

NAVIGATING THE CULTURAL MALAISE: FOREIGN DIRECT INVESTMENT DISPUTE RESOLUTION IN THE PEOPLE'S REPUBLIC OF CHINA

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I. Introduction

China is considered to be one of the oldest living civilizations on earth. Until the twentieth century, and for essentially five thousand years, feudal lords and kings ruled China. However, since 1979, under Deng Xiaoping's open door policy, the Chinese economy and legal structure have developed rapidly. China's domestic markets and potential purchasing power is all but measureless. Most economists suggest that China has the third largest economy in the world, has unfathomable potential, and is predicted by many to be the most powerful economy by the middle of the twenty-first century. Even prior to being accepted into the World Trade Organization ("WTO"), China had attracted a considerable amount of foreign direct investment ("FDI"). Foreign investors are eager to do business and invest in projects in China, but many are not sure about the proper methods for dispute resolution if a deal goes bad. While the overwhelming majority of FDI projects in China are successful, inevitably projects go sour, and they will need to be resolved in the best interests of all parties.

Problems such as government expropriation;² lack of transparency and

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² Expropriation is "to take possession of, especially for public use by the right of eminent domain, thus divesting the title of the private owner . . . to dispossess of ownership." WEBSTER'S NEW UNIVERSAL UNABRIDGED DICTIONARY 683 (3rd ed. 1996). Chinese law forbids nationalization of

obscurity of the law; reliance on a non-public operational code, rather than publicly accessible regulations;³ administrative and political control in the form of uncoordinated laws and policies at different levels of the Chinese bureaucracy;⁴ inconsistent interpretations of the law;⁵ inadequate fiduciary duty rules for joint venture partners;⁶ and profit restrictions on investments,⁷ to name just a few,⁸ are still major concerns that foreign investors should be keenly aware of when investing in China. Recent turmoil in Beijing regarding McDonald's serves as a good example:

FDI ventures, including joint ventures, equity joint ventures and wholly foreign owned enterprises. However, there are special circumstances when this would be allowed, including "national security considerations and obstacles to large civil engineering projects. . . . There have been no cases of outright expropriation of [FDI] since China opened to the outside in 1979." *Id.* But, if there were, and they could be proved, Chinese law allows for compensation of expropriated foreign investments, but has not defined what the actual terms of compensation would be. *See id.* *See* Folsom, at 761-64 (detailing anti-expropriation laws in *The Law on Wholly Foreign-Owned Enterprises* (1986)).

³ *See* Pat K. Chew, *Political Risk and U.S. Investments in China: Chimera of Protection and Predictability?*, 34 VA. J. INT'L L. 615, 622 (1994). "The conflict between the Chinese and Western approaches to the law is not helped by the Chinese practice of citing unpublished laws. . . . Under the Western notion of law, this practice clashes head on with due process. . . ." *Id.*

⁴ *See* Anna M. Han, *China's Company Law: Practicing Capitalism In A Transitional Economy*, 5 PAC. RIM. L. & POL'Y J. 457, 489 (1996) (stating that "[d]espite provisions in the Chinese Constitution to the contrary, the confusing and often overlapping lines of authority remains a problematic issue facing China's enterprises."). *See* Daniel C.K. Chow, *The Limited Partnership Joint Venture Model In The People's Republic Of China*, 30 LAW & POL'Y INT'L BUS. 1, 39 (1998).

⁵ *See* Han, *supra* note 3, at 491-92.

⁶ *See* Chow, *supra* note 3, at 38.

Current Chinese law does not appear to have an equivalent concept to fiduciary duty. While this means that all non-control groups are exposed to the risks associated with the lack of such duty, the local partner in the type of foreign-controlled joint venture . . . is particularly vulnerable because of the amount of control vested in the foreign investor. This lack of general protection most clearly exposes the non-control group to risks where the control group seeks to intentionally exploit the non-control group.

⁷ *See* Henry J. Graham, *Foreign Investment Laws of China and the United States: A Comparative Study*, 5 J. TRANSNAT'L L. & POL'Y 253, 277 (1996).

⁸ Another problem is the concept of requiring "foreign operators . . . [to] generate at least half their sales volume from Chinese-made goods." *See id.*

Beijing recently ordered McDonald's to vacate its prize location in a shopping district near Tiananmen Square. The American fast-food chain not only has its largest restaurant on the site, as a commitment to the Chinese market, but also signed a twenty-year lease They [McDonald's] have been ordered off the property to make way for a development project. . . . As a result, McDonald's, one of China's earliest investors, is reviewing its China investment strategy. [Meanwhile] [o]ther possible investors, like Ford Motor Company, remain on the sidelines.⁹

Undoubtedly, this example creates an environment of "business disenchantment" regarding the Chinese investment market.¹⁰

Before foreign investors enter the Chinese market, they should consider many unique Chinese cultural and legal concepts. Only with time will a foreign firm begin to understand the Chinese relational conditions and business environment.¹¹ Therefore, the longer the foreign enterprise functions in China, the more competent and efficient it will become at navigating the Chinese bureaucratic malaise and at avoiding problematic situations.¹² This improved competency and efficiency ranges from understanding basic concepts of Chinese culture to understanding how to handle arbitration or, if necessary, litigation issues.

