JUDICIAL REVIEW OVER ARBITRATION IN CHINA: ASSESSING THE EXTENT OF THE LATEST PRO-ARBITRATION MOVE BY THE SUPREME PEOPLE'S COURT IN THE PEOPLE'S REPUBLIC OF CHINA

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INTRODUCTION

In China, the final say over arbitral jurisdiction, such as ruling on the existence and validity of an arbitration agreement,[1] belongs to the national court, which is deemed as one of the two limbs of supervisory powers of courts versus arbitration.[2] However, the real exercise of judicial supervision depends on how the court treats arbitration, which largely influenced by the status quo of its judicial system. This article attempts to explore the answers to three key questions. First, whether there is any shortage in the legislative approach of judicial review over arbitration agreements under the current China Arbitration Law (AL) and its ancillary rules after comparison with international arbitration norms. Second, to what extent recently has the Supreme People's Court (SPC) made efforts to live up to international standards for prevention of excessive judicial intervention in arbitral jurisdiction? Third, whether these regulatory remedies are sufficient, particularly whether enforcement difficulties still exist despite the rigorous SPC pro-arbitration move in the past decade.

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1 For the purpose of this article, judicial supervision over the arbitral jurisdiction is confined to that over the existence and validity of the arbitration agreement.

2 The court's supervisory power over arbitration is exercised in two ways (1) to examine the effectiveness of the arbitration agreement and (2) to review the arbitral award.

I. PRIORITIZED JUDICIAL REVIEW UNDER CHINA ARBITRATION LAW AND THE SUPREME PEOPLE'S COURT'S INTERPRETATIONS

The "parallel reviewing power over the arbitration agreement between the arbitral body and national court" underlying Article 5 of the AL seems to conflict with the "prioritized judicial review." "Prioritized judicial review" is subsequently prescribed under Articles 20 and 26 which is where the legislative ambiguity arises.

A. LEGISLATIVE AMBIGUITY AMONG THE PROVISIONS

Under the AL, judicial review over the arbitration agreement is addressed through the provisions found in Articles 5, 20, and 26. Article 5 mandates the conditions to invoke such review:

> If the parties have concluded an arbitration agreement and one party initiates an action in a people's court, the people's court shall not accept the case and shall refer that to the arbitration commission, unless the arbitration agreement is null and void. The decision by the arbitration commission is final.[3]

According to the legislative annotations, Article 5 has been formulated to respect the original intention of the parties to arbitrate. Further, the provision intends to strike a balance between party autonomy and judicial intervention in that the people's court will not intervene in the arbitration process *unless* the arbitration agreement is non-existent or invalid.[4] Article 5, thus, appears to accord with modern arbitration norms.[5]

Article 20 addresses the procedure with respect to the exercise of judicial review. It deals with the competing jurisdiction between a court and an arbitration commission, where the party challenges the validity of an arbitration agreement. Pursuant to Article 20:

> If a party challenges the validity of an arbitration agreement, it may request the arbitration commission to make a decision or apply to the people's court for a ruling. If one party requests the commission to

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[3] Arbitration Law of China (promulgated by Order N.31 of the President of the People's Rep. of China, Aug. 31, 1994, effective Sept. 1, 1995), art. 5.

[4] ARBITRATION LAWS OF CHINA 36-37 (The Legislative Affairs Comm'n of the Standing Comm. of the Nat'l People's Cong. of the P.R.C. ed., 1997).

[5] *Id*. at 37.

> make a decision and the other party applies to the court for a ruling, the court *shall* give a ruling. A party's challenge of the effect of the arbitration agreement shall be raised prior to the arbitral tribunal's first hearing.[6]

This jurisdictional challenge provision has two meanings (1) if the parties separately apply to the arbitration commission and the people's court for a ruling on the effect of the arbitration agreement, the decision of the court will prevail, and (2) the request for judicial review (raising the jurisdictional challenge) should be made before the first hearing of the tribunal.[7] It follows from Article 20 that the judicial power to review the enforceability of arbitration agreements trumps the arbitration commission. This, however, contradicts the underling ideology of Article 5 and may lead to the internal conflict about the understanding of the provisions.[8]

Article 26 also addresses the condition and procedure prescribed under Articles 5 and 20. It provides that:

> If the parties have concluded an arbitration agreement and one party has initiated an action in a people's court without declaring the existence of the arbitration agreement and, after the people's court has accepted the case, the other party submits the arbitration agreement prior to the first hearing of the court, the people's court shall dismiss the case unless the arbitration agreement is null and void. If, prior to the first hearing, the other party has not raised an objection, it shall be deemed to have renounced the arbitration agreement and the people's court shall continue to try the case.[9]

Subject to the time limit under Article 20, Article 26 provides that the failure to submit the jurisdictional challenge to the court within the statutory period (before the first hearing) will be treated as a waiver of the arbitration agreement.[10] Yet, Article 26 fails to clarify the confusion between Articles 5 and 20 about whether judicial review over the effect of an arbitration agreement is superior to its arbitral counterpart.

The legislative ambiguity under the AL was addressed, in 1998, by the *SPC Reply on the Confirmation of the Validity of Arbitral Agreement* (SPC Reply).[11] Under Article 3 of the SPC Reply, if an arbitration

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6 Arbitration Law, art. 20 (P.R.C.).

7 ARBITRATION LAWS OF CHINA, *supra* note 4, at 62-63.

8 JOHN SHIJIAN MO, ARBITRATION LAW IN CHINA 106 (2001).

9 Arbitration Law, art. 26 (P.R.C).

10 ARBITRATION LAWS OF CHINA, *supra* 4, at 66.

11 Reply on the Confirmation of the Validity of Arbitral Agreement (promulgated by the Sup. People's Ct., Nov. 5, 1998) Fa Shi (1998) No. 27 [hereinafter SPC Reply 1998 No. 27]

commission has accepted the jurisdictional challenge and has rendered a decision *prior to* the same motion being filed in the people's court, the court *must* dismiss the application. However, if the arbitration commission has not made its decision before the party raises a jurisdictional challenge to the court, the court *shall* accept the application of challenge, and notify the commission to terminate the arbitral proceeding.[12] In 1998, the Xiamen Intermediate People's Court applied this article of the SPC judicial interpretation in *Re Xingda Co (Xiamen) Ltd*.[13]

Under Article 4 of the SPC Reply the following can occur (1) if one party files a dispute for arbitration arising from a contract or other property issues while the other party challenges the validity of the arbitration agreement before the people's court, and (2) initiates the lawsuit in respect of the same dispute, then, (3) once the case has been accepted by the people's court, the court *must* instruct the arbitration commission to terminate the arbitral proceeding. Article 4 further provides that after the court decides the arbitration agreement it *shall* send a copy of its ruling to the arbitration commission, which must then decide either to resume the proceeding or withdraw the case according to the court's instructions.[14] In 1999, these rules were applied by Chongqing Higher People's Court in *Hongji Real Estate Development Company Ltd v. Communication Bank (Chongqing)*.[15]

The case relates to a contract for the sale of a commercial residence concluded in December 1998. The contract contained an arbitration clause to the "arbitration institution of Chongqing Municipality." Since the Hongji Company did not wish to pursue arbitration as a means for resolving disputes, in 1999, it applied to the Chongqing Higher People's Court for a ruling that the arbitration clause was invalid and asked the court to try the case instead. The court notified the Chongqing

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[12] *Id*. art. 3.

[13] In the *Re Xingda Company* case, there was a contract for the sale of steel between a Xiamen Company (A) and a Hong Kong Company (B). The contract of sale had two versions: a printed English version providing for arbitration in CIETAC and a handwritten Chinese version providing for arbitration in the US. In 1998, A submitted the dispute to CIETAC, but B challenged CIETAC's jurisdiction to the Xiamen Intermediate People's Court on the ground of the handwritten arbitration clause. The Xiamen Court, while the CIETAC proceedings were still ongoing to reach the determination on the effect of the arbitration clause, accepted the case and notified CIETAC to stop the proceeding pursuant to Article III of the SPC Reply. *See* MO, *supra* note 8, at 83, ¶3.06.

[14] SPC Reply 1998 No. 27, art. 4.

[15] Hongji Real Estate Dev. Co. Ltd. v. Bank of Commc'ns (Chongqing Branch), (Chongqing Higher People's Ct., 1997), *available at* http://www.bjac.org.cn/news/view.asp?id=124&cataid=9 (last visited May 19, 2009).

Arbitration Commission to suspend the arbitral proceeding. In ruling on the validity, the court held that the arbitration clause was reasonably clear as the Chongqing Arbitration Commission was established in accordance with the AL. The court dismissed the application and the arbitration commission resumed the arbitral proceeding.

There are several points worth noting about Article 3 of the SPC Reply. To begin with, under Chinese jurisprudence, judicial interpretations must be qualified by the primary law to be interpreted.[16] Pursuant to Article 20 of the AL, jurisdictional challenge to arbitration must be raised prior to the first hearing of the arbitral tribunal. Therefore, the SPC rules apply only when a party brings the jurisdictional challenge before the first hearing of the arbitral tribunal. In addition, within the timeline, the judiciary may intervene whenever the arbitration commission's decision on the effect of the arbitration agreement is pending, and the arbitral proceeding must be stopped once the court accepts the case. In accordance with Article 3(2) of the SPC Reply, the arbitral tribunal can only resume the proceeding if the court instructs it to do so. As such, the rules may provide the chance for the opposing party to use dilatory tactics to request judicial review. Such judicially-oriented review procedures defeat the efficiency of arbitration. Moreover, the SPC rules confirm the primacy of judicial power in determining the arbitral jurisdiction versus the arbitration commission.[17]

While there is a trend to minimize judicial intervention in arbitration proceeding in the international arbitration community, the comparative research discussed below shows that the gap between the Chinese regulatory approach and international norms is still large.

B. GAPS WITHIN INTERNATIONAL ARBITRATION NORMS

This section will discuss the two major defects of judicial review over arbitral jurisdiction in China in comparison with international arbi-

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[16] According to the *PRC Legislation Law* and *People's Court Organization Law*, the SPC judicial interpretation cannot violate the provisions of the basic law it interprets. *See* Law on Legislation (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 2000, effective July 1, 2000), art. 8 (P.R.C.); Organic Law of the People's Courts (revised 2006) (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2006, effective July 1, 1979), arts. 4 & 33 (P.R.C.).

[17] Some authors comment such "priority" as one aspect of Chinese distinctive "court-decisive" theory in arbitration. *See* XIUWEN ZHAO, STUDIES ON INTERNATIONAL COMMERCIAL ARBITRATION AND ITS APPLICABLE LAW [GUOJI SHANGSHI ZHONGCAI JIQI SHIYONG FALV YANJIU] 43 (2002).

tration norms (1) the prioritized judicial review in procedure, and (2) the wider scope of judicial scrutiny in reviewing defective arbitration agreements.

1. PROCEDURE OF REVIEW

While international arbitration norms recognize national courts as the final power to determine arbitral jurisdiction, the grant of a stay in cases of jurisdictional challenge will never stop the arbitral proceeding from moving forward. Instead, there are parallel proceedings before the arbitral tribunal and court.

The United Nations Commission of International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration (ML) is largely modeled off of Article 21 of the Arbitration Rules of the UNCITRAL, which deals with jurisdiction pleas in the arbitral tribunal.[18] Under the ML, judicial review of the arbitration agreement can be exercised in three different stages: before, during, or after the arbitral proceeding. Pursuant to the ML:

> (1) The court may decide, *before the tribunal has been formed*, whether a valid arbitration agreement exists. Arbitral proceedings may nevertheless be commenced or continued and an award may be made while the issue is pending before the court.[19]
>
> (2) *During the arbitral proceeding*, if the tribunal decides as a preliminary ruling of the validity of the arbitration agreement,[20] within thirty days upon the receipt of the ruling of the tribunal, any party may request the court to decide the matter as to which decision is not subject to appeal.[21]
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> (3) If the tribunal decides to rule on the validity of an arbitration agreement in the arbitral award which is usually the circumstance

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[18] Article 21(3)-(4) of the UNCITRAL Rules provides that, in general, the arbitral tribunal should rule on the plea as a preliminary question. However, the tribunal may also proceed with the arbitration and rule on the plea in its final award, which will only happen when it considers that the plea is obviously unfounded. U.N. Comm'n on Int'l Trade Law Model Law Arbitration Rules, art. 21(3)-(4), G.A. Assembly Resolution 31/98 (Apr. 28, 1976).

[19] U.N. Comm'n on Int'l Trade Law [UNCITRAL], *Model Law on International Commercial Arbitration*, art. 8, U.N. Doc. A/40/17/annex I, A/61/17//annex I (Jul. 7, 2006) [hereinafter UNCITRAL Model Law].

[20] According to Article 16 of the UNCITRAL Model Law, the arbitral tribunal has discretion to choose whether to decide a jurisdiction problem in the manner of preliminary question or in an award of merits. *Id*. art. 16(3).

[21] *Id.*

> when it is convinced it has jurisdiction,[22] then, the court's review must wait until *after the arbitral proceeding ends* and be exercised during the proceeding of recourse against the award.[23]

When dealing with a jurisdictional challenge, the ML acknowledges that the tribunal's ruling on arbitral jurisdiction is subject to a final ruling of the court.[24] However, after the tribunal has been formed and the arbitral proceeding has been commenced, a party intending to make a jurisdictional challenge must first exhaust available arbitral procedures in accordance with Article 16(3) of the ML. For example, recently, in *Netsys Technology Group AB v. Open Text Corp*., the Ontario Supreme Court granted a stay and held that it would not be appropriate for the court, at this stage in the arbitral proceeding, to rule before the tribunal has spoken on the effect of the arbitration agreements. Thus, the court deferred to the arbitrator to be the first to interpret the arbitration clause.[25]

Moreover, the ML requires that any challenge to the tribunal's jurisdiction should not affect the arbitral hearing of the case. The purpose of such "concurrent or parallel proceedings"[26] is to avoid the dilatory tactics and disruption to the proceedings by unfounded challenges to the jurisdiction of the tribunal.[27] In fact, the tribunal is allowed to continue with the arbitral hearing and even render an award while the jurisdictional challenge is pending before the court. As such, two proceedings are allowed at the same time, one before the national court concerning jurisdictional matters and the other before the arbitral tribunal on the merits of the case.

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[22] *Id.*

[23] *Id.* art. 34(2)(a)(ii).

