the WTO, this process is gradual, cautious and ongoing. For the time being, foreigners have limited access to the Chinese financial markets. For example, foreign investors cannot trade in China's stock market except through several designated means such as the Qualified Foreign Institutional Investors (QFII).⁶⁵ Further, the Chinese government still exerts tight control over its currency policy. For instance, there are restrictions on capital accounts; the Chinese currency, the *renminbi* or *yuan*, is not fully convertible yet; the exchange rate is set in a managed floating range. All these measures have

⁶³ See Hui Huang, 'China's Legal Responses to the Global Financial Crisis: From Domestic Reform to International Engagement' (2011) 12(2) *Australian Journal of Asian Law* (forthcoming).

⁶⁴ See e.g., John C Coffee, Jr., 'Financial Crises 101: What Can We Learn from Scandals and Meltdowns—from Enron to Subprime?', keynote address delivered at the 2008 Conference on the Credit Crunch and the Law, Sydney (August 2008).

⁶⁵ For a detailed account of the QFII mechanism and other means for foreigners to invest in China's stock market, see Hui Huang, *International Securities Markets: Insider Trading Law in China* (2006) pp.12-13.

collectively operated as a firewall to insulate China's financial system from the spills of the financial crisis overseas.

China can take some comfort from the fact that its financial system has sustained relatively modest losses in the current financial crisis, however it should not be overjoyed about its lucky escape, overlooking the real problems it has faced. As observed by the People's Bank Governor, the fault of the previous crisis was "not in the technical sophistication of the products" but rather arose from "problems in information disclosure or the pricing mechanisms."⁶⁶ Some have observed that the technology of securitization and financial derivatives, if used and regulated properly, can make the market more efficient and effective.⁶⁷ China is thus best advised to further develop its financial markets by investigating the applicability of such financial tools, while at the same time strengthening its regulatory system to avoid abuse.

What is required is a more effective regulatory framework that can take on the increasingly complex challenge of providing coordinated supervision of innovative financial products and multi-service financial groups. This challenge has been acknowledged worldwide as tall order inasmuch as federal regulators now admit that in relation to the most recent financial crisis, "neither the investors, nor the rating agencies, nor the regulators, nor even the firms that designed the securities fully appreciated the risks those securities entailed...in part because the regulators – like most financial firms and investors – did not fully understand or appreciate them."⁶⁸ As discussed earlier, China presently adopts a traditional sectoral system of financial regulation, which has exhibited several inadequacies in meeting the regulatory challenges in a rapidly changing market. This author has discussed the issue elsewhere through a comparative analysis of the relevant experiences in some advanced economies including the US, the UK and Australia. Each of these jurisdictions represents a different regulatory approach, namely the 'multiple-regulators' model or 'sectoral regulation' model in the US, the 'single-regulator' model or 'integrated regulation' model in the UK, and the 'twin-peaks' model or 'objectives-based regulation' model in Australia. When looking to overseas regulatory models for guidance, regard must be taken not only of their advantages and disadvantages, but also of the local conditions in China. This author suggests that the US model merits consideration in the short term, and that with further growth of China's financial markets in the long run the Australian model provides the preferred direction for reform.⁶⁹

With regard to China's systems of financial dispute resolution, following the financial crisis, China saw the emergence of CIETAC's financial dispute resolution mechanism. The question remains, despite conventional wisdom favouring private arbitration over in-court litigation, why might the number of financial dispute resolution cases brought to CIETAC be low? In general, CIETAC is amongst the

⁶⁶ Xiaochuan Zhou, 'Instability and Evolution of the Financial System' in Leo F Goodstadt, Reluctant Regulators, *How the West Created and How China Survived the Global Financial Crisis* (Hong Kong University Press 2011).

⁶⁷ For more detailed discussion of securitization and derivative transactions, see e.g., Joseph C Shenker and Anthony J Colletta, 'Asset Securitization: Evolution, Current Issues and New Frontiers' (1991) 69 *Texas Law Review* 1369; Christina A Johnson, 'At the Intersection of Bank Finance and Derivatives: Who Has the Right of Way?' (1998) 66 *Tennessee Law Review* 1.

⁶⁸ Ben S Bernake, FRB Chairman, 'Economic Challenges: Past, Present, and Future', speech at the Dallas Regional Chamber (7 April 2010).

⁶⁹ Hui Huang, 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis'.

most well known arbitral institutions in China and the first to introduce a financial dispute resolution system. Therefore, it is not due to lack of awareness or the absence of a specialized program that has deterred users. One reason might be that CIETAC case handling fees are less expensive when compared with other international arbitration venues, but for domestic cases CIETAC fees can be high.⁷⁰ As a result, case fees may be a deterrent to mid-size businesses and sole proprietorships. Going forward, CIETAC may consider a sliding scale fee for mid-size businesses and sole proprietorships. In addition, because pre-dispute arbitration clauses in standard-form contracts can be held invalid in a number of circumstances under the PRC Law⁷¹, this presents an additional barrier to CIETAC use by small/mid-size businesses. It is possible to “tick the box” to select arbitration, but in practice, few people choose to do this. Therefore, greater awareness is needed among small businesses regarding the benefits of arbitration as well as a commensurate sliding scale fee to make the arbitration process more accessible.

