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## Commercial Dispute Settlement in China-United States Trade: Conciliation in Perspective

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# Commercial Dispute Settlement in China-United States Trade: Conciliation in Perspective

Denis Woychuk

## **Abstract**

This Note analyzes the Chinese approach to commercial dispute settlement in the context of international contracts. Part I examines article VIII, the dispute settlement portion of the Trade Agreement, and the Chinese procedures for private dispute settlement. Part II discusses the problems of legal uncertainty that exist in the Chinese approach and the prospect of emerging Chinese law. Part III discusses the current importance of conciliation in Chinese dispute settlement, presents a case study of an actual joint conciliation conducted in China, and evaluates the results.

# COMMERCIAL DISPUTE SETTLEMENT IN CHINA-UNITED STATES TRADE: CONCILIATION IN PERSPECTIVE

## INTRODUCTION

With a quarter of the world's population,<sup>1</sup> the People's Republic of China is potentially the United States' most significant new trade partner of the century.<sup>2</sup> The dramatic increase in the volume of annual bilateral trade between the United States and China from near zero in 1970 to almost five billion United States dollars ten years later<sup>3</sup> appears to be the beginning of an expanding commer-

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1. A widely accepted estimate is that China has approximately one billion people. See OFFICE OF TECHNOLOGY ASSESSMENT, CONGRESS OF THE UNITED STATES, *WORLD POPULATION AND FERTILITY PLANNING TECHNOLOGIES: THE NEXT 20 YEARS 200* (1982); see also *China, Pop. 1,008,175,288: One-Fourth of the World*, N.Y. Times, Oct. 28, 1982, at A1, col. 5; Wren, *China Counts Its Quarter of the World's Noses*, N.Y. Times, July 6, 1982, at A1, col. 4; Nixon, *10 Years After the Visit to China*, N.Y. Times, Feb. 28, 1982, at E19, col. 1.

2. See *The New Era in East Asia: Hearings Before the Subcomm. on Asian and Pacific Affairs of the House Comm. on Foreign Affairs*, 97th Cong., 1st Sess. 235 (1981) (statement of David S. Tappan, Chairman of the Board of Directors of the National Council for United States-China Trade) [hereinafter cited as *Hearings*]. However, it should be noted that the one billion potential customers of China are very poor customers indeed. Jan S. Prybyla, Professor of Economics at Pennsylvania State University and a specialist on the economy of the People's Republic of China, discusses the present reality in China today:

1. the per capita gross national product of China is on the order of \$400-450 but very likely less;

2. the average yearly industrial wage (modern industry) is approximately \$360;

3. the bulk of the peasantry makes about 20¢ per person per day from collective endeavor;

4. the Chinese authorities admit that ten percent of the population (100 million people) do not have enough to eat (other reports speak of 200 million peasants being in a condition of acute privation);

5. per capita grain production today is the same as it was twenty years ago;

6. annual foreign trade turnover is less than \$20 a head; and

7. the \$1 billion current trade with the United States represents one-third of one percent of total U.S. trade.

Prybyla, *Comments*, 5 INT'L TRADE L.J. 45, 46 (1979). But see Berney, *China's Growing Consumer Market*, CHINA BUS. REV., Mar.-Apr. 1981, at 18 (indicating the rapid expansion of China's market for ready-made consumer goods); *Rising Purchasing Power*, BEIJING REV., Sept. 6, 1982, at 7 (indicating the rising purchasing power of Chinese households).

3. G. HOLLIDAY & J. HARDT, CHINA-U.S. TRADE ISSUE BRIEF 3 (Library of Cong., Cong. Research Service—Major Issues Sys., Brief No. IB75085, Dec. 15, 1975, updated May 1, 1981). In 1981 total United States-China trade is estimated to have exceeded U.S.\$5,600,000,000. *China Data*, CHINA BUS. REV., Jan.-Feb. 1982, at 67, 69.

cial partnership.<sup>4</sup> If the United States can increase its share of the Chinese market to twenty percent,<sup>5</sup> the value of trade with China could increase to an amount between ten and sixteen billion dollars by 1990.<sup>6</sup>

China is already a significant participant in United States international trade. After Japan and South Korea,<sup>7</sup> China is the United States' third largest Asian customer,<sup>8</sup> and the potential for future growth is great.<sup>9</sup> For the first time in its long history, China

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4. See *infra* note 9, which indicates the complementary natures of the United States and Chinese economies.

5. In 1980, the United States share of the Chinese market was only about 12%. *Hearings, supra* note 2, at 198 (prepared statement of David S. Tappan). In comparison, the Japanese share was about 25%. *Id.*

Both Japan's and the United States' share of the Chinese market is estimated to have dropped in 1981 despite a larger volume of trade with China by both countries (as measured in United States dollars). See *China Data*, CHINA BUS. REV., Jan.-Feb. 1982, at 67, 69. This evidences China's increasingly active role in world trade. A further indication of the continued expansion of China's foreign economic and trade relations is the growing number of trade agreements and economic cooperation agreements with other countries. Between 1970 and 1980 about 140 such agreements were signed, 50 of which were signed from 1978 to 1980. Ren Jianxin, *China's Foreign Economic and Trade Law—Work Is Progressing* 4 (Jan. 1981) (unpublished) (on file at the *Fordham International Law Journal* Office) (Mr. Ren is Director, Legal Affairs Department, China Council for the Promotion of International Trade).

6. *Hearings, supra* note 2, at 209 (prepared statement of Mary Ames Wadsworth, Area Vice-President, People's Republic of China, Allis-Chalmers Corp.).

7. *Id.* at 198 (prepared statement of David S. Tappan).

8. *Id.* at 193 (statement of Congressman Stephen J. Solarz, Chairman of the House Subcomm. of Asian and Pacific Affairs).

9. See *id.* at 208 (prepared statement of Mary Ames Wadsworth). "China is rich in energy resources, and the U.S., while needing resources, is highly advanced in the technological skills and means of resource exploitation." *Id.* China is fourth in the world in energy production, Clarke, *Commercial Implication of Normalization*, 5 INT'L TRADE L.J. 93, 97 (1979), and greatly in need of Western technology. Dole, *Comments*, 5 INT'L TRADE L.J. 60, 61 (1979). See also Wang, *The People's Republic of China—Industrial Power with a Strong Mineral Base*, in HOW TO DO BUSINESS WITH CHINA 325-39 (1979) (discussion of oil and gas resources).

By 1979, petroleum had become China's leading export to the United States. Mathews, *Petroleum Becomes Peking's Top Export to U.S.*, Wash. Post, Aug. 27, 1979, at 23, col. 1. China exports approximately 300,000 barrels of oil a day, which earned U.S. \$4 billion in foreign exchange last year. Farnsworth, *China Starts to Play Its Oil Card*, N.Y. Times, Sept. 5, 1982, at F4, col. 3. However, some experts predict that China will become a net importer of oil in the future. *Id.* China intends to further develop its oil resources and is interested in American business participation. *Id.* See generally Wren, *China Energy: Chance for U.S.*, N.Y. Times, Oct. 14, 1982, at D1, col. 3 (discussing potential for American business). During 1979 and 1980, American oil exploration companies conducted seismic surveys in the South China Sea and thereby won the right to bid for the development of China's offshore oil resources. Woodard & Goodwin, *Supplying Offshore Services*, CHINA BUS. REV., Mar.-Apr. 1982, at 9. The surveys cost the companies an estimated \$200 million and were free to the Chinese. *Id.* Bids have also been made for exploration rights in the Yellow Sea. *Offshore Bids*

is actively encouraging foreign investment.<sup>10</sup> To help smooth the way for increased trade relations, the United States and China signed the Agreement on Trade Relations Between the United States of America and the People's Republic of China (Trade Agreement) in 1979.<sup>11</sup>

The Trade Agreement includes a provision for the resolution of contract disputes<sup>12</sup> which in effect incorporates the Chinese ap-

*Under Review*, CHINA TRADE REP., Sept. 1982, at 11. Contracts for development should be signed by mid-1983; all exploration costs will be borne by the foreign companies. Green, *Offshore Business*, CHINA BUS. REV., May-June 1982, at 17. The terms of the model contract issued by the Chinese emphasizes China's determination to be in control of the undertaking and to expand its own capabilities to conduct future offshore operations. Brown, *Tough Terms for Offshore Oil*, CHINA BUS. REV., July-Aug. 1982, at 34. The total cost of exploration for the areas of the first round of bidding is estimated to be between \$2 billion and \$3 billion. *Id.* at 35. See generally Note, *Legal Aspects of Sino-American Oil Exploration in the South China Sea*, 14 J. INT'L L. & ECON. 443 (1980).

Furthermore, "China has a wealth of human capital, and America has much to offer in economic management and organizational skills." *Hearings*, *supra* note 2, at 208 (prepared statement of Mary Ames Wadsworth). American management skills are being taught by American professors to Chinese technocrats at the Dalian Institute of Technology, Dalian, China. The Dalian program is considered the "most successful ingredient of the Chinese-American protocol on scientific and technical cooperation." Wren, *Chinese Get Latest Word on U.S. Management Skills*, N.Y. Times, Aug. 17, 1982, at A6, col. 1. This program costs the United States about \$160,000 a year. *Id.* See also Reed, *Student Exchange: Far East Meets Midwest*, N.Y. Times, Aug. 22, 1982, § 12, at 43.

In some respects United States and Chinese business ideologies are growing closer, with China "embracing capitalist-style incentives . . ." Nixon, *supra* note 1, at E19, col. 6. China is now encouraging domestic private enterprise. See *Help Wanted—China Fights Unemployment*, TIME, Dec. 7, 1981, at 60; Wren, *China, To Relieve Unemployment, Gives Private Sector More Leeway*, N.Y. Times, Nov. 24, 1981, at A1, col. 1. By offering labor-intensive means of production for cooperative ventures with the Chinese, the United States may help alleviate China's unemployment problem. See *Hearings*, *supra* note 2, at 203 (statement of Mary Ames Wadsworth).

10. Cohen, *The Year of the Law*, in A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 139, 142-43 (H. Holtzmann & W. Surrey eds. 1979). See *supra* note 9. Within China itself "Special Economic Zones" are being developed for the purposes of promoting foreign trade and improving foreign trade management." Ellis, *Decentralization of China's Foreign Trade Structures*, 11 GA. J. INT'L & COMP. L. 285 (1981).

11. Agreement on Trade Relations, July 7, 1979, United States-People's Republic of China, 31 U.S.T. 4651, T.I.A.S. No. 9630 [hereinafter cited as Trade Agreement].

Until May, 1979, the free flow of trade between the United States and China was impeded by the unresolved Sino-American assets-claim issue, but that issue was resolved by the Agreement Concerning the Settlement of Claims, May 11, 1979, United States-People's Republic of China, 30 U.S.T. 1957, T.I.A.S. No. 9306. See Comment, *The Blocked Chinese Assets—United States Claims Problem: The Lump-Sum Settlement Solution*, 3 *FORDHAM INT'L L.F.* 51 (1979) for a discussion thereof.