⁹ *Id. But see, id.* at 268-69.

One bright shining example for the world and the rest of China to behold is Guangdong province, the mainland alter ego of its vibrant neighbor, Hong Kong. Guangdong is blazing the path for the rest of China providing regulations governing . . . joint ventures and the transfer of land-use rights . . . [W]estern legal concepts have taken hold in Shenzhen [as well], courtesy of Hong Kong. . . . Whether China can emulate Guangdong's success and adaptability remains to be seen.

¹⁰ *See id.* While such uncertainty may not bode well for the near-term investment, the Chinese government is hastily trying to create a much improved investor environment. *See* Part III.

¹¹ *See* Rajib N. Sanyal & Turgut Guvenli, *American Firms In China: Issues In Managing Operations*, 9 MULTINATIONAL BUS. REV., Oct. 1, 2001, at 41.

¹² *See id.*

II. FDI Cultural and Dispute Resolution Considerations

1) *Chinese Culture and Business Relationships: How These Factors Affect FDI Negotiations*

Understanding Chinese culture is vital to understanding how to effectively negotiate in and out of business deals in China. Unknowledgeable foreigners are often baffled by the way Chinese attorneys and businessmen cultivate long lasting relationships and negotiate business transactions. Thus, before negotiating a project or venture in China, a few concepts must be understood by potential foreign investors and their attorneys.

A) *Face*

Saving face is by far the most important concept in Chinese society. Face is a Confucian¹³ concept meaning “prestige” and “personal character.”¹⁴ A loss of face can be extremely detrimental to one’s ability to adequately negotiate a deal. Direct and confrontational behavior is an inherent part of most foreign legal and business systems.¹⁵ However, “Chinese negotiators consider direct and confrontational behavior as rude, offensive and losing face.”¹⁶ Thus, many Chinese are particularly sensitive and will quickly take offense to any remarks that could cause them to lose face. Therefore, when negotiating with Chinese counterparts, foreign investors and their attorneys must understand the concept of face during negotiations, or else cultural confusions could lead to greater frustrations, ultimately undermining the investment or venture opportunity.

B) *Guanxi*

Guanxi is another very important idea of Chinese culture that will inevitably play a major role in business and legal relationships and negotiations in China. In

¹³ See DUN J. LI, *THE AGELESS CHINESE* 340 (Charles Scribner’s Sons 3d. ed. 1978) (1965) (explaining that Confucius was born in 551 B.C. and died in 479 B.C. . . . and taught the virtue of *Li*, which are the concepts of “propriety, ceremony, ritual, rite, mannerism, etiquette, etc.”).

¹⁴ Bee Chen Goh, *Trade And Investment Negotiation With The Chinese, in CHINA’S INTERNATIONAL TRANSACTIONS: TRADE AND INVESTMENT* 39 (K C D M Wilde ed., LBC Information Services 2000).

¹⁵ Such as the United States legal system.

¹⁶ Goh, *supra* note 13, at 39-40.

essence, *guanxi* is a principle that dictates the way parties relate to each other in business transactions.¹⁷ *Guanxi* is “a special relationship individuals have with each other in which each can make unlimited demands on the other.”¹⁸ Most business and professional relationships tend to begin and develop by way of *guanxi* connections.¹⁹ “What is uniquely Chinese is the fact the moral sense of obligation is so overwhelming that one normally has to comply with requests, unless the request itself is impossible, or outside one’s means to perform it.”²⁰ If a refusal of a *guanxi*-based request occurs, then the requesting party will lose face.²¹ Furthermore, the value of “good” *guanxi* cannot be overemphasized; it is extremely important in Chinese society.²²

C) *Patience, Flexibility, and Compromise*

In Chinese society, the idea of reasonableness is considered a constant of everyday life.²³ Yet, the idea of reasonable contract terms is not the same as in most western common law systems.²⁴ Generally, Chinese contract negotiations are broadly based, and “seek general principles,” rather than detailed rules explicitly built into the contract.²⁵ For example:

[t]he Chinese step back from an actual agreement and begin negotiations by presenting a letter of understanding that outlines general principles. U.S. managers are often put off because they want to get to details. They’re not averse to the rhetoric of the preambles,

¹⁷ *See id.* *See also* Sanyal & Guvenli, *supra* note 10, at 42.

¹⁸ Goh, *supra* note 13, at 39-40.

¹⁹ *See id.*

²⁰ *Id.*

²¹ *See supra* Part IV.1.A.

²² *See* Sanyal & Guvenli, *supra* note 10, at 43.