Despite handling a limited number of cases, CIETAC has been generally effective in providing a forum for the resolution of commercial disputes, while its hearing of financial related disputes continues to have much scope for growth. In order to further strengthen CIETAC’s role in providing a venue for the resolution of financial related disputes, there is a need to provide further training to arbitrators so that they become well versed in financial systems, laws and regulations.⁷² In addition, CIETAC may consider drafting a general model clause for use in financial product sales contracts. This will make CIETAC a more attractive venue of the resolution of financial disputes.

On the other hand, the Financial Division of the Shanghai Courts has handled a wide range of banking, corporate and financial cases. In addition to the above-cited sample, the court has handled an additional 242,686 civil disputes including financial

⁷⁰ See ‘Arbitration Fee Schedule’ (*Arbitration Fee Schedule, Application for Arbitration, CIETAC*) (<http://www.cietac.org/index.cms>) accessed 26 August 2011.

⁷¹ See *Application by Qiu Donglan and Wu Feng for Confirming Validity of an Arbitration Agreement* [(2009) Kunming Intermediate Court, First Civil Division, Initial Ruling, Case No.1] [21 January 2009]. In that case, the applicants and the respondents were parties to a contract for sale and purchase of commodity housing, of which art.14 was a standard arbitration clause submitting the dispute to Kunming Arbitration Commission. Although the Court held that art.14 was valid, it suggested that a standard arbitration clause could be invalidated if there was evidence indicating that:

- (1) the scope of the arbitration agreement exceeds that permitted by law; any of the parties concerned was incapable of concluding the arbitration agreement; and the agreement was obtained by coercion (art.17 of the Arbitration Law of the PRC).
- (2) the arbitrable matters and the choice arbitration commission were not clearly specified (art.18 the Arbitration Law of the PRC).
- (3) the arbitration agreement excluded the liabilities of the party supplying the agreement, increased the liabilities of the other party, or deprived the other party of any of its material rights (art.40 of the Contract Law of the PRC).
- (4) the agreement was obtained by fraud or duress; the parties colluded in bad faith; the parties intended to conceal an illegal purpose; the agreement harms public interests; the agreement violates a any law or administrative regulation (art.52 of the Contract Law of the PRC).
- (5) the agreement excluded liabilities for personal injury or liabilities for property loss caused by intentional misconduct or gross negligence (art.53 of the Contract Law of the PRC).

⁷² See also: Ali, Shahla F. and Kwok, John Koon Wang, *After Lehman: International Response to Financial Disputes – A Focus on Hong Kong* (August 1, 2011). *Richmond Journal of Global Law and Business*, Vol. 10, No. 2, 2011.

cases.⁷³ Comparing the case type and volume with CIETAC, one can readily observe that the financial division of the Shanghai Courts has clearly had greater exposure, experience and familiarity with financial disputes.

With respect to both CIETAC and the Financial Division of the Shanghai Courts, further training and development is necessary. It is suggested that a comprehensive financial dispute resolution training program consider the inclusion of both a course based program followed by an examination and an in-person evaluation program. The course content could include topics such as: the arbitration process, ethical considerations, how to determine potential conflicts of interest, managing the hearing process, fairness and impartiality, determining the facts of a case and the relevant law, and drafting an award. Such a training program will enhance the competency of the arbitrators and the confidence of the parties in the proceedings.

In addition to a comprehensive training program, proving potential parties with a draft clause to include in their contractual agreements will provide a clear route to resolution. The following essential elements must be included in a valid arbitration clause: the administering institution, the arbitration rules, reference to any dispute arising out of the agreement, the place (seat) of arbitration, the number of arbitrators, the method of selection and replacement of arbitrators, the language of arbitration and the rules of law governing the contract. In addition to these essential elements, the parties may also consider including terms such as the allocation of costs, time limits and discovery considerations.

The authors are of the view that given CIETAC's limited exposure to banking and financial-sector disputes, in the immediate term, parties are advised to seek resolution through reference to local financial division dispute resolution mechanisms such as the financial division of the Shanghai Courts. In the long term, prospects for greater strengthening of national mechanisms such as CIETAC and the Securities Dispute Resolution scheme will provide additional avenues of recourse.

VI. Conclusion

The article has shown that China's systems of financial dispute resolution and regulation has undergone significant changes since economic reforms in the late 1990s. The current Chinese regulatory regime is broadly similar to its United States counterpart, adopting a traditional sectoral regulatory structure. It comprises the PBC as the central bank and three sector-specific regulators, namely the CBRC, the CSRC, and the CIRC responsible for banking, securities and insurance respectively. Similarly, its financial dispute resolution structures are just emerging at the provincial level as specialized programs within courts and arbitral tribunals.

The authors recommend that in the short term, given CIETAC's limited exposure to banking and financial-sector disputes, parties are advised to seek resolution through reference to local financial division dispute resolution mechanisms such as the financial division of the Shanghai Courts. In the long term, prospects for greater strengthening of national mechanisms such as CIETAC and the Securities Dispute Resolution scheme will provide additional avenues of recourse.

⁷³ See Shanghai Fayuan Falu Wenchu Jiansuo Zhongxin at <http://www.hshfy.sh.cn:8081/flws/list.jsp#>.