12. Trade Agreement, *supra* note 11, art. VIII. Article VIII reads as follows:

1. The Contracting Parties encourage the prompt and equitable settlement of any disputes arising from or in relation to contracts between their respective firms,

proach to commercial dispute settlement.<sup>13</sup> It encourages parties to a dispute to resolve their differences through "friendly consultations, conciliation or other mutually acceptable means."<sup>14</sup> Should these means prove ineffective, the Trade Agreement provides for recourse to arbitration.<sup>15</sup> The Chinese, however, are reluctant to go to arbitration, even in China, and prefer friendly consultation and

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companies and corporations, and trading organizations, through friendly consultations, conciliation or other mutually acceptable means.

2. If such disputes cannot be settled promptly by any one of the above-mentioned means, the parties to the dispute may have recourse to arbitration for settlement in accordance with provisions specified in their contracts or other agreements to submit to arbitration. Such arbitration may be conducted by an arbitration institution in the United States of America, the People's Republic of China, or a third country. The arbitration rules of procedure of the relevant arbitration institution are applicable, and the arbitration rules of the United Nations Commission on International Trade Law recommended by the United Nations, or other international arbitration rules, may also be used where acceptable to the parties to the dispute and to the arbitration institution.

3. Each Contracting Party shall seek to ensure that arbitration awards are recognized and enforced by their competent authorities where enforcement is sought, in accordance with applicable laws and regulations.

13. Surrey & Soble, *United States Law and Treaties Affecting China Trade*, in A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 13, 28 (H. Holtzmann & W. Surrey eds. 1979).

14. Trade Agreement, *supra* note 11, art. VIII, para. 1.

15. *Id.* para. 2. The Trade Agreement does not demand that arbitration proceedings take place in China, nor does it require that parties submit to such proceedings according to Chinese rules. *See id.* However, the Chinese are reluctant to submit their disputes to foreign arbitration panels and in their contracts or other agreements with the foreign party may refuse to provide for arbitration outside of China. Theroux, *Arbitration in China? You May Need a Chinese Lawyer*, CHINA BUS. REV., May-June 1982, at 38. "More and more contracts provide for arbitration to be conducted in China." Ren, *supra* note 5, at 8. However, there is evidence that the Chinese have become less hostile to arbitration in neutral settings (third countries). Yeow, *Arbitration*, CHINA BUS. REV., Nov.-Dec. 1981, at 48. *See also* Comment, *An Evaluation of the People's Republic of China's Participation in International Commercial Arbitration: Pragmatic Prospectus*, 12 CAL. W. INT'L L.J. 128, 137 (1982) which attests to China's acceptance of "Western-style" international arbitration.

More than half of all United States-China trade contracts contain clauses which specify arbitration in third countries. Yeow, *supra*. The Chinese may include such clauses to meet the demands of their trading partners. *Id.* at 49. A problem that may arise with some contracts results from the lack of a clearly defined "trigger mechanism" which starts the arbitration process. Without an effective "trigger mechanism," either party to a dispute may resist arbitration by claiming that an amicable solution can still be found. *Id.* at 50. Furthermore, some contracts call for arbitration in China if the Chinese party is the defendant, and in a third country only if it is not. *Id.* at 49. *See also* Ren, *supra* note 5, at 8 (indicating approval of providing for arbitration in the defendant's country). In such a case, should the defendant be Chinese, the foreign party may not be permitted to have other than Chinese legal representation. Theroux, *supra*, at 39. *See also infra* notes 36-41, 79-81 and accompanying text.

conciliation as means for settling disputes.<sup>16</sup> It is therefore important for the American businessman to understand how the Chinese mechanisms for dispute resolution function.

The Chinese approach to commercial practices in general, and to methods of resolving contract disputes in particular, are unfamiliar and, in many ways, fundamentally different from those used in the West. The Chinese avoid going to court, especially over commercial matters.<sup>17</sup> Their methods of settling commercial disputes are among the most informal in the world.<sup>18</sup> "[T]hey have abolished the opportunity for adversaries in a dispute to squander their energies and fortunes in legal combat in a court of law,"<sup>19</sup> a noteworthy achievement. However, a definite dispute resolution procedure that gives confidence to the trader or transnational investor does not exist.

This Note analyzes the Chinese approach to commercial dispute settlement in the context of international contracts. Part I examines article VIII, the dispute settlement portion of the Trade Agreement, and the Chinese procedures for private dispute settlement. Part II discusses the problems of legal uncertainty that exist in the Chinese approach and the prospect of emerging Chinese law. Part III discusses the current importance of conciliation in Chinese

16. Lubman, *Trade Between the United States and the People's Republic of China: Practice, Policy, and Law*, 8 LAW & POL'Y INT'L BUS. 1, 45 (1976). See Yeow, *supra* note 15, at 49. See also *infra* notes 36-43, 75-80 and accompanying text.

17. See *infra* notes 36-40 and accompanying text. Economic courts have recently been established—more than one thousand since 1980. Allen & Palay, *Economic Courts*, CHINA BUS. REV., Nov.-Dec. 1981, at 44. They are empowered to dispose of economic and trade disputes involving a foreign party. *Id.* "Foreign litigants who want to have attorneys to act for them to protect their rights and interests must appoint lawyers of Chinese nationality." Ren, *supra* note 5, at 7. In China, lawyers represent the facts, not the client, and will refuse to represent a client believed to be "incorrect"; furthermore, on appeal, according to Chinese law, lawyers who believe that the lower court ruling was proper "must remain silent." Allen & Palay, *supra*, at 48. However, Chinese courts of law do not take jurisdiction over foreign trade disputes where an arbitration agreement is in force. See *infra* note 43. See also Pattison, *China's Developing Legal Framework for Foreign Investment: Experience & Expectations*, 13 LAW & POL'Y INT'L BUS. 89, 138-41 (1981) (discussion of the economic courts).

The United States Justice Department has decided to permit the Chinese to sue in American courts. This is based on its finding that legal reciprocity now exists between the United States and China. Lewin, *U.S. Allows China to Sue It*, N.Y. Times, Nov. 2, 1982, at D9, col. 4.

18. See *infra* notes 38-45 and accompanying text for a discussion of the Chinese resolve to avoid legal formalities.

19. NATIONAL COUNCIL FOR UNITED STATES-CHINA TRADE, SPECIAL REPORT NO. 4, ARBITRATION AND DISPUTE SETTLEMENT IN TRADE WITH CHINA 4 (1974) [hereinafter cited as SPECIAL REPORT].

dispute settlement, presents a case study of an actual joint conciliation conducted in China, and evaluates the results.

### I. PRIVATE DISPUTE SETTLEMENT: THE TRADE AGREEMENT AND THE CHINESE APPROACH

The encouragement of settling international disputes by private settlement mechanisms is becoming the norm in United States agreements with socialist countries,<sup>20</sup> and arbitration clauses currently are standard practice in contracts between Western corporations and socialist foreign trade organizations.<sup>21</sup> Arbitration<sup>22</sup> has

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20. Aksen, *Dispute Settlement Under U.S.-China Trade Agreement*, N.Y.L.J., Aug. 9, 1979, at 1, col. 1.

Agreements with Romania and Hungary, for example, contain provisions in which the governments recommend arbitration of disputes arising from international commercial transactions. Section 2 of article VIII of the April 2, 1975 Trade Agreement with Romania provides:

*The Parties encourage the adoption of arbitration for the settlement of disputes arising out of international commercial transactions* concluded between firms, companies and economic organizations of the United States of America and those of the Socialist Republic of Romania. Such arbitration should be provided for by provisions in contracts between such firms, companies and economic organizations, or in separate agreements between them in writing executed in the form required for such contracts. Such agreements (a) should provide for arbitration under the rules of arbitration of the International Chamber of Commerce in Paris; and (b) should specify as the place of arbitration a place in a country other than the United States of America or the Socialist Republic of Romania that is a party to the Convention for the Recognition and Enforcement of Foreign Arbitral Awards of New York on June 10, 1958; however, firms, companies and economic organizations party to a contract may agree upon any other form or place of arbitration.

Agreement on Trade Relations, Apr. 2, 1975, United States-Romania, 26 U.S.T. 2305, T.I.A.S. No. 8159 (emphasis added) (footnote omitted).

Article VIII of the March 17, 1978 Trade Agreement with Hungary provides:

1. The Parties encourage the prompt and equitable settlement of commercial disputes between their firms, enterprises and companies.

2. Both Parties endorse the adoption of arbitration for the settlement of such disputes not otherwise amicably resolved. *The Parties encourage their respective firms, enterprises and companies to provide in their contracts for arbitration under internationally recognized arbitration rules.* Such agreements may specify a place of arbitration in a country other than the Hungarian People's Republic or the United States of America that is a Party to the 1958 Convention for the Recognition and Enforcement of Foreign Arbitral Awards. Parties to the contract may provide for any other place or rules of arbitration.

Agreement on Trade Relations, Mar. 17, 1978, United States-Hungary, 29 U.S.T. 2711, T.I.A.S. No. 8967 (emphasis added).

21. Holtzmann, *Arbitration in East-West Trade*, 9 INT'L LAW. 77, 77 (1975). In fact, virtually all international contracts contain arbitration clauses for the settlement of disputes between the parties. Guide on Drawing Up Contracts for Large Industrial Works, U.N. Doc. No. ECE/TRADE/117, at 30, U.N. Sales No. E.73.II.E.13 (1973).

22. Arbitration may be defined as a voluntary agreement by parties to a contract that disputes arising out of the contract or in connection therewith will be settled by one or more



been preferred by Western businessmen in order to avoid the uncertainties and complications associated with litigation in foreign courts.<sup>23</sup> Furthermore, because arbitration proceedings generally do not result in published opinions,<sup>24</sup> they preserve the confidentiality of commercial arrangements.<sup>25</sup>

arbitrators rather than by litigation in the courts. Holtzmann, *supra* note 21, at 77.

23. The significant advantages of arbitration over litigation can be summarized as follows:

- a) Since arbitrators are normally chosen directly by the parties, they enjoy their confidence.
- b) For the same reason, they may be particularly competent for the settlement of a certain dispute.
- c) In international contract cases, the arbitrators may be of different nationalities, and more specifically they—or one of them—may be of a nationality other than those of the parties.
- d) The parties may choose any place they like as the place of the arbitration.
- e) The parties may, within the limits of the public policy of the country where the arbitration is being held, adopt whatsoever rules of procedure they like and select the language in which the arbitration is to be conducted.
- f) The procedure is therefore much more flexible, and thus normally faster, than court procedure.
- g) The arbitration award is normally final and immediately binding upon the parties, and only subject to being set aside for one of several specific reasons.
- h) Recognition and enforcement of arbitration awards are, as a consequence of existing international conventions widely ratified, easier than recognition and enforcement of court judgements.

Berlingieri, *International Maritime Arbitration*, 10 J. MAR. L. & COM. 199, 199-200 (1979).

24. See, e.g., INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 291, RULES OF CONCILIATION AND ARBITRATION OF THE ICC art. 23(2) (1975) [hereinafter cited as ICC RULES]. In the United States, arbitration may be chosen because it usually *precludes* review of any sort. "[T]he AAA [American Arbitration Association] apparently discourages the practice of written arbitral opinions in order to insulate the arbitral process from any judicial review." *I/S Stavborg v. National Metal Converters, Inc.*, 500 F.2d 424, 429 (2d Cir. 1974) (footnote omitted). In China, arbitral awards are explained in writing, and open hearings are encouraged; the purpose of open hearings is to educate bystanders as well as disputants. Holtzmann, *A New Look at Resolving Disputes in U.S.-China Trade*, in *A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA* 235, 329 (H. Holtzmann & W. Surrey eds. 1979).