²³ This is called “*chian tao li*,” meaning the reasonable way. *See* Goh, *supra* note 13, at 40. This concept started during the time of Confucius; it is a Confucian precept. *See supra* note 12.

²⁴ *See generally* Goh, *supra* note 13, at 40.

²⁵ *See id.*

but they want to build a relationship on facts. For their part, the Chinese stress friendly introductions as a way of establishing their relationship.²⁶

Therefore, the Chinese do not place priority on contractual specificities, but on “other social precepts such as mutual benefit, social harmony and long-term objectives as their guiding principles in observing the spirit of the transaction.”²⁷ This concept is deeply embedded in Chinese societal history and culture through the teachings and writings of great philosophers such as Confucius (including Neo-Confucian philosophies)²⁸ in the *Analects*,²⁹ Sun Tzu’s *Art of War*,³⁰ *The Book of Changes* (the *I Ching*),³¹ the *Tao-te Ching (Book of Taoist Virtue)*,³² and the *Book of Mencius*.³³ Therefore, the Chinese place a premium on an agreement that enables “both parties to act flexibly and reasonably and to make compromises as the

²⁶ *Id.*

²⁷ *Id.* See, e.g., ERIC LEE, COMMERCIAL DISPUTES SETTLEMENT IN CHINA 1-4 (Lloyd’s of London Press 1985) (explaining the “Confucian virtue of compromise”).

²⁸ See LI, *supra* note 12, at 229-34 (explaining that the emergence of Neo-Confucianism came about by the increasing popularity of Buddhism and Taoism during the T’ang Dynasty). One of the primary figures promoting Neo-Confucianism was Chu Hsi (1130-1200), regarded by many to be one of the greatest Chinese philosophers of all time. *Id.* at 228. Neo-Confucianism is the Chinese philosophy that developed the concept of Yin and Yang. *Id.* at 232. See *supra* note 26. See generally PETER HOWARD CORNE, FOREIGN INVESTMENT IN CHINA: THE ADMINISTRATIVE LEGAL SYSTEM 17-42 (Hong Kong University Press 1997) (e.g., providing informative insight into the Confucian value system and its affect on social order in China).

²⁹ The *Analects* (circa 479) was a book of Confucius’ sayings compiled by his disciples shortly after his death. See CORNE, *supra* note 27, at 71. The basic premise behind this extremely important Chinese philosophy is man’s relationship to man, relatives, their gods, ancestors, and the state. *Id.* at 76-77.

³⁰ See generally, Sun Tzu, THE ART OF WAR 27-30 (Thomas Cleary trans., Shambhala Publications, Inc. 1st ed. 1988) (establishing that the book was based on sayings by a great military leader, Sun Tzu, during the Warring States period (403-221 B.C.) of the Chou dynasty).

³¹ See LI, *supra* note 12, at 81. Deals predominantly with the supernatural, and was claimed by both Confucians and Taoists as part of their tradition.

³² See *id.* at 327. The primary book of the Taoist belief system and philosophy, which was founded by Lao-tzu in the 6th century B.C. See *id.* at 84-85. This was a philosophy based on the ideas of fate and the idea of “nothingness;” that nothing is what it really seems to be. *Id.* at 85-86.

³³ See *id.* at 77-78. Book written by the great Confucian philosopher Mencius (372-289 B.C.), which stresses man’s inherent good nature.

situation so requires while at the same time abiding by the actual objectives of the dealings themselves.”³⁴ In essence, the Chinese handle contracts by establishing a very general contract, which can then be amended at various times to allow the parties greater maneuverability.³⁵ While this may seem rather frightening to the foreigner, it is business as usual to the Chinese.

The foreign investor³⁶ must also learn to be patient. Patience is truly a virtue in China, not to mention in almost every other country in Asia. “[T]o do successful business in China you need large reservoirs . . . [of] patience . . . patience . . . [and] patience.”³⁷ The Chinese consider patience a valued asset, thus Chinese negotiators take a very leisurely approach when negotiating investment contracts and ventures.³⁸ Furthermore, the Chinese place strong emphasis on “poise, reason, and self-control[;]”³⁹ impatient and negative behavior is heavily frowned on.⁴⁰

2) *The Consultation Process – The Culturally Preferred Method Of Dispute Resolution*

Most foreign investors generally consult with lawyers before and during the process of FDI negotiations. However, the Chinese do not normally consult with lawyers because such consultation would infer a mistrust of the parties involved in the negotiations.⁴¹ In fact, lawyers are normally only brought in after the FDI contract has already been negotiated.⁴² Thus, when a problem with the agreement arises, or when a problem arises during the life of the investment or venture, the

³⁴ Goh, *supra* note 13, at 41.

³⁵ *See id.*

³⁶ “*Wei-gorin*” in Mandarin Chinese. *See generally* JOHN DEFRANCIS, *BEGINNING CHINESE* (Yale University Press 2nd ed. 1976) (1964).

³⁷ Goh, *supra* note 13, at 42.