[24] *Id*. art. 16(3).

[25] Netsys Tech. Group AB v. Open Text Corp., [1999] O.J. 3134, §34 (Jul. 29, 1999), *available at* http://www.canlii.org/en/on/onsc/doc/1999/1999canlii14937/1999canlii14937.html.

[26] *See* PETER BINDER, INTERNATIONAL COMMERCIAL ARBITRATION AND CONCILIATION IN UNCITRAL MODEL LAW JURISDICTIONS ¶2-047 (2nd ed. 2005), where Professor Binder suggests that the ML allows two proceedings at the same time, one before the national court concerning the jurisdiction issue and the other before the arbitral tribunal on the merits of the case.

[27] *See Analytical Commentary on Draft Text of a Model Law on International Commercial Arbitration*, art. 8, ¶ 5, U.N. Doc. A/CN.9/264 (Mar. 25, 1985) ("to reduce the risk and effects of dilatory tactics of a party reneging on his commitment to arbitration"). For example, the tribunal can "assess in each case whether the risk of dilatory tactics is greater than the danger of wasting money and time in a useless arbitration," and decide accordingly a jurisdiction question preliminarily or in the final award. For example, the tribunal can "assess in each case whether the risk of dilatory tactics is greater than the danger of wasting money and time in a useless arbitration," and decide accordingly a jurisdiction question preliminarily or in the final award. *See* HOWARD HOLTZMANN & JOSEPH NEUHAS, A GUIDE TO THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION 486 (1989).

The United Kingdom takes a similar "concurrent/parallel" approach regarding the procedure of judicial review over arbitration agreements. First, British courts will only rule on the enforceability if it is satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed.[28] Second, while different standards apply to the judicial review of different types of arbitral awards (domestic and international),[29] the regime for reviewing arbitral jurisdiction in relation to the condition and procedure are applicable to both domestic and international arbitration.[30] Third and most importantly, by virtue of Article 67(2) of the 1996 United Kingdom Arbitration Act (UKAA), the arbitral tribunal may continue the arbitral proceeding and make an award *while* an application to the court challenging arbitral jurisdiction is pending.[31] Then, the tribunal can move to render the jurisdictional determination in the form of either a preliminary ruling or a final award.

Based on the authoritative commentary on the *1996 Arbitration Act*,[32] the purpose of Article 67(2) is to avoid unnecessary delay in arbitral proceedings, and to "let the arbitrators who used to be timid about proceeding in such circumstances have clear authority to do so."[33] In *People's Insurance Company of China, Hebei Branch v. Vysanthi Shipping Co Ltd (The "Joanna V")*, the British Court of Appeal struck down a motion by the respondent who attempted to halt the arbitral proceeding by challenging the jurisdiction of the arbitral tribunal.[34]

Chinese regulations have addressed the issue of judicial supervision over arbitration agreements by dividing the jurisdictional power between the court and arbitration commission. The overwhelming impression of the AL and SPC Reply is that procedurally, the court has been equipped with greater authority in reviewing the arbitration agreement. Therefore, rather than the "concurrent or parallel proceedings" approach under the ML and UKAA, where judicial "intervention" should follow

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[28] Arbitration Act, 1996, c. 23, art. 9(4) (U.K.) [hereinafter UKAA].

[29] Parties can appeal on a question of law of domestic arbitral awards, while this is not available to international awards. *See* UKAA, art. 69. This is similarly worded under Section 23 of the Hong Kong Arbitration Ordinance. *See generally* Arbitration Ordinance, (1997) Cap. 341, § 23. (H.K.).

[30] UKAA, art. 86(1) & (2).

[31] UKAA, art. 67(2).

[32] BRUCE HARRIS, ROWAN PLANTEROSE & JONATHAN TECKS, THE ARBITRATION ACT 1996: A COMMENTARY (4th ed. 2007).

[33] *Id.* at 309.

[34] People's Ins. Co. of China, Hebei Branch v. Vysanthi Shipping Co., [2003] EWHC 1655 (Comm). (U.K.).

the tribunal's ruling on arbitral jurisdiction,[35] the people's courts in China are authorized to exercise jurisdictional power even before the arbitral tribunal.[36] This peculiar procedural mechanism allows judges in China to intervene in the arbitral proceedings too early. In practice, this may improperly subject arbitration to the courts. Some Chinese commentators argue that the procedural priority of the people's court in reviewing arbitration agreements allows for excessive judicial intervention or even a negation of the doctrine of *competence-competence*.[37] In addition, unless the tribunal has accepted the case and has made a ruling on the effect of the arbitration agreement before the court's action, all arbitral proceedings will be stayed until the court has announced its decision.[38] Therefore, the objecting party may take advantage of the procedural loophole and delay the dispute resolution process.

However more controversial is Article 58 of the AL which stipulates that the people's courts can revoke or refuse to enforce an arbitration award on the basis of a "non-existent" arbitration agreement.[39] Pursuant to Article 20 of the AL, Chinese judicial review with respect to arbitral jurisdiction may only be exercised before the commencement of arbitral proceedings.[40] It is, therefore, contentious whether "invalidity" could be considered a grounds for invoking judicial review in the award enforcement stage or whether the judicial supervisory power regarding arbitration agreements can be extended to the post-award stage. The AL failed to address the issue and the subsequent SPC Reply did not clarify this point.

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[35] The tribunal's jurisdictional power derives from the doctrine of *competence-competence*.

[36] A number of Chinese arbitration scholars have named the practice *youxian guanxiaquan* in Chinese. *See, e.g.,* XIAOHONG LIU, JURISPRUDENCE AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION IN CHINA [GUOJI SHANGSHI ZHONGCAI XIEYI DE FAIL YU SHIZHENG] 114-15 (2006).

[37] The doctrine of *competence-competence* means that arbitral tribunals have the power to determine their own arbitral jurisdiction and jurisdictional challenge. For comments by Chinese scholars in regards to the negation of the doctrine due to prioritized judicial review, *see* SHISONG XIE ET AL., STUDIES ON COMMERCIAL ARBITRATION [SHANGSHI ZHONGCAI FAXUE] 209-10 (2003).

[38] SPC Reply 1998 No. 27, *supra* note 11, art. 3.

[39] Arbitration Law, art. 58 (1) (P.R.C.); Civil Procedure Law (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 3, 1982, effective Oct. 10, 1982), art. 260 (1) (P.R.C.). Article 58 of the Arbitration Law and Article 260 of the Civil Procedure Law both provide grounds for refusal of the recognition and enforcement of arbitral awards, among which, the first ground refers to "the non-existence of an arbitration agreement." *Id*. Neither of the two provisions involves the "invalidity of the arbitration agreement" as one of the grounds to exercise judicial supervision.

[40] *See* Arbitration Law, art. 20 (P.R.C.).

2. SCOPE OF REVIEW

Prevailing international norms provide a broader scope than the AL in saving defective arbitration agreements by national courts. As such, in practice, courts have openly shown their tendency to respect the parties' intention to arbitrate except in cases of extreme vagueness of arbitral agreements.[41]

Pursuant to Article 8(1) of the ML, the court is bound to honor the arbitration agreement, "unless the agreement is null and void, inoperative or incapable of being performed."[42] Under Article 8(1), modeled on Article II(3) of the New York Convention (NYC), the court of a contracting state, when challenged by one party with respect to the effect of the arbitration agreement, with respect to the effect of the arbitration agreement between the parties, shall at the request of one of the parties, refer the parties to arbitration, "unless it finds the said agreement is null and void, inoperative or incapable of being performed."[43] Article 9(4) of the UKAA has adopted similar wordings to the ML and NYC with respect to a mandatory stay by the British courts, even if there is only a slim chance for "operativeness or effectiveness" of arbitration agreements.[44] This is natural since most of the jurisdictional challenges that come before the court relate to ambiguous arbitration agreements resulting from defective draftsmanship—defectiveness often borders on the verge of enforceability and unenforceability.[45] Thus, it is important to what extent the national courts accommodate these drafting defects and consequent pathologies. In this regard, both British courts and courts under ML jurisdictions have given broad interpretation to arbitration agreements, favoring arbitral authority.[46] This happens even in some extreme pathological cases, such as the famous *Lucky-Goldstar* ruling rendered by Justice Kaplan in Hong Kong.[47] Based on Professor Pieter Sanders' observation of international commercial arbitration, this broader scope of

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[41] PIETER SANDERS, THE WORK OF UNCITRAL ON ARBITRATION AND CONCILIATION 79-82 (2nd ed., 2004).

[42] UNCITRAL Model Law, art. 8(1).

[43] United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. II, § 3, June 10, 1958, 330 U.N.T.S. 4739 [hereinafter New York Convention].

[44] UKAA, art. 9(4).

[45] ALAN REDFERN & MARTIN HUNTER, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 3-69 (2004).

[46] *See* discussion *infra* Part II.A.2.

[47] In Lucky-Goldstar, the court held that despite the poorly drafted arbitration clause, it sufficiently indicated the parties' intention to arbitrate. *See* Lucky-Goldstar Int'l v. Ng. Moo Kee Eng'g Ltd., [1993] No. A94 ¶ 21 (C.A.). *See generally* discussion *infra* Part II.A.2.

judicial respect for arbitration prevalent in the international context has become part of a general trend where courts are increasingly willing to "recognize the preference of parties to have their commercial disputes decided in arbitration."[48]

In China, however, the court has been vested with more judicial discretion in reviewing arbitration agreements. The obvious difference between the Chinese regulations and international norms is that the AL lacks a transitional area of "operativeness/inoperativeness" through which the court's mandatory stay has been restricted to circumstances of either nullity or invalidity of arbitration agreements.[49] The omission of "inoperativeness" as the critical ground to opt-in/out-of the court's jurisdiction surely enlarges the scope of judicial scrutiny. As such, it restricts the room for judicial "support" whereby the court can take into account the surrounding circumstances to "imply" the parties' intent to arbitrate.[50] Given the rigid validity requirements of the arbitration agreement under the AL,[51] this may provide an excuse for Chinese courts to reject arbitral jurisdiction by adopting a strict textual interpretation of the arbitration agreement and consequently stay the arbitral proceedings in cases of "pathological yet operative" arbitral clauses. The legislative deficiency with regard to judicial power over arbitral jurisdiction raises the concern of excessive judicial intervention into arbitration.[52] This helps to explain why the SPC has been busy issuing judicial interpretations regarding pathological arbitration agreements and why it has been so vigorous in leading the reform of aligning Chinese arbitration standards with international standards.

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[48] SANDERS, *supra* note 41, at 73.

[49] *See* Arbitration Law, arts. 5 & 26 (P.R.C.).

[50] *See* Fei Gao, *Support and Supervision Towards Arbitration by Chinese Courts* 7 [*Zhongguo fayuan dui zhongcai de zhichi yu jiandu*], *in* ARBITRATION IN CHINA [ZHONGGUO ZHONGCAI] 6 (2001).

[51] *See generally* Arbitration Law, art. 16 (P.R.C.).

[52] ZHIDONG CHEN, INTERNATIONAL COMMERCIAL ARBITRATION LAW [GUOJI SHANGSHI ZHONGCAI FA] 144 (1998).

II. SPC INITIATIVES TO LIMIT JUDICIAL INTERVENTION: ALIGNMENT WITH INTERNATIONAL ARBITRATION NORMS

In response to the international trend of giving more judicial respect to arbitration, over the past decade the SPC has issued a long list of clarifications regarding how to exercise judicial supervision over arbitration agreements. These clarifications have introduced reforms such as more cautious procedures reviewing arbitration agreements and a more liberal scope in exercising the review power.

A. MORE CAUTIOUS PROCEDURE

The reform to implement more cautious procedures with respect to arbitration includes the introduction of the following schemes (1) the pre-reporting system, (2) an intermediate-level-above and collegiate-panel system, and finally (3) a review-waiving system.

1. PRE-REPORTING SYSTEM

The SPC, through a series of notices in 1995 and 1998 (known as SPC Notices), established the "pre-reporting" system (*yuxian baogao*) among the people's courts in reviewing the effect of foreign-related arbitration agreements and arbitral awards.[53] In accordance with these SPC Notices, the "pre-reporting" system can be sub-divided into three scenarios in arbitral cases involving foreign elements (1) before the SPC provides an official response, the lower people's courts shall not announce the arbitration agreement to be null or void; (2) until the SPC provides an official response, the lower people's court shall not rule to refuse the recognition and enforcement of the award; and (3) only after the SPC provides an official response can the lower people's courts rule to deny the effect of arbitration agreements or arbitral awards.[54]

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[53] *See* SPC Notice on Some Issues Concerning Foreign Arbitration and Arbitration in Foreign Countries, Fa Fa (1995) No. 18; SPC Notice on Regulations on the Fee and Time Limit of Recognition and Enforcement of Foreign Arbitration Awards, Fa Shi (1998) No. 28; and SPC Notice on Some Issues Concerning Setting Aside Arbitration Awards Related to Foreign Elements by the People's Court, Fa Fa (1998) No. 40.

[54] *See* SPC Notices concerning foreign arbitration, *supra* note 53.

The origin of the "pre-reporting" system arises from the dual-track approach adopted by the AL, where preferential treatment has been reserved for foreign-related arbitration. Based on this tradition, grounds for enforcing foreign-related awards are aligned with international standards and restricted to procedural review; however, domestic arbitral awards need to be subject to substantive as well as procedural checks.[55] Under these circumstances, because ineffective agreements are one of the grounds leading to the denial of enforcing foreign-related awards,[56] a separate and preferential treatment regarding the judicial review over foreign-related arbitral agreements has been formed. The "pre-reporting" system has an interesting feature, which is to control the negative ruling of the lower people's courts. If the foreign-related arbitration agreement has been upheld and the arbitral award enforced at the lower level judiciary, then reporting is not at all necessary. With respect to arbitration agreements, the "report" is mandatory only when the lower level people's courts tend to *negate* the effect of the agreement. Since there is no appellate procedure for rulings on matters of arbitral jurisdiction, the key importance of the "pre-reporting" is to prevent undue local influences over arbitration[57] and to improve the enforceability of arbitral jurisdictions by setting up a "pyramidal internal supervisory mechanism within the judiciary" where the SPC can control the final result of review.[58] As Tao concludes, the system reflects the prudential attitude of the SPC towards arbitration agreements and is seen as a positive trend by the SPC in leading the lower level people's courts in China to support arbitration.[59]

The scheme, however, is not free from defects. Obviously, it is only applicable to the foreign-related regime. The quality of judicial review over domestic agreements is not subject to the same examination. Thus, vast numbers of domestic arbitration agreements are still risky ventures, subject to the discretionary power of local judges. Moreover,

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[55] Domestic awards in China will be checked on the grounds of errors of law, insufficiency of evidence, and arbitrator misconduct. *See generally* Arbitration Law, art. 63 (P.R.C.) and Civil Procedure Law, art. 217 (P.R.C.). The grounds of foreign-related awards are limited to procedural irregularities. *See generally* Arbitration Law, arts. 70, 71 (P.R.C.) and Civil Procedure Law, art. 260 (P.R.C.).