25. The Chinese system for dispute resolution offers similar advantages and disadvantages to Western arbitration proceedings. The difficulty of assessing the fairness of arbitration awards and other settlements because of the unavailability of reports thereon, SPECIAL REPORT, *supra* note 19, at 15-16, creates the advantage of preserving the confidentiality of the commercial arrangements of the parties. See *supra* notes 20-24 and accompanying text. See generally 1-5 J. WETTER, *THE INTERNATIONAL ARBITRATION PROCESS: PUBLIC AND PRIVATE* (1979) (extensive treatment of the subject). Because arbitration is less formal and less divisive than court proceedings, it provides a means for resolving disputes in a manner more likely to preserve good will between the parties. Thus arbitration is to be preferred especially where the parties are committed to maintaining a harmonious relationship. Stevenson, *An Introduction to ICC Arbitration*, 14 J. INT'L L. & ECON. 381, 381 (1980).

The existence of a comprehensive commercial law does not necessarily mean that such a law will control in an arbitration proceeding. "In the United States the arbitrators are not

The Trade Agreement encourages private settlement of international contract disputes through the use of several novel provisions.<sup>26</sup> Included are: pre-arbitral procedures<sup>27</sup> not found in previous trade agreements;<sup>28</sup> the possibility of new arrangements;<sup>29</sup> a broad definition of disputes covered;<sup>30</sup> greater emphasis on institutional arbitration;<sup>31</sup> direct reference to a set of recognized interna-

required to strictly apply the law and are not even required to give reasons." Berlingieri, *supra* note 23, at 216. "[T]he extent of an arbitrator's obligation to explain his award is necessarily related to the scope of judicial review of it." *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1214 (2d Cir. 1972). See generally Sweeney, *Judicial Review of Arbitral Proceedings*, 5 FORDHAM INT'L L.J. 253 (1982).

Foreign investors have voiced concern about the tendency to issue compromise awards of International Chamber of Commerce (ICC) arbitrators, Stevenson, *supra*, at 390, as well as Chinese arbitrators, in cases where one party is entitled to complete victory. Of the Chinese, one renowned practitioner writes: "[T]here is some evidence to suggest that the [foreign] seller will have to yield even when he is convinced that the Chinese claim is groundless or exaggerated, in order to preserve the air of compromise." Lubman, *Legal, Financial and Practical Aspects of Trade with the People's Republic of China*, 1973 PRIV. INV. ABROAD 111, 141. See also, e.g., Diary kept by Donald B. Straus, President of Research Institute of the American Arbitration Association, of Second Trip to People's Republic of China, October 9-23, 1977, at 58 (unpublished) (available at the AAA Library in New York with Mr. Straus' permission) [hereinafter cited as Diary II], where in the course of negotiating a settlement, the Chinese conciliator suggested that the calculations reached (to determine the extent of liability) be cut in half. However, another author suggests that Westerners misperceive the Chinese desire for harmony as a readiness to compromise. H. KIM, FUNDAMENTAL LEGAL CONCEPTS OF CHINA AND THE WEST 118 (1981).

Wilfred Feinberg, Chief Judge of the United States Court of Appeals for the Second Circuit, writes:

Arbitrators [in general] are, after all, dependent on the good will of their employers for their livelihood, even if the work is only part-time, and so there may be a nagging pressure to avoid making either party more unhappy than necessary, to look for the easy solution rather than the correct one.

Feinberg, *Maritime Arbitration and the Federal Courts*, 5 FORDHAM INT'L L.J. 245, 248 (1982). The risk of judicial vacation of an arbitral award is minimized when an award opinion is not published. *Id.* at 249.

26. Aksen, *supra* note 20, at 1, col. 1.

27. Trade Agreement, *supra* note 11, art. VIII, para. 1 ("friendly consultations, conciliation").

28. Aksen, *supra* note 20, at 1, col. 1.

29. Trade Agreement, *supra* note 11, art. VIII, para. 1 ("or other mutually acceptable means"). Other mutually acceptable means have included joint conciliation and joint handling. Ren, *supra* note 5, at 9. An agreement to use joint conciliation for dispute settlement was reached in 1980 between the Bureau of Industrial Property of France and the China Council for the Promotion of International Trade. *Id.* Joint conciliation has been successfully conducted in China by China's Foreign Economic and Trade Arbitration (FETAC). See *infra* Part III of this Note for a detailed account.

30. See Trade Agreement, *supra* note 11, art. VIII, para. 1.

31. *Id.* para. 2.

tional arbitration rules;<sup>32</sup> and government aid in obtaining legal enforcement of international awards.<sup>33</sup> What is striking about the Trade Agreement is that the provisions relating to dispute resolution are not limited to arbitration. Included are "friendly consultations, conciliation or other mutually acceptable means."<sup>34</sup> These terms are absent from the trade agreements between the United States and other countries.<sup>35</sup> The Chinese have a clearly stated preference for friendly negotiation<sup>36</sup> or conciliation;<sup>37</sup> both procedures are less formal than arbitration.

What appears to be typical of the Chinese approach is the proclivity to avoid legal formalities of any kind.<sup>38</sup> The Chinese

32. *Id.*

33. *Id.* para. 3. However, despite reference thereto in art. VIII, para. 2, it should be noted that unlike the United States, China is not a signatory to the United Nations Convention for the Recognition and Enforcement of Foreign Arbitral Awards, *opened for signature* June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38. It was acceded to by the United States on September 30, 1970, and incorporated into domestic law in 9 U.S.C. §§ 201-208 (1976). "China . . . is unwilling to entrust dispute resolution to an international body; it favors bilateral negotiations between the parties." Li, *Sovereignty at Sea: China and the Law of the Sea Conference*, 15 *STAN. J. INT'L STUD.*, 225, 235-36 (1979). Because China is not a signatory to the United Nations Convention for the Recognition and Enforcement of Foreign Arbitral Awards, *supra*, China is not necessarily bound to enforce such awards as a matter of international law. Surrey & Soble, *supra* note 13, at 32. Whether the United States is bound by the terms of the Trade Agreement regarding the enforceability of arbitral awards when the Chinese may not be, is, given the current state of affairs, ambiguous. *Id.* It might be wise for the parties negotiating contracts with China to include a provision about the enforcement of arbitral awards in their contracts and joint venture agreements. *Id.*

34. Trade Agreement, *supra* note 11, art. VIII, para. 1.

35. *See, e.g.*, United States-Hungary Agreement on Trade Relations, *supra* note 20.

36. *See* Jen & Liu, *People's Republic of China*, 3 *Y.B. COM. ARB.* 153, 153 (P. Sanders ed. 1978). Because friendly negotiation is, in effect, private discussions between parties to a dispute, reports thereof are generally unavailable.

37. *See Trade with China*, 65 *A.B.A. J.* 1063, 1065 (1979). *See infra* notes 108-12 and accompanying text for a discussion of conciliation in China today. It should be noted that the encouragement of conciliatory settlements is not uniquely Chinese. For example, the International Chamber of Commerce has also encouraged conciliation as an option to arbitration. *See, e.g.*, ICC RULES, *supra* note 24, arts. 1-5.

38. *See* McCobb, *Foreign Trade Arbitration in the People's Republic of China*, 5 *N.Y.U. J. INT'L L. & POL.* 205, 206-08 (1972).

Chinese reluctance to engage in legal formality is indicated by an unwillingness to exchange formally memoranda of a tentative agreement to have a joint conciliation between the American Arbitration Association (AAA) and the Foreign Trade Arbitration Commission of China. *Diary II, supra* note 25, at 3. A successful joint conciliation did take place, but when a settlement was finally reached, the Chinese refused to sign a statement of settlement terms, insisting that such formality was unnecessary. *Id.* at 108. The Chinese were reluctant to sign and are generally reluctant to put things in writing because the individual Chinese bureaucrat is less exposed to recriminations from the Chinese bureaucracy when writings are

resort to arbitration<sup>39</sup> procedures only when less formal methods fail to reach an acceptable settlement.<sup>40</sup> As a result, the vast majority of disputes in China never reach the arbitration stage. Over ninety percent of the cases in which Chinese international arbitral institutions participate are settled by friendly consultation or conciliation.<sup>41</sup> About ten to fifteen percent of the settlements come

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unavailable. Personal communication by Donald B. Straus, author of *Diary II*, to the author of this Note (Sept., 1982). The American party and the AAA agreed that signing was unnecessary because it was felt that insistence on signing would be damaging to future joint conciliations. *Id.* For a more complete synopsis of this joint conciliation, see *infra* Part III of this Note.

However, despite their aversion to formalistic mechanisms for resolving disputes, the Chinese have earned a reputation as strict constructionists of the controlling provisions of commercial contracts. Surrey & Soble, *supra* note 13, at 32.

"So strict is Chinese insistence on adherence to the contract that several European manufacturers have been known to encounter Chinese complaints or even refusal to accept the goods when they shipped at no added cost pieces of machinery that were newer models than those actually specified in the contract." Lubman, *supra* note 25, at 138. "Requiring very strict compliance with contract specifications . . . is commonly found in all bureaucracies whose officials wish to avoid being blamed for purchasing or accepting defective foreign goods." Lubman, *supra* note 16, at 6. Because the Chinese have this "strict constructionist" attitude toward contracts, the United States Department of Commerce urges businesspeople to press for inclusion of all terms. INDUSTRY & TRADE AD., U.S. DEP'T OF COM., STOCK NO. 003-009-00316-4, DOING BUSINESS WITH CHINA 12 (1979), reprinted in HOW TO DO BUSINESS WITH CHINA 215 (1979) [hereinafter cited as DOING BUSINESS]. "Grave uncertainty exists . . . as to the law governing circumstances outside the four corners of the document." Hudspeth, *The Nature and Protection of Economic Interests in the People's Republic of China*, 46 ALB. L. REV. 691, 699 (1982). "Contract law . . . remains the vaguest area of China's civil economic law." Kato, *Civil and Economic Law in the People's Republic of China*, 30 AM. J. COMP. L. 429, 449 (1982). See generally Hsiao, *Role of Economic Contracts in Communist China*, 53 CAL. L. REV. 1029 (1965). However, in most cases the American businessman will find that negotiating the terms of his choice is not an easy matter. See *infra* notes 77-81 and accompanying text for a discussion thereof.

39. Arbitration is more formal than either friendly negotiation or conciliation; less formal, of course, than litigation.

40. Lubman, *supra* note 16, at 45. "Many host developing countries have reservations about international arbitration." United Nations Economic & Social Council, Commission on Transnational Corporations, *Transnational Corporations in World Development: A Re-examination*, U.N. Doc. E/C.10/38, para. 404 (1978) ("Latin American States have traditionally opposed international arbitration as a derogation from their sovereignty . . ." *Id.*) "[A]t its current state of economic development, China is a developing country." Trade Agreement, *supra* note 11, art. II, para. 3.

