China: Changes in Judicial Review of Arbitral Awards – Why Foreign Companies Should Pay Attention

In China, foreign arbitral awards as well as Chinese awards involving a foreign element (i.e. "foreign-related" awards) are subject to a special judicial review mechanism, called the "Prior Reporting System". Under this mechanism, lower courts must seek the approval of the higher courts, up to the Supreme People's Court ("SPC"), where they intend to refuse the enforcement of foreign or foreign-related awards.

Although praiseworthy in principle, this mechanism suffers from various flaws, the most important being its lack of transparency and the delays it causes to the enforcement process.

In the context of a general reform of judicial supervision, this mechanism is about to be extended to apply to all awards, *i.e.* including also domestic awards. This additional burden may increase the caseload of the courts significantly. What will it mean to the effective enforcement of arbitral awards in China? How should foreign companies manage the increased risks related to this upcoming reform?

1. The Prior Reporting System – The Current Framework

In its original form, the Prior Reporting System, designed in 1995 and 1998, established a duty for lower courts to report and request approval from the higher courts (all the way up to the SPC) if the former intends to annul or refuse enforcement of a foreign-related or foreign award.

The original purpose of the Prior Reporting System was to ensure consistency and a minimum quality for the judicial review of foreign-related arbitration cases. The Prior Reporting System is believed to have contributed to the substantial reduction of local protectionism and to a more pro-arbitration environment in the Chinese court system.

Yet this improvement came with a price: Given the lack of specific time limits imposed on the courts as well as the lack of sanctions for undue delay, the Prior Reporting System has led to substantial delays in the process for enforcing arbitral awards. It is thus not uncommon for recalcitrant parties against whom enforcement is sought to exploit this weakness by using their local influence and power to pressure courts into sending cases through the Prior Reporting System, thereby taking advantage of the resulting delays. Better late than never when it comes to the result. In addition, with the professionalism of an impartial and independent arbitral tribunal, and the supervision from the SPC, the local influence is less likely to make the courts to deviate from the law comparing to usual local court practices.

In view of these flaws, the arbitration community has been pushing for reforms.

2. Changes Implemented by the SPC Provisions on the Prior Reporting System (2017)

On 29 December 2017, the SPC promulgated the Provisions on Questions Concerning Approval and Reporting in Arbitration-Related Judicial Review Cases (《关于仲裁司法审查案件报核问题的有关规定》) ("SPC Provisions on the Prior Reporting System (2017)"), officially extending the Prior Reporting System to all arbitration-related cases, regardless of the domestic or foreign-related nature of the arbitration.

The major change envisioned in the SPC Provisions on the Prior Reporting System (2017) is the extension of the Prior Reporting System to all arbitration-related cases, whether foreign, foreign-related, or domestic. In other words, no court in China will be able to issue a decision refusing enforcement of an award or an arbitration agreement, or annulling an award, without having obtained the prior approval of the higher court(s). This reform serves to ensure further consistency in the judicial review of arbitration-related cases.

As mentioned at the beginning of this newsletter, this reform means that the number of cases potentially subject to the Prior Reporting System has just been multiplied by many times. How are local courts supposed to cope with such an increase?

3.What It Means for Western Companies

In view of the potentially impact that this reform could have on the Chinese court system as concerns judicial review of arbitral awards, it has become even more important to carefully evaluate and choose an appropriate dispute resolution mechanism for commercial relationships with Chinese parties.

In particular:

1) **Be patient :**

The present reform of the Prior Reporting System may increase time of proceeding to successfully enforce your award, diminishing in the same time differences of treatment between domestic awards in one hand and foreign and foreign-related awards in other hand.

2) **Design a global and comprehensive enforcement strategy at the stage of contract conclusion:**

You should not wait for a dispute to arise, or worse, for an award to be issued, to start evaluating potential enforcement avenues. Instead, enforcement considerations should be taken into account at the very time of negotiating the contract. This means:

(1) Know your partner: Proceed with due diligence of your contractual Chinese partner (who are they, who are the shareholders / beneficial owners) as well as preliminary asset research (how are they organized, where do they have assets). Although more and more Chinese companies nowadays have cross-border commercial relationships and are thus likely to have assets abroad, it is not always easy to identify such assets, or seize them.

(2) Negotiate commercial guarantees and/or contractual penalties: Try as much as possible to provide commercial guarantees in your contracts (e.g. performance guarantees) as well as favorable payment terms (e.g. advance payments, performance retainers, etc.)

(3) Get proper insurance coverage: Depending on your geographical location and industry, you may be able to contract for insurance covering the risk of non-performance of the contract or non-enforcement (or delay in enforcing) of a potential award. You should seriously consider these options. The insurance premium may end up being very small compared to the costs of lengthy, delayed or unsuccessful enforcement proceedings.

(4) Resort to other alternative dispute resolution mechanisms, such as dispute boards or mediation: The dispute resolution framework in China offers a broad range of alternatives to arbitration, including dispute boards, mediation/conciliation and med-arb or arb-med. Needless to remind that conciliation and settlement are always recommended.

(5) Keep in mind the possibility of Third-Party Funding**:** If you need to go to arbitration, consider approaching a so-called "**Third Party Funder**". This funder may be willing not only to fund the arbitration proceedings but also to trace assets and finance enforcement proceedings in various parts of the world. There are multiple institutions in various countries offering to finance legal procedures, including in China.

At Asiallians and Altenburger, we have over 20 years of experience in the Greater China area, including Mainland China, Hong Kong and Taiwan, and we would be pleased to advise you in designing effective enforcement strategies in connection with your China-related commercial transactions.

Thanks to our strong network in China and Europe, we are able to take care of every aspect of your enforcement case, from the cumbersome translation and legalization process to PRC qualified lawyers and liaising with the competent court. In China, we integrate the resources of our Partner Wang Jing & Co, a PRC law firm with a team of more than 20 partners and 100 lawyers across the country to appear before any Chinese court from the lower court towards the Supreme People's Court.

Our connections to foreign embassies and consulates in China further allow us to seek diplomatic assistance and support when encountering difficulties in the enforcement process.

Please contact Beijing@asiallians.com for more information.

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