International Review of Business Research Papers
Vol.5 No. 1 January 2009 Pp. 135-148

Australian and Chinese in Commercial Ventures China's Arbitration Legislation - Finding Solutions

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This paper considers aspects of the context of those trading relationships where there is a contractual partner in Australia and a contractual partner in China, in the milieu of the first decade of the millennium. The paper is alert to the different traditional foundations underpinning commercial ventures in Australia and China. Against this backdrop specific cases from the Hong Kong court are sourced for the light they throw on arbitration as a dispute resolution mechanism in commercial ventures. Chinese legislation relevant to commercial arbitration is considered. The paper commends China's arbitration legislation as a valuable dispute resolution mechanism in commercial ventures.

Field of Research: Business Law: Commercial dispute resolution, Consumer protection

1. Introduction

Partners enter international commercial ventures with optimism and the expectation that the undertaking will come to a successful conclusion. The planning of the venture requires considerable consultation between parties to ensure that there is genuine agreement on specific terms. If a venture is to be concluded to the mutual satisfaction of parties, nothing can be left to chance.

Arguably the commodity of time is the most important factor in ensuring that the objectives and outcomes of a commercial undertaking are achieved. The realities of the twenty-first century commercial world are such that the parties can rarely give sufficient time to consultation during the negotiation process. Consequently, commercial disputes can and do occur. However, the maintenance of amicability between individuals and corporations in nations as closely connected as Australia and China, is particularly important. Therefore, a mechanism is required whereby problems in commercial ventures can be appropriately addressed and solved. China's arbitration legislation is such a mechanism.

This paper focuses on the context of Australia and Chinese individuals and corporations in trading ventures. It seeks to identify some of the fundamental differences inherent in the traditional commercial foundations of both nations. It seeks to identify the contribution China's arbitration legislation offers to the management and resolution of problems in commercial ventures.

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2. Literature Review

The selection of cardinal arbitration legislation from the Peoples' Republic of China reveals the development of commercial arbitration in China.

The paper places emphasis on media reports produced by government and trading partners in Chinese-Australian commercial ventures. The reason for the extensive use of such reports as a primary source is that ephemeral publications present a window through which contemporary commerce can be viewed from a variety of perspectives. The particular value of contemporary ephemeral publications is that they are unmediated by the passage of time. Thus, they provide a cutting-edge perspective on issues. As well, the ephemeral publications are written by those involved in commercial ventures. Consequently, they offer a pragmatic view.

The selected Hong Kong Law Reports and academic commentary reveal the development of principles for the interpretation of arbitration clauses through judicial interpretation.

3. Methodology

The methodology is inferential deduction. This involves interpretation of the materials both individually and as a cohort.

The legislation itself is a major primary source for the paper and the literal or plain meaning rule is applied in its interpretation. In this approach, the assumption is that the meaning and intention of the legislature is clear in the words used in the statute.

The ephemeral materials are subjected to a contextual interpretation and aligned with commentary and other secondary sources.

Through contextual deduction and inference, the Hong Kong Law Reports disclose the development of legal principles important in the drafting of commercial arbitration clauses.

This qualitative methodology provides a contextual and interpretative investigation of China's commercial arbitration legislation.

4. Australians and Chinese in Business

Bourke & Wells

The rise of China as a major industrial global power1 is of vital significance to Australia. China has been a member of the World Trade Organisation(WTO) since 2001. Increasingly, China is adopting internationally recognised methods and procedures to improve the nation's investment environment and trade interaction.

One of these measures with particular relevance to Australia is the agreement reached by the leaders of both Australia and China to launch negotiations on a Free Trade Agreement(FTA)2 between Australia and China in April 2005. This agreement is no doubt based upon the two countries envisaging the mutual benefits it would provide, such as higher economic growth, more jobs and higher living standards3.

China is already experiencing increasing affluence, apparently based upon the economic reform which has lifted hundreds of millions of people out of poverty4. However, Ted C. Fishman(2006)5 posits that China's increasing affluence has created a new wave of poverty. Fishman(2006) explains that the enthusiasm and diligence of the rural population, with their village and town enterprises budding into industries, has caused the demise of the state-owned factories; the staggering statistics are that from 1978 to 2006 nearly forty thousand state-owned industries have been shut down, concomitant with 53 million people working in China's state sector losing their jobs between 1996 - 2006.

