

# **New opportunity of Arbitration for multinational companies in China<sup>1</sup>**

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## **ABSTRACT**

As there is more and more international business in China, a dispute is inevitable to happen because of unfamiliar with local law and culture. It is important to choose an appropriate dispute resolution. With the absence of right resolution, there would lead to big cost, wasting time and even, breaking the business relationship. So far, many companies solve the dispute through arbitration. Nevertheless, it is inefficient to a certain extent. This paper answers why inefficient arbitration is in China. With the application of the MADM method, it suggests an alternative solution of mediation-arbitration hybrids which ultimate the efficiency of arbitration, ensuring the fairness and maintaining the business relationship. This recommendation considers the benefit of both parties.

**Key words:** ADR, dispute in China, multinational business dispute, arbitration, hybrids resolution, opportunity>

## **1. INTRODUCTION**

Over the past few years, China has been one of the fastest developing countries. It has a great impact on the economics of all countries around the world. Plus, with the announcement of “The Belt and Road initiative” recently, there will be more and more business opportunity in China. However, when a foreign company does business in China, it is inevitable to meet dispute problems because of the unfamiliar of country laws and cultural awareness. According to the Arcadis global construction disputes report, we knew that dispute issues were increasing globally on both the cost of time and money. If a dispute takes a long time and is costly to solve, it is not efficient for business development neither benefit.

There is four main type of Alternative dispute resolution (ADR) in China: negotiation, mediation, arbitration, and litigation. If taking consideration of time, cost, fairness, relationship and privacy, each ADR presents different advantages according to various cases. However, as international companies need more concern about power balance, relationship and privacy

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aspects. In these points, arbitration shows its advantage. It has formal procedures that can keep the privacy of parties but less time and cost than litigation. It successfully maintains the business relationship with the participation of third parties. Mediation seems appropriate as well, but its informal procedures may lead a power imbalance between parties. Therefore, most of the international companies prefer to use arbitration.

Although arbitration is a quite good choice and is widely used, it still takes a longer time to solve disputes than mediation and negotiation. Even, in some cases, it may be too complicated to do reasonably. From a business benefit perspective of both parties, it is important to know which is a better way to solve dispute issue and which mechanism is more efficient and benefits for both parties.

To summarize, this paper has been undertaken to answer the following question,

- 1) The reasons for why arbitration is inefficient;
- 2) The new opportunities for arbitration to improve efficiency

## **2. METHODOLOGY**

In this section, it will show the existing resolutions in China through a Radar chart in order to see the positive and negative point of each ADR. Then, it is going to explain the situation as well as defining the problem of arbitration. After providing three alternative solutions, they will be analyzed with the DOMINANCE Method of Multi-attribute decision making (MADA). Dominance method is commonly used while a problem occurs subjective attributes. After the comparison, it will provide one or more resolutions which can improve the efficiency of dispute resolution while using arbitration.

### **2.1 ADR in China**

Since the phenomenon of “litigation explosion” in the United States, Alternative Dispute Resolution (ADR) has been created as a third-party mediation mechanism as well as widely used in many fields and countries, such as Australia and the United Kingdom.

Generally, ADR processes are prevention, negotiation, standing neutral (dispute board), non-binding resolution (mediation), private binding resolution (arbitration) and litigation.

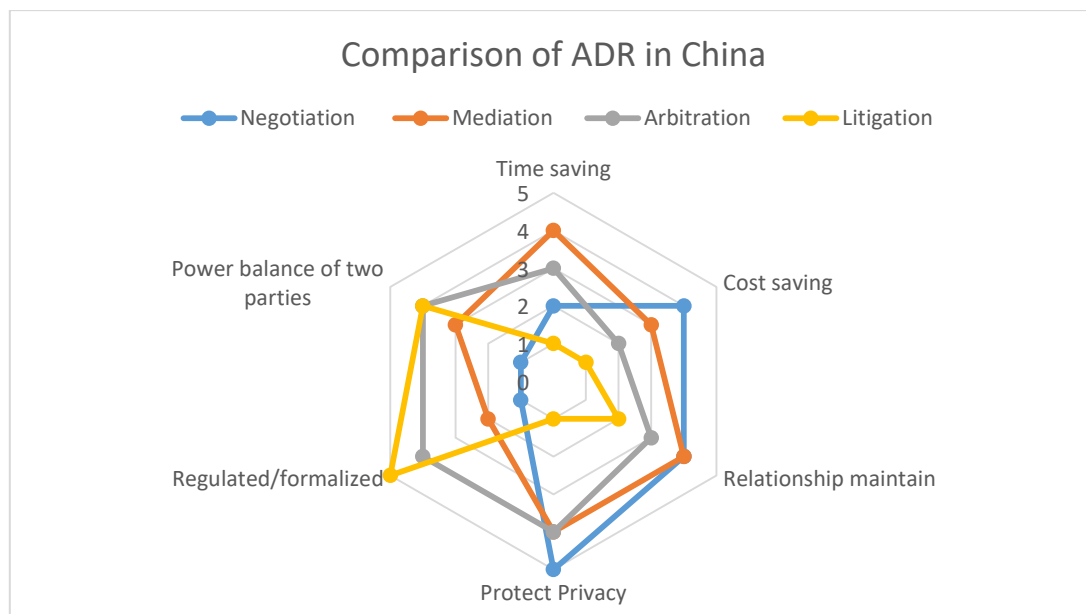
However, because of the differences between the cultural and legal systems, there is no dispute board in China. The most common ADR in China are as 1) Negotiation, 2) Mediation, 3) Arbitration, 4) Litigation.

