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“It is Better to Enter a Tiger’s Mouth Than a Court of Law” or Dispute Resolution Alternatives in U.S.-China Trade

Steven N. Robinson*
George R.A. Doumar**

1. Introduction

President Richard Nixon’s historic visit to the People’s Republic of China in 1972, which hastened efforts to normalize relations between the United States and China, prefaced an explosive growth in trade between the two countries.¹ China has since become a major trading partner of the United States² but the potential for continued growth in this relationship is limited by several factors, including

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² In 1980 the volume of trade with China surpassed the level of trade with the Soviet Union and China moved into first place as a non-market trading partner with the United States. Theroux, Technology Sales to China, 14 J. INTL. LAW AND ECON. 185, 186 n.1 (1980). The United States is now China’s third largest trading partner after Japan and Hong Kong, representing approximately 12% of total Chinese trade. See NATIONAL COUNCIL FOR U.S.-CHINA TRADE, U.S.-CHINA TRADE STATISTICS 1985 (1986), at 4.
China's ability to generate foreign exchange, the reluctance of the United States government to allow exports of high technology and the degree of certainty that can be achieved by the legal system meant to enforce contracts with businesses in China.

To use its enormous resource base effectively, China has undertaken an ambitious effort to modernize, known as "the Four Modernizations." Crucial to China's success in this endeavor is its effective use of international trade to import modern technology; but China must also inspire in trading partners confidence that a legal system exists under which they can enforce import/export contracts if it is to develop successful trading relationships with other countries and attract sought-after technologies and investment. This article examines the influence Chinese attitudes toward law have upon the various methods of dispute resolution in United States-China trade. It concludes that, although reasonably effective mechanisms for the resolution of disputes are available, the primary emphasis of counsel should be to prevent the dispute from occurring through promoting informed negotiation of the original contract.

II. Chinese Attitudes Toward Law

China since earliest recorded times has considered itself to be the "middle kingdom" and the center of life. The effect of tradition is omnipresent in China and, in particular, the attitude toward the

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3. The shortage of foreign exchange has proved to be a particularly critical brake on increased trade in the past two years. See Gelatt, The Foreign Exchange Quandary, CHINA BUS. REV., May-June 1986, at 28; Stuermer, The Foreign Exchange Situation, CHINA BUS. REV., Jan.-Feb. 1986, at 14.


7. Id. at 207.

8. Chief Judge Re, of the United States Court of International Trade, has suggested that a vital role for lawyers is to act as a counselor and to prevent litigation. See Re, The Lawyer as Counselor and the Prevention of Litigation, 31 CATH. U.L. REV. 685 (1982). It should be required reading for all law students and lawyers!

legal system reflects many influences from the past. To understand current Chinese dispute resolution methods, it is necessary first to examine the evolution of Chinese attitudes toward law.

A. "li" and "fa": The Conflict Between Legalism and Moralism

Two central themes, which are somewhat diametrically opposed, have principally influenced the development of the Chinese philosophy of law. The Confucian concept of "li" postulates that ethics should control one’s behavior and that seeking harmony with the universe provides sufficient guidance to conduct one’s affairs. Under this view, moral precepts regulate behavior in society, and law and litigation are unnecessary, improper means of controlling conduct. This emphasis on customary principles also means that one’s station in life dictates expected standards of behavior. The "li" influence is reflected in a graduated scale of criminal punishments, the punishments being hierarchically structured to correlate with social standing.

On the other hand, the legalists espoused a concept of "fa," which was a stricter view of the law as "codified in books, kept in government offices, and promulgated among the hundred surnames.” From the time of the development of the legalist philosophy in the third century B.C. until the present, tension has existed between the written codes of laws enforceable by governmentally imposed punishment and the natural order required by the community and enforced by social pressure.

The historical tension between the "li" and "fa" influences in Chinese history exemplifies the Asian idea of the Yin-Yang, the concept that everything is made up of two forces or elements: the strong and weak, active and passive, positive and negative. Similarly, it reflects the Marxist concept of the dialectic, which suggests that historical development occurs only through the continual resolution of conflict between a thesis and its corresponding antithesis.