Another dimension of the impact of China's current industrial revolution is identified by John Garnaut and Maya Li(2007)7, with their estimation that 132 million people have left the rural areas of China to work in the cities in the last fifteen years. As a result there has been decay and decline of the traditional rural population base in China, and attendant social dislocation.

Aside from this change in China's rural population, Australia's trading relationship with China is apparent from facts such as China currently being Australia's second-largest merchandise export market, the fourth largest services market, and Australia's second-largest trading partner overall8. Australia's traditional rural-based exports to China of wool9, cotton10, beef 11 and dairy products12 have been joined by a new product, wine13, along with iron ore14 and liquefied natural gas15. Australia's services trade with China provided Australia with exports of $2.4 billion in 200516, these services including the areas of education, tourism, architecture, banking and legal services17.

While these are some of Australia's trade in goods and services with China, there is also an enormous trade with industries in Australia having product components manufactured in China. As well, increasing numbers of employees of Australian companies are being sent to branches of their company in China18.

Increasingly, therefore, Australians are contracting with people in China, both as individuals and as partners in corporate trading ventures. Thus it is essential that 'across the border' issues do not hamper Australia's trade with China.

5. Commercial Customs and Legal Principles

Perhaps 'across the border issues' can be best identified as the methods and customs adhering to business and commerce. The endowments of English common law include notions such as intention to create legal relations, capacity to contract, offer, counter-offer, acceptance, consideration; these are the customs and modes an Australian partner brings to a commercial venture with a Chinese partner.

But how much does that Australian partner know of the corresponding customs and modes of the Chinese partner? Is it not somewhat unrealistic and decidedly unilateral to expect the Chinese partner to know and adhere solely to the English common law principles of contract law? Surely it is important that the regulations19 already in place, together with the customs in China, be respected by Australians and viewed as integral to the marketing ethos in China.

It cannot be denied that the mode of doing business in China has evolved over many more centuries than Australia has been trading. A country with China's discrete provincial areas can be expected to demonstrate different interpretations of regulations at national and provincial levels. Similarly, a country with centuries of reliance upon provincial elders, as is the case with China, may be subject to what appear to the outsider to be sudden changes of interpretation of regulations.

Much can be done to overcome these 'across the border' issues through careful and painstaking attention to detail, and sensitivity to difference. One such measure is the utilization of interpreters and translators from the beginning of any project, in particular in early negotiations.

Case studies of specific companies in Australia-Chinese ventures provide valuable lessons in the successful minimization of across the border issues. For example, Woodhead International is a leading Australian architectural firm that has built a strong international reputation for airport and hotel design. Woodhead International has won tenders for the Hong Kong, Singapore and Beijing airports, among other projects20. This company has established a presence in China by locating its offices at Shanghai and Beijing and staffing them with both Chinese and expatriate Australian staff21. Woodhead International's Managing Director Geoffrey Lee encourages those who are considering establishing commercial links with China to remember that each province in China is akin to a separate country22.

Thus, the specifics of each province must be acknowledged and appropriately addressed. The traditional people of influence in each province must be identified and acknowledged. Appropriate dialogue must be established with these traditional elders in order to achieve success in the commercial venture.

Conducting business in unfamiliar territory presents challenges, according to Peter Osborne, Senior Trade Commissioner and Country Manager, China, for Austrade23, who cautions that the potential for misunderstandings to occur is high. Thus, business partners need to have in place, from the beginning of the venture, a suitable mechanism for the resolution of problems. Such a mechanism can result in timely steps being taken towards the resolution of a problem, should one occur.

6. Commercial Transactions and Consumer Protection

China can be seen to be increasingly sensitive about its reputation as a manufacturer, particularly in the light of the 2007 worldwide recall of *Mattel* toys after they were found to be potentially hazardous to young children24. While China rigorously demands that all manufacturers fulfil the appropriate certification requirements, Australian Customs closely monitor toy shipments for lead contamination25.

Similar embarrassment attaches to *Bindeez Beads*: named as the 2007 Toy of the Year and highly acclaimed by the Australian Toy Association26. Some of the beads have been found to contain an adhesive solvent named '1,4 butylene glycol'27 a chemical which converts into gamma-hydroxy butyrate,28 when eaten. Children in Australia have fallen unconscious after ingesting the beads29 and children in New Zealand and America have similarly fallen ill30.