41. Holtzmann, *supra* note 24, at 255, 346 n.23. This figure may appear high to Americans, but settlement of large numbers of cases before an arbitral award is made is not uniquely Chinese. Approximately 50% of the cases handled by the ICC are settled before an award is made. *Id.* at 255. Approximately 40% of the cases handled by the AAA are so settled, with a like percentage reported for the Foreign Trade Arbitration Commission of the U.S.S.R. *Id.* Japan reports an even higher percentage of settlements before awards were issued than China. For example, during the first half of 1974, out of 1,497 cases received by

after the conciliators make non-binding recommendations.<sup>42</sup> Arbitration is thus merely an auxiliary process to friendly consultation and conciliation.<sup>43</sup>

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the Japan Commercial Arbitration Association, only five were settled by arbitration. *Japan-China Trade Agreement Concluded*, Q. JAPAN COM. ARB. A., Apr.-Sept. 1974, at 8. Consultation was effectively used to reach a settlement in 1,119 of those cases; adjustment on the complaint was used in 373 cases; conciliation was not used. *Id.* In comparison, during that same year, of the over one hundred commercial and maritime disputes submitted for arbitration in China, all but twelve were settled by friendly negotiation. AAA Visit to FTAC of the People's Republic of China, January 16-28, 1975, from notes taken by Donald B. Straus, at 32 (unpublished) (available at the AAA Library in New York with Mr. Straus' permission) [hereinafter cited as *Diary I*]. Of the twelve that reached the conciliation stage, only one went to arbitration. *Id.* See also G. HSIAO, *FOREIGN TRADE OF CHINA: POLICY, LAW AND PRACTICE* 156-57 (1977).

42. Holtzmann, *supra* note 24, at 255, 346 n.23.

43. See *Trade Agreement*, *supra* note 11, art. VIII, para. 2. Despite the dearth of cases which go to arbitration and the likelihood that most disputes be resolved "amicably," the availability of an effective procedure for arbitration can be vital. Its availability can provide a strong impetus to compel serious attempts to settle disputes by informal means and can also safeguard against unacceptable delay in friendly consultation and conciliation. Furthermore, an effective arbitration clause becomes indispensable should the dispute remain unresolved by friendly consultation and conciliation. Holtzmann, *supra* note 24, at 322. See *supra* note 15 for discussion of arbitration in China.

One major advantage that the Chinese report is their ability to reach a settlement in considerably less time than their Western counterparts. *Diary I*, *supra* note 41, at 68. The average time for friendly negotiations in China was reported to be six months, and for arbitration, twelve months. *Id.* This compares favorably with ICC arbitration proceedings, which generally last at least eighteen months, and sometimes as long as five years. Goekjian, *ICC Arbitration from a Practitioner's Perspective*, 14 J. INT'L L. & ECON. 407, 430 (1980) (figures for the fiscal year 1977). Litigation in the United States is, on the whole, a slower process than the Chinese mechanism for resolving disputes, and resembles in timing the ICC arbitration procedure. For example, according to a 1980 report, a civil trial in a federal district court took an overall average time of twenty months. ADMINISTRATIVE OFFICE OF THE U.S. COURTS, ANN. REP. OF THE DIRECTOR 393 (1980). See *id.* at 393-96 for detailed tables showing times required by United States District Courts to dispose of civil cases.

However, there are reports which indicate that Chinese contentions of quick settlement are inaccurate, and that in the past many economic disputes could not be settled quickly by using informal means. Allen & Palay, *supra* note 17, at 45. This led to the creation of economic courts. *Id.* No foreign company has yet appeared in an economic court. *Id.* at 48. See *supra* note 17 for a discussion of the newly created economic courts.

"The Chinese courts of law do not seize cases of foreign trade and maritime disputes where an arbitration agreement is in force." Jen & Liu, *supra* note 36, at 156. The same could be said of American courts. In *Scherck v. Alberto Culver*, the Supreme Court held that "the agreement of the parties in this case to arbitrate any dispute arising out of their international commercial transaction is to be respected and enforced by the federal courts in accord with explicit provisions of the Arbitration Act." 417 U.S. 506, 519-20 (1974). See also *Federal Arbitration Act*, 9 U.S.C. §§ 1-208 (1976). This legislation initially was enacted in 1925. Act of February 12, 1925, Pub. L. No. 68-401, 43 Stat. 883 (1925). Its constitutionality was unsuccessfully challenged in *Marine Transit Corp. v. Dreyfuss*, 284 U.S. 263 (1932).

The preference for informal dispute resolution is not limited to the Chinese.<sup>44</sup> This approach is compatible with the American preference for avoiding commercial litigation in countries such as China, where relatively little is known about the practice and procedure of a legal system so fundamentally different from that of the United States.<sup>45</sup> Nonetheless, an effective understanding of the meaning of and the relationship among friendly consultation, conciliation and arbitration is crucial.

Typically, friendly consultation is the first step in resolving a dispute and is expected to continue even if the parties begin conciliation, or even arbitration.<sup>46</sup> Conciliation, while generally preceding arbitration, may likewise take place while arbitration is in progress.<sup>47</sup> Thus, the Chinese approach is not composed of distinct and separated processes occurring in rigid sequence, but in fact is a flexible system of procedures which may or may not be employed concurrently.<sup>48</sup>

### A. Friendly Consultation

Friendly consultation<sup>49</sup> is the attempt to settle a dispute through discussion and correspondence by the parties themselves.<sup>50</sup> It can be compared to pre-trial negotiation between litigating par-

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It has been suggested that arbitration clauses are included in contracts solely to avoid the jurisdiction of foreign courts, and that the Chinese have no actual intention to go to arbitration. Note, *Foreign Investment in the People's Republic of China: Compensation Trade, Joint Ventures, Industrial Property Protection and Dispute Settlement*, 10 GA. J. INT'L & COMP. L. 233, 260 (1980). See Henderson & Matsuo, *Trade with Japan*, in LAW AND POLITICS IN CHINA'S FOREIGN TRADE 54 (V. Li ed. 1977).

44. See Lohr, *Tokyo Air Crash: Why the Japanese Do Not Sue*, N.Y. Times, March 10, 1982, A1, at D5, col. 3. "The lack of litigiousness in Japan is often cited as an economic advantage. The Japanese, it is said, do not spend much time, money or energy suing each other but, instead, concentrate on outproducing other nations." *Id.* See also Holtzmann, *Use of Impartial Technical Experts to Resolve Engineering and Other Technological Disputes Before Arbitration*, in COMMERCIAL ARBITRATION: ESSAYS IN MEMORIAM EUGENIO MINOLI 233 (1974).

45. Holtzmann, *supra* note 24, at 246.

46. *Id.* at 247.

47. *Id.* at 247-48. "Arbitration and conciliation are interrelated and complementary to one another. They are not antagonistic and do not exclude each other." Jen & Liu, *supra* note 36, at 155.

48. Holtzmann, *supra* note 24, at 247.

49. "Consultation" is sometimes used synonymously with "negotiation." See *id.* at 248.

50. *Id.* at 249.

ties followed by a settlement out of court, a process with which American lawyers are familiar.<sup>51</sup> The Chinese tendency is toward maintaining friendly relationships.<sup>52</sup> "In traditional Chinese society, law often was equated with coercion . . . ."<sup>53</sup> A failure to resolve commercial disputes through negotiation and compromise implies that the disputants may not be honorable or reasonable men.<sup>54</sup>

The Chinese prefer to negotiate a settlement in terms of future business dealings and are reluctant to make cash payments in settlements.<sup>55</sup> In this way, continuing business relationships are not only encouraged, but assured; thus, a dispute can give rise to additional commerce between the parties according to the terms set forth by the settlement reached.<sup>56</sup> "Friendly" relations are preserved.

The unique aspect of friendly consultation in modern commercial disputes is the practice of third party assistance at the request of the disputants.<sup>57</sup> In China this assistance may be administered by the Foreign Economic and Trade Arbitration Commission (FETAC)<sup>58</sup> or the Maritime Arbitration Commission (MAC).<sup>59</sup> The

51. It should be noted that the use of extensive formal legal briefs is not part of the Chinese approach. *See, e.g., id.* at 299-300.

52. Li, *Reflections on the Current Drive Toward Greater Legislation in China*, in *A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA*, 81, 87 (H. Holtzmann & W. Surrey eds. 1979). "You do not do business again with a partner who has sued you in the court. Do you?" Hsiao, *Communist China's Foreign Trade Contracts and Means of Settling Disputes*, 22 *VAND. L. REV.* 503, 512 (1969) (statement attributed to Chinese General Chamber of Commerce trade representative).

53. Li, *supra* note 52, at 85.

54. *Id.* at 86.

55. *See* Diary II, *supra* note 25, at 77.

56. For example, if a settlement is reached whereby the injured party will receive a ten percent discount on the million dollars worth of future purchases, he must continue to purchase in order to take advantage of the discount.

57. Holtzmann, *supra* note 24, at 249.

58. To indicate the broadened scope of disputes of which it will take cognizance, the Foreign Trade Arbitration Commission (FTAC) was renamed the Foreign Economic and Trade Arbitration Commission (FETAC) in February, 1980. Excerpt from speech by Shen Shiao-ming to the American Arbitration Association's Corporate Counsel Committee Meeting (Nov. 12, 1981) at 5. This Note uses the term FETAC.

59. Holtzmann, *supra* note 24, at 249.

FTAC was established in 1956, and MAC, in 1958. Disputes arising from contracts and transactions in foreign trade are within their jurisdiction. The basis of the treatment of disputes is founded on the principle of equality of the parties, irrespective of the size of the countries they come from and the amount of capital they possess. These commissions adhere to the rule that "both contracting parties should observe contracts faithfully and honour their

process of friendly consultation thereby encompasses the attempt to settle the dispute by the parties themselves and a process in which they are assisted by a third party.

### B. Conciliation

It is difficult to determine the point at which friendly consultation conducted with the assistance of third parties ends and the process of conciliation begins.<sup>60</sup> The Trade Agreement defines neither term.<sup>61</sup> However, there is a distinction: “[C]onciliation begins when one or more third parties are designated as conciliators and embark on a process of assisting the parties to gather facts and analyze their dispute in a deeper and more systematic way than generally occurs in friendly consultation.”<sup>62</sup> Unlike arbitration—where the arbitrator’s decision is final and binding<sup>63</sup>—the parties to a dispute are free to adopt or reject the proposal of the third party.<sup>64</sup>

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promises,” Jen & Liu, *supra* note 36, at 154, and are resolutely opposed to national egoism, in making use of arbitration to favor the party of their own nationality. *Id.* at 153-55.

When ascertaining the rights and obligations of the contracting parties, the FTAC and the MAC also have to refer to those reasonable international practices which have formed themselves in a long period of time in world trade and are favourable to the development of international trade and marine transport. In short, in handling cases, the FTAC and the MAC not only abide by the Chinese laws, observe the provisions of the contracts signed by the parties, but also pay due regard to the international practice. Combining these three elements organically, they are able to solve problems in a fair, reasonable and truth-seeking way.