³⁸ *See id.*

³⁹ *Id.*

⁴⁰ *See generally id.*

⁴¹ *See* Graham, *supra* note 6, at 254.

⁴² *See id.*

Chinese always prefer to settle the dispute by amiable consultation.⁴³

Consultation is the preferred way to solve disputes, “and has been the main method for settling disputes for thousands of years.”⁴⁴ Most Chinese FDI regulative devices stipulate that if a dispute arises, the parties should try to settle the dispute through consultation.⁴⁵ Although China is a member of the International Centre for Settlement of Investment Disputes (“ICSID”) and has ratified the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”), the Chinese place a strong emphasis on resolving disputes through informal consultation. Furthermore, consultation is the most natural form of dispute resolution for Chinese enterprises, primarily because “Chinese culture and attitudes . . . favor [] harmony and good relationships between people [and enterprises] and . . . most Chinese . . . would prefer a compromise reached by themselves to a decision imposed by another.”⁴⁶ At its core, this exemplifies the true spirit of the Chinese; control.

Consultation⁴⁷ is simply an attempt to discuss, negotiate, and resolve a dispute between the parties.⁴⁸ Consultation is an informal method of voluntary and friendly discussion between the parties.⁴⁹ While Chinese regulations and laws do not

⁴³ See Zhang Yuqing, *Like Bamboo Shoots After a Rain: Exploiting the Chinese Law and New Regulations on Sino-Foreign Joint Ventures*, 8 N.W. J. INTL. L. & BUS. 59, 97 (1987).

⁴⁴ Gary J. Dernelle, *Direct Foreign Investment and Contractual Relations in the People's Republic of China*, 6 DEPAUL BUS. L.J. 331, 357 (1994). See generally Part IV.1.C. See also Sanyal & Guvenli, *supra* note 10, at 43 (inferring that starting with this process will help build good relations with the local governments and businesses involved). Studies have suggested that the better the foreign enterprise communicates with the Chinese government, the easier it is to maneuver within the Chinese system. See, e.g., *id.* at 42.

⁴⁵ See Dernelle, *supra* note 43, at 358. See also Sanyal & Guvenli, *supra* note 10, at 43 (asserting that “the firm in solving various operational problems . . . reaffirms that positive government cooperation can help foreign firms address specific operational problems that they may face”). Obviously, the longer the foreign enterprise has operated in China, the smoother things will operate. See generally, *id.*

⁴⁶ Kui Hua Wang, CHINESE COMMERCIAL LAW §9.2.2, at 280 (1st ed., 2000).

⁴⁷ “*Xieshang*” in Chinese. See DEFRANCIS, *supra* note 35.

⁴⁸ See LEE, *supra* note 26, at 9-10.

⁴⁹ See John S. Mo, *Alternative Dispute Resolution*, in INTRODUCTION TO CHINESE LAW 368 (Wang Chenguang & Zhang Xianchu eds., Sweet & Maxwell Asia 1997).

directly explain how to conduct the consultation process,⁵⁰ both parties must first agree to “consult each other to determine the rights and liabilities and to obtain the truth from facts.”⁵¹ Informal consultation starts at any agreed time and ends once the parties have either achieved their goals or abandoned the consultation process.⁵² This is not a method of “compromise through concession and apportionment of liabilities.”⁵³ While consultation is premised on the idea of fairness and “fully-informed voluntariness,” parties can take advantage of each other or make certain unfair concessions.⁵⁴ For an agreement to be binding, both parties to the consultation must be happy with the final result.⁵⁵ “A dissatisfied party may renege on the agreement and resort to other means of settlement such as arbitration or litigation.”⁵⁶ Furthermore, while it is a rather *ad hoc* process and can be abused by the more powerful and influential of the parties, consultation serves as a very good starting point to resolve disputes between both foreign and Chinese parties in FDI disputes.

3) *The Mediation Process – The Favored Back-up To Consultation*

While consultation is the preferred method for resolving FDI disputes in China,⁵⁷ mediation⁵⁸ is by far the second most preferred method, and is generally

⁵⁰ *See id.*

⁵¹ LEE, *supra* note 26, at 10.

⁵² *Id.* at 10-11.

⁵³ *Id.* at 10.

⁵⁴ *See* Mo, *supra* note 48, at 368-69.

⁵⁵ *Id.* at 369.

⁵⁶ *Id.*

⁵⁷ *See* International Trade Administration, *supra* note 1. *See also* Yuqing, *supra* note 42, at 97.