Apparently '1,4 butylene glycol' did not appear on the initial *Bindeez* list of ingredients secured by the Australian medical team testing the beads after children who had eaten them fell ill31. China's safety watchdog has confirmed that the beads were supposed to be coated with non-toxic '1,5 pentanediol'32 a compound which is more expensive than '1,4 butylene glycol.' Subsequently, the export licence of the Wangqi Product Factory in Shenzen has been suspended33.

In the emotional response which attaches to any situation where a child is ill, the object of the *Bindeez* toy is overlooked: children were to use it by 'arranging small, multi-coloured beads coated with glue in shapes, then spraying them with water to fix them together'34. Such a task is well beyond the capacity of a 'two year-old', one of the children admitted to hospital in Sydney after swallowing the beads35.

Media reports of the issue omit important facts such as:

- the beads were not intended to be eaten;

- a toddler of two years should not have small beads for toys;
- carers have a responsibility to supervise children; and
- the age and developmental stage of a child are fundamental factors when adults select toys for children.

The result of the *Bindeez Beads* saga is *mal odour* for the Chinese manufacturing industry in general, rather than specifically for the Wangqi Product Factory, the maker of the product. As well, there has been absolute quiescence about the responsibility of child carers to provide appropriate toys for children and the need to supervise children at play.

The *Bindeez Bead* incident emphasizes, in particular, the need for Australian trading partners with China, including importers and distributors, to work together to maintain quality control of products, achieve consumer protection and maintain conscionability in trade between business partners in the two countries.

7. Commercial Dispute Resolution Options

Kui Hua Wang's (2005)36 concise and authoritative perspective of trade dispute resolution mechanisms in China shows these measures include consultation, negotiation, conciliation or mediation, arbitration and litigation37. While each of these methods is distinctive in its own right, it could be said that the remarks of His Honour Justice Stone concerning commercial litigation in *Trafigura Beheer BV Amsterdam v China Navigation Co Ltd and Harvest Fortune Shipping Ltd*38 apply as easily to consultation, negotiation, conciliation, mediation and arbitration: the prior preparation of an agreed list of issues to be ventilated during the action is essential.

In the *Trafigura* case39 an action was brought by the plaintiff for breach of contract, conversion and bailment. A copper cathodes cargo, shipped from Australia to China, was incorrectly delivered, without bills of lading. The action was first brought in 199840 and the delay in resolving the dispute may well have been fuelled by the disputant parties having failed to focus on specific aspects of their dispute before coming to court. Thus, full and detailed preparation of the matters in dispute is required before arriving at the court.

A critical distinguishing characteristic in Chinese business methodology is that traditionally, less formal methods of resolving disputes are preferred in China41. Consequently, the dispute resolution clause inserted in contracts between a party inside China with a party outside China, ought to veer away from the litigious to a more informal method. To overlook the insertion of such a clause in the trading contract disregards the warning issued by L. S. Ying (1998)42 that a major problem encountered by foreign investors with Chinese business partners, is the inability to maintain a harmonious and consensual working business relationship.

Conciliation and mediation can be seen as methods having the desirable elements of informality appropriate in dispute resolution between Chinese and foreign business people43. However, time is required to resolve disputes by conciliation and mediation. Unfortunately, the reality of the commercial world does not provide the luxury of time. Commercial ventures demand speedy and conclusive resolutions of differences in order to minimize loss in profitability. Consequently, foreign investors are increasingly inserting arbitration clauses in joint venture contracts with China, apparently in order to avoid loss of time and profits, reduce legal costs and preserve amicable business relationships44.

8. Arbitration and its Importance for Commerce in China

Recent cases before the Hong Kong Court are instructive in showing that the court upholds arbitration clauses in contracts. This fact, then, supports the inference that the Hong Kong Court has a high regard for arbitration; indeed it could well be further inferred that the court decisions reveal that the process of arbitration has an intrinsic and revered place in Chinese society.

The decision in *Choi Chuen Yau and Ano and Prudential Co Ltd* [2006] 3 HKLRD 160 shows that only in exceptional situations will the arbitration clause in a contract not be upheld by the Hong Kong court. In this case the plaintiff took out an insurance policy with the defendant for the plaintiff's business and properties. The insurance policy had an arbitration clause. A fire occurred, destroying the plaintiff's property and the defendant refused to pay on the plaintiff's claim. The plaintiff took the non-payment of the insurance policy to court. The defendant then sought a stay of proceedings because the plaintiff had gone to court instead of arbitration.