In concrete work, the FTAC and the MAC adopt the method of combining arbitration with conciliation . . . . An arbitral award is made . . . only where the dispute cannot be settled through conciliation. Experience proves that most of the cases seized by the FTAC and the MAC can be settled by conciliation in the course of investigation or examination, prior to the arbitration proceedings or before an award is granted. This is welcomed by both of the disputing parties, Chinese and foreign. The FTAC and the MAC put emphasis on investigation and study. When handling cases, they not only examine statements of facts from the disputing parties, but also listen to the views of other persons concerned, and make investigations on the market or on the spot whenever necessary and possible, which enables them to draw a clear line between the right and the wrong, to ascertain liability, to be fair and reasonable and truth-seeking.

*Id.* at 154.

60. Holtzmann, *supra* note 24, at 249.

61. See Trade Agreement, *supra* note 11, art. VIII, para. 1.

62. Holtzmann, *supra* note 24, at 250.

63. “An arbitration award once made has the force of law . . . .” Jen & Liu, *supra* note 36, at 159.

64. “Conciliation . . . does not lead to any binding judgements or demands on the disputing parties.” Shen, *supra* note 58, at 4. However one commentator suggests that the



As a means of dispute settlement, conciliation is favored by the Chinese because it is more conducive to continuing friendship and trade relations<sup>65</sup> than is arbitration. However, contrary to a belief that appears prevalent in the West, the Chinese may not be opposed to arbitration.<sup>66</sup> The Chinese do not consider a request for arbitration an unfriendly act,<sup>67</sup> provided that a serious effort to settle the case through friendly negotiations and conciliation has been made.<sup>68</sup> The Chinese do not consider arbitration and conciliation to be mutually exclusive or antagonistic, but rather, complementary processes that may be carried on concurrently.<sup>69</sup>

The participation of arbitrators in the process of conciliation is not unique to the Chinese. Its acceptance in the West is confirmed by the Code of Ethics for Arbitrators in Commercial Disputes,<sup>70</sup> which states:

It is not improper for an arbitrator to suggest to the parties that they discuss the possibility of settlement of the case. However, an arbitrator should not be present or otherwise participate in the settlement discussions *unless requested to do so by all parties*. An arbitrator *should not exert pressure on any party to settle*.<sup>71</sup>

As occurs in friendly negotiations with the assistance of third parties, the role of the conciliator in trade disputes in China is

compulsion to conciliate is so great that the nature of conciliation is not voluntary at all. McCobb, *supra* note 38, at 207. "Indeed, mediators are praised for seeking out and settling disputes even before the parties have decided upon mediation." *Id.* One author suggests that the non-binding recommendation process is but an extension of friendly negotiation and makes no mention of conciliation. See Note, *An Analysis of Chinese Contractual Policy and Practice*, 27 WAYNE L. REV. 1229, 1248 (1981).

65. Jen & Liu, *supra* note 36, at 155.

66. See Liu Y., *Foreign Trade and Maritime Arbitration* 9 (1976) (unpublished manuscript) (available in the American Arbitration Association Library in New York). *But see supra* note 16 and accompanying text.

67. *Id.* "We do not think a request for arbitration outside of China is 'unfriendly.'" Diary I, *supra* note 41, at 65 (remark attributed to Jen, Secretary General of F[E]TAC). *But see* SPECIAL REPORT, *supra* note 19, at 19 (reporting that the Chinese regard insistence on arbitration as unfriendly or evidence of bad faith).

68. Diary II, *supra* note 25, at 2. Thus the contention of some that the Chinese regard insistence on arbitration as unfriendly or evidence of bad faith, SPECIAL REPORT, *supra* note 19, at 19, is perhaps only valid when a serious effort to settle through friendly negotiation or conciliation has *not* been made. See also *supra* note 15.

69. Jen & Liu, *supra* note 36, at 155.

70. CODE OF ETHICS FOR ARBITRATORS IN COMMERCIAL DISPUTES (1977) (prepared by the American Arbitration Association in conjunction with the American Bar Association).

71. *Id.* Canon IV, H (emphasis added). *But see infra* note 139 (UNCITRAL Conciliation Rules, article 19).

generally played by FETAC. It is also possible that a corresponding conciliatory institution of the foreign party's choice can function with FETAC in a process called joint conciliation.<sup>72</sup> Joint conciliation is not intended to supersede any existing contractual provisions.<sup>73</sup> Furthermore, a failure to reach a settlement does not constitute submission by the parties to the jurisdiction of the conciliatory bodies for arbitration purposes.<sup>74</sup>

### C. Arbitration

Should the "friendlier" means of resolving disputes fail, arbitration, China's procedure of last resort,<sup>75</sup> may be initiated.<sup>76</sup> The Trade Agreement provides "recourse to arbitration for settlement in accordance with provisions specified in their contracts or other agreements to submit to arbitration."<sup>77</sup> The parties may agree on arbitration in China, the United States, or a third country,<sup>78</sup> but there is no requirement that the Chinese consent to arbitration outside of China in any particular contract. The Trade Agreement merely states that such an agreement is valid. Generally, the Chinese are reluctant to agree to arbitration anywhere other than China,<sup>79</sup> and some commentators contend that the likelihood of

72. Shen, *supra* note 58, at 3-4; Ren, *supra* note 5, at 9. For an account of a joint conciliation conducted between American and Chinese parties, see *infra* Part III of this Note.

73. Diary II, *supra* note 25, at 103-04. See also Holtzmann, *supra* note 24, at 290.

74. Holtzmann, *supra* note 24, at 290.

75. See SPECIAL REPORT, *supra* note 19, at 15, 17, 19; Lubman, *supra* note 16, at 46.

"[A]ctual arbitration procedure in China should not be one of the Western businessman's prime concerns." Article, *Dispute Settlement in China*, 4 A.S.I.L.S. INT'L L.J. 71, 88 (1980). But see Comment, *China, Modernization, and Sino-United States Trade: Will China Submit to Arbitration?*, 10 CAL. W. INT'L L. J. 53 (1980), where the author contends, based on an historical analysis, that China's views on arbitration are changing.

An effective arbitration clause can prevent courts from obtaining jurisdiction over a dispute. See *supra* note 43.

76. Holtzmann, *supra* note 24, at 253. See also *supra* note 15.

77. Trade Agreement, *supra* note 11, art. VIII, para. 2.

78. *Id.*

79. Note, *supra* note 43, at 268. "Chinese negotiators typically will insist that arbitration take place in Beijing." Yeow, *supra* note 15, at 49. The Chinese wonder why a dispute should be settled in a third country. Diary II, *supra* note 25, at 49. However, they might be willing to have some cases arbitrated in the United States or third countries in order to gain experience with the various ways of settling disputes. *Id.* See also *supra* note 15 and accompanying text.

The Chinese are extremely able negotiators. See Jenkins, *Dealing with the Chinese*, 5 INT'L TRADE L.J. 27, 29 (1979). See also Brown, *supra* note 9, at 35-37, for a discussion of

third-country arbitrations is minimal.<sup>80</sup> The details of dispute resolution remain open for negotiation on an ad hoc basis, subject to the provisions of the contract.<sup>81</sup>

The Trade Agreement also emphasizes the use of the arbitration rules of FETAC,<sup>82</sup> MAC, the American Arbitration Association (AAA), the United Nations Commission on International Trade Law (UNCITRAL), or other internationally recognized rules.<sup>83</sup> This emphasis on institutional arbitration, in view of general Chinese practice, is likely to lead to more consistent arbitration procedures than would use of ad hoc arbitration. This greater likelihood of consistent procedure is to be preferred in that it "substantially alleviates the obvious difficulties of trying to establish a more comprehensive scheme in the arbitration clause."<sup>84</sup>

## II. LEGAL UNCERTAINTY AND THE PROSPECT OF EMERGING CHINESE LAW

The Trade Agreement represents a major step forward in the normalization of the free flow of trade between China and the

Chinese model contract terms for oil ventures in the South Yellow and South China Seas and the Beibu Gulf. Furthermore, the dispute resolution provision is typically the last item of a contract to be negotiated, often by an attorney who has instructions not to prevent the consummation of the contract by disagreement as to its terms. Surrey, *Trade and Economic Relations with the People's Republic of China: Recent Developments*, 14 INT'L LAW. 15, 19 (1980). Chinese insistence that China operate as the forum will usually result in acquiescence by the other party. However, agreements to arbitrate in Stockholm, Sweden, under Swedish law and procedure have been negotiated. Bosco, *The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment*, 6 BROOKLYN J. INT'L L. 217, 235-37 (1980). See generally Paulsson, *The Role of Swedish Courts in Transnational Commercial Arbitration*, 21 VA. J. INT'L L. 211 (1981). At least one agreement to arbitrate in Toronto, Canada has been negotiated as well. SPECIAL REPORT, *supra* note 19, at 4.

80. See, e.g., Lubman, *supra* note 25, at 126, which reports there were no known cases in which China was a seller where arbitration was held outside of China. In fact the likelihood of any arbitration at all, in Beijing or elsewhere, is not great. See *supra* note 41 and accompanying text which indicates the generally small number of disputes settled by such means. But see Comment, *supra* note 15, at 136-40 (contending Chinese acceptance of Western style international arbitration).

81. See Cohen, *Is There Law in China?*, 5 INT'L TRADE L.J. 73, 78-79 (1979). The Chinese are strict constructionists. See *supra* note 38. "Failure to specify these essential points [in an arbitration clause] may, for practical purposes, nullify the existence of the clause." Theroux, *Technology Sales to China: New Laws & Old Problems*, 14 J. INT'L L. & ECON. 185, 239 (1980). See *supra* note 15 for a brief discussion of the need for a clearly defined "trigger mechanism" which starts the arbitration process.

82. See Shen, *supra* note 58, at 5.

83. Trade Agreement, *supra* note 11, art. VIII, para. 2.

84. Stevenson, *supra* note 25, at 386, where the quoted material is used in reference to the adoption of the United Nations Commission for International Trade Law (UNCITRAL)

United States. However, many American and other foreign businessmen will hesitate to invest in China because of what they perceive as a climate of legal uncertainty<sup>85</sup> despite China's excellent credit rating in the world financial community<sup>86</sup> and China's international reputation for fairness<sup>87</sup> and reliability.<sup>88</sup> Foreign investors ordinarily have no way of knowing what substantive law will govern international commercial transactions because most Chinese laws and regulations remain uncodified.<sup>89</sup> A comprehensive com-

Arbitration Rules, 31 U.N. GAOR Supp. (No. 17) at 35-50, U.N. Doc. A/31/17 (1976); the quoted material is equally applicable to other consistent arbitration procedures.

85. See Cohen, *supra* note 10, at 143, 147.

86. "China's past loan repayment record had been exemplary and on the basis of this performance, the country has an excellent credit rating in the world financial community." Prybyla, *supra* note 2, at 50. "[T]he British have offered a \$1.2 billion line of credit, the Japanese . . . \$2 billion . . ." Clarke, *supra* note 9, at 99.

87. "The very few cases that have been arbitrated were reportedly conducted very fairly." DOING BUSINESS, *supra* note 38, at 216. "It has been reported that, as of 1960, 61 cases involving parties from Great Britain, Switzerland, Finland, Greece, the U.A.R., India, Ceylon, Canada and Singapore had been arbitrated—without apparent complaint of the proceeding or the award." SPECIAL REPORT, *supra* note 19, at 16. See Surrey & Soble, *supra* note 13, at 35, for testimony as to fairness in conducting inspections.