13. See, e.g., id. at 1291.
14. KIM, supra note 10, at 3-4 & n. 12 (quoting W. LIAO, THE COMPLETE WORKS OF HAN FEI TZU (1939)). See also Ellis & Shea, Foreign Commercial Dispute Settlement in the People’s Republic of China, 6 INT’L TRADE L.J. 155, 157 (1981). The legalist influence reached its height during the time of the Q’in dynasty, from 221-208 B.C. A backlash against the harshness of this regime led to its overthrow and replacement by the Confucian Han dynasty.
15. See Lubman, supra note 12, at 1291.
16. For a discussion of the analogy between Chinese and Marxist thought, see H. Holtzmann, A New Look at Resolving Disputes in US-China Trade, in A NEW LOOK AT
With the advent of Communist control of China in 1949, the moralist principles of the "li" prevailed over the "fa," resulting in the abolition of the legal codes in the 1950s. This abolition reflected a preference by the Chinese Communist leaders for a formal legal system rather than for the codes themselves. As a noted scholar observed, "law was not regarded as a major social achievement and a symbol of rectitude, but as a regrettable necessity to be used by the state to enforce its will upon subjects who refused to submit to alternative means of social control."

B. Early Chinese Experience with International Law

China's early exposure to international law resulted in disenchantment similar to that the Chinese had with their own court system. The growth of trade with the outside world in the 1800s brought the smuggling of opium into China. China's Imperial Commissioner Lin Tse-hsu became acquainted with Vattel's *The Law of Nations* and sought to employ its legal concepts to stop foreign nations' smuggling efforts. Pursuant to Vattel's suggestions, Commissioner Lin wrote to Queen Victoria, seeking assistance in restraining her citizens from their illegal trading.

Instead, Britain started and won the first Opium War (1839-1842) and imposed even more onerous trading conditions on China, including increased levels of opium smuggling. The Chinese view this period of their history as one of "exploitation and humilia-
Not surprisingly, the Chinese developed a distrust of international law, viewing it "just like Chinese statutory law — unreasonable and unreliable. If there is a right without might the right will not prevail." 28

Lacking the military might to enforce its desires on its trading partners, China withdrew from participation in the world’s economy in 1949 and only during the past fifteen years has it begun to renew its contacts. In view of the previous disastrous experience with international law, it is understandable that China has been reluctant to whole-heartedly accept the Western legal establishment.

C. The Ebb and Flow of Legalism in China

Following the revolution in 1949, China initially relied on mediation to settle civil disputes. 27 With the rise in the influence of the Soviet Union in China, the Chinese adopted a “Soviet-style” legal system in 1953. 28 This system was abolished in 1957, and from that point until Mao Tse-Tung’s death in 1976, a more traditional community mediation system gradually replaced the country’s formal legal system. 29 The decimation of the legal structure accelerated during the Cultural Revolution to the point that there were virtually no active lawyers, judges, legal scholars or courts in all of China. 30 The attitude toward the legal system during that period is best represented by a quote from Chairman Mao stating “Depend on the rule of man, not the rule of law.” 31

The dependence on the rule of man was not without significant drawbacks. 32 Since Mao’s death, China’s present leaders, recognizing these shortcomings, have reversed the trend of the previous twenty years and have attempted to build a formal legal structure. Several important legal codes have been enacted to meet both national and international issues and gain from its citizens and trading partners the confidence essential to a successful modernization campaign. 33

25. See Theroux, supra note 2, at 188.
26. COHEN & CHIu, quoted in Comment, supra note 5, at 59.
27. See Lubman, supra note 12, at 1285-86.
28. Comment, supra note 5, at 61-62.
29. Id. at 62.
30. Hsia, Sources of Law in the People’s Republic of China: Recent Developments, 14 INT’L LAW 25, 27 (1980). This article also provides an excellent analysis of the status of legal literature in China. See also Comment, supra note 5, at 62 & n.72.
32. The prospect of arbitrary punishment bred fear and uncertainty among the population and had a corresponding adverse impact on economic growth. The uncertainty inherent in not having a formal legal system also retarded the growth of international business relationships.
33. See supra note 4.
To gain the trust of its own citizens, a comprehensive Constitution was established in 1978, which has partially eliminated fears of arbitrary punishment. In addition, a legal education program was recently instituted among the populace and formal arbitration committees were established all over the country to settle local disputes. Similarly, in the past ten years China has established a framework of laws to provide foreign investors and trading partners the certainty required to enter into substantial trade agreements.