Their Honours Justices Woo V-P and Cheung, referred to the general rule that the court should give effect to an arbitration agreement, and court proceedings stayed in favour of arbitration, save in exceptional circumstances. The party objecting to arbitration bore the burden of satisfying the court that sufficient reasons existed for not going to arbitration.

In the case of allegations of fraud, the court followed the three-fold test set down in *Cunningham-Reid and Ano v Buchanan Jardine* [1988] 1 WLR 678, that is:

(i) there must be sufficient evidence of fraud;

(ii) the court does not normally accept fraud if it is the sole reason for the objection;

(iii) the court has regard to all the circumstances, such as whether a trial is more appropriate and whether the case involves public interest which goes against referring it to arbitration.

In this particular case, the court held that the three-fold test favoured the exercise of the discretion to refuse a stay. The relevant factors were that:

> (i) evidence supported the allegation of fraud;
> (ii) referring the matter to arbitration would entail transferring the case, ultimately causing delay and increasing costs for the plaintiff; and
> (iii) the issue of the conduct of an insurance company with consumers was a matter of such public interest that an open trial was desirable.

The distinctive nature of an arbitration clause in a contract is distinguished by their Honours Justices Yuen and Barma in *Grandeur Electrical Co Ltd v Cheung Construction Co Ltd* [2006] 3 HKLRD 535. In this case, a sub-contractor claimed the main contractor had breached a sub-contract by non-payment. His Honour Justice Yuan45 relied upon the UNCITRAL Model Art 7(1) and 8(1) definition of an arbitration agreement as:

> 'an agreement between parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.'

His Honour Justice Barma held that where an agreement provides a choice between arbitration and litigation in court, it is not an arbitration clause in the true meaning of the UNCITRAL model because of the option to go to litigation.

Given the reality of party autonomy in dispute resolution, a clause in a contract providing for disputes to be settled by arbitration should not readily be construed as providing a choice between litigation and arbitration, unless that choice is specifically spelled out, applying *Tommy CP Sze and Co v Li and Fung (Trading) Ltd* [2003] 1 HKC 418.

Interestingly, His Honour Justice Barma insisted that an arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement46. Thus, parties to a contract may well have a dispute resolution agreement in a document which is distinct and separate from their commercial contractual document.

What are the implications of separating the contract from the dispute resolution agreement? Such a method creates a dual system, with the contract taking precedence. The dispute resolution agreement only achieves ascendancy when the contract is in suspension because of breach or lack of *ad idem* of the parties. The aims of the commercial venture are paramount and the parties can maintain the optimistic focus essential for successful business ventures.

The possibility that something may go wrong is therefore attended to and can be referred to if necessary. However, optimism and buoyancy of the parties is not diminished in the contractual document by the foreshadowing of potential problems with a dispute resolution clause. As well, the partition of the dispute resolution mechanism into a separate covenant from the commercial contract

requires the parties to give specific thought and time to considering dispute resolution.

Clearly, then, these cases emphasise the current attitude of the Hong Kong court to an arbitration clause in a commercial contract. To be effective as an arbitration clause, it is essential for the contract to clearly and unequivocally state that arbitration is the method of dispute resolution. The court will only exercise its discretion to divert from such a definite statement of the parties' chosen method of dispute resolution if two specific criteria are met; these are that:

(i) in the circumstances, and based upon the evidence, fraud is an issue; and

(ii) the matter is such that it is in the public interest to go to public trial as distinct from having an *in camera* arbitration hearing.

9. China's Commercial Arbitration Legislation

Aside from the preference contractual parties may demonstrate for arbitration, and the upholding of this preference by the common law, there is also a legislative foundation encouraging arbitration. For example, two important laws governing foreign investment enterprises in China reveal an inclination towards arbitration: These are *The Law of the People's Republic of China on Sino-Foreign Cooperative Enterprises*(*Cooperative Ventures Law)* and *The Law of the People's Republic of China on Sino-Foreign Joint Equity Enterprises(Equity Joint Venture Law).*

The *Law of the People's Republic of China on Sino-Foreign Cooperative Enterprises*(*Cooperative Ventures Law)* was adopted by the National People's Congress on 13th April 1988 and became effective on the same date47. Its Article 26 requires the resolution of a dispute through arbitration or litigation if negotiation and conciliation
fail48.