88. See, e.g., *supra* note 86. However:

China's credit history is not necessarily a reliable indicator of China's future credit performance . . . China's present borrowing plans bear little relationship to past practice and must be examined on their own precise merits. This cannot be done unless the Chinese authorities release fuller information than they have done so far on their assets, liabilities, reserves and debt service ratios. If China wants to participate in the world economic community, she should be made to understand that continued obsessive secrecy regarding her economic performance constitutes unacceptable conduct.

Prybyla, *supra* note 2, at 50.

This "obsessive secrecy" is not limited to China's economic performance. It extends to many areas. Although more than 8,000 Chinese scholars, scientists, and students are in the United States, most of whom are studying some form of technology, the 300 or so Americans studying in China find their efforts hampered by obstacles "erected against studying in China." Butterfield, *Testing the Limits of U.S.-China Exchanges*, N.Y. Times, Aug. 8, 1982, at E20, col. 1. For details on Chinese technical personnel in the United States, see Green, *Chinese Technicians in the United States*, CHINA BUS. REV., Nov.-Dec. 1977, at 27, 30. The Chinese have "a penchant for classifying most written materials as secrets . . ." Butterfield, *supra*, at col. 3. Some local newspapers, decades-old economic data and even 16th century maps have been so classified. *Id.* at col. 4. Furthermore, there has been a ban on field research, which suggests that American sociologists and anthropologists are little more than spies. *Id.* See also N.Y. Times, June 6, 1982, at 15, col. 5, which reports the expulsion of an American teacher on charges of stealing state secrets.

89. See, e.g., Cohen, Huang & Nee, *China's New Joint Venture Law*, in A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 195, 205-07 (H. Holtzmann & W. Surrey eds. 1979). For example, there are no laws protecting industrial property rights, or protecting against expropriation, nationalization or other taking of property. *Id.* at 207. Despite the preference of the Chinese for resolving disputes by informal means, contractual obligations

mercial code does not exist,<sup>90</sup> and despite recent efforts toward legislation in this area,<sup>91</sup> China's legal system remains limited almost exclusively to the criminal area.<sup>92</sup> Moreover, detailed reports of trade arbitration or other means for dispute resolution involving Chinese corporations are virtually unavailable,<sup>93</sup> and the Trade Agreement itself contains terms that are ill-defined and subject to more than one interpretation.<sup>94</sup>

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are an entirely different matter. The Chinese have earned a reputation for adhering strictly to the controlling provisions of commercial contracts. See Hudspeth, *supra* note 38, at 693-702 for a discussion of some Chinese laws which have been codified.

90. See generally Cohen, *supra* note 81, at 73, for a discussion of the recognized need for law within contemporary China.

Reports indicate that China is in the process of drafting a commercial code, but it is expected to be broad, thus leaving many trade questions unanswered. Hudspeth, *supra* note 38, at 715-17; Mathews, *Chinese Seek Grasp of Western Laws*, Wash. Post, Nov. 25, 1979, at 28, col. 1. Peng Zhen, Vice-Chairman of the Standing Committee, stated at a recent National People's Congress that priority should be given to drafting a law on contracts so that economic legislation will keep abreast of economic reform. *The People's Republic of China*, U.S. FOREIGN BROADCASTING INFORMATION SERVICE DAILY REP., Sept. 2, 1980, at L34. See Kato, *supra* note 38, at 449. *But see* Foster, *Codification in Post-Mao China*, 30 AM. J. COMP. L. 395, 428 (1982) (indicating an abandonment of the sweeping program of national codification proposed in 1978 in favor of more conventional Chinese law-making mechanisms. Party leadership continues to be the real source of authority.).

91. See Cohen, *supra* note 81, at 76-79. See, e.g., *The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment*, BEIJING REV., July 20, 1979, at 24, *reprinted in* 18 I.L.M. 1163 (1979) [hereinafter cited as Joint Venture Law]. This law essentially functions as an enabling act, permitting foreign businessmen to negotiate a comprehensive agreement with the appropriate Chinese agency. Cohen, Huang & Nee, *supra* note 89, at 197. For a discussion of the Joint Venture Law by a Chinese lawyer see Shen, *China's New Law on Joint Ventures Using Chinese and Foreign Investment*, 34 Sw. L.J. 1183 (1981). Article 14 of the Joint Venture Law calls for the settlement of disputes through consultation, conciliation or arbitration. See Joint Venture Law, *supra*, at 26; Lewis & Ottley, *China's Developing Labor Law*, 59 WASH. U.L.Q. 1165 (1982) (which has bearing on joint ventures in China); *New Regulations*, CHINA BUS. REV., Mar.-Apr. 1981, at 49-56 (additional new regulations). See also *infra* note 98.

92. U.S. DEP'T OF STATE, PUB. NO. 7786, BACKGROUND NOTES: CHINA, PEOPLE'S REPUBLIC OF 5 (1979), *reprinted in* HOW TO DO BUSINESS WITH CHINA 7 (1979).

93. Lubman, *supra* note 16, at 46. This inaccessibility has been confirmed by Jaqueline A. Keith, Program Director, United States Council, International Chamber of Commerce on January 25, 1982 and by Richard E. Lerner, Associate General Counsel, American Arbitration Association, on January 26, 1982, both in personal communications to the author. *But see* Jen & Liu, *supra* note 36, at 159 ("The [arbitral] award shall be made in writing . . ."). Article 30 of FETAC rules provides for a written award and an opinion explaining the basis for the decision. Decision of the Government Administration Council of the Central People's Government Concerning the Establishment of a Foreign Trade Arbitration Commission within the China Council for the Promotion of International Trade (May 6, 1954), *reprinted in* SPECIAL REPORT, *supra* note 19, at 49-51. However, the FETAC is not willing to give copies of the award unless it has permission of the parties. Diary I, *supra* note 41, at 65.

94. For example, article I paragraph 3 of the Trade Agreement states: "Commercial transactions will be effected on the basis of contracts between firms, companies and corpora-

The Chinese recognize the need to strengthen their legal system.<sup>95</sup> They realize that national rules governing economic and civil matters will promote China's program of modernization<sup>96</sup> and help to induce foreign investment and foreign commercial and economic contact.<sup>97</sup> The Chinese leadership has demonstrated an effort to implement a formal system of law.<sup>98</sup> However, the evolution of a legal system is difficult.<sup>99</sup> The development of new laws for interna-

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tions, and trading organizations of the two countries. They will be concluded on the basis of *customary international trade practice and commercial considerations* such as price, quality, delivery and terms of payment." Trade Agreement, *supra* note 11, art. I, para. 3 (emphasis added).

This is in keeping with the Chinese policy of adopting, in the absence of a comprehensive commercial code, customary international trade practices in dealings with foreign enterprises. See *Some Questions on Developing Economic and Technological Exchanges with Foreign Countries*, BEIJING REV., Apr. 27, 1979, at 17, 19-20 (interview with Zou Siyi, member of the Export Bureau of the Ministry of Foreign Trade). However, "customary international trade practices and commercial considerations" are by no means uniform throughout the world. A number of customary Chinese trade practices conform neither to an objective standard of customary international trade practice (to the extent that an established standard exists), nor to customary practices of the United States. Surrey & Soble, *supra* note 13, at 35. In export sales contracts for example, payment for certified conforming goods usually is to be made at final inspection. *Id.* The final inspection of exports generally is specified in Chinese sales contracts to take place in China; thus the foreign importer relying on the language "customary international trade practices" may not be aware that he bears the risk of loss during shipment. *Id.* He must be careful, familiar with all the proposed provisions of the contract, and "know the territory" if he is to negotiate the best arrangement and the best protection from costly misunderstanding. Hammer, *A Primer for Doing Business in China*, N.Y. Times, Apr. 11, 1982, at F2, col. 6 (Armand Hammer is chairman of the Occidental Petroleum Corporation). See generally *id.* for one businessman's approach.

95. Address by Ren Jian-xim, Director Legal Affairs Department, The China Council for the Promotion of International Trade, *Some Aspects of China's Work in Economy, Trade and Law*, at 3, given at the American Arbitration Association in New York City (Dec. 11-14, 1979) (reproduced for distribution by the AAA). "[W]e must strengthen our legal systems." *Id.* See Hudspeth, *supra* note 38, at 715-17 for discussion of the forces compelling the enactment of commercial statutes in China. *But see* Foster, *supra* note 90, at 428 (indicating an abandonment of the sweeping program of national codification).

96. See Li, *supra* note 52, at 96, 101 n.27.

97. See Cohen, *supra* note 81, at 77-78.

98. Li, *supra* note 52, at 83-84. Work has progressed in the areas of corporations law, civil law and civil procedure, and taxation. *Id.* See also *supra* note 91. But note that a similar effort mounted in the mid-1950's collapsed a few years later. Li, *supra* note 52, at 84, 92. See Cohen, *supra* note 81, at 82 for discussion of Chinese tax studies. For reprints of regulations, laws and forms on taxation of individuals, joint ventures, and foreign enterprises, see PRICE WATERHOUSE INFORMATION GUIDE, DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA 43-90 (1982).

Law schools have reopened in China. See Diary I, *supra* note 41, at 44. In 1979 the graduating class at Beijing University Law School had eighty students. Cohen, *supra* note 81, at 75.

99. See V. LI, LAW WITHOUT LAWYERS 20-31 (1978).

tional trade will be based on their utility in implementing Chinese policy<sup>100</sup> according to three principles:

1) the policy of independence and of keeping the initiative in Chinese hands;<sup>101</sup>

2) the policy of mutuality and equal benefits;<sup>102</sup> and

3) the policy of taking international practice into consideration.<sup>103</sup>

"[T]o formulate the practices of a particular moment into codes of law might imbue them with a greater sense of permanency than they ought to have."<sup>104</sup> Social and economic conditions in China are changing at a pace that requires reciprocal development of the rules to be applied.<sup>105</sup> "First we [the Chinese] must deal with cases and then sum up experience. Only in this way can we codify procedures."<sup>106</sup>

The prospect of an emerging commercial code offers little assurance to the American businessman or lawyer who is made uncomfortable by the uncertainties of trade, particularly in the face of an unfamiliar dispute resolution mechanism about which practi-

100. Buxbaum, *Continuity and Change in China's Legal Theory and Practice Affecting Importing and Other Aspects of Foreign Trade*, in *A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA* 437, 443 (H. Holtzmann & W. Surrey eds. 1979). See *infra* note 105 and accompanying text.

Western trading partners should . . . bear in mind that people from many states with less sophisticated legal systems than the Western model, have found the Chinese arbitration system very much to their liking. After all, there is no merit in sophistication for its own sake. I am sure that many here will welcome a legal system which ensures that the chances of their success do not depend too heavily on the amount of legal fees they are prepared to invest in their claim. Instead, a do-it-yourself kit like the Chinese system may not be such a bad thing. (Coming from a practising lawyer, the last statement has certainly been unbiased and disinterested!) In view of the popularity the Chinese system is at present enjoying internationally, it would be foolish to expect it to be drastically changed to suit the tastes of a few.

Liu, *supra* note 66, at 13.