[56] Civil Procedure Law, art. 260(1) (P.R.C.).

[57] *See* discussion *infra* Parts III, IV.D.1 regarding local administrative influence over arbitration. *See* discussion *infra* Part II.B.2 regarding local judicial influence over arbitration.

[58] Shengchang Wang, *Arbitration Agreement and its Validity Determination* [*Zhongcai xieyi jiqi xiaoli queding*], *in* SYMPOSIUM ESSAYS ON ECONOMIC AND TRADE ARBITRATION BETWEEN THE TAIWAN STRAITS [HAIXIA LIANG'AN JINGMAO ZHONGCAI YANTAOHUI WENJI] 39 (2001).

[59] JINGZHOU TAO, ARBITRATION LAW AND PRACTICE IN CHINA 58 (2004).

the timeline is unclear for such "report." In SPC Notices regarding the "pre-reporting" system, there are only time limits provided for the judicial review of awards. The intermediate people's court shall report to the higher people's court its decision to revoke or set aside within thirty days of the party's enforcement period; the higher people's court shall, by the same token, report to the SPC within fifteen days of its decision.[60] I have to clarity that the "vague timelines" only refer to "timelines of pre-reporting system applicable to arbitration agreements." In terms of "pre-reporting of arbitral awards," the timeline is clear enough, as has been set out the in the text. However, none of the SPC Notices that have been issued have mentioned the time limits for the review of arbitration agreements. Absent this time limit, arbitral efficiency is hard to protect. Imagine that no timelines have been set for reporting and pre-reporting (of judicial review of arbitral agreements), parties whose agreements have been turned down at lower level courts will have endless waits before they get answered from higher level courts. That certainly runs contrary to the efficiency argument of arbitration.

2. INTERMEDIATE-LEVEL-ABOVE AND COLLEGIAL-PANEL SYSTEM

Subsequent to the introduction of the "pre-reporting" system, in 2000, in a reply to the Shandong Higher People's Court, the SPC announced that any motion challenging the effect of foreign-related arbitration agreements must be made before the people's court at either the intermediate level or above.[61] Furthermore, the SPC now mandates that any jurisdictional challenge on the basis of a non-existent or invalid arbitration agreement, irrespective of whether it is foreign-related or domestic, will be received by the intermediate people's court under Article 12 of the SPC Interpretations on Arbitration Law in 2006 (SPC Interpretation).[62] Generally, intermediate courts are equipped with better qualified

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[60] *See* SPC Notices concerning foreign arbitration, *supra* note 53.

[61] SPC Reply to the Shandong Higher People's Court on "Which Level of People's Court Shall Handle the Jurisdictional Challenge of the Validity of Arbitration Agreements," Fa Shi (2000) No. 25.

[62] It should be noted that Article 10 of the Domestic Draft still bifurcates the court level system in reviewing the arbitration agreement. *See* Domestic Draft, July 22, 2004, *available at* http://www.chinacourt.org/public/detail.php?id=124300 (last visited June 2, 2009). On the other hand, the 2006 SPC Interpretation appears to take matters to a broader horizon. *See* Interpretation of the Supreme People's Court Concerning Several Matters on Application of the Arbitration Law (P.R.C) (adopted at the 1375th meeting of the Judicial Comm. of the Sup. People's Ct., Dec. 26, 2005, effective Sept. 8, 2006), art. 12 [hereinafter SPC Interpretation], *available at* http://www.chinacourt.org/flwk/show.php?file_id=112964 (last visited June 6, 2009).

and more experienced judges as compared with district courts.[63] Moving jurisdictional review to the intermediate court could help downplay the local influences and better protect the quality of judicial review.[64]

In addition, a collegiate-panel mechanism has now been introduced under Article 15 of the SPC Interpretation, which requires the people's court to form a collegiate panel to conduct the examination of arbitration agreements.[65] This provision[66] adds further "caution" to the procedure of judicial review over arbitration agreements. For the first time in the Chinese arbitration history, the effect of arbitration cases, albeit very simple ones with small amounts of money involved, may be considered by the collective wisdom of three judges.[67] Although the provision may be questioned with respect to the allocation of judicial resources, generally this is seen as a welcomed development because it will increase the likelihood of parties' arbitral wishes being upheld.

3. REVIEW-WAIVING SYSTEM

In an attempt to further address the concerns of prioritized judicial review under the AL and the SPC Reply, Article 13 of the SPC Interpretation restates the relationship between the arbitration commission and the people's courts in the case of a competing jurisdiction:

> Pursuant to Article 20 of the AL, where a party does not object to the validity of an arbitration agreement prior to the tribunal commences the first hearing of the case, but later applies to the people's court for announcing the invalidity of the agreement, the people's court shall not accept the case. If an arbitration commission has made its ruling on the effect of an arbitration agreement, any application made by a party to the people's court for setting aside the decision of the commission shall not be entertained by the people's court.[68]

The most recent SPC Interpretation clarifies when judicial review could be exercised upon the arbitration agreement, i.e., before the first hearing

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[63] Judges Law of the P.R.C. (promulgated by the Sup. People's Ct., Aug. 26, 2006), art. 9(6), *available at* http://en.chinacourt.org/public/detail.php?id=2692.

[64] TAO, *supra* note 59, at 144-46.

[65] SPC Interpretation, *supra* note 62, art. 15.

[66] There have been no counterpart provisions in either the Foreign-Related Draft or Domestic Draft to address the number of the judges in exercising the judicial review. *See* Domestic Draft, *supra* note 62; Foreign-Related Draft, Dec. 31, 2003, *available at* http://www.chinacourt.org/public/detail.php?id=97517&show_all_img=1 (last visited June 2, 2009).

[67] SPC Interpretation, *supra* note 62, art. 15.

[68] *Id.* art. 13.

of the arbitral tribunal,[69] and where the arbitration commission has not ruled on the effect of the agreement.[70] This SPC arrangement is called a "review-waiving" system and is a contribution to the international arbitration jurisprudence on the finality of the jurisdictional determination by the arbitral body.[71] That is, the people's court would waive its supervisory power once the effect of the arbitral agreement has been decided by the arbitration commission and such a decision is considered "final" with no further chance of judicial review.[72] The "review-waiving" system, cited by Professor Xiaohong Liu of East China University of Political Science and Law, is an extreme case of the SPC's approach to minimize judicial intervention with regard to the ruling of arbitral jurisdiction.[73] Other commentators, however, argue that it deprives the parties the right of judicial recourse on the issue of arbitral jurisdiction, and therefore it is not compatible with the international stipulations.[74] Generally, this should be a welcome development. Once the arbitration commission has ruled on the validity of the arbitral agreement, it will bring certainty and finality to its effect. However, it is not clear whether arbitral proceedings could continue, pending the jurisdictional challenge before the court, prior to the tribunal rules on the jurisdiction. The latest SPC Interpretation fails to address the point. Therefore, it may be argued that "prioritized" judicial review still exists in some stage of the arbitral proceeding.

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69 *See* Arbitration Law, art. 20 (P.R.C.).

70 SPC Reply (1998) No. 27, *supra* note 11, art. 3(1).

71 Xingjun Ge, *Brief Comments on the Judicial Supervision Over Arbitration and Improvement of Arbitration System* [*Jianshu zhongcai sifa jiandu yu zhongcai zhidu de wanshan*], *in* JUDICIAL REVIEW OF THE FOREIGN-RELATED ARBITRATION [SHEWAI ZHONGCAI SIFA SHENCHA] 16-17 (2006).

72 SPC Interpretation, *supra* note 62, art. 13.

73 LIU, *supra* note 36, at 117.

74 Since neither Article 58 of the AL nor Article 260 of the CPL provides for "invalidity of the arbitration agreement" as one ground to revoke the arbitral award, Zhao considers that if the court waives the judicial supervision after the tribunal rules on the validity of the arbitration agreement, then it is equal to the court's depriving the parties of the right of judicial resort on the point of jurisdictional challenge on the basis of an invalid arbitration agreement determined by the commission. *See* XIUWEN ZHAO, *Arbitral Seat and Judicial Supervision* [*Zhongcai didian yu sifa jiandu*], *in* JUDICIAL REVIEW OF THE FOREIGN-RELATED ARBITRATION, *supra* note 71, at 51.

B. MORE LIBERAL SCOPE

1. MORE REMEDIABLE PATHOLOGIES

Over the past decade, great progress has been made in liberalizing the scope of arbitration agreements via SPC's issuing judicial interpretations with respect to defective arbitration agreements.[75]

On the one hand, the SPC no longer adheres to the signature-based writing and a more expansive scope of the "written agreement" has been introduced.[76] Besides "incorporation by reference,"[77] the SPC, corresponding with the recently published Contract Law (CL), also recognized the effect of arbitration agreements in circumstances of contract transfer and as such can extend its effect to non-signatory third parties.[78] On the other hand, many drafting defects with respect to "clear and unequivocal arbitral commission or institution" have been stated as remediable and operative. Most recently, by virtue of its Interpretation in 2006, the SPC mandates that prescribing the institutional rules will be sufficient to indicate the choice of the arbitral institution which administers the rules.[79] Moreover, unclear drafting in regards to the "arbitral institution" may be held valid so long as the institutional identity can be reasonably ascertainable from the surrounding context.[80]

The interpretations by China's highest judiciary show more respect to parties' drafting autonomy in arbitration and helps to bridge the gap between the AL and international arbitration norms. The practical reality of the SPC-led reform, for example, enforcement of defective arbitration agreements, will be examined in Section IV of this article.

2. FREEDOM OF CHOICE IN APPLICABLE LAW

In international commercial arbitration, finding the law applicable to the arbitration agreement is a pre-condition in determining its va-

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[75] *See, e.g.*, a list of SPC replies [*pifu*], notices [*tongzhi*], and opinions [*yijian*] issued by the Supreme People's Court regarding the interpretation of defective arbitration agreements in ARBITRATION LAW AND PERTAINING REGULATIONS [ZHONGCAIFA JI PEITAO GUIDING] (Dehua Tang & Xiujun Sun eds., 2005).

[76] SPC Interpretation, *supra* note 62, art. 1.

[77] *Id.* art. 11.

[78] *Id.* arts. 8, 9.

[79] *Id.* art. 4.

[80] *Id.* art. 3.

lidity. However, in many cases, parties may forget to spell out the governing law of their arbitration agreements. Where the jurisdictional challenge is brought before the people's court, the Chinese judges used to apply universally the *lex fori* (law of the reviewing court) in determining the effect of the arbitration agreement.[81] Hence, the arbitral jurisdiction may easily be turned down due to the rigid requirements imposed on the validity of the agreement by the AL.[82] According to Article 145 of the CL, parties can choose foreign law as the governing law only if the contract involves foreign elements.[83] The AL fails to provide a conflict of law rule—which law should be used to determine the validity of foreign-related arbitration agreements—and the SPC tries to fill in the regulatory gap.[84]

In 1999, the SPC first announced its opinion in a rather informal way that absent the parties' choice of law applicable to their arbitration agreements, the validity should be determined according to the *lex arbitri* (law of place of arbitration).[85] Later, in a more formal manner, Article 17 of the Foreign-Related Draft provided a detailed roadmap of the applicable law in determining the validity of an arbitration agreement that the people's court shall apply:

> (1) the "law" agreed upon by the parties; or
>
> (2) if the parties have not agreed on the "applicable law" of the arbitration agreement but have agreed on the place of arbitration (arbitral seat),[86] the law of the arbitral seat, the *lex arbitri;* or

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[81] Adam Li & George Wang, *Conflict of Law Issues in Ascertaining Validity of an Arbitration Agreement, in* ARBITRATION IN CHINA: A PRACTICAL GUIDE 81, 89 (Jerome Cohen et al. eds., 2004).

[82] Arbitration Law, arts. 16, 18 (P.R.C.). A valid arbitration agreement in China must designate a Chinese arbitration commission clearly and unequivocally. *Id.*

[83] Contract Law (Promulgated by the Second Session of the Ninth Nat'l People's Cong., Mar. 15, 1999, effective Mar. 15, 1999) (P.R.C.). Therefore, in the domestic setting, there is no question whether the Chinese AL will apply in determining the validity of the arbitration agreements. On the other hand, while the AL does not mention the conflict of law rules for determining the validity of foreign agreements, "the governing law will be determined according to the choice of the parties; absent the choice, the law that has the closest connection to the contract is the applicable law." *Id.*

[84] *See* discussions *infra* Parts III, IV.

[85] *Mitsubishi Co. Ltd. (HK) v. Sanxia Inv. Co. Ltd. and Hubei Mech. Eng'g Co. Ltd.*, Zui Gao Fa Fa Jing Han [1999] No. 143, reprinted *in* JIANLIN ZHU, COMMENTS AND ANALYSIS ON INTERNATIONAL COMMERCIAL ARBITRATION CASES [GUOJI SHANGSHI ZHONGCAI ANLI PINGXI] 375-377 (2002).

[86] Sometimes the arbitral seat is called *arbitral situs*, which is the Latin expression of arbitral seat where the arbitral proceedings are held.

> (3) if the parties have neither agreed on the arbitral seat or the arbitral seat is not made clear from the arbitration agreement, the law of the court that received the application of jurisdictional review, the *lex fori*.[87]

In the most recent SPC Interpretations in 2006, Article 16 confirms the three-step formula taken under the Foreign-Related Draft.[88] The clarification accords with the general principle of party autonomy espoused under Articles 19 and 28 of the ML which permits the parties to freely select and determine both the substantial law and procedural rules to be followed during the arbitral proceedings.[89]

III. UNRESOLVED JUDICIAL INTERVENTION: DUAL-TRACK CONCERNS

In the initial stage, the AL authorized the people's courts prioritized right of review in procedure and more stringent review in scope with respect to arbitration agreements. This deviates from international arbitration norms and raises the issue of excessive judicial intervention in Chinese arbitration.[90] The SPC, therefore, has taken a series of measures to bridge the gap. On the one hand, a more cautious judicial approach has been adopted in the procedure of review where in some extreme circumstances people's courts may even waive their supervisory power if the arbitration commission has made a ruling on the validity of the arbitral agreement.[91] On the other hand, more liberal interpretations on the scope of validity have been introduced for the more liberal exercise of judicial supervision.