Based on the article of The Choice of Different Commercial Dispute Resolution Methods<sup>2</sup>, we listed the following factors as comparison criteria. Then, according to the report of DISPUTE

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<sup>2</sup> (LI, 2014)

RESOLUTION AND GOVERNING LAW CLAUSES IN CHINA-RELATED COMMERCIAL CONTRACTS<sup>3</sup> and the report of New Development of ADR in China<sup>4</sup>, the Radar chart compared the four types of ADR in China. From 1 to 5 shows the degree from negative to positive.



Through the chart above we can easily see that,

- Negotiation (Blue) which the parties communicate directly is strong to protect privacy and maintain the relationship. But there is power distance issue and usually, negotiation is not easy to go smoothly.
- Mediation (Red) is done by the third party. It is useful for saving time thanks to the informal process.
- Litigation (Yellow) is the last scenario to go if we have another choice. It takes both long time and great cost. And it does no benefit for a relationship.
- Arbitration (Grey) is done by institutions that process is more formal than mediation. It allows to protect privacy and ensure the power balance of both parties.

It seems arbitration and mediation would be good choices. However, looking back to the long cultural background of China, it has a profound influence on the development of ADR of China. Chinese people prefer to resolve disputes in a less formal and non-confrontational way which refers to a cultural tradition of comity. People rely on judicial procedures to solve problems. Therefore, arbitration has become the most common for disputes resolution, especially for multinational business.

<sup>3</sup> (Herbert Smith Freehills, 2016)

<sup>4</sup> (Yanming, 2010)

## **2.2 Problem definition**

Companies mostly choose arbitration. It is more efficient than litigation but still takes a long time to process.

So, why does arbitration take a long time to process?

### **1) The ambiguous agreement about dispute resolutions**

When signing a contract, many companies may consider the agreement of dispute resolution, but they somehow neglect a lot of details or do not mention the choice of arbitration institutions or the arbitration institutions not fit for them. They may also not choose dispute resolution provisions in an appropriate manner. Those result in prolongation or invalidation of the arbitration agreement and even leading to litigation.

### **2) Incomplete arbitration system in China**

China's arbitration system is still under continuous improvement. For the objection of jurisdiction, the composition of the arbitration tribunal, the procedures for expressing opinions, submitting documents and evidence etc. each institution has its own rules. It is easy to lead procedural abuse. In fact, many of the rules of the institution are incomplete and not rigorous. Abuse of proceedings in arbitration not only leads to delays and sabotage of arbitration, but also tends to result in an increase in the costs and expenses of arbitration as well as a weakening of arbitration's advantages.

### **3) The incomplete government regulation**

The absent or imperfection of laws and regulations of the country increases both the difficulty of determining and disagreeing a judgment in the arbitration process which results in prolonging the arbitration timeframe. According to the China International Commercial Arbitration Report 2016, arbitration disputes about intellectual property rights are the least among all the classification of cases in 2015. It does not mean that China has no intellectual property disputes. The fact is that China has a severe problem of intellectual property right. The main issues affecting the development of intellectual property arbitration in the country include the incomplete legislation of intellectual property, incompletes of ad hoc arbitration which lead to slow down the process of resolution of disputes.

## **2.2 The feasible alternatives and outcome**

Option 1- Hybrids dispute resolution: Mediation-Arbitration hybrids

Using the combination of mediation and arbitration to overcome the limitation of arbitration itself and to form a more flexible, efficient dispute settlement method.

Option 2- Use mediation instead of arbitration

As the analysis above, less formal procedures, less cost, mediation is also an ideal alternative for solving disputes. It can maintain the relationship of both parties.

**Option 3- Expedited arbitration and Ad hoc arbitration**

Comparing with general arbitration, the expedited procedure for arbitration has relatively short deadlines, a more straightforward composition of the tribunal.

**2.3 Alternative comparison**

To stay with the same criteria as mentioned before, now it will use DOMINANCE method to compare those alternative solutions. The degree is decided by reviewing the respective conditions and clauses of mediation-arbitration, mediation, expedited arbitration and ad hoc arbitration in China which are from Beijing International Arbitration Center (BIAC)<sup>5</sup>, Hong Kong international arbitration center (HKIAC)<sup>6</sup>, the report of The Establishment of China's expedited Arbitration System<sup>7</sup>. A further explanation will be given in the following section.