101. Jen & Liu, *supra* note 36, at 153-54.

102. *Id.*

103. *Id.*

104. V. Li, *supra* note 99, at 4.

105. *Id.* "Law must be developed step by step, from simple to complex. We [the Chinese] do not advocate making complete set of codes, we prefer separate regulations and acts. Because our country is socialist, our country develops with each passing day. We must adjust laws to men, not men to laws." Diary I, *supra* note 41, at 55 (statement attributed to Jen Tsien-Hsin, Secretary General of F[E]TAC, Director of Legal Affairs Department).

106. Diary II, *supra* note 25, at 46 (statement attributed to Jen Tsien-Hsin, Secretary General of F[E]TAC, Director of Legal Affairs Department).

cally nothing, other than hearsay reports, is available. Despite the Chinese reputation for fairness and good faith dealing, the material on the mechanism in action can be looked upon as neutral at best. Alternatively, it can be looked upon as a deliberate move on the part of the Chinese to exclude examination of their mechanism by foreign parties.<sup>107</sup>

Undoubtedly, the study of experience is the means to knowledge and understanding. Unfortunately, American and foreign businessmen have little to study in the way of Chinese commercial law in general, or the Chinese dispute resolution mechanism in particular. A policy of confidentiality does not allow it.

### III. THE IMPORTANCE OF CONCILIATION IN CHINESE DISPUTE SETTLEMENT

#### A. The Current Role of Conciliation

Conciliation as a means of dispute settlement in China has continuing vitality.<sup>108</sup> The Chinese still regard arbitration with

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107. See *supra* note 88 for a perspective on China's "obsessive secrecy." However, the confidentiality of private dispute settlement mechanisms is what makes them preferred by Western businessmen. See notes 20-25 and accompanying text.

108. The Chinese favor conciliation as a settlement technique. Reynolds, *The Joint Venture Law of the People's Republic of China: Preliminary Observations*, 14 INT'L LAW. 31, 42 (1980); Yeow, *supra* note 15, at 51. See Lubman, *supra* note 16, at 45 for discussion of the Chinese preference for "amicable negotiation" and hostility toward third-party participation in dispute settlement. Even in the context of criminal trials, the Chinese policy of settlement by conciliation is in evidence. See Allen & Palay, *supra* note 17, at 47. *But see* Pattison, *supra* note 17, at 136 (contending that Chinese predilection for conciliation has eroded).

Conciliation has been recognized by the United Nations as a viable means of settling international disputes. UNCITRAL Conciliation Rules have been unanimously adopted by that agency. Report of the United Nations Commission on International Trade Law, 35 U.N. GAOR Supp. (No. 17) at 32, U.N. Doc. A/35/17 (1980) [hereinafter cited as UNCITRAL Conciliation Report]. Representatives of both China and the United States were members of the Drafting Party. *Id.* at 11. See *id.* at 33-38 for the text of the adopted Rules. Article 1 provides that these Rules are applicable by agreement of the parties, and that the parties may modify the Rules at any time. *Id.* at 33.

Article 17 provides that unless otherwise agreed, costs are to be borne equally by the parties. *Id.* at 37. These costs do not include expenses of the parties themselves but do include the expenses of conciliator(s), witnesses, experts, conciliation fees, etc. *Id.* This can be important to an American party who travels to China to partake in joint conciliation. It may motivate both parties to reach a quick settlement as expenses mount. Furthermore, as provided by article 18 the conciliator(s) (and this presumably could include an American joint conciliator) may request each party to deposit equal amounts in advance for these costs. *Id.*



distrust, to be conducted only as a last resort.<sup>109</sup> "If they could, the Chinese would perhaps dispense with dispute settlement clauses in their contracts altogether."<sup>110</sup> In a survey of twenty-nine United States-China trade contracts, three had no such clauses, and the remaining twenty-six called for the settling of differences through conciliation.<sup>111</sup> At least five disputes in United States-China trade have been resolved successfully through conciliation.<sup>112</sup> While official reports detailing the actual settlements would be illustrative, formal records are unavailable.<sup>113</sup> However, some unofficial observations of a joint conciliation conducted in 1977 may help the Western reader to understand the nature of the Chinese conciliation process.<sup>114</sup>

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109. Yeow, *supra* note 15, at 48. The great majority of disputes between the Chinese themselves are settled by informal means. See Allen & Palay, *supra* note 17, at 48, reporting 4,382 settlements before trial out of 6,132 cases examined by the economic courts. See generally *supra* notes 15, 36, 37, 68, 75 and accompanying text.

110. Yeow, *supra* note 15, at 48.

111. *Id.* at 48-49.

Given their dislike of adversary proceedings, it is not surprising that the Chinese seldom resort to arbitration. The few instances of arbitration with Western companies have all taken place in Beijing, according to Chinese sources.

Yet US lawyers involved in China trade insist that the arbitration clause is an indispensable part of any contract. . . . [T]he Chinese will include arbitration clauses in order to meet the needs of their trading partners. But there is considerable variety in the types of clauses agreed to.

At one extreme the language is so vague as to be almost meaningless. *Id.* at 49. See Note, *supra* note 43, at 260 which suggests that arbitration clauses are included in contracts by the Chinese in order to avoid jurisdiction of foreign courts. *But see* Comment, *supra* note 15 (commentary purporting China's acceptance of "Western-style" international arbitration). See generally *supra* note 15.

112. Yeow, *supra* note 15, at 51.

113. See *supra* note 93 and accompanying text. Some unofficial reports of case examples do exist, see, e.g., SPECIAL REPORT, *supra* note 19, at 21-38, but they are relatively uninformative.

114. The following material is drawn from an unpublished diary of Donald B. Straus, Diary II, *supra* note 25. This joint conciliation was the result of almost three years of constructive discussions between the AAA and CCPIT. *Id.* at 25. Aspects of this 1977 joint conciliation, other than those discussed in this Note, have been reported, most notably in Holtzmann, *supra* note 24, at 299. The unavailability of more current material is primarily a result of the desire of the parties to maintain the confidentiality of their business arrangements, and this is particularly true in light of the Chinese emphasis on the importance of continuing business relations. Personal communication by Donald B. Straus to the author of this Note. See *supra* notes 20-25, 65 and accompanying text (general discussion of the preferred position of confidential arrangements). See *infra* note 137 (brief discussion of reference to this joint conciliation made in later years).

Joint conciliation is compatible with article 3 of the UNCITRAL Conciliation Rules, which provides that the parties may agree that there shall be two conciliators. UNCITRAL

### B. A Case Study

The dispute arose in a multimillion dollar transaction between an American seller of commodities and a Chinese buyer. Representatives of the AAA and the Chinese FETAC conducted a successful joint conciliation in China to the satisfaction of the parties.

The contract between the parties required that the product in question be delivered at United States ports by the American seller to the Chinese buyer who would transport the product in ships of its own designation. The seller was unable to meet the delivery date originally agreed upon and requested a revised delivery schedule. The Chinese buyer responded with a new schedule. Subsequently the price of the product dropped sharply; the Chinese buyer failed to meet its revised pick-up schedule. The product was finally shipped to China after long delays that the American seller claimed cost several million dollars in storage and interest charges (carrying charges) which it was entitled to recover under a provision in the contract.<sup>115</sup> The seller requested that a joint conciliation be initiated

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Conciliation Report, *supra* note 108, at 33. In an earlier draft, article 2 concerned the number of conciliators and provided that "[t]here shall be one conciliator unless the parties have agreed that there shall be three conciliators." Report of the United Nations Commission on International Trade Law, 34 U.N. GAOR Supp. (No. 17), at 39, U.N. Doc. A/34/17 (1979). However, it was the view of the Commission on International Trade Law (Commission) that the use of two conciliators was not uncommon and that an odd number was not essential because the role of the conciliator(s) was to make recommendations, not decisions. *Id.* In an intermediate draft, article 3 provided: "There shall be one conciliator unless the parties have agreed that there shall be two or three conciliators." UNCITRAL Conciliation Report, *supra* note 108, at 15.

The United Nations Commission on International Trade Law addressed the question whether multiple conciliators would have to act jointly or could act individually as well. *Id.* The Commission's view was that conciliators should act jointly, *id.*, and article 3 of the UNCITRAL Conciliation Rules now provides: "There shall be one conciliator unless the parties agree that there shall be two or three conciliators. Where there is more than one conciliator, they ought, as a general rule, to act jointly." *Id.* at 33. Article 4(1)(b) provides: "In conciliation proceedings with two conciliators, each party appoints one conciliator . . . ." Article 4(2) emphasizes the importance of appointing impartial and independent conciliators. *Id.* at 34. In the appointment of one or three conciliators article 4(2) requires that "the advisability of appointing a conciliator of a nationality other than the nationalities of the parties" be taken into account. *Id.* Thus, the spirit of joint conciliation and the above articles are in accord.

115. The written contract specified a carrying charge to be paid by the buyer for delays caused by the buyer. Diary II, *supra* note 25, at 11. It was noted during the conciliatory process that the provision for a carrying charge was really meant to protect the buyer because with such a provision the seller could not cancel the contract if the buyer's ship arrived later than specified. *Id.* at 37. ("Apparently 40% of all deliveries in the commodity trade are late." *Id.*).

to help find a friendly solution to the problems that had arisen between the seller and the Chinese buyer.

The buyer's position was that the difficulties all stemmed from the seller's inability to deliver according to the original schedule.<sup>116</sup> The buyer calculated that it justifiably could have cancelled the contract to protect its own interest; under the principles of equality and mutual benefit, it did not.<sup>117</sup> However, the Chinese buyer offered little or no evidence to support its counterclaim for damages.<sup>118</sup>

The Chinese conciliators suggested that the American seller had no valid claim and should look to future trade<sup>119</sup> because, eventually, each side would benefit from growing trade.<sup>120</sup> This solution was rejected.<sup>121</sup> The seller wished to negotiate on the case at hand.<sup>122</sup>

After repeated attempts to reach a mutual understanding, a settlement was reached, consisting of a payment of more than one million dollars by the buyer.<sup>123</sup> The Chinese stressed that they admitted no liability but agreed to the settlement in the spirit of

116. Diary II, *supra* note 25, at 34.

117. *Id.* at 35.

118. The Chinese party asserted that it made no claim on these losses in the name of friendship, and thus, because no claim was made, supporting evidence was unnecessary. *Id.* at 83.

The American party documented its loss with a 45 page brief supported by 14 exhibits. The exhibits included: (1) the contract; (2) a full set of correspondence between the parties; (3) statistical tables; (4) computer printouts of relevant figures; (5) copies of invoices; (6) affidavits by experienced individuals not connected with the transaction to attest to customary trade practices; and (7) copies of United States, British, Swiss and Philippine statutes to demonstrate prevailing international legal principles. Holtzmann, *supra* note 24, at 299-300 (in reference to this same joint conciliation). According to the Chinese approach, the principle of conciliation requires that the search for facts and documentary evidence be limited only to the "essential facts," but the meaning of "essential facts" was never satisfactorily conveyed. Diary II, *supra* note 25, at 5-6.

Article 5(3) of the UNCITRAL Conciliation Rules provides: "At any stage of the conciliation proceedings the conciliator[s] may request a party to submit to him such additional information as he deems appropriate." UNCITRAL Conciliation Report, *supra* note 108, at 34. These Rules should alleviate the problem of inadequate information upon which to base a recommendation. Article 11 provides that the parties co-operate with the conciliator(s) in good faith and endeavor to comply with requests for written materials and evidence. *Id.* at 36.

