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CIETAC: U.S. BUSINESSES CAUGHT IN DISPUTE BETWEEN TWO DISPUTE RESOLUTION FACTIONS

It is common for China-related commercial contracts involving one or more non-Chinese parties to include a provision requiring binding arbitration to resolve disputes; and it is increasingly common for such arbitration provisions to require that the arbitration be conducted under the auspices of the China International Economic and Trade Arbitration Commission ("CIETAC"). Indeed, CIETAC is the best known arbitration center in China for arbitrations involving a foreign element. It has sub-commissions in Beijing, Shanghai, Shenzhen as well as Tianjin and Chongqing but it was the sub-commissions in Shanghai and Shenzhen that have been the focus of attention since the middle of last year.

In 2012, the business community in China was shocked by the very public power struggle that erupted within CIETAC and, with still no end in sight to the dispute, U.S. businesses are caught in the middle.

Background of the Dispute

The conflict was triggered by the introduction of amended CIETAC Arbitration Rules ("Amended Rules") which came into force on May 1, 2012. The Amended Rules were meant to replace the pre-existing rules, adopted in 2005 ("2005 Rules"), that applied to all CIETAC sub-commissions. Most of the amendments are uncontroversial and merely bring CIETAC procedures more closely in line with international best practices. Article 2.6, on the other hand, requires all CIETAC arbitrations to be administered by CIETAC headquarters (in Beijing) unless the relevant arbitration clause explicitly stipulates a particular sub-commission.

Prior to this, under the 2005 Rules, whenever parties to a contract chose CIETAC arbitration, it was common practice for disputes concerning the contract to be resolved by CIETAC headquarters in Beijing or at any of its other sub-commissions and it was unnecessary for the arbitration clause to specify which sub-commission would conduct the arbitration proceedings. In practice, most CIETAC arbitration clauses do not specify a particular sub-commission.

This change in the rules was interpreted by the sub-commissions in Shanghai, Shenzhen and Tianjin as a grab for power and revenue. CIETAC Shanghai and the sub-commission in Shenzhen ("CIETAC South China") both responded by refusing to adopt the Amended Rules. On May 14, CIETAC Shanghai instituted its own rules ("Shanghai Rules") based on the 2005 Rules while CIETAC South China announced that it would continue to carry on using the 2005 Rules. CIETAC headquarters then announced that CIETAC Shanghai and CIETAC South China had forfeited their authority to accept and administer arbitration cases and, to drive the point home, headquarters declared that all parties that have agreed to arbitration in either of these sub-commissions must submit their disputes to CIETAC (Beijing) headquarters to ensure that the arbitration proceedings are conducted in accordance with the Amended Rules.

CIETAC Shanghai and CIETAC Shenzhen have since gone on a public relations offensive, disavowing any connection to CIETAC headquarters and warning parties that have agreed to arbitration in Shanghai and Shenzhen to submit disputes directly to CIETAC Shanghai or the CIETAC South China, respectively, instead of to CIETAC headquarters or to the new Shanghai or Shenzhen offices that CIETAC headquarters has established.

Since October 22, CIETAC South China has been referring to itself as both the "South China International Economic and Trade Arbitration Commission" and the "Shenzhen Court of International Arbitration."

2012 came to a close without any sign of reconciliation between the parties but with CIETAC headquarters having the last word. It announced – on December 28 – that the Shanghai and Shenzhen sub-commissions remain mere branch offices of CIETAC and all of their

actions taken to assert independence from CIETAC have no legal basis. This assertion flies in the face of fairly clear evidence that CIETAC Shanghai was established independently under the auspices of the Shanghai municipal government.

Needless to say, this state of affairs has led to confusion within the business community and raises serious questions about the authority that CIETAC Shanghai and CIETAC South China have to resolve disputes.

Impact on Arbitration

The current impasse means that there are now three sets of rules being held out to govern CIETAC arbitrations, depending on where parties choose to settle their disputes: the Amended Rules, the 2005 Rules and the Shanghai Rules. CIETAC's December 28 announcement disavowing the independence of CIETAC Shanghai and CIETAC South China did nothing to resolve the uncertainties that now surround CIETAC arbitration. Given that the business community looks to CIETAC to provide a stable and predictable framework for resolving contractual disputes in China, this uncertainty is alarming.

Until a higher authority within the PRC government intervenes and resolves the impasse, it is unclear how parties to an existing contract with a CIETAC clause should proceed if they have a dispute. The validity of any arbitration clauses choosing administration by either CIETAC Shanghai or CIETAC South China would be open to challenge by the parties. It is also unclear what will happen when an arbitration award made by either CIETAC Shanghai or CIETAC South China comes before a court for enforcement.

It seems clear that parties in any of these situations face significant risks, given the potential for costly debates over jurisdiction.

Recommendations

Pending the final resolution of this power struggle, we recommend the following:

A. Where the arbitration clause has not yet been agreed on

- For parties in foreign-related contracts that have the option of choosing arbitration offshore, it would be prudent to select a forum outside of mainland China.
- For parties that must choose arbitration within China, if they wish to submit disputes to CIETAC for arbitration they should expressly refer to the Amended Rules, that administration will be by CIETAC in Beijing, and also indicate where they want the seat of arbitration to be.
- Parties should avoid arbitration under the auspices of CIETAC Shanghai or CIETAC South China but the seat of arbitration can be in Shanghai or Shenzhen, as the case may be.

B. Where parties already have a CIETAC arbitration clause

- If the clause makes no mention of the place of arbitration or, if it calls for arbitration in Beijing, parties should submit their dispute to CIETAC in Beijing.
- If the clause calls for arbitration before CIETAC Shanghai or CIETAC South China, the parties should seek legal advice before proceeding with the arbitration. It may be possible to rectify this simply by entering into a supplemental agreement to submit future disputes to arbitration by CIETAC Beijing.
- All other parties to any contract containing a CIETAC clause would be wise to review their contracts and clarify, if necessary, the institution that they prefer to arbitrate their disputes.

Additional Information

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