



Litigation and arbitration in China: Which is better?

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Introduction

Foreign investors have long been reticent about getting involved with Chinese courts and have accordingly the usual practice has been to draft watertight arbitration clauses in their contracts. Yet, the decision to choose arbitration over litigation should not be considered a *fait accompli* – there are some circumstances where foreign clients may prefer to use the Chinese court system as opposed to arbitration. This article explores the differences between these two forms of dispute resolution and highlights the times where litigation may be preferred.

What is arbitration?

Arbitration is an alternative form of dispute resolution where, rather than using the public court system, the parties' dispute is heard before a private arbitrator. Importantly, arbitration can only be made mandatory via a specified clause in the relevant contract. The clause should specify the arbitral body, the location of where the arbitration will be held, the language of the arbitration, the applicable procedural rules and any other relevant matters.

What are the key differences?

Some of the key differences between these two forms of dispute resolution are as follows:

1. In respect of arbitration, the parties have the right to take appointment an arbitrator from the selected list. While for the litigation, judges are appointed by the state and cannot be designated by the parties.
2. In respect of arbitration, the parties concerned have the right to choose the arbitration body, the arbitration rules applied and the arbitration location. While the litigation procedure must be strictly in accordance with the law and the regulations.
3. In principle, the arbitration hearing is not open and the decisions/judgments are not made publicly available. Civil cases adjudicated by people's courts shall usually be heard publicly, except for the cases that involve state secrets or the private affairs of individuals,

or are otherwise provided by law. A divorce case or a case involving trade secrets may not be heard publicly if a party so requests. People's courts shall publicly pronounce their judgments in all cases regardless if the cases were tried publicly or privately.

4. Generally speaking, an arbitration award is final. After the award is given, the arbitration commission or the People's Courts shall not accept the re- application of the suit concerning the same dispute by any of the parties concerned.
5. In trying civil cases, the People's Courts shall, according to the provisions of the law, follow the systems of panel hearing, withdrawal, public trial and the court of second instance being that of last instance.

Are all matters appropriate for arbitration in China?

No, some matters cannot be arbitrated. In accordance with China's Arbitration Law, the following disputes cannot be put to arbitration:

1. Disputes arising from marriage, adoption, guardianship, bringing up of children and inheritance; and
2. Disputes that have been stipulated by law to be settled by administrative organs.

Which is better for foreign investors: litigation or arbitration?

Generally speaking, litigation is not a poorer option as a dispute resolution mechanism compared with the arbitration. The main problem with litigation is that the process, whilst improving, is still more susceptible than it ought to be to improper influence and to the risks of incompetent adjudication. In addition, where "foreign elements" are involved, a People's Court is not required to complete the adjudication of a case within a specified time. That does not mean that the time period for handling foreign-related civil cases can be delayed indefinitely. But normally the time period of litigation is longer than arbitration.

The single biggest advantage of arbitration is that it is far easier to enforce arbitral award in foreign countries than it is to enforce court judgments. To the best of the authors' knowledge no Chinese judgment has ever been registered as a judgment in the United States and vice versa. This effectively means that if you obtain a judgment against a Chinese client in a United States court you have no ability to obtain any assets located in China.

Arbitration in China does suffer from a number of shortcomings when compared with the standards generally expected in international arbitration. There can be problems with the way in which the local courts exercise their supervisory jurisdiction over local arbitrations. This can be a real problem since Chinese arbitration commissions lack important powers such as the granting of interim remedies (e.g. asset freezing), to preserve evidence and to rule upon their own jurisdiction.

Is litigation ever preferable for a foreign investor?

Despite the conventional wisdom that foreign investors should always insist upon arbitration clauses, there are some occasions where it is advantageous to not include an arbitration clause. This is for the same reason that was identified as a negative of litigation in the preceding section – the inability to enforce Chinese judgments in the United States. Where the obligations in a contract generally fall in favour of the Chinese party, and/or where the foreign party has no assets in China, it may be preferable not to have an arbitration clause. To enforce the obligations under a contract without an arbitration clause the Chinese party would need to effectively commence proceedings in the United States. This would act as a significant disincentive to sue.

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