119. Diary II, *supra* note 25, at 51, 71, 77.

120. *Id.* at 71.

121. *See id.* at 51.

122. *Id.* at 76.

123. *Id.* at 100.

friendship.<sup>124</sup> The Chinese insisted that signing the settlement agreement was unnecessary,<sup>125</sup> and that the agreement would be kept.<sup>126</sup>

The key to the American party's right to recovery was a controlling contractual provision that ascertained in advance the legal rules that would apply. Legal rights can be preserved by comprehensive and detailed contracts that cover all conceivable possibilities, exigent or not. However, aside from the extreme impracticability of such an approach with even the most cooperative party, negotiating the terms of choice with the Chinese will be difficult.<sup>127</sup> While the penchant of American lawyers to provide in the contract against every conceivable eventuality is perhaps the most extreme in the world,<sup>128</sup> the Chinese practice of legal informalism, particularly of avoiding written commitment on their part,<sup>129</sup> is equally extreme. Furthermore, "insistence on highly formal and abstract solutions [on the part of American negotiators] . . . might call into question [for the Chinese] the neutrality of the rules . . .

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124. *Id.* at 101.

125. Diary II, *supra* note 25, at 108. Article 13(2) of the UNCITRAL Conciliation Rules requires that if the parties reach a settlement agreement, it be signed by the parties, and article 13(3) makes such a signed agreement binding. UNCITRAL Conciliation Report, *supra* note 108, at 36.

126. *Id.*

127. In this case the controlling provision was included as protection for the buyer. See *supra* note 115. A recent study of a number of contracts revealed that the terms were decidedly in favor of the Chinese party. G. HSIAO, *supra* note 41, at 143-52. See Brown, *supra* note 9, for a discussion of Chinese model contract terms. See also *supra* notes 77-81 and accompanying text.

It is important to remember that negotiating climates may vary not only because of changing international relations but also because of changing domestic policy. See Jenkins, *supra* note 79, at 29. For a discussion of the negotiation of an international agreement see Verbit, *Negotiating with China: A Minor Episode in CHINA'S PRACTICE OF INTERNATIONAL LAW* 154-66 (J. Cohen, ed. 1972).

128. See Remarks of Bertholt Goldman, ICC Forum: International Commercial Arbitration (Apr. 4, 1978):

The tendency of American lawyers to want to provide in the contract against every conceivable eventuality is the subject of some amusement on the part of some of their colleagues in other countries. During the course of a recent seminar in Paris on ICC arbitration, a French lawyer recounted to the general mirth of his audience his experience with an American counterpart who wished to "improve" the standard ICC clause by adding "or its successor" after "International Chamber of Commerce."

Reprinted in Stevenson, *supra* note 25, at 401 n.110.

129. See, e.g., *supra* note 38 and accompanying text.

urged . . . .”<sup>130</sup> However, this is not to say that United States negotiators should not be firm on points of economic significance. Persistence, composure, patience,<sup>131</sup> and perhaps a bit of insouciance can sometimes turn even a “non-negotiable” issue into one that is negotiable.<sup>132</sup>

This successful resolution of a dispute through joint conciliation, while a simplified account of a complex settlement, is nevertheless instructive. It illustrates the paramount principle that agreements and stipulations of the parties to a contract must be observed<sup>133</sup>—despite the Chinese insistence that the American seller had no valid claim. It also illustrates the Chinese preference for looking to future trade as a way to settle current disputes,<sup>134</sup> as well as the Chinese penchant for informality in their legal approach.<sup>135</sup> Furthermore, the fact that the awarded sum was approximately half the amount sought may be indicative of the Chinese readiness to compromise.<sup>136</sup>

Despite the apparent success of this joint conciliation in reaching a settlement, no further joint conciliations have been conducted by the AAA and FETAC.<sup>137</sup> This may indicate a dissatisfaction on

130. Lubman, *supra* note 16, at 9. The Chinese have been skeptical of the attorney's role in negotiating business arrangements. Jenkins, *Implications of Recent Agreements for United States-China Trade*, 14 INT'L LAW. 5, 5 (1980). However, this attitude is changing, due in part to the growing importance of attorneys within China itself. Lawyers representing American firms will play an important role as negotiators of commercial contracts. Hudspeth, *supra* note 38, at 735-40.

131. Contracts with the Chinese do not materialize overnight. Occidental's coal deal took two and one half years of give-and-take negotiations before an agreement was reached. Hammer, *supra* note 94, at F2, col. 3. A co-production contract between the Chinese and Avon Products Inc. was signed after a year and a half of negotiations. Wren, *Peking Factory Making Avon Cream for Chinese*, N.Y. Times, Sept. 23, 1982, at D1, col. 5.

132. Jenkins, *supra* note 79, at 31-32.

133. *Pacta sunt servanda*. BLACK'S LAW DICTIONARY 999 (5th ed. 1979). See H. KIM, *supra* note 25, at 94.

134. See *supra* note 55 and accompanying text.

135. See *supra* note 38 and accompanying text (the Chinese insisted that signing an agreement of settlement was an unnecessary formality).

136. See *supra* note 25 for materials on compromise. In the West parties often receive in settlement considerably less than the amount to which they feel they have a right, and this is not considered a compromise.

137. Personal communication to the author of this Note by Donald B. Straus, former President of the American Arbitration Association. Confirmed by Michael Hoellering, General Counsel of the American Arbitration Association in a telephone conversation with the author of this Note on September 22, 1982 [hereinafter cited as Hoellering conversation]. Reference in Ren, *supra* note 5, at 9, to two joint conciliations conducted in 1978-79 by a branch of the CCPIT and the AAA is said to be in error as to the date. Hoellering conversa-

the part of the Chinese with the joint conciliation process, at least in this instance.<sup>138</sup> In effect, the conciliatory bodies acted as advocates for the entities of their own nations.<sup>139</sup> The Chinese, in pursuit of Chinese control of the dispute settlement process,<sup>140</sup> may consider the AAA's role to have been overly assertive and a derogation from Chinese authority.

### CONCLUSION

The likelihood of growing trade between the United States and China gives increasing importance to the Trade Agreement between these two nations and to its dispute resolution procedures.

tion, *supra*. The second joint conciliation referred to was settled almost immediately after initiation, before joint conciliation took place. *Id.* See Diary II, *supra* note 25, at 4.

138. An agreement to settle disputes arising from trade with a French entity was signed in 1980. Ren, *supra* note 5, at 9.

139. See Diary II, *supra* note 25, at 52, 76, 77 for examples. Permission to publish these statements made in the heat of negotiation has understandably been denied by Mr. Straus.

Ideally, joint conciliators should be impartial and should act jointly. See *supra* note 114. The likelihood of partiality is diminished when a conciliator is appointed by each of the parties to a dispute as compared to the appointment of only a Chinese (or for that matter only an American) conciliator. Another possibility that would tend to maintain impartiality is the appointment of a single or third conciliator who is neither Chinese nor American.

Article 19 provides that in subsequent proceedings the conciliator(s) not act as arbitrator, representative, counsel, or witness of a party. *Id.* at 38. This provision can be particularly important should American and Chinese parties to a dispute fail to reach a settlement through conciliation in the case where arbitration in China is the next stage in the settlement process.

140. The policy of independence and keeping the initiative in Chinese hands is a principle of great importance to the Chinese. Jen & Liu, *supra* note 36, at 153-54. Modern international law is essentially a creation of the West. 1 J. COHEN & H. CHIU, *PEOPLE'S CHINA AND INTERNATIONAL LAW* 3 (1974). The Chinese distrust of using international law to define relations with the West, see Li, *supra* note 33, at 235-36 (indicating Chinese unwillingness to entrust dispute resolution to international bodies), is founded in substantial part on unfortunate experiences of prior dealings with the West. Chinese economic history is marked by foreign exploitation and humiliation. 1 J. COHEN & H. CHIU, *supra* at 6. See generally, *e.g.*, A. WALEY, *THE OPIUM WAR THROUGH CHINESE EYES* (1958) (account of China's unsuccessful attempt to prevent British traders from smuggling opium into China). In the past, international law was manipulated by Western powers and Japan to victimize and exploit China. 1 J. COHEN & H. CHIU, *supra* at 9. In more recent years, the Western, and particularly the United States, attitude toward China has been marked by open hostility and opposition. See generally Lee & McCobb, *United States Trade Embargo on China, 1949-1970: Legal Status and Future Prospects*, 4 N.Y.U. J. INT'L L. & POL. 1 (1971). Although there have been significant shifts in China's attitude toward the West in recent years "the lingering association between foreign trade and foreign exploitation remains . . ." Lubman, *supra* note 16, at 11. But see Comment, *supra* note 15, at 137 (attesting to China's acceptance of "Western-style" international arbitration).

When a dispute cannot be resolved by the parties themselves, the participation of an objective third party can help the disputants view the matter as part of a continuing business relationship that is in their mutual interests. Conciliation, unlike arbitration or litigation, is a system that allows parties to voluntarily adopt a settlement. The Chinese will continue to prefer conciliation, their traditional means of dispute resolution, although they may experiment with arbitration and court systems in order to appease their foreign business partners.

Joint conciliation, a method not explicitly mentioned in article VIII, has been successfully conducted in China by representatives of the American Arbitration Association and the Chinese FETAC, and evidences the flexibility of the Chinese system. It further manifests the need for flexibility by Americans doing business in China.

The Chinese will continue to assert control over the dispute resolution procedure in whatever form it takes. Foreign parties will want to protect their interests by requesting a provision in the contract requiring joint conciliation should a dispute arise. This is especially true for American businessmen who will feel more secure utilizing this form of dispute resolution. Joint conciliation between American and Chinese parties can take on an adversarial nature because in effect the AAA and FETAC may represent the party of their nation. The American is more comfortable because the settlement process is analogous to being in court; yet, the mechanism is an informal one and trade relations remain friendly.<sup>141</sup> However, the Chinese consider participation, indeed, perhaps even observation, by foreign third parties as encroaching on Chinese control. Negotiating such terms into the contract, therefore, will require concessions by the foreign parties in other areas. The Chinese would prefer to eliminate dispute settlement provisions entirely.

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Chinese determination to control Chinese destiny is evidenced by contract terms, *see, e.g.,* Brown, *supra* note 9, at 34, and the requirements that foreign litigants, and perhaps parties to arbitration proceedings, have Chinese lawyers, if any; yet Chinese lawyers represent "facts," not clients. *See supra* notes 15, 17. Unfortunately, part of the Chinese determination to maintain control manifests itself in an attitude of secrecy toward the West. *See supra* note 88.

141. *See supra* note 65 and accompanying text. However, one author suggests that because of the risk of nationalization, investors should seek high short-term returns on their capital. *See* Kato, *supra* note 38, at 455.

It is important for the Chinese to understand that American investors and traders will be hesitant to commit capital to a venture in China if they lack confidence that their investment will be legally protected should a dispute arise with their Chinese business associates. Accustomed to Western legal practices, American businessmen will want to know in advance and in definite terms what their rights and obligations will be under the law. Those who invest at all will do so on terms that take into account the perceived risk that uncertainty creates. Joint conciliation will minimize the perceived risk—and that will increase the attractiveness of doing business in China.

*Denis Woychuk*