Despite the impressive regulatory progress made by the SPC in minimizing judicial intervention, it should be noted that the degree of judicial caution varies substantially between the two tracks. Preferential treatment has been reserved for the foreign-related track.[92] Judicial re-

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87 Foreign-Related Draft, *supra* note 66, art. 17.

88 SPC Interpretation, *supra* note 62, art. 16.

89 Article 19 of the ML gives the parties' the full freedom in choosing the procedural rules. *See* UNCITRAL Model Law, art. 19. Article 28 of the ML permits the parties full autonomy in selecting the law applicable to their substantive dispute. *See* UNCITRAL Model Law, art. 28(1).

90 *See* discussion *supra* Part I.B.

91 SPC Interpretation, *supra* note 62, art. 13. S*ee* discussion *supra* Part II.A.3, regarding the "review-waiving" system.

92 Foreign-related arbitration in China will only be subject to procedural review by the people's courts. Arbitration Law, arts. 58, 63 (P.R.C.); Civil Procedure Law, art. 217 (P.R.C.). On the

view over the foreign-related regime will be extra-protected under the "pre-reporting" system.[93] Although the handling court is now upgraded to intermediate level; foreign-related cases must be reported to the higher level people's court for approval if the lower court negates the effect of arbitration agreements or arbitral awards.[94] The "pre-reporting" system, by centralizing the reviewing power, would be important to prevent the rampant local protectionism found in Chinese judicial practice.[95]

However, the "pre-reporting" system has serious shortcomings. First, the system consists of a purely internal supervision method. The parties are neither notified about the "report" nor have a chance to participate in the hearing held by the higher level people's court.[96] Therefore, the decision-making process lacks transparency. Without the parties' right of access to the judicial proceeding, it could lead to due process concerns. In addition, allowing one case to go through limitless reviews may be an inefficient use of judicial resources. More importantly, the pre-reporting works like the referral system (*qinshi*) within the hierarchy of the Chinese judiciary where higher level people's courts can influence the decision of the lower levels. Thus, it harms judicial independence. Lastly, and most controversially, the system is not available to the domestic regime.

The fact that standards for enforcing domestic awards are stricter than foreign-related awards suggests that the domestic regime is more difficult to enforce.[97] Specifically, in an empirical study conducted by Professor Randall Peerenboom, among the sixty-three domestic awards handled by one court in a large city in Jiangsu Province, two were refused and thirty-five were listed as pending.[98] Hence, the domestic regime needs careful judicial review as well—at least no less than its foreign-related counterpart.[99] The different treatment by the SPC raises serious concerns with respect to the dual-track system. Disparate treat-

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other hand, domestic arbitration is subject to substantive review even on those matters such as the authenticity of evidence, etc.

93 *See* discussion *supra* Part II.A.1. regarding the "pre-reporting" system.

94 *Id.*

95 *See* discussion *infra* Parts IV.C.3, IV.C.4.

96 *See* SPC Notices concerning foreign arbitration, *supra* note 53.

97 *See, e.g.* Arbitration Law, arts. 63, 70, 71 (P.R.C.); Civil Procedure Law, arts. 217, 260 (P.R.C.). *See also supra* note 55.

98 Randall Peerenboom, *Seek Truth from Facts: An Empirical Study of Enforcement of Arbitral Awards in the PRC*, 49 AM. J. COMP. L. 249, 284 n.108 (2001).

99 For example, the scope of judicial review in domestic arbitration shall be restricted to the procedural review and the application of the "pre-reporting" system.

ment could potentially lead to discrimination by people's courts from the beginning (arbitration agreement) to the end (arbitral award) with respect to the rights and autonomy of parties seeking domestic arbitration.

IV. ENFORCEMENT ANALYSIS AND PRACTICAL APPLICATION OF THE SPC INITIATIVES

This section will analyze the enforcement reports of the SPC's pro-arbitration initiatives by seeking truth from facts. The enforcement samples collected in this section have been divided into two groups according to the different types of defectiveness (1) those of "non-signatory third party," and (2) those of "ambiguous arbitration commission." Reports by people's courts at different levels and localities will be examined pertaining to both groups.

A couple of issues must be borne in mind. In China, judicial review over arbitral jurisdiction has been restricted to the pre-award stage.[100] Thus, enforcement reports with respect to arbitration agreements are generally unavailable to the public. However, because of the "pre-reporting" system in the foreign-related regime, some negative rulings on arbitral agreements by the local people's court become accessible through the SPC's publication of its "replies of jurisdiction" in the Gazette. The following discussion is, therefore, only examining "negative" cases and limited to the "foreign-related regime." Nevertheless, it sheds light on the rulings of the domestic regime and may highlight practical constraints in the enforcement of arbitral agreements in both domestic and foreign cases.

Moreover, during the transition from a planned to a market economy and in the process of developing the rule of law in China, the entire judiciary is faced with many challenges. The lack of judicial integrity and quality and the unbalanced development among the people's courts in different areas of the country may all contribute to the divergent enforcement records both in court judgments and arbitral awards.[101] These problems are also reflected in the area of enforcement of arbitration agreements.

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[100] *See* discussion *supra* Part I.A regarding the time limit of judicial review that can be exercised over arbitral jurisdiction in China.

[101] For an example of these arguments, *see* Jerome Cohen, *China's Legal Reform at the Crossroads*, FAR EASTERN ECON. REV., Mar. 2006, 23-25.

A. ENFORCEMENT CONCERNING "NON-SIGNATORY THIRD PARTIES"

The SPC has articulated a number of occasions in which transfer of legal rights and obligations of a party under an arbitration agreement should not invalidate the effect of the agreement such that it will still bind the non-signatory transferee.[102] Misunderstanding and mishandling have nevertheless been found in the local judicial application.

1. *LONGHAI* CASE: MISAPPLICATION OF SEPARABILITY

In 1993, the Hong Kong Longhai Company (Longhai) and Wuhan Donghu Import and Export Company (Donghu) signed an equity joint venture (EJV) contract in which a China International Economic and Trade Arbitration Commission (CIETAC) arbitration clause was included. In December, Donghu assigned all its equities to Wuhan Zhongyuan Scientific Company (Zhongyuan) and left the EJV. Then Longhai and Zhongyuan signed a new EJV contract where Zhongyuan agreed to take over all the rights and obligations of Donghu in the original EJV contract. In 1998, a dispute arose out of the investment share between Longhai and Zhongyuan. Longhai applied to CIETAC arbitration in Beijing when Zhongyuan challenged the arbitral jurisdiction before the Wuhan Intermediate People's Court.

The Wuhan Intermediate People's Court ruled that the arbitration clause was not binding upon Zhongyuan on the basis that "the arbitration clause has independent character so that the clause in the original contract has no legal force upon the new assignee. Therefore the CIETAC jurisdiction is rejected."[103] Upon reporting, the Hubei Higher People's Court replied that the arbitration agreement should survive the contract assignment and the CIETAC jurisdiction was affirmed.[104]

This case reflects how a local people's court misapplied the separability rules. The doctrine of separability of arbitration agreements refers to separation of arbitration clauses from the "effect" of main contracts so that the non-existence or invalidity of the main contract will not

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[102] The judicial guidance has been endorsed by the SPC early in its replies to the Hubei and Henan Higher People's Courts in 1997 and 1999 respectively and has been confirmed in the SPC Interpretation in 2006. SPC Interpretation, *supra* note 62, arts. 8, 9. For the SPC Hubei and Henan Replies, see Wang Shengchang, *Arbitration Agreements and its Validity, in* SYMPOSIUM ESSAYS ON ECONOMIC AND TRADE ARBITRATION ACROSS THE STRAITS [HAIXIA LIANG'AN JINGMAO ZHONGCAI YANTAOHUI WENJI] 15-20 (CIETAC China Law Press, 2001).

[103] Wuhan Interm. People's Ct. Civil Adjudication (1998) No. 0277.

[104] Hubei Higher People's Ct. (1999) E Fa Shen Jian Jing Zai Zi.

affect that of the arbitration clause.[105] Textually, however, the arbitral clause is part of the main contract such that transfer of the main contract will include transfer of the arbitral clause, unless otherwise provided. Therefore, although the arbitration clause and main contract are deemed to be two separate agreements in validity considerations, the former is textually attached to the latter.[106] As such, the arbitration clause shall be valid and binding on the non-signatory third party if it has been deemed valid before the transfer. In the case above, the new investor (Zhongyuan) has succeeded all of the rights and obligations from the original investor (Longhai) where a valid CIETAC arbitral clause forms a part. The intermediate court wrongfully applied the separability doctrine between "textual composition" and "validity effect" with respect to the relationship between the arbitral clause and its main contract. As a result, this led to the denial of the arbitral jurisdiction. The *Longhai* case raises concerns with respect to the correct understanding of modern arbitration norms at the lower level people's courts.

2. *HUAXIANG* CASE: SCOPE OF JUDICIAL DISCRETIONS

In July 1997, Qingdao Huaqiang International Trade Company (A), the Japan Beitiaoli Chemical Research Institute, and the Japan Zhuneitiegong Company invested together in establishing the Qingdao Huaxiang Joint Venture (BJV). Article 38 of the JV contract provided that "any dispute among the three investing parties regarding the investment contract shall be resolved by CIETAC according to its rules." In September 2001, upon the agreement by the three investing parties, Huaqiang assigned its entire 35 percent share in the JV to the Qingdao Huaqiangda Technical Company (C). Later, C withdrew all its investment from the BJV. B sued C for violating the investment obligations under the original JV contract. Before the first statement on defense, C raised jurisdictional challenge to the Qingdao Intermediate People's Court. The challenge was based on the arbitration clause found in the original JV contract which stated that CIETAC should be the proper venue for dispute resolution.

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[105] Pierre Mayer, *The Limits of Severability of the Arbitration Clause*, *in* IMPROVING THE EFFICIENCY OF ARBITRATION AWARDS: 40 YEARS OF APPLICATION OF THE NEW YORK CONVENTION 261 (Albert Jan van den Berg ed., 1999).

[106] Guangqing Qu, Xiaoyun Chen & Lei Xing, *Thinking of the Effect of the Arbitration Clause under the Contract Transfer–Comments on the Hong Kong Longhai Co. v. Wuhan Zhongyuan Co.*, *in* INTERNATIONAL COMMERCIAL DISPUTE RESOLUTION REVIEW [GUOJI SHANGSHI ZHENGYI JIEJUE LUNCONG] 90 (2004).

In September 2003, in ruling on the validity of the arbitration clause between B and C, the opinions were divided within Qingdao Intermediate Court.[107] The first group opined that "the rights and obligations of dispute resolution should accompany the general transfer of the rights and obligations of the investment contract so that the arbitration clause should be enforceable upon C and B." The second group was of the opinion that "the arbitration clause had independent nature and thus the share transfer could not necessarily lead to the transfer of dispute resolution clause unless it was expressly agreed by the transferee." The Intermediate Court finally referred to the "Beijing Opinion 1999" in resolving the dilemma. Article 3 of the "Beijing Opinion 1999" provided that: "If there is an arbitration agreement among the investing parties for resolving the dispute(s) arising out of the investment, that arbitration agreement will not be binding between the investor and JV investee."[108] Hence, the CIETAC jurisdiction was denied.[109] The Shandong Higher People's Court,[110] on the basis of the "Beijing Opinion 1999," confirmed the ruling of the Qingdao Intermediate Court through the reporting system.[111] In the final stage of the reporting, in its reply to the Shandong Higher People's Court, the SPC confirmed the court jurisdiction and held that:

> Since the BJV has not taken part in the negotiations of the JV investment contract where the arbitration clause forms a part, the arbitration agreement within the JV contract will not carry effect upon the non-investing party who did not involve in the performance of the JV contract.[112]

Several points may be observed from the *Huaxiang* case. First, like the *Longhai* case in the Wuhan Intermediate People's Court, misunderstanding as to the principle of separability also existed in the Qingdao Intermediate Court.[113] The coincidence may, to some extent, reflect the

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[107] Qingdao Interm. People's Ct. Civil Adjudication (2004) No. 068.

[108] Beijing Judicial Opinion on the Handling of Arbitration Cases, art. 3, promulgated Oct. 1999, (Beijing Higher People's Ct.) mandates that arbitral agreements signed by investors will not bind the investee JV.

[109] *Supra* note 107.

[110] The Shandong Higher People's Court is the highest judicial authority in the Shandong Province where the Qingdao city resides.

[111] Petition to the Sup. People's Ct. in Determining the Validity of the Arbitration Agreement in a JV Contract, Shandong Higher People's Ct, Lu Gao Fa [2004] No. 203.

[112] *SPC Reply to the Shandong Higher People's Court Concerning the Validity of the Arbitration Agreement in a JV Contract*, Zui Gao Fa [2004] Min Si Ta Zi No. 41.

[113] *See, e.g.*, the second group of opinions within Qingdao Interm. People's Ct. Civil Adjudication (2004) No. 068.

poor knowledge of modern arbitration by lower level courts. Since Wuhan and Qingdao are upper mid-level Chinese cities, their judicial quality with respect to handling of arbitration cases indicates the average quality of local Chinese judges with respect to understanding arbitration norms. In addition, when the SPC criterion is unclear, the enforcement record could be subject to the discretionary interpretative power by the local judges themselves. According to the facts, the arbitration clause was agreed to resolve disputes among the investors. The transfer of the share may thus justify C's arbitral *locus standi* should a dispute arise between C and the other two Japanese investors, in accordance with the then SPC guidelines.[114] However, the SPC failed to provide whether such an arbitration clause could extend its effect to the investee—the JV—which is a non-signatory third party to the original investment contract when the arbitration clause was included.