⁵⁸ In China, mediation and conciliation are synonymous with one another. Here, to avoid confusion, mediation will be used for ease of understanding and reading. [Mediation/conciliation is] a consensus based dispute resolution process in which the parties to a dispute meet with a third party [the mediator] to discuss mutually acceptable options for resolution of the dispute. The [mediator] has some input into the resolution of the dispute in the sense that the [mediator] encourages the parties to consider options for resolution, which are fair in all circumstances. Wang, *supra* note 45, §9.3.1 at 282.

considered to be part of the same process as consultation.⁵⁹ Like consultation, the origins of mediation are “deeply rooted” in Confucian philosophy, which strongly discourages social conflict due to its possible obstruction with the natural order of life and other intrinsic disharmonious principles.⁶⁰ Even under the rule of Mao Zedong’s long lasting Communist regime, mediation was a powerful tool for applying social, political, and economic pressures on problematic enterprises and individuals.⁶¹ In fact, under Chairman Mao, the Communist party used mediation to consolidate its power-base, thereby instituting its policies as way of social control.⁶² Today mediation is a favored option for dispute resolution by the Chinese government because it embodies certain Communist tenets, such as “communal obligations” and “rejects formal judicial mechanisms which [have] traditionally been characterized as pre-revolutionary institutions for class manipulation.”⁶³ Hence, the link between mediation, consultation, Confucian philosophy, and the Communist ideology is deeply embedded in China’s modern business practices and the FDI negotiation structure.⁶⁴

Mediation is considered by most Chinese officials to be the “‘first line of defense’ against the deterioration of ‘disputes between friends,’”⁶⁵ which could result as a dispute between enemies, as often occurs in other forms of dispute resolution, most notably litigation. Mediation is a “pre-arbitration or pre-litigation”⁶⁶ process.

⁵⁹ *Id.*

⁶⁰ *See* Parts IV.A-C. *See also* Lee, *supra* note 26, at 11.

⁶¹ *See* Ralph H. Folsom & John H. Minan, *Mediation and Conciliation, in* INTERNATIONAL BUSINESS AGREEMENTS IN THE PEOPLE’S REPUBLIC OF CHINA 86 (Ralph H. Folsom & W. Davis Folsom eds., Martinus Nijhoff Publishers 1996).

⁶² *See* Lee, *supra* note 26, at 11 (stating that “In February 1954, with the promulgation of the Provisional General Rules Concerning the Organization of the People’s [Mediation] Committees, hundreds of People’s Committees were set up throughout the country.”). These rules “consolidated the work of the people with regard to conciliation and placed the conciliation machinery on a proper footing.” *Id.* at 11-12.

⁶³ *Id.*

⁶⁴ *See id.*

⁶⁵ *Id.* *See generally* Folsom & Minan, *supra* note 60, at 86-113.

⁶⁶ *See* Lee, *supra* note 26, at 12.

Therefore, when the consultation process is unsuccessful or inappropriate for the particular FDI dispute, either party involved may request mediation.⁶⁷ Considering the alternatives, especially the potentially hazardous and opaque process of litigation,⁶⁸ mediation is the safest method for a foreign investor to protect its interest in expensive, and rather valuable, FDI projects or ventures. Furthermore, mediation is the safest and most cost-effective way to manage a dispute in a country where “lawyers are scarce . . . discovery procedures are limited . . . courts do not possess injunctive or contempt powers . . . there is little [] liability insurance . . . judges are under trained . . . [and] there is a tradition of [Communist] party review of judicial decisions.”⁶⁹

The actual mediation process is quite informal, as procedural issues will not arise within the context of the mediation process.⁷⁰ Essentially, each process is molded to fit the particular dispute at hand.⁷¹ Although numerous commercial dispute laws have been passed in China,⁷² the most important legal mechanisms for commercial or FDI mediation are the Arbitration Law of the People’s Republic of China (“China Arbitration Law”),⁷³ the China International Economic and Trade Arbitration Commission (“CIETAC”) rules,⁷⁴ and the Rules of the Beijing Conciliation Centre.⁷⁵ “[Mediation] has [also] been accepted as a means of dispute

⁶⁷ See Dernelle, *supra* note 43, at 358.

⁶⁸ See Folsom & Minan, *supra* note 60, at 86-87. See *infra* Part IV.5.

⁶⁹ *Id.* at 86.

⁷⁰ See Lee, *supra* note 26, at 12.

⁷¹ See Wang, *supra* note 45, §9.3.1 at 282.

⁷² See generally Mo, *supra* note 48, at 370-81 (detailing all of the various forms of mediation/conciliation in China).

⁷³ See Wang, *supra* note 45, at 284 n.18 (describing that the China Arbitration Law “was passed by the Standing Committee of the NPC on 31 August 1994 and became effective on 1 September 1995. Articles 51 and 52 [] deal with [mediation]”).