The *Law of the People's Republic of China on Sino-Foreign Joint Equity Enterprises(Equity Joint Venture Law), was adopted on 1st July 1979 at the 2nd Session of the 5th National People's Congress and amended on 4th April 1990 at the 3rd Session of the 7th National People's Congress49,* Its Article 14 requires conciliation or arbitration if consultation fails50.

The *Equity Joint Venture Implementation Regulations* for Article 14 indicate that a joint venture contract must, together with other requirements, contain ways and procedures for settling disputes between the parties to the joint venture51. While the contents of Article 14 are included in the contract as an annexure, Kui Hua Wang(2005)52 maintains that under Article 14 the annexure to the contract of a joint venture is as authoritative as the contract itself.

With both the *Cooperative Ventures Law and Equity Joint Venture Law* requiring the parties to use less formal methods, such as consultation or negotiation before resorting either to arbitration or litigation, it can be inferred there is a specific custom underpinning China's commerce: it is an inherent optimism and valuing of the capacity of parties to resolve difficulties and differences through communication. Perhaps this optimism is a key to China's success in commerce and business.

Be that as it may, however, the scenario of parties not being able to resolve their problems is addressed with the mechanism of arbitration. The *Foreign Trade Arbitration Commission* within the *China Council for the Promotion of International Trade* was established by a Decision of the Government of China and adopted on 6th May 1954 at the 215th Session of the Government Administration Council53. The Foreign Trade Arbitration Commission was thus established54. By accepting 3292 international economic and trade cases between 1992 and 1997, and resolving 2793 of them55, the Foreign Trade Arbitration Commission established an enviable record of success.

Arbitration received a further legislative boost in the People's Republic of China in the *Arbitration Law* at the 9th Meeting of the Standing Committee of the Eighth National People's Republic on October 31, 1994. This law was promulgated by Decree No 31 of the President of the People's Republic of China on the same day56. This *Arbitration Law* formally adopted arbitration into China's corpus of legislation.

Another statute regulating arbitration in China is the *Code of Civil Procedure of the People's Republic of China*. Importantly, Chapter 28 of this *Code,* together with Articles 5 and 9 of the *Arbitration Law*, exclude the jurisdiction of Chinese courts where the parties have specifically agreed to arbitration as the means for resolution of problems57. These laws also protect the arbitration award as final except in so far as the award can be challenged under Article 260 of the *Code of Civil Procedure*. Hence status is accorded to the arbitration award through this legislation.

In matters where one of the parties is foreign to China, under Article 68 of the *Arbitration Law* and Item 2 of the *Notice Of the Office of the State Council on Clarification of Several Issues concerning the Implementation of the Arbitration Law of the PRC,* the Intermediate People's Court is the court to enforce the arbitration award.

Importantly, Article 259 of the *Code of Civil Procedure* is a solid block to jurisdictional double-dipping. It prohibits parties to an arbitration award made by a Chinese arbitration commission dealing with Sino-foreign disputes, from commencing legal proceedings over the same matter in a Chinese court. Thus, the finality of an arbitration decision is established by this legislation.

10. Conclusion

Clearly, then, arbitration can be seen as an important mechanism in dispute resolution in commercial ventures between partners in Australia and China. The two nations are in close proximity to each other and trading partnerships between them are of mutual value. The basis of dispute resolution can be seen as the ability to find solutions, and in commerce, dispute resolution is essential for the wheels of business to continue turning.

The valuable contribution made by the commercial arbitration legislation of the Peoples' Republic of China is not confined to stabilizing trading ventures between Australians and Chinese; it contributes a means of appropriately addressing problems in commercial ventures *per se*.

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55 Xinhau News Agency,'CCPIT (China Council for the Promotion of International Trade)improves its service' Beijing, 18 April 1998, Article Item No. 0418076,
56 CIETAC, http://www.cietac.org.cn/english/laws/laws_5.htm @1 visited 18/8/2007
57 This exclusion of the jurisdiction of the courts of China is also guaranteed under Article 257 of the *Code of Civil Procedure* in Sino-foreign economic, transportation or maritime disputes where there is agreement to submit to arbitration.