Two further issues arise within this context. First, quoting the views of the second group in the Qingdao Intermediate Court, it seems that in order for the arbitration clause to survive the contractual assignment and be effective upon the investor assignee, it must be *expressly agreed* to by the assignee.[115] If we recall the SPC judicial interpretations, the arbitration clause shall be enforceable upon the assignee as long as the assignee is aware of the arbitral clause during the contract assignment.[116] International arbitration norms have also suggested a similar approach in determining the validity of arbitration clauses undergoing the contractual assignment or subrogation.[117] This raises the issue of compatibility of judicial opinions between the local judiciary and the SPC. Apart from the issue of justice, such as whether the share assignment in this case would involve transfer of some onerous obligations, it seems that Qingdao Intermediate Court sets a higher burden of proof upon the assignee than the SPC does in invoking the arbitration agreement. Since most parties would not bother to specifically agree to the dispute resolution clause during the contractual transfer, the Qingdao approach may constitute an undue burden on the assignee to resort to arbitration. Thus, despite the SPC's pro-arbitration guideline, it might in its practical application, be subject to local understandings as the aforementioned case demonstrates.

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[114] Foreign-Related Draft, *supra* note 66, arts. 27, 28; Domestic Draft, *supra* note 62, arts. 1, 2.

[115] *Id.*

[116] Foreign-Related Draft, *supra* note 66, arts. 27, 28; Domestic Draft, *supra* note 62, arts. 1, 2.

[117] Norbert Horn, *The Arbitration Agreement in Light of Case Law of the UNCITRAL Model Law*, 8(5) INT'L ARB. L. REV. 148 (2005).

Second, based on the holding history, both the Qingdao Intermediate and Shandong Higher People's Courts have referred to the "Beijing Opinion 1999" for authority in determining the enforceability of the arbitration clause upon the investee JV.[118] However, controversy arises regarding whether local judicial opinions could be applicable to judicial practices outside the issuing jurisdiction, although there are no restrictions under the Chinese jurisprudence to not do so. It shall be noted that, in China, only the SPC has *de facto* rule-making power where its judicial interpretations carry the force of law.[119] The underlying rationale is to supervise and unify the judicial behavior across the country via the hierarchical arrangement of the judiciary.[120] Hence, the applicability of the local judicial opinion outside its issuing jurisdiction may still be a lingering issue not only in the area of arbitration but also in the general Chinese judicial practice. In essence, it is important to note that the two issues discussed above reflect the problems created by the uncertain scope of local judicial discretions in enforcing arbitration agreements. The uncertain scope could be wider or narrower, depending on how the local court perceives arbitration and whether the SPC guideline is clear enough for reference.

3. *BAOTOU* CASE: LOCAL INTERESTS AS REAL CONSIDERATION

In September 2005, A Building Company (A) and B Commercial Company (B) signed a building contract where A agreed to construct a three-story commercial building for B in Baotou city, Neimenggu Autonomous Region. Both parties further agreed that "any dispute relating to the performance of this contract will be resolved by the arbitration commission in the place of construction." Later, B refused to pay A because of the unsatisfactory quality of the building constructed. A resorted to the Baotou Arbitration Commission for dealing with the contractual dispute. In January 2006, after holding several hearings, the arbitration commission ruled in favor of A, and therefore B was asked to pay the money. In February 2006, in enforcing the arbitral award, Company C (C) challenged the award to the Baotou Intermediate People's Court on

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[118] Beijing Judicial Opinion on the Handling of Arbitration Cases, art. 3, promulgated Oct. 1999, (Beijing Higher People's Ct.).

[119] Article 33 of the Organic Law of the People's Courts (P.R.C.) confirms SPC's *de facto* rule-making power. *See supra* note 16.

[120] NANPING LIU, JUDICIAL INTERPRETATIONS IN CHINA: OPINIONS OF THE SUPREME PEOPLE'S COURT 24-25 (1997).

the ground that the arbitration clause should be voided. C argued that B had dissolved and merged into C at the time of concluding the arbitration agreement. Since C had never signed any arbitration agreement with A, C should not be bound by the award between A and B.

In March 2006, in deciding whether the merger was true or not, the Baotou Intermediate People's Court examined the commercial background of both B and C. During the examination, the court found that C was conducting the key government-supported business (*zhengfu zhongdian fuchi chanye*),[121] and the award enforcement could affect C's working capital and lead to its cash flow problem. The Baotou Intermediate Court finally declared the arbitration agreement invalid and denied the award accordingly on the basis that:

> The arbitration agreement could not extend to the third party. Due to the dissolution of B, a contractual relationship existed only between A and C. However, since A and C had not reached a new arbitration agreement, the original arbitration clause without C's participation would not be enforceable against C.[122]

The negative ruling was reported all the way to the SPC where it finally reversed the rulings of both the Baotou Intermediate and Neimenggu Higher People's Courts,[123] holding that the arbitration clause should succeed the merger and be effective upon the successor.[124]

A pair of issues may be observed from the *Baotou* enforcement report. First, in China, it is still doubtful whether an invalid arbitration agreement can be a ground to revoke the arbitral award.[125] As illustrated before, people's courts can review arbitration agreements only before the arbitral tribunal has its first hearing on the proceeding.[126] Accordingly, the judicial review conducted in the current case may have arguably ex-

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[121] The local government, in developing the commercial economy in the given locality, will promote a series of preferential policies to support some businesses so as to attract investment and talents. For example, many of the central provinces in China have taken the information technology enterprises as the supporting objects.

[122] Baotou Interm. Ct. Civil Adjudication (2006) No. 024.

[123] The Neimenggu Higher People's Court is the highest judicial authority in the Neimenggu Autonomous Region where the Baotou city resides.

[124] See a compilation of online comments in Zhiqing Xu & Shu Dai, Merger of the Company: Is the Original Arbitration Clause Still Effective [Gongsi bei jianbin, yuan zhongcai tiaokuan shifou renran youxiao], *China Arbitration*, http://www.china-arbitration.com (last visited Mar. 10, 2009). *See also* SPC Reply to the Neimenggu Higher People's Court, Fa Jing (2006) No. 19 Han.

[125] In denying the recognition and enforcement of arbitral awards in China, the ground in relation to arbitral agreements only encompass situations as to non-existent agreements rather than invalid agreements. *See* Arbitration Law, art. 58 (P.R.C.). *See also supra* Part I.B.1.

[126] *See* Arbitration Law, arts. 20, 26 (P.R.C.). *See also supra* Part I.A.

ceeded the timeframe required by the AL and SPC interpretations.[127] In addition, as the AL and SPC interpretations have never expressly objected to judicial review taking place during or after the arbitral proceeding, there may be room available for judicial discretions.

The second and more contentious issue relates to how the local judiciary exercises their judicial discretion; i.e., the actual factors they consider in allowing or denying the arbitral jurisdiction. Based on the facts, the Baotou Intermediate Court took into account the merits of the case, particularly the economic status of the arbitral party, in determining the effect of the arbitration agreement and its subsequent arbitral award.[128] Given that C is a key local enterprise receiving government support it is highly probable that C's business is associated with local economic interests. If it lost the case the government would have to pay the debt.[129] While it is not uncommon for the court to check the merits of the case in ascertaining arbitral jurisdiction, it is rare for the court to give weight to the party's economic status or its relationship to the government. It might, therefore, be argued that if the party is a very important company in the given region, the arbitration agreement could be checked because being involved in a claim might harm the company's business reputation and be detrimental to local economic interests. By controlling arbitration agreements, the local court may indirectly *control* the result of arbitration and thereby help to protect local interests and save state-owned enterprises.[130] These issues, however, raise the concern of fair play in the actual enforcement of arbitration in China. Local people's courts have the discretion to extend the period of judicial review. In addition, they can take local interests into consideration as a ground for denying arbitral jurisdiction and the outcome of arbitration. This results in low enforcement rates of arbitration agreements and subsequent arbitral awards in some parts of the country.

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[127] Even if the official SPC Interpretation did not come out when the case occurred, the Domestic Draft also required the exercise of judicial review be restricted to the stage before the first hearing of the arbitral tribunal. *See* Domestic Draft, *supra* note 62, art. 8.

[128] *See supra* note 122, regarding the facts of the *Baotou* case.

[129] Arthur Anyuan Yuan, *Enforcing and Collecting Money Judgments in China from a U.S. Judgment Creditor's Perspective*, 36 GEO. WASH. INT'L L. REV. 757 (2004).

[130] Weixia Gu, *Recourse against Arbitral Awards: How Far Can a Court Go? Supportive and Supervisory Role of Hong Kong Courts as Lessons to Mainland China Arbitration*, 4 CHINESE J. INT'L L. 481, 497 (2005).

4. CASE SUMMARY

The cases above, to some extent, reflect the difficulties in enforcing arbitration agreements. But for the pre-reporting system, all these agreements could have been voided under the local judicial examinations.

Several conclusions can be drawn from the case discussions. First, as is shown from both the *Longhai* and *Huaxiang* case, notwithstanding the liberal approach developed by the SPC in the past decade, local judges lack knowledge of modern arbitration theories, and this practice results in a misunderstanding of the doctrine of separability. Second, when the SPC guideline is not clear enough, there is uncertainty regarding the scope of judicial supervision in which case the extent of the supervision depends on how the local judiciary understands arbitration. This was reflected in the *Huaxiang* case where the local people's court adopted a rigid interpretation of the effect of an arbitration agreement when the arbitral parties have undergone merges. The same applies to the *Baotou* case, where the procedural timeframe of review was extended by local judicial discretion.[131] Third, the judicial check may involve examination into some merit details and even economic standing of the arbitral parties. As demonstrated by the *Baotou* case, although it is highly doubtful whether local economic interests could be applied as a determining factor in exercising the judicial scrutiny, in practice the court has included this factor when assessing a case.

Other problems may also be relevant within the context of these judicial enforcement reports, such as the interplay between local judicial opinions and SPC's judicial interpretations, and the consistency among the local judicial practices in different parts of China. The AL fails to set out any rules to deal with these issues, and the subsequent SPC Interpretations fail to improve the situation.

B. ENFORCEMENT OF "AMBIGUOUS ARBITRATION COMMISSION"

The second group of case reports is concerned with defective arbitration agreements without including a "definite arbitration commission." Therefore, this part of the article will examine the extent to which local people's courts have enforced these agreements pursuant to the SPC's liberal instruction on "ascertainable arbitration commission."

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[131] *See* supra note 122, regarding the judicial reasoning of the *Baotou* case.

1. *WEIGE* CASE: INTERPRETATIVE TECHNIQUES

In 1994, the Taiwan Fuyuan Company (Fuyuan) made a timber purchase contract with the Xiamen Weige Wood Production Company (Weige). Within the contract, there was a clause providing that "both parties should refer to ICC arbitration for dispute resolution relating to the performance of the contract." Later on, a dispute arose and Fuyuan filed a claim at Xiamen Intermediate People's Court against Weige's breach of contract. Weige, before submitting its statement of defense, alleged jurisdictional objection on the basis that a valid arbitration agreement existing between the two parties.

In 1996, the Xiamen Intermediate People's Court ruled against the jurisdictional challenge on two grounds (1) the arbitral institution was not specified by the contracting parties, and (2) the parties failed to reach a supplementary arbitration agreement clarifying the arbitral body and institutional rules. Therefore, according to Articles 16 and 18 of the AL, the arbitral clause was voided.[132]

The Xiamen Intermediate People's Court then reported its negative rulings to the Fujian Higher People's Court. In late 1996, the Fujian Higher Court[133] opined that both the arbitral body and institutional rules could be ascertained based on the parties' intention to arbitrate in the ICC Court of Arbitration (1) both parties had agreed to the ICC arbitration; (2) pursuant to Article 8 of the ICC Arbitration Rules, "when both parties submit disputes to arbitration under the ICC, it shall be deemed that both parties have selected the ICC Arbitration Rules";[134] (3) under Article 1 of the ICC Arbitration Rules, "the only arbitral body attached to the ICC is the ICC Court of Arbitration, which is the only institution within the ICC that could apply the ICC Arbitration Rules."[135] Therefore, the parties shall be deemed to have selected the ICC Court of Arbitration as their arbitral body, which complied with the validity requirements under Article 16 of the AL.[136]

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[132] Nanshen Sun, *Jurisdictional Conflict Issues in the Judicial Review of the Foreign-Related Arbitration* [*Shewai zhongcai sifa shencha zhong de guanxia chongtu wenti*], *in* JUDICIAL REVIEW OF THE FOREIGN-RELATED ARBITRATION, *supra* note 71.

[133] The Fujian Higher People's Court is the highest judicial authority in the Fujian Province where the Xiamen city sits.

[134] Int'l Chamber of Commerce Rules of Arbitration, art. 6(1), Jan. 1, 1998 [hereinafter ICC Rules].

[135] ICC Rules, art.1.

[136] SPC Reply to the Fujian Higher People's Court in Ascertaining the Validity of an Arbitration Clause for ICC Arbitration, Zui Gao Fa Fa Jing Han [1996] No. 449. *See* Sun, *supra* note 132, at 23.

In this case, the key reason leading to the different enforcement results by the two levels of people's courts[137] was the different interpretative technique adopted by the courts.[138] During the judicial review, the Xiamen Intermediate People's Court adopted the textual interpretation where the prescription for the ICC itself was not taken as an arbitral institution, and hence the institutional ambiguity must void the arbitration agreement. However, the Fujian Higher People's Court interpreted the arbitral agreement according to the objective of the contract.[139] Given the textual uncertainty of the clause, the court looked into the parties' arbitral intention rather than mere text of the arbitration clause in ascertaining the identity of the institution.[140] Therefore, the word "ICC" was interpreted to refer to the parties' implied selection of the "ICC Court of Arbitration" for dispute resolution.[141] This judicial approach accords with Article 125 of the CL, which provides that when there is controversy in understanding contractual clauses, the interpretation shall follow the objective of the contract rather than its mere text.[142] The Fujian Higher People's Court gave an important indication as to how drafting defects with respect to institutional uncertainty should be dealt with in the future. The court found that the "objective-oriented" interpretative technique would show more judicial respect to party autonomy.

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[137] Both the factual basis and review criteria remained the same in the first and second trial. The criteria of the judicial review in this case are Articles 16 and 18 of the AL, which prescribes a certain arbitral body is a must in validating an arbitration agreement. *See* Arbitration Law, arts. 16, 18 (P.R.C.).