⁷⁴ See Professor Tibor Varady, Class Lecture in International Commercial Arbitration at Emory University School of Law (Jan. 24, 2002). CIETAC is a very popular Chinese arbitration tribunal working under a formalized set of international arbitration rules, however, the tribunal does regularly assist “disputing parties” in mediation proceedings. *Id.*

⁷⁵ See generally Wang, *supra* note 45, at 286-89. The Beijing Mediation Centre was set-up in 1987 under

settlement in Article 128 of the Contract Law [and]. . . Article 14 of the Equity Joint Ventures Law.”⁷⁶

Parties must follow a few basic tenets to initiate mediation. For example, under CIETAC, the following mediation guidelines exist: 1) there must be rules that both parties are willing to accept;⁷⁷ 2) mediation “is conducted by CIETAC to ascertain the facts and distinguish right from wrong on questions under dispute;”⁷⁸ 3) mediation is to lead both parties to a form of compromise;⁷⁹ 4) the parties decide on the choice of law provisions to be completely recognized and enforceable;⁸⁰ 5) international practices can be used and are generally honored;⁸¹ and 6) if an agreement cannot be reached or mediation cannot be continued, mediation will be terminated and “an examination and oral hearings” can take place in accordance with arbitration rules and standards.⁸² Mediation can be conducted prior to arbitration under the CIETAC rules in several ways. Under CIETAC, mediation includes face-to-face discussions, discussions over the telephone, and discussions by mail or e-mail.⁸³ Also, the parties can request that two members of an informal CIETAC mediation panel speak with each side separately, thus being a conduit for compromise.⁸⁴ The parties may also have a sole mediator “pass [] compromise

the China Chamber of Commerce. It deals with international commercial mediation and maritime mediation. The Centre’s headquarters are situated in Beijing. It presently has about 25 local branches throughout the country and about 250 listed mediators. The Centre was set up in response to demands for international commercial mediation . . . from the China Chamber of Commerce. Mo, *supra* note 48, at 380.

⁷⁶ Wang, *supra* note 45, at 284.

⁷⁷ *Id.* at 285. These basic mediation tenets were established by CIETAC arbitrator Yanming Huang. *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

schemes or convey [] opinions to the other party.”⁸⁵ While CIETAC is by far the most popular forum for mediation, other options, such as administrative mediation by local or city governments⁸⁶ or court-conducted mediation, are also available.⁸⁷

4) *Arbitration*

If the parties are unable to settle their dispute through negotiation or mediation, arbitration is naturally the next step in the process.⁸⁸ Even though the Chinese prefer negotiation and mediation, arbitration has become, over the last two decades, a mainstream form of dispute resolution in China and the primary way to resolve international commercial disputes.⁸⁹ In fact, “[b]etween 1992 and 1997, the CIETAC accepted 3,292 international economic and trade cases and resolved 2,793 of them.”⁹⁰ This is primarily because foreign multinationals establishing investment

⁸⁵ *Id.* at 286.

⁸⁶ *See* Mo, *supra* note 48, at 374-75 (describing that these “organizations have a general power and obligation to resolve ‘small’ disputes falling within their jurisdiction in order to strengthen social stability”).

⁸⁷ *See id.* at 377-79 (explaining that Chinese courts may initiate a mediation session in most economic/business cases at any point of the litigation process, if they so desire). *See generally* Lee, *supra* note 47, at 13-14 (explaining that this form of mediation dates back to “the Chinese Resistance against the Japanese Invasion before the People’s Republic of China was established. A judge, Ma Xi-wu, first combined court proceedings with [mediation] in liberated areas”).

⁸⁸ *See* LEE, *supra* note 26, at 15. *See generally* Fredrick Brown & Catherine A. Rogers, *The Role of Arbitration in Resolving Transnational Disputes: A Survey of Trends in the People’s Republic of China*, 15 BERK. J. INT’L. L. 329, 330 (1997) (providing a very thorough discussion on the arbitration process in China).

⁸⁹ *See generally* Graham, *supra* note 6, at 254-55.

Arbitration eventuated, in part, from the Confucian ideal of social harmony and conciliation. Historically, such self-regulation kept most “private law” disputes out of the state courts, depending instead on local conciliation [or arbitration] and the threat of social censure. [Today,] [a]rbitration and other forms of alternative dispute resolution represent the mainstream in China. [f]urthermore, arbitration can serve the dual purposes of providing a “face-saving” approach to dispute resolution while preserving the underlying business relationship benefiting both sides. [Thus,] [t]he increasing prevalence of long-term contractual relationships in international business [and investment] underscores the importance of conciliatory dispute resolution mechanisms.

⁹⁰ Wang, *supra* note 45, §9.4.2 at 293.

projects in China prefer the control and autonomy of this process.⁹¹ Many international investors view this as a way to get around China's problematic court system.⁹² Nonetheless, an arbitration clause in an FDI agreement creates a contractual obligation to submit any dispute to an impartial tribunal chosen by the parties.⁹³ Thus, international commercial arbitration, with regard to Chinese FDI disputes, has very appealing qualities, such as procedural fairness, party autonomy in choosing the arbitration rules, neutrality, efficiency and cost effectiveness, arbitrator competence, and binding awards for the parties to enforce.⁹⁴

CIETAC is the main international commercial arbitration commission in China.⁹⁵ In fact, CIETAC is the "sole organization in the [People's Republic of

⁹¹ See generally Professor Tibor Varady, Class Lecture in International Commercial Arbitration at Emory University School of Law (Jan. 8, 2002) (discussing that while the fate of the case does lie with a third party, the proceedings must follow what is provided in the arbitration clause in the FDI contract). See *supra* note 88. See Brown & Rogers, *supra* note 87, at 330 (stating that "the key paradox is that, while arbitration in China is imperfect, it remains the best alternative for international investors").