Attributes	Med-Ard vs Mediation	Mediation vs E/A Arbitration	E/A Arbitration vs Med-Ard
Time saving	Worse	Better	Better
Cost saving	Worse	Equal	Better
Relationship maintain	Equal	Better	Equal
Protect Privacy	Better	Worse	Equal
Regulated/formalized	Better	Worse	Better
Power balance of two parties	Better	Worse	Equal
Dominance	Better	No	Maybe

**FINDINGS**

In this section, we analysis the result from the table above and decide the best alternative solution. First of all, it is better to know about the characteristics and differentiate each alternative.

Mediation-arbitration hybrid keeps the advantage of both ADRs. It aims to use mediation and arbitration methods in a single two-step process to provide the parties with ultimate effectiveness and efficiency in dispute resolution. The parties shall first start the arbitration or mediation proceedings. During the process, the same arbitrator shall mediate the case. The case would be resumed with arbitration, if the parties fail to make any mediation or after the successful mediation. Because the mediation agreement does not have legal validity. The

<sup>5</sup> (BIAC, 2015)  
<sup>6</sup> (HKIAC, 2017)  
<sup>7</sup> (ZHANG, 2017)

advantage of this mechanism ensures the judicial power, formalized procedures, and business relationship while cutting down the cost and time.

Then, how about Mediation? Although the rules of mediation are somehow a bit different amongst institution, the advantages of the method are same. In accordance with the regulation of the HKIAC, "After the mediator has been appointed, ... must be made to conclude the mediation within 42 days. Unless all parties to the dispute have agreed in writing, the term of office shall not be extended for more than three months."<sup>8</sup> If we look at the mediation price list of China Council for the Promotion of International Trade (CCPIT), it costs from 05%-6% of the total disputed amount. It shows that mediation is significant efficient and low cost. Nonetheless, if the mediation is successful, there will be a contractual agreement between the parties. In our current judicial system, mediation agreements do not have the force of enforcement.

Expedited arbitration is a simplification arbitration with a limited condition which only adapts for cases with a disputed amount under 1000k Yuan (about 150k dollars) in China and 25000k (3000k dollars) in Hong Kong. The decision must be provided within 75 days.

Ad hoc arbitration means "the arbitration is entirely arranged by the arbitrators and the parties. The parties themselves must conceive and advance the arbitration proceedings under the jurisdiction of the arbitral tribunal. Parties may choose to use ready-made arbitration rules (such as UNCITRAL Arbitration Rules) or customize a set of rules for a particular case."<sup>9</sup> It shows this type of arbitration is entirely flexible and adaptable. However, ad hoc arbitration is accepted with limited condition and there is not yet legislation about it in the Arbitration Law in China. The parties can choose to apply Hong Kong or other foreign arbitration institutions.

### **3.1 Best solution and recommendation**

We can found that the best and more universal solution may be mediation-arbitration hybrids.

Mediation seems good. But, as an international company, the informal procedure may 1) bring a worse situation to the result; 2) have a possibility of power imbalance between parties. Also, the agreement has no enforcement. Considering multinational business are usually with large dispute amount which is not suitable for the expedited arbitration method. Finally, the ad hoc arbitration is not recognized in China mainland. Although companies can choose institutions outside China, it increases the complexity of dispute procedure or even, the decision would not be accepted by Chinese legislation.

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<sup>8</sup> (HKIAC, 1999)

<sup>9</sup> (HKIAC, 2017)

## CONCLUSIONS

To conclude, this paper has discussed and answered the following question,

- 1) The reasons of inefficient of arbitration;
- 2) The new opportunities of arbitration to improve efficiency

It firstly mentioned the existing four ADR mechanism in China and (dis)advantages of each. Then, it found out the fact that international companies prefer to use arbitration. With going down to explore the reasons of arbitration inefficiency, we found that ambiguous agreement about dispute resolutions, incomplete arbitration system and government regulation lead the prolongation and more complicated.

In order to improve the efficiency, the paper provides three alternatives solution which is Mediation-arbitration hybrids, mediation and expedited and ad hoc arbitration. It also provided an analysis based on their terms and different characteristics.

In the end, we strongly suggest international companies use mediation-arbitration hybrids method as first consideration of dispute resolution. This recommendation did concern about the time, cost, relationship maintaining, power balance (fairness) of both owners and contractors' perspective.

## FOLLOW ON RESEARCH

After the study, I found that dispute resolution is not mature and still need to develop on both the legislation of law and the clauses of arbitration intuitions. There are so many local intuitions which are not professional enough to judge fairly. How to govern the regulations of all arbitration centers? How to improve the legislation system to support the dispute resolution? Those questions are related and expected to do further study.

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