[138] Xuemei Cui & Peiyang Xu, *On the Expansive Interpretation of the Arbitration Agreement and the Implied Arbitration Agreement* [*Lun zhongcai xieyi de kuoda jieshi—jianyi moshi zhongcai xieyi*], *available at* http://www.chinacourt.org/public/detail.php?id=187389 (last visited Mar. 10, 2009). *See also* the discussions of the "implied terms" in Weixia Gu, *Confidentiality Revisited: Blessing or Curse in International Commercial Arbitration*, 15 AM. REV. INT'L ARB. 613 (2004).

[139] *See supra* Part IV.C.1 in regards to the judicial reasoning of the *Weige* case. The details of the case are compiled in Sun, *supra* note 132.

[140] *Id*.

[141] Professor Sun also considered that the judicial interpretation of the Fujian Higher People's Court had referred to the international arbitration custom where the selection of the "ICC Court of Arbitration for arbitration" was always abbreviated to "ICC arbitration." *See* Sun *supra* note 132, at 24.

[142] According to Article 125 of the CL, "if a dispute arises between the parties concerning the understanding of a clause of the contract, they shall determine the true intention of that clause by making reference to words and sentences used in the contract, the relevant clauses of the contract, *objective of the contract*, trading practice and the principle of good faith." Then, as one kind of the contract, the interpretation of the arbitration agreement should follow the same rules as applied to the other contractual clauses. Contract Law, art. 125 (P.R.C.).

2. *SINGAPORE* CASE: IMPORTANCE OF APPLICABLE LAW

In 1998, a Shanghai Corporation (A) signed a sales contract with a Singapore Company (B) within which an arbitration clause was agreed upon as a mode for dispute resolution. However, the clause only provided that arbitration proceedings shall be conducted in Singapore without further specifying the arbitral institution to conduct the arbitration. Later, A brought a breach of contract action in the Shanghai Second Intermediate People's Court (Second Intermediate Court). B challenged the court's jurisdiction by relying on the arbitration clause within the contract. A argued that the arbitral clause should be voided because the arbitral institution was not articulated.

In June 1999, the Second Intermediate Court of Shanghai ruled against the validity on the ground of an unspecific arbitration institution in the arbitration agreement by referring to Articles 16 and 18 of the AL.[143]

In August 1999, in receiving the report, the Shanghai Higher People's Court (Higher Court) first examined the governing law of the arbitration agreement. Since the parties did not expressly provide for the governing law, the Court referred to the applicable law rules under the 1958 New York Convention under which both China and Singapore are member states. Then pursuant to Article V(1) of the Convention, "absent the parties' choice, the law of the place of arbitration will be deemed as the parties' implied choice of applicable law."[144] Accordingly, the Singaporean law was adopted to determine the validity. Because a specific arbitral institution was not required under the Singaporean arbitration legislation for validity,[145] the arbitration agreement was held valid and the arbitral jurisdiction was therefore supported.[146]

In this case, the primary reason that the courts diverged with respect to enforcement is that they applied different legal rules in interpreting the effect of the arbitration agreement. Although the law governing the agreement was not mentioned in the ruling of the Second Intermediate Court, the reference to Articles 16 and 18 of the AL indicated that

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[143] Sun, *supra* note 132, at 21.

[144] New York Convention, art. V(1)(1).

[145] Singapore adopted the ML in 1993. Then, following the ML jurisprudence, the arbitral institution is only a relevant consideration rather than an essential ingredient in determining the validity of the arbitration agreement.

[146] The judicial analyses by the Shanghai Higher People's Court are compiled online. *See* China Foreign-Related Commercial and Maritime Trial Web, http://www.ccmt.org.cn (last visited Mar. 10, 2009).

the court applied *lex fori* (Chinese law) in determining the validity. The approach by the Intermediate Court reflects the often-quoted "judicial ignorance of the applicable law rules" in the review of foreign-related arbitration agreements among Chinese lower level judiciary before 2006.[147] Hence, the general application of Chinese arbitration legislation could easily deny the arbitral jurisdiction for an unclearly specified arbitral institution. The Higher Court paid more attention to the importance of governing law and the Singapore Arbitration Law (*lex arbitri*) was applied. This approach was consistent with the subsequent SPC Reply to the Hubei Higher People's Court discussed previously.[148] In the *Singapore* case, before the SPC officially announced guidelines with respect to applicable legal rules in foreign-related arbitration, the Shanghai Higher People's Court had searched for Chinese legislations, including the international treaties that China had acceded to; i.e., the 1958 New York Convention, to save the effect of foreign-related arbitral agreements.[149] As Professor Liu Xiaohong analyzes the case, Shanghai is a leading city in the country's economic development and its judicial attitude towards arbitration could well influence the parties' confidence in Chinese commercial dispute resolution environment as a whole.[150] To that end, the affirmative decision by the Shanghai Higher People's Court may be seen as an example of the provincial effort to support arbitration.[151]

3. *XIANGYU* CASE: INITIAL TEST OF THE SPC DRAFTS

In March 2004, the China Xiamen Xiangyu Corporation (buyer, "Xiangyu") and the Swiss Mechel Trading AG Company (seller, "Mechel") signed a steel sales contract. They agreed that "the conducting of contractual rights and obligations shall be referring to 'CISG 1980'[152] and 'UNIDROIT PICC 1994.'"[153] They further agreed that, "[f]or any dispute arising out of the contract, the parties shall arbitrate in Beijing ac-

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147 Sun, *supra* note 132, at 24.

148 *Mitsubishi Co. Ltd. (HK) v. Sanxia Inv. Co. Ltd. and Hubei Mech. Eng'g Co. Ltd.*, Zui Gao Fa Fa Jing Han [1999] No.143.

149 *See* Sun, *supra* note 132, at 21, regarding the judicial reasoning of the *Singapore* case.

150 LIU, *supra* note 36, at 210.

151 *See supra* Part IV.C.2.

152 U.N. Convention on the Int'l Sale of Goods, G.A. Assembly Resolution 61/33 (July 7, 2006) *available at* http://www.uncitral.org/uncitral/en/case_law/digests/cisg.html [hereinafter CISG].

153 UNIDROIT Principles of Int'l Commercial Contracts (adopted 2004 by the Governing Council of UNIDROIT), *available at* http://www.unidroit.org/english/principles/contracts/main.htm [hereinafter UNIDTROIT PICC]

cording to the ICC Rules of Arbitration and the language of arbitration in either Chinese or English." In August 2004, the ICC Court of Arbitration in Paris accepted the complaint filed by Mechel as the claimant with Xiangyu as the respondent. In September 2004, Xiangyu challenged the ICC's jurisdiction to the Xiamen Intermediate People's Court for an invalid arbitration clause. Xiangyu alleged that the parties had agreed that the arbitration would be held in Beijing, and according to China's arbitration legislation, an arbitration agreement must be void if the arbitral institution is unspecified.

On November 23, 2004, the Xiamen Intermediate Court divided the examination of the arbitral clause into two stages. The first stage related to the applicable law. The court considered that, due to the separability doctrine, both the CISG and PICC should be the laws governing substantive rights and obligations of the contract rather than validity of the arbitral clause. Thus, in accordance with the SPC judicial opinion, absent the parties' choice, the law of the agreed place of arbitration (Beijing) shall be applied to govern the validity of the arbitral clause.[154] The second stage concerns whether the arbitration institution was clearly provided so as to comply with the validity requirements under the applicable law (Chinese law).

In the judicial examination, the court first referred to the AL and SPC interpretations where an arbitral institution was required to be reasonably ascertainable.[155] The court then opined:

> [G]iven the parties have adopted the arbitral clause recommended by the ICC and given further the ICC Court of Arbitration is the only institution that could conduct the ICC Arbitration Rules, there is no ambiguity in identifying the institution under the SPC interpretative jurisprudence and the parties' intention to arbitrate in ICC Court of Arbitration could be ascertained.

In giving the ruling, the court finally quoted the SPC Foreign-Related Draft as the authority in supporting the judicial reasoning, Article 26 of which provided that the agreement on the institutional arbitration rules should be interpreted to mean the parties' having selected the relevant institution to which the rules were attached.[156] The Xiamen Court con-

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[154] *Mitsubishi Co. Ltd. (HK) v. Sanxia Inv. Co. Ltd. and Hubei Mech. Eng'g Co. Ltd.*, Zui Gao Fa Fa Jing Han [1999] No. 143.

[155] *See supra* Part II.B.1-2.

[156] Article 26 of the Foreign-Related Draft provides that "if the parties agreed to some institutional rules but failed to agree to arbitration under the institution, the people's court should support the arbitration clause by allowing the institution of which the rules were attached to decide the arbitral case." *See* Foreign-Related Draft, *supra* note 66, art. 26.

cluded that, although the Draft had not gone into effect, it reflected the latest arbitration jurisprudence and practice of China. On December 14, 2004, the Court held that the arbitration clause was valid under the Chinese law and the ICC jurisdiction was confirmed.[157]

Several important points can be drawn from the *Xiangyu* case. To begin with, in reviewing the arbitration agreement, the Xiamen Intermediate Court had not only prioritized the rules of applicable law, but also clearly understood the doctrine of separability. The application of *lex arbitri* supported the parties' intention at the time of making the arbitration agreement.[158] Moreover, in ruling on the effect of the arbitral clause under Chinese law, the Court, on its own discretion, relied on the SPC interpretative jurisprudence in ascertaining the identity of the arbitral institution. This may reflect that the Court, in respecting parties' arbitral wishes, was *eager* to follow the more liberal SPC approach despite the risk that the award rendered by foreign arbitration conducted in China may not be recognized and enforced finally.[159] However, when it comes to the final stage of adjudication, it seems that the absence of specific SPC guidance and a shortage of relevant judicial precedents forced the local court to look for support outside the existing judicial interpretations. This may explain the reference to SPC Draft Provisions for legal authority despite their not having entered into force at the time of jurisdictional ruling. Overall, as the initial test of the SPC Foreign-Related Draft,[160] the *Xiangyu* case is, undoubtedly, important to an appreciation of the increased judicial acceptance by the Chinese lower level people's courts towards arbitration.

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[157] Case Report: Xiamen Interm. People's Ct. Rejected the Petition to Invalidate the Arbitral Clause by the Xiamen Xiangyu Group [Xiamen zhongyuan caiding xiamen xiangyu jituan youxiangongsi shenqing hetong zhongcai tiaokuan wuxiao], compiled by the Hangzhou Arb. Comm'n, Dec. 14, 2005, *available at* http://www.hzac.gov.cn/alfx/al8.htm (last visited Mar. 10, 2009).

[158] Weixia Gu & Joshua Lindenbaum, *The NYPE 93 Arbitration Clause: Where Ends the Open-end?* 37 J. MAR. L. & COM. 245, 247, 254 (2006).

[159] The top Chinese legislator responsible for arbitration legislation, when asked during the ICCA Congress roundtable in Beijing in May 2004 whether ICC and foreign arbitration can be conducted in China, replied no. *See* Michael Moser, *Commentary on Arbitration and Conciliation Concerning China*, *in* IMPROVING THE EFFICIENCY OF ARBITRATION AWARDS, *supra* note 105, at 89.

[160] As the judicial clerk in the Fujian Higher People's Court announced, given that the Xiangyu jurisdictional ruling (November 2004) was given just after the SPC Drafts closed its solicitation of opinions (August 2004), it was among those initial cases for judicial test.

4. CASE SUMMARY

As shown by the three cases above, where the arbitral institution is not clearly provided, it is generally observed that the Chinese local people's courts tend to uphold the arbitration agreement by respecting the parties' arbitral wishes. The supportive judicial approach is mirrored through the courts' flexible interpretative technique (*Weige* and *Xiangyu*) and their attention to the rules of applicable law (*Singapore* and *Xiangyu*). The pro-arbitration approach has been most obviously reflected in the *Xiangyu* case where the Xiamen Intermediate Court liberally exercised its discretion to refer to the yet-to-be-promulgated SPC Draft Provisions.

In both *Weige* and *Singapore*, the different rulings in these two cases reflect the difficulties with enforcement at the lower and intermediate levels of the judiciary. In China, generally, provincial higher people's courts are equipped with more experienced judges who are better able to draw on the principles from the national legislation and judicial interpretations in an effort to address the lack of sufficient applicable legal rules. In enforcing defective arbitration agreements regarding "ambiguous arbitration commission," because the *prima facie* wording of the agreement could satisfy the examination, the judicial check may not need to extend to case substance and there are fewer concerns about local protectionism.[161] As such, the rejection by the intermediate courts in *Weige* and *Singapore* might mostly be due to the lack of knowledge about arbitration by local judges.[162] Under the pre-reporting system, the higher-level judiciary could have a chance to redress the flawed adjudications of the lower level. But, whether the redress actually takes place may largely rely upon the judicial quality of the higher-level court.

In *Weige* and *Singapore*, both the Fujian and Shanghai Higher People's Courts understood and correctly applied the pro-arbitration approach of the SPC guidelines, so that the parties' arbitral wishes were confirmed at the provincial level rather than having to be dealt with at the SPC. Given that the timelines for the "report" and "reply" under the "pre-reporting" system are unclear from the SPC Notices, the more

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[161] In determining the validity of the arbitration agreement in cases of "non-signatory third party," however, the judicial check may need to extend to the case substance to verify the change of the arbitral party. The substantial review could involve the knowledge of the financial standing of the relevant company such that the local protectionism concerns might arise. *See* discussions *supra* in Section A.3 of this chapter.

[162] *See* discussions *infra* in Sections B.1 and B.2 of this chapter.

courts involved could mean the more time costs in realizing the parties' arbitral interest.[163] In addition, Xiamen Intermediate People's Court reflects the increasing judicial deference to the principle of party autonomy with the passage of time.

Finally, it may still be doubtful whether the then soliciting SPC Draft Provisions could be justified as legal authority in the judicial ruling. As the *Xiangyu* case indicates, though the intermediate court was eager to affirm the parties' intention to arbitrate, the SPC jurisprudence may not be clear enough to make the judges reach that decision. Luckily, the situation has now been remedied by Article 4 of the most recently promulgated SPC Interpretation.[164] The reasoning report by the Xiamen Intermediate Court, however, to some extent, reflects the local judicial reluctance in exercising the pro-arbitration discretion absent SPC's specific guidelines.

C. ANALYSIS OF ENFORCEMENT DIVERGENCES AND DIFFICULTIES

The enforcement reports above reflect the inadequate Chinese judicial system in the area of arbitration. The local people's courts lack judicial independence and integrity, and do not have the knowledge or experience to handle arbitration cases.