⁹² See generally *infra* Part III.

⁹³ See Brown & Rogers, *supra* note 87, at 330. See also INTERNATIONAL COMMERCIAL ARBITRATION §II.1. (Tibor Varady, John J. Barcelo III, & Arthur T. von Mehren eds., West Group 1999). An arbitration tribunal from practically any country, due to party autonomy, can be chosen by mutual agreement of the parties. See *id.* See also Yuqing, *supra* note 42, at 97.

⁹⁴ See INTERNATIONAL COMMERCIAL ARBITRATION, *supra* note 92, AT §II-§V. See also Professor Tibor Varady, Class Lecture in International Commercial Arbitration at Emory University School of Law (Jan. 8, 2002; Jan. 18, 2002; Feb. 19, 2002). See John A. Spanogle, Jr. & Tibor M. Baranski, Jr., *Chinese Commercial Dispute Resolution Methods: The State Commercial and Industrial Administration Bureau, in INTERNATIONAL BUSINESS AGREEMENTS IN THE PEOPLE'S REPUBLIC OF CHINA* 129 (Ralph H. Folsom & W. Davis Folsom eds., Kluwer Law International Ltd 1996). But, investment contracts often stipulate arbitration in Stockholm because the forum there is considered neutral. Most Chinese contracts stipulate arbitration by [CIETAC]. During the past year, several western participants and panel members in CIETAC proceedings raised concerns about the organizations procedures and effectiveness. In one instance, a highly respected American member of an arbitration panel threatened to resign from CIETAC over alleged procedural irregularities during consideration [of] a case [believing] enforcement of arbitral awards [to be] sporadic. Sometimes, even when a foreign company wins in arbitration, the People's Intermediate Court in the locality where the foreign venture is situated may fail to enforce the decision. Even when the courts do attempt to enforce a decision, local officials often ignore court decisions with impunity. *Foreign Investment Laws: Changes, May 2001*, *supra* note 57.

⁹⁵ See Wang, *supra* note 5, §9.4.4 at 297.

The CIETAC was established in Beijing. . . . It also has two regional offices, one

China] authorized to hear non-maritime commercial arbitration cases between Chinese and foreign parties.”⁹⁶ The China Chamber of Commerce originally developed CIETAC’s arbitration rules.⁹⁷ CIETAC is made up of an official Chinese administrative body able to exercise its “delegated legislative power under the Chinese Constitution and the relevant regulations of the State Council.”⁹⁸ While arbitration is a complex process,⁹⁹ CIETAC has jurisdiction to cover matters such as: international or foreign trade-related disputes, including those related to the Hong Kong SAR, Macao, or Taiwan regions;¹⁰⁰ disputes arising “between enterprises with foreign investment and disputes between an enterprise with foreign investment and another Chinese legal person . . . or economic organization;”¹⁰¹ disputes arising from project financing;¹⁰² or certain special cases stipulated in the administrative regulations of the People’s Republic of China.¹⁰³

established in Shenzhen . . . and the other in Shanghai[;] . . . the CIETAC has 418 arbitrators on its name list for international economic and trade arbitration. Among these arbitrators, 25 are citizens of Hong Kong SAR and 112 are foreigners, of whom eight are Australians.

Id. For an expose on CIETAC, see Paul R. Weber, *China International Economic and Trade Arbitration Commission*, in CHINA AND HONG KONG IN LEGAL TRANSITION: COMMERCIAL AND HUMANITARIAN ISSUES 73-75 (Joseph W. Dellapenna & Patrick M. Norton eds., American Bar Association 2000).

⁹⁶ Ge Liu & Alexander Lourie, *International Commercial Arbitration in China: History, New Developments, and Current Practice*, in INTERNATIONAL BUSINESS AGREEMENTS IN THE PEOPLE’S REPUBLIC OF CHINA 389 (Ralph H. Folsom & W. Davis Folsom eds., Kluwer Law International 1996).

⁹⁷ See Mo, *supra* note 48, at 384.

⁹⁸ *Id.*

⁹⁹ E.g., INTERNATIONAL COMMERCIAL ARBITRATION *supra* note 92, at §I. See generally Jerome Alan Cohen, *The Role of Arbitration in Economic Co-operation with China*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE’S REPUBLIC OF CHINA 508-31 (Michael J. Moser ed., Oxford University Press 2nd ed. 1987).

¹⁰⁰ See Mo, *supra* note 48, at 384.