Some of the major laws which have been enacted address joint ventures (1979), taxation (1980), investment generally (various times), trademark (1982), patent protection (1984), foreign economic contracts (1985), and wholly foreign-owned subsidiaries (1986). The effects of China’s new trade laws are just beginning to be felt, and the results of this trend toward legalism, while not without problems, appear extremely favorable.

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34. Jerome Cohen has stated “If you want people to participate in the modernization movement, you must guarantee them some protection against arbitrary rule. New ideas aren’t going to come forth if it pays to keep your mouth shut.” Quoted in Comment, supra note 5, at 63 n. 79.


36. Approximately two-thirds of the officials in China’s leading central departments have engaged in legal studies since the fall of 1985. China Daily, October 3, 1986, at 3.

37. Approximately one billion economic contracts have been signed in China. China Daily, Jan. 13, 1986, at 3. Reflecting the Chinese attitude that “A lawsuit breeds ten years of hatred,” most disputes under these contracts are resolved through mediation. China Daily, Dec. 22, 1986, at 4. Chinese officials have stated that approximately 70% of such disputes are resolved through mediation by local arbitration committees. Id. It is estimated that a total of 6.47 million civil disputes (excluding domestic relation cases) were resolved by such mediation in 1984. China Daily, Aug. 19, 1985, at 1.

38. See also supra note 2, at 206-09 for a discussion of the development of China’s emerging legal structure. See also supra note 30, at 27-30; Ellis & Shea, supra, note 14 at 158.


40. Internally, the certainty of a formal legal structure with some assured rights for citizens may have contributed to demonstrations against the government in early 1987, which provoked a backlash against any form of dissent. See China’s Anti-Westernization Drive Won’t Threaten Cultural Exchanges, J. Comm., Mar. 2, 1987, at 4A. Externally, disputes involving foreign parties have increased, China has experienced severe foreign exchange shortages, and foreign investment in China dropped an estimated 20-40% in 1986 over 1985 levels. See supra note 1.

41. For a history of the legal profession in China, see Leung, The Re-Emergence of the
III. The Nature of U.S.-China Trade

Three essential objectives form the basis for China's trade policy: Importing high technology, establishing joint ventures and obtaining investment capital and foreign exchange. China principally seeks to increase the importation of high technology and the exportation of its own goods. It concurrently seeks to establish joint ventures in China with its trading partners. Working together, these two objectives are designed to help China develop its own production capabilities using modern technology. This drive to modernize pervades China's new trade laws and is characterized by the slogan: "Buy hens that lay eggs."\footnote{42} Finally, because China traditionally has been reluctant to become a major borrower, its leaders have striven to maintain a balance between imports and exports. Mao strongly opposed borrowing from other nations\footnote{43} and only during the past few years has China sought loans and investment from outside sources.\footnote{44} To obtain and maintain this investment, China must demonstrate continued financial and political stability.

IV. China's Trading Establishment

Chinese citizens cannot enter into export or import contracts on their own behalf.\footnote{45} The organizations originally most involved in carrying out China's plans for trade were the Foreign Trade Corporations (FTCs). These government entities were established primarily under the purview of the Ministry of Foreign Trade (MOFERT), and were granted both import and export functions.\footnote{46} The FTCs traded on behalf of end-users and producers, thus the consumer fre-

\begin{footnotes}
\item[42] Theroux, supra note 2, at 195.
\item[43] For a discussion of the reluctance of the Chinese to become dependent on the outside world, see Theroux supra note 2, at 188-95.
\item[44] Id. at 191-92. To make foreign investment more attractive, China has established the Chinese International Trust and Investment Corporation (CITIC) with the responsibility of administering foreign investment agreements. For an English version of CITIC's charter, id. at 198-200. China has increasingly turned to the international bond market for funds, raising over $1 billion through this method during the past four years. China Daily, Jul. 9, 1986, at 1 (Business); China has not attempted to obtain financing in the United States because of unresolved claims related to bonds of the Imperial Chinese Government. These claims have recently been dismissed see Jackson v. People's Republic of China, 794 F.2d 1490, (11th Cir. 1986), cert. denied, 107 S.Ct. 1371 (1987).
\item[45] Theroux, supra note 2, at 214.
\item[46] Id. at 196.
\end{footnotes}
quently was unaware of the actual producer or end-user involved in a transaction. Since 1980, the number of entities analogous to FTCs, but created under ministries other than MOFERT has steadily increased, effectively diluting the role of MOFERT.