1. LACK OF JUDICIAL INDEPENDENCE AND INTEGRITY

The striking ruling in the *Baotou* case indicates that some local people's courts tend to intervene into arbitration where local businesses are involved, particularly where the business affects the local economy.[165] Local protectionism is intertwined with a general lack of independence of the court system. In China, judicial intervention in arbitration actually comes from local political and administrative pressures. Professor Randall Peerenboom has explained the issue of judicial independence by creating two categories, *collective independence* of the judiciary as a whole and *independent decision-making* by individual judges.[166] The collective independence requires the courts to be adequately funded so that they function free from governmental influences; while independent

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[163] Weixia Gu & Robert Morgan, *Improving Commercial Dispute Resolution in China*, ASIAN DISPUTE REV., Apr. 2005, at 8-9.

[164] *See* SPC Interpretation, *supra* note 62, art. 4 (second paragraph).

[165] For discussions on the *Baotou* case, *see supra* Part IV.A.3 of this article.

[166] RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARDS RULE OF LAW 288-90 (2002).

decision-making requires the judges' terms of office to be secured and their appointment depolicized so that judges can perform impartially.[167]

In China, the PRC Constitution and Organic Law of the People's Courts provides that Chinese courts have the right to be free from external interferences in their work.[168] However, the laws further require that individual courts at different levels must be administratively and institutionally accountable to the corresponding level of the people's congresses.[169] In addition, courts in China are subject to dual leadership.[170] They receive political supervision from the Party Committee (*dangwei*) within the court, and the Party Political and Legal Affairs Committee (*zhengfawei*) outside the court. At the same time, their decisions and court judgments are scrutinized professionally by higher-level people's courts on the basis of judiciary hierarchy. This stands in sharp contrast with the understanding of collective independence in the Western ideologies where all individual courts enjoy functional independence. As such, based on Professor Peerenboom's observation, the Chinese courts as a whole appear to enjoy institutional independence, although individual courts do not.[171]

The independence of local people's courts is further undermined by the way in which they are funded. Courts in China are financed by governments at their corresponding levels.[172] Therefore, local courts are subsidized by the relevant local people's governments. It is unfortunate that while the SPC supervises the adjudicative work of all lower level people's courts, it has no power over their budgets.[173] Local judiciaries are thus dependent on local governments for even basic necessities such as salaries and housing allowances. However, since local governments need to support themselves and local courts through local taxes, fees, and charges collected from local businesses, an incentive for the court to lean on local businesses has formed.[174] A locally subsidized court may be subject to accusation if the ruling hampers the local economic interests and the court itself might be financially disadvantaged. Particularly,

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[167] *Id.*

[168] XIAN FA art. 126 (2004) (P.R.C.); Organic Law of the People's Courts, art. 4 (P.R.C.).

[169] XIAN FA art. 128 (2004) (P.R.C.).

[170] ALBERT HUNG-YEE CHEN, AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA, ch. 7 (2004).

[171] PEERENBOOM, *supra* note 166, at 298.

[172] *Id.* at 311.

[173] XIAN FA art. 127 (2004) (P.R.C.)

[174] *See* Laifan Lin, *Judicial Independence in Japan: A Re-Investigation for China*, 13 COLUM. J. ASIAN L. 185, 197-201 (1999).

where the state-owned enterprise (SOE, *guoyouqiye*) or government-supported business (GSB, *zhengfufuchichanye*) is at issue, and where the arbitration agreement provides for arbitration outside the locality,[175] the local court is more likely to seize its jurisdiction and refuse to refer parties to arbitration outside the local jurisdiction.[176] Moreover, since Chinese local governments have a political responsibility to maintain the social stability in the locality, they might interfere in the judicial ruling if the enforcement could hamper a major local business. From the perspective of government authorities, strict implementation of independent courts and judges may lead to the loss of *control* on the final outcome of commercial dispute resolution and thus exert an adverse impact on the SOE and GSB as a political, economic, and social safety net in China. Thus, the possible cash flow problems of the GSB would trigger the exercise of judicial umbrella as the *Baotou* case above illustrates. Some commentators, however, argue that, in such cases, both the court ordering enforcement and the SOE receiving the order are governmental organs. Therefore, local protectionism must be prevalent unless the court can relieve itself from the budget constraints.[177]

The courts' financial reliance on the local government has allowed local political and administrative powers to encourage local protectionism. It has further led to the unbalanced development of local people's courts across the country. Dean Chenguang Wang of the Tsinghua University Law School notes that the court system in coastal areas are better developed than their hinterland counterparts as the economy in coastal areas has been better off and administrations more liberalized.[178] By contrast, rural areas often suffer a budget constraint due to the under-developed economy. As a result, the court system there may suffer more administrative interferences. This helps to explain the difference of judicial attitudes taken by the *Baotou* and *Xiamen* Intermediate Courts albeit the former is a more recent case.[179]

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[175] If it is a local arbitration agreement pointing to dispute resolution under the local arbitration commission, then there is already leverage for exercise of local government control given the administrative infrastructure of these commissions.

[176] In China, SOEs are thought to promote economic development and maintain social stability in that they produce jobs and provide various forms of social welfare to their workers, retirees, and their family members.

[177] *See* Yuan, *supra* note 129.

[178] Ellen Reinstein, *Finding a Happy Ending for Foreign Investors: The Enforcement of Arbitration Awards in the People's Republic of China*, 16 IND. INT'L & COMP. L. REV. 37, 54 (2005).

[179] The Baotou Intermediate Court adjudicated the case in 2006, where the Xiamen Intermediate Court adjudicated the *Xiangyu* case two years earlier in 2004.

With respect to independent decision-making, in the Western ideology, judicial independence includes independent decision-making by individual judges. However, it is a different story in China.[180] In the Chinese context, individual judges, by and large, do not have the right to decide cases on their own. Judges at all levels of people's courts are divided into different administrative ranks; i.e., the President of the Court (*yuanzhang*), Vice President (*fuyuanzhang*), and Division Heads of the Chambers (*tingzhang*).[181] The people's congresses at different levels decide on the appointment of the court presidents and the presidents then decide on the appointment of the vice presidents and division heads.[182] Most cases are heard by a collegiate panel of three judges and the presidents or division heads will determine which judge will act as the chair of the panel, and they may further review the panel's decisions if they think necessary.[183] In turn, collegiate panels are often required under the court's internal rules to obtain the approval of the division heads, vice presidents, presidents, and the court's Adjudicative Committee (*shenpanweiyuanhui*)[184] before they render their judgments. Thus, the administrative rank of the judge is important in determining the final outcome of the case. The decision-making of individual judges is controlled indirectly through these administrative means.[185]

Outside the court, local governments and the Chinese Communist Party (CCP) Committee (*dangwei*) may further influence judicial decisions of significant cases, and on the appointment, promotion, and removal of local judges.[186] Judges rely on salaries and housing benefits

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[180] PEERENBOOM, *supra* note 166, at 286.

[181] Organic Law of the People's Court, arts. 19, 24, 27, 31 (P.R.C.)

[182] *Id*.

[183] Organic Law of the People's Court, art. 10 (P.R.C.)

[184] The Adjudicative Committee is the highest adjudicative body inside the court, the establishment of which functions to guide the handling of difficult cases received by the court. The committee is composed of the Party Secretary, President, Vice-Presidents, and Division Heads of the court concerned. *See* Organic Law of the People's Court, art. 11 (P.R.C.)

[185] Dean Liming Wang of the People's University is one of the many scholars who have called for an end to the system of administrative ranking of judges.

[186] The CCP Committee exerts tremendous influence at all levels of the court system. According to Article 101 of the PRC Constitution, it should be the local people's congress that appoints chief judges of the provincial court and the chief judge nominate the other lower level of judges. However, in reality, the local CCP Committee often selects judges, and the people's congress ratifies its choices. These judges serve on the Adjudication Committee [*shenpan weiyuanhui*] of each court, wielding considerable power in determining the outcome of controversial cases. Most of the judges are also CCP members the leader of which discuss cases involving difficult legal issues with the Political-Legal Committee [*zhengfa weiyuanhui*] and accept general policies set by the CCP. XIAN FA art. 101 (2004) (P.R.C).

provided by the municipal government. Moreover, when appointing and promoting judges, the local political and administrative regime evaluates them in terms of obedience to its policy.[187] Hence, local judges may have to intervene in the case in order to render a favorable judgment when the local business is at stake. This is required in order to safeguard the local financial needs of the court and to allow the judge to continue to be promoted. As Professor Stanley Lubman comments, this personal dependence has resulted from the institutional dependence of the individual local people's courts, the combination of which has subjected the Chinese local judiciary to local politics and administration.[188] Judicial interventions in arbitral enforcement follow as a natural result. In this regard, the unpredictability in enforcing arbitration agreements corresponds to the past notorious records of the enforcement of arbitral awards by the Chinese local judiciaries.[189] In extreme cases, judges could help local companies with fraudulent transfers of assets as a way of evading enforcement.[190]

The SPC has become aware of the issue and has openly criticized the detrimental practices of local protectionism in the Chinese social legal system.[191] There have been some improvements in the general

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[187] Yuwen Li, *Court Reformation in China: Problems, Progress and Prospects*, *in* IMPLEMENTATION OF LAW IN THE PEOPLE'S REPUBLIC OF CHINA 55, 58-9 (Jianfu Chen et al. eds., 2002). *See also* Robb LaKritz, *Taming a 5,000 Year-old Dragon: Toward a Theory of Legal Development in Post-Mao China*, 11 EMORY INT'L L. REV. 237, 260, 262 (1997).

[188] STANLEY LUBMAN, BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO 252, 279 (1999).

[189] According to Cheng, Moser, and Wang, intermediate people's courts where respondent was domiciled or their property was located had repeatedly refused to enforce a number of arbitral awards because the enforcement might have impaired the local interests to which the courts attached significance. *See* DEJUN CHENG, MICHAEL MOSER & SHENGCHANG WANG, INTERNATIONAL ARBITRATION IN THE PEOPLE'S REPUBLIC OF CHINA: COMMENTARY, CASES AND MATERIALS 76 (1995).

[190] In the *Revpower* case, the Chinese company appeared to be insolvent under the arrangement of the local people's court so that the enforcement was delayed. *See* Fredrick Brown & Catherine Rogers, *The Role of Arbitration in Resolving Transnational Disputes: A Survey of Trends in the People's Republic of China*, 15 BERKELEY J. INT'L L. 329, 341-2 (1997).

[191] Jianxin Ren, then Chief Justice of the Supreme People's Court, proposed at the National Conference on Politics and Law in December 1992 "five prohibitions" for the removal of local protectionism. Those proposals were that (1) local CPC cadres should be prohibited from interfering with the judicial process; (2) governmental officials should be prohibited from making threats against judges carrying out the enforcement of court orders; (3) judicial organs should be prohibited from making unfair rulings in favor of local parties; (4) officials of the public security and procuratorial organization should be prohibited from interfering with the adjudication of commercial cases; and (5) any organ or individual should be prohibited from hindering enforcement of orders of courts. *See* Chief Justice Jianxin Ren, "Five Prohibitions" Proposal, Nat'l Conf. on Pol. & Law, Dec. 1992, *available at* http://bjds.bjdj.gov.cn/ShowArticle.asp?ArticleID=7596 (last visited June 8, 2009). The "five prohibitions" are listed in the eighth paragraph.

enforcement records, including those taking place in the area of arbitration.[192] However, remarkable improvements have not been seen if we separate the judicial enforcement records by localities. The problem here lies in the fact that China is a highly-centralized system where the SPC supervises its lower level courts, yet local judicial powers may deviate from their central controllers in pursuing local economic interests. One author explains that local government needs to supply its own social welfare, to promote industries in its locality, and to finance itself in order to implement its plans.[193] According to the observation by Professor Pitman Potter, Chinese courts could be more dependent upon the local government due to a gradual administrative decentralization that will be taking place alongside China's WTO membership.[194] The decentralization in the course of pursuing economic reforms may then fuel the local judicial efforts to develop their own practices in implementing the national rules according to their own needs. Thus, even though local judges might understand the SPC's pro-arbitration approach correctly, they may not be able to implement it when a local interest must be protected.

2. LACK OF JUDICIAL COMPETENCE ON ARBITRATION

With respect to the judicial *quality* in handling arbitration cases, as reflected by a line of cases discussed previously (*Longhai*, *Huaxiang*, *Baotou*, *Weige*, and *Singapore*), there is an apparent lack of proper understanding and experience regarding standard arbitration norms and practices among local Chinese judges.

In the early 1980s, approximately two-thirds of the Chinese judges did not have a law degree, and one-third were demobilized military personnel.[195] This has changed to a large extent in the early twenty-first century. Now, new judges are required to pass the National Judicial Exam.[196] Existing judges without a law degree will be trained under the

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[192] *See* discussions *infra* in Section V.A of this article.

[193] Taroh Inoue, Introduction to International Commercial Arbitration in China, 36 HONG KONG L.J. 171 (2006).

[194] Pitman Potter, *Legal Reform in China: Institutions, Culture and Selective Adaptation*, 29 LAW & SOC. INQUIRY 465, 473 (2004).

[195] *See* LUBMAN, *supra* note 188, at 253. In the reconstruction of the court system that commenced immediately after the Cultural Revolution, demobilized soldiers became judges, since they were considered good candidates owing to their propensity to promote proletarian ideologies. Thus, many of their decisions were based not on law but on communist ideologies. *See* Li, *supra* note 187, at 59, 63.

[196] Judges Law, art. 12 (P.R.C.).

central or local judges' colleges.[197] However, education for judges on commercial law practices is still insufficient. They have limited knowledge of modern standards of arbitration, let alone the generally practiced, pro-validity approach in determining the effect of arbitration agreements. Accordingly, local judges sometimes mistakenly apply the doctrine of separability, demonstrated in the *Longhai* and *Huaxiang* cases. In addition, local judges also ignore the applicable legal rules when determining the validity of foreign-related arbitration agreements, as seen in the *Singapore* case. This general shortage of judicial expertise on arbitration has also caused some arbitral awards to be unduly set aside or not enforced.