¹⁰¹ *Id.*

¹⁰² See *id.*

¹⁰³ See *id.*

China ratified the New York Convention in 1986¹⁰⁴ with a few reservations. First, China would only enforce the Convention on the basis of mutual recognition, thereby refusing to enforce an award in a non-New York Convention country. Second, the Convention would only apply to disputes recognized under Chinese law.¹⁰⁵ Also, under CIETAC arbitration, an award must be rendered within nine months from the date when the arbitration tribunal is formed.¹⁰⁶ However, if the parties wanted a quicker and more efficient process, they would simply agree in writing and apply for the case to be conducted under the Summary Procedure of CIETAC.¹⁰⁷ Thus, an award could be rendered within thirty days if heard orally, or within ninety days of the formation of the arbitration tribunal if the case is examined “on the basis of documents only.”¹⁰⁸ Finally, and most importantly, all arbitration pertaining to commercial or investment matters in China is institutional; there is no *ad hoc* arbitration.¹⁰⁹

5) *Litigation – Venturing Into The Undesired World Of Last Resort*

The Chinese have a very bad impression of the court process and prefer more amicable ways of settling disputes, primarily due to being non-confrontational in nature and not wanting to risk losing face.¹¹⁰ However, over the past few decades, the Chinese government has established economic court divisions within the legal framework to handle civil litigation regarding economic and commercial disputes to curtail “speculation, profiteering, and all kinds of criminal activities.”¹¹¹ It is important to note that:

¹⁰⁴ See *id.* at 392. See, e.g., DOCUMENTS SUPPLEMENT TO INTERNATIONAL COMMERCIAL ARBITRATION 1 (Fibor Varady, John J. Barcelo III, & Arthur T. von Mehren eds., West Group 1999).

¹⁰⁵ See *id.* For example, the China Arbitration Law. See *supra* Part IV.3.

¹⁰⁶ See Wang, *supra* note 45, §9.4.4 at 299.

¹⁰⁷ See *id.*

¹⁰⁸ *Id.*

¹⁰⁹ However, CIETAC does not object to *ad hoc* arbitration. See *id.* In fact, “[i]n cooperation agreements signed between CIETAC and arbitral institutions of other countries, there are provisions allowing parties to select *UNCITRAL Arbitration Rules* and form an *ad hoc* arbitration tribunal.” *Id.*

¹¹⁰ See LEE, *supra* note 26, at 9.

¹¹¹ *Id.* at 18.

[l]itigation of [a] dispute is possible, but is usually a last resort. To litigate a dispute involving a foreign economic contract in the Chinese court system, the foreign economic contract must not include an arbitration clause and a written agreement to arbitrate must not later be reached. In practice, few foreigners or foreign countries have litigated their contractual disputes.¹¹²

Rule of law is still developing in China.¹¹³ The court system is still predominantly state controlled and opaque in character. Many Chinese court justices and attorneys have relatively inadequate legal training, compared to western standards,¹¹⁴ and bias against foreigners in the Chinese court system is commonplace.¹¹⁵ Foreign litigants face additional problematic factors such as rapidly changing and volatile laws. Furthermore, Mandarin Chinese, the official Chinese language, is required in all court proceedings, and foreign parties can only be represented by Chinese counsel. Collectively, these factors could cause considerable hardship and uncertainty in the litigation process for a foreign enterprise.¹¹⁶ Therefore, a foreign enterprise doing business in China must have a very good arbitration clause built into its investment or joint-venture contract, or find an alternative means for resolving a dispute in a neutral international forum rather than contend with a Chinese court.¹¹⁷

¹¹² Dernelle, *supra* note 43, at 358-59. *See also* Yuqing, *supra* note 42, at 97.

¹¹³ *See* Brown & Rogers, *supra* note 92, at 333. *See also* Stanley B. Lubman, *Sino-American Relations and China's Struggle for the Rule of Law*, in CHINA AND HONG KONG IN LEGAL TRANSITION: COMMERCIAL AND HUMANITARIAN ISSUES 9-60 (Joseph W. Dellapenna & Patrick M. Norton eds., American Bar Association 2000) (detailing the significant legal reforms presently underway in the Chinese legal system).

¹¹⁴ *See generally* RALPH H. FOLSOM & JOHN H. MINAN, LAW IN THE PEOPLE'S REPUBLIC OF CHINA 169-241 (Ralph H. Folsom & John H. Minan eds., Martinus Nijhoff Publishers 1989).

¹¹⁵ *See* Brown & Rogers, *supra* note 92, at 333. *See generally* Zheng Zhaohuang, *On the Adjudicatory Jurisdiction of Chinese Courts over Foreign Investment Disputes*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 532-45 (Michael J. Moser ed., Oxford University Press 2nd ed. 1987) (discussing the role of Chinese courts in disputes involving foreign investment).

¹¹⁶ *See* Wang, *supra* note 45, §1.2.9 at 35-36; §1.2.13 at 45; §9.5 at 306-08.

¹¹⁷ *See id.* at 333-34. *See also* Graham, *supra* note 6, at 254-55.