The lack of a tenure system and of decent salaries (as compared to lawyers) has also exacerbated the shortage of skilled commercial judges. Some judges have committed corruption, while others have abandoned their posts for the more lucrative practice in large law firms.[198] The qualifications of local judges are also economic-driven.[199] Economically well developed areas attract better judges with the skills to deal with foreign cases and international arbitration norms. Therefore, judges in coastal areas (such as Shanghai, Xiamen) are more competent and they take a more liberal approach towards arbitration agreements.[200] Rural areas (such as Baotou) are ill prepared to handle arbitration cases.[201] The unbalanced qualification of judges also brings about the uncertainty of judicial attitude and approach towards arbitration in different areas of China. This is also the reason why when Hong Kong signed a mutual agreement with the mainland in 2000 with respect to recognition and enforcement of arbitral awards, Hong Kong was reluctant to subject its arbitral awards to review by people's courts in all Chinese places. Some of the intermediate courts in the mainland have never taken up any Hong Kong or foreign-related cases, nor do they have qualified judicial personnel to deal with such cases.[202]

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[197] Report by Xiao Yang, President of the Sup. People's Ct., at the 4th Session of the 9th National People's Congress in Beijing, Mar. 10, 2001.

[198] One SPC judge commented that in 1998-1999 alone, approximately 15 percent of all people's court judges left their position for a position in a law firm. *See* Reinstein, *supra* note 178, at 60, 71.

[199] Lecture with Dean Chenguang Wang, N.Y.U Law School, Lecture on Resolving Business Disputes in China (Mar. 18, 2007).

[200] *See supra* Part IV.C.1-3 for case analyses of *Weige*, *Singapore* and *Xiangyu* of the Xiamen and Shanghai People's Courts.

[201] See *supra* Part IV.A.3 for case analyses of Baotou court in *Baotou*.

[202] Xian Chu Xhang, *The Agreement Between Mainland China and the Hong Kong SAR on Mutual Enforcement of Arbitral Awards: Problems and Prospects*, 29 HONG KONG L.J. 463 (1999).

In addition, there are perceptions that the rapid development of arbitration may decrease courts' caseloads. This has fostered judicial hostility towards arbitration. Such judicial hostility tends to make local people's courts compete for cases with local arbitration commissions in that local judges use their review power to turn down arbitration agreements in order to "win" the jurisdiction.[203]

All of these factors could affect the quality of judicial review over arbitration. Eventually, excessive judicial intervention resulting from the misunderstanding of local judges will undermine the quality of enforcement of arbitration (both agreements and awards).[204]

D. CONCLUSION: PRACTICAL CONSTRAINTS

It is important to note that under the Chinese judicial review system over arbitration, a couple of defects are evident. First, most local people's courts suffer institutional deficiency both in terms of finance and function. Hence, within the current Chinese context where local protectionism and corruption are still pervasive, the local court may not be able to refrain from local party and governmental pressures which seriously influence their decision making in the area of enforcement. Second, local judges are not equipped to deal with arbitration cases. This has led to some arbitration agreements and awards to be unfairly denied. Under the circumstances, parties may find it hard to proceed to arbitration at the lower level judiciary.

Although the SPC has been working hard to pay more judicial respect to parties' autonomy and interest in arbitration by issuing a long list of liberal guidelines, the efforts are found to have been mitigated downstream, thereby negating any advantages gained by the SPC's pro-validity initiatives. Accordingly, although the SPC is pro-arbitration, lower level people's courts may not be. Their institutional incapacity (including incapacity of the judicial personnel) has thus subjected the enforcement ruling, i.e. *outcome* of arbitration, to political and administrative hands. As stated previously, arbitration has been one of the areas reflecting the general enforcement problems faced with the Chinese courts. In particular, it reflects the uncertainty of enforcement by the Chinese local level courts. In light of such uncertainty, foreign investors,

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[203] Gu, *supra* note 130, at 497.

[204] Jianhua Zhong & Guanghua Yu, *Establishing the Truth on Facts: Has the Chinese Civil Process Achieved This Goal*, 13 J. TRANSNAT'L. L. & POL'Y. 393, 429-433 (2003).

suspicious about the biased local judges, and in order to avoid the unpredictable and sometimes corrupted Chinese court system, often add an arbitration clause outlining a strategy for pursuing a more impartial outcome of commercial disputes. However, given that both arbitration agreements and arbitral awards must undergo review by the Chinese courts for enforcement, foreign parties may yet find themselves forced into the situation they tried to avoid.

Domestic parties may even worry about their autonomy and interest in arbitration being denied without the procedural remedy such as the "pre-reporting" system available to their foreign-related counterparts. The "pre-reporting" system applies to foreign-related arbitration agreements and arbitral awards as a way for higher people's courts to counteract local protectionism and local judicial malpractices. Local protectionism, however, attacks not only foreign parties but domestic parties from outside the region as well. Therefore, it remains uncertain how to protect the lawful arbitral interests of large numbers of domestic "alien" parties. The dual-track system and the foreign party favored treatment have been warmly welcomed by foreign investors as centralized review will prompt better enforcement results.[205] Nevertheless, it may not be welcomed by domestic investors and this practice has been criticized for having overlooked domestic interests. Moreover, the higher level judiciary's interference into jurisdictional rulings of lower level courts has been challenged as a violation of due process and the independence of judicial decision-making.[206] Serious measures are thus urgently needed to officially address the inadequate lower level court system in China and to significantly improve their quality in handling arbitration cases.

IV. FURTHER JUDICIAL EFFORTS AND THEIR RESTRICTIONS

There have been wide international concerns by academics and practitioners about the enforcement problems of Chinese arbitration.[207]

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[205] Hu Li, *Setting Aside an Arbitral Award in the People's Republic of China*, 12 AM. REV. INT'L. ARB. 36-7 (2001).

[206] Dan Ye, *On the Reasonability of the Judicial Power in Arbitration from the Perspective of Modern Judicial Ideologies*, *in* JUDICIAL REVIEW OF THE FOREIGN-RELATED ARBITRATION, *supra* note 132, at 98.

[207] *See, e.g.*, Li, *supra* note 205; Gu, *supra* note 130; Reinstein, *supra* note 178; Inoue, *supra* note 193.

To address the situation, the SPC has introduced a series of measures to enhance the infrastructure of the judiciary. Furthermore, there have been efforts at the provincial level to pay equally close attention to judicial review over arbitration on both tracks.

A. SPC EFFORTS IN ENHANCING THE INFRASTRUCTURE OF THE JUDICIARY

In the past decade, the SPC has initiated reforms and measures to improve the judicial infrastructure. One of the key reforms is the *Five-Year Reform Plan of the People's Court* (1999-2003) (First Five-Year Reform Plan)[208] which focuses on promoting the quality of judges through a more depoliticized judge selection system.[209] Subsequent to that, in October 2004, the SPC promulgated the *Outline of the Second-Five-Year Reform Plan of the People's Court* (2004-2008) (Second Five-Year Reform Outline).[210]

The Second Five-Year Reform Outline appears particularly bold in setting out no fewer than fifty objectives for upgrading the Chinese court system. As a whole, the provisions demonstrate a cautious awareness of the importance of greater professionalism, independence and integrity of the judiciary, reducing local protectionism, and stamping out corruption, while acknowledging the leadership by the Party and supervision by people's congresses at each level.[211] On collective independence, the SPC seeks to enhance the autonomy of the local people's courts, and begins to explore the establishment of a *guaranteed financing* for local courts by inserting provisions in central and provincial government budgets.[212] Perhaps the program's boldest proposal is loosening the grip

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[208] *Five-Year People's Courts Reform Plan* [*Renmin fayuan wunian gaige gangyao 1999-2003*], *in* GAZETTE OF THE SPC [ZHONGHUARENMINGONGHEGUO ZUIGAORENMINFAYUAN GONGGAO] 1999 No. 6, 182-90, *available at* http://china.findlaw.cn/fagui/gj/22/14526.html (last visited June 8, 2009).

[209] In the next five years, all the people's courts must adopt a selection system which requires that the higher court judges be selected from the most-qualified judges of lower courts, or high-performance lawyers, or other high-level legal professionals. Judges who are newly recruited from the recruitment examination should first work for the intermediate people's courts and basic people's courts.

[210] *Outline of the Second Five-Year People's Court Reform Plan* [*Renmin fayuan di'erge wunian gaige gangyao 2004-2008*], available at http://www.law-lib.com/law/law_view.asp?id=120832 (last visited Mar. 11, 2009).

[211] For the reassertion of the leadership under the Party and people's congress, *see id*. Part Seven, Basic Principles of the Reform, ¶4.

[212] *Id*. art. 48.

of local power holders over local courts. The SPC calls for "within a certain geographic area, the implementation of a system of *uniform recruitment* and *uniform assignment* of local judges in basic and intermediate courts by the upper level people's courts."[213]

Further, under the First Five-Year Reform Plan, the judicial personnel must pass the National Judicial Examinations to get qualified. Under the more recent Outline, judges now need to participate in annual judicial training to keep up-to-date on legal rules so that they can better deal with cases.[214] Some other legal education opportunities in the area of international commercial practice have also begun in China in an attempt to respond to the country's accession to the WTO. For example, since 1999, more than 240 provincial and intermediate-court-level judges have graduated from the Tsinghua-Temple International Business Law LLM program sponsored by the SPC in which an intensive course on "international commercial arbitration" is involved.[215] Local judges from the coastal area courts may have more chances to study abroad due to the more developed economy and liberal administration.[216] This supports the findings of pro-validity enforcement in the *Singapore* and *Xiangyu* cases by the Shanghai and Xiamen Intermediate Courts discussed previously.[217] These measures are seen as important steps to improve understanding of modern commercial laws and arbitration norms among the Chinese judges.

B. LOCAL JUDICIAL EFFORTS IN MERGING THE DUAL TRACKS

Before the official promulgation of the SPC Interpretation, many academics proposed that "pre-reporting" be clearly written into the Interpretation to keep with the more relaxed judicial supervision over the foreign regime.[218] The Beijing Higher People's Court, however, argued that

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[213] *Id*. art. 37.

[214] The SPC has trained the LHPC judges at the National Judge Institute, and those judges are responsible for training other judges. Outline of the Second-Five-Year People's Court Reform Plan, art. 39 (P.R.C.).

[215] Conversation with Huang Ying, Shanghai Higher People's Court judge, who participated in the Tsinghua-Temple LL.M. program in 2001.

[216] For example, the Shenzhen Intermediate People's Court provides a western legal training program for its judges. Each year since 1998, approximately fifteen judges have been sent to the University of Hong Kong Law Faculty to study the Master of Common Law (MCL) program.

[217] Mei Ying Gechlik, *Judicial Reform in China: Lessons from Shanghai*, 19 COLUM. J. ASIAN L. 97, 122-32 (2005).

[218] See a series of academic essays commenting on the lack of incorporating "pre-reporting" system in the SPC Interpretation by Shengchang Wang, Xiaolong Lu, Chengxin Zhou, Jinqian Zhang

the protection shall be applied equally to both sides. As such, an "internal pre-reporting" scheme has been established within the Beijing people's courts.[219]

Pursuant to the scheme, where the first instance court attempts to turn down the jurisdiction in domestic arbitration, it must report directly to the Beijing Higher People's Court. Lower level courts in Beijing cannot deny the effect of either domestic arbitral agreements or awards until they get it affirmed by the highest court in the Municipality.[220] Having done so, the gap in "pre-reporting" with respect to the previously overlooked domestic arbitral regime can now be closed in Beijing. As Judge Tian Yuxi, Head of Enforcement Division of the Beijing Higher People's Court, introduces it, "[t]he creation of the 'internal pre-reporting' system shows the determination of the Beijing judiciary to provide a pro-arbitration environment for investment both at home and abroad."[221] Beyond that, it may represent local judicial efforts to merge the two tracks where other provincial courts may follow the footsteps. Perhaps, rather than applying the "pre-reporting" to both the foreign and domestic regimes, the system could be abolished altogether because "pre-reporting" is an inefficient use of judicial resources. In addition, it influences the independent judicial thinking of lower level judges.[222]

C. CONCLUSION: RESTRICTIONS UNDER STATE CONTROL

The enforcement study reveals that there has been distorted state control over the judiciary in China, which has indirectly *controlled* the *outcome* of arbitration such as enforcement of both arbitral agreements and awards. Born of the dependent status of local people's courts on local governments for survival and development, they are seriously pressured by local political and administrative powers in their decision-making process. It is also observed that the Chinese local courts are not sufficiently equipped both infra-structurally and professionally to keep up with the pro-validity and pro-enforcement arbitration reforms initiated by the SPC. Thus, lack of cooperation by the local judiciary is a frequent

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and Lianbin Song in JUDICIAL REVIEW OF THE FOREIGN-RELATED ARBITRATION, *supra* note 132, at 127-83.

[219] Speech of Tian Yuxi, Head of Enforcement Division of the Beijing Higher People's Court, at the Forum Protection of International Investment and Financing, Beijing, July 16, 2005, http://www.hzac.gov.cn/zclt/lt0508012.htm (last visited Mar. 11, 2009).

[220] *Id.*

[221] *Id.*

[222] *See* discussions *supra* in Section II.A.1 of this article.

occurrence in the enforcement of arbitration agreements, thereby possibly negating any advantages gained by the SPC's pro-arbitration initiatives. As such, the sooner the local people's courts can realize their institutional independence and improve their quality, the faster China's enforcement records can develop.

To address the enforcement difficulties pervasive among the lower level judiciary (especially in the hinterland), the SPC has introduced quite a few directives aimed at the independence and integrity of the judiciary including the most recent Second Five-Year Reform Outline. It has also attempted to provide education opportunities on arbitration norms for lower-level judges. The improved independence and education is expected to bring along increased judicial respect to parties' autonomy in arbitration. Although an optimistic view has been taken towards the implementation of this ambitious Second Five-Year Outline, so far, neither the practice of "guaranteed financing" nor "uniform recruitment" of lower level judges has been reported in other places in China. As such, the extent to which these reforms will actually be implemented are yet to be seen. Based on the observation by Professor Jerome Cohen, the political status quo in China does not allow rapid expansion of its judicial power as the Party government may not wish to make quick changes, especially those that might threaten the primacy of the administrative power.[223] This, seen from another perspective, explains the checkered development of the Chinese judiciary, which is largely subject to state control, such as the country's political and administrative encroachment. Therefore, more breakthrough changes need to take place to *empower* the courts and individual judges in decision-making of the cases. The success of the reforms will always be tested on the basis of the degree to which they are implemented in practice.

[223] Cohen, *supra* note 101, at 27.