The structure and legal status of FTCs remain undefined because their charters generally have not been made public. They do not have assets abroad, nor do they have foreign offices, although they have used representatives in the United States; therefore, the FTCs are essentially immune from process or liens against their assets except in China.

Equally important in the conduct of foreign trade is the China Council for Promotion of International Trade (CCPIT) and three of its subdivisions: the Foreign Economic Trade Arbitration Committee (FETAC), the Maritime Arbitration Committee (MAC) and the Legal Affairs Department. Since maritime disputes are beyond the scope of this paper, suffice it to say that MAC is FETAC's maritime analogue.

The Legal Affairs Department is the working arm and coordinating body for the two arbitration committees. It plays a significant role in the resolution of disputes at all stages and works in harmony with the committees. The former Director of the Legal Affairs Department, Ren Jianxin, who was also the Secretary General of both committees and is currently Vice President of the People's Supreme Court in Peking, was instrumental in developing a structure for dispute resolution in United States-China trade. In 1980, the Legal Affairs Department under Ren Jianxin established a Legal Advisor's Office, which is responsible for providing advice to foreigners doing business with China. Furthermore, the Legal Affairs Department is in charge of administering the 1976 agreement between the American Arbitration Association (AAA) and the CCPIT to conduct joint conciliation of disputes.

47. Id. at 197. Note, however, that to some extent individual enterprises have gained authority to negotiate trade contracts. See Mitchell & Stein, United States-China Commercial Contracts, 20 INT'L LAW 897 (1986). It is unclear whether this trend will continue or be reversed in light of the current debate over modernization.

48. Id. at 197.

49. Id.


51. Theroux, supra note 2, at 208.

52. Although no written agreement was entered into between the two organizations, it
FETAC plays an important role in international trade by facilitating the settlement of disputes at all stages. FETAC was originally created in 1954 as the Foreign Trade Arbitration Commission, but in 1980 the importance of the other economic aspects of China's development was recognized and given more emphasis by adding the word "Economic" to the title. FETAC now has jurisdiction for disputes arising under trade contracts, financing agreements and joint ventures. FETAC's primary function is to conduct arbitration. This may be done pursuant to the guidelines established in FETAC's Provisional Rules of Procedure, which were published in 1956 and are still in effect, or under other agreed upon rules. The procedures for arbitration will be discussed below.

V. The American Counterparts

The types of American entities doing business with China are more varied and more difficult to define, yet at the same time their legal nature is more familiar, thus, less interesting. They are corporations and individuals who recognize the potential market for and source of produced goods and raw materials. The most important characteristic about their legal nature from the dispute resolution standpoint is that they can be sued in American courts for non-recognition in China. Over 90% of all cases in which FETAC or MAC participate are resolved prior to arbitration. Over 90% of all cases in which FETAC or MAC participate are resolved prior to arbitration. Id. at 255.

For a discussion of the arrangement, see Holtzmann, supra note 16, at 288-291.

L. Fung, CHINA TRADE HANDBOOK 255 (1984). It should be noted, however, that when an official of the Ministry of Justice was queried whether the Economic Courts have had any cases which had any impact on trade, he was unaware of any cases which had been heard by the courts regarding trade. Discussed during telephone interview of Ms. Jeanne Chiang, National Council on United States-China Trade, by Mr. Steven Robinson (April 7, 1983) [hereinafter Chiang Interview].

For a comparison of other systems of international commercial arbitration with the FETAC rules, see Lockett, supra note 1, at 247-257. See also Ellis & Shea, supra note 14, at 164-68. Use of FETAC has become increasingly popular in recent years. The membership of FETAC has been increased from 21 to 65. 1985 saw FETAC participate in over 50 arbitrations, 80 mediations, and 100 consultations. See China's Foreign Economic and Trade Arbitration is Gradually Being Perfected, Hong Kong Liaowong Overseas Edition, Jan. 27, 1986, at 4. Another source stated that 60 arbitration cases involving foreign firms were brought before FETAC in 1985. Beijing Rev., No. 18, p. 28 (1986). Ninety such cases had been brought in the first 11 months of 1986. China Daily, Dec. 22, 1986, at 4.
ognition of arbitral awards.\textsuperscript{57}

A private, non-profit organization whose role cannot be overemphasized is the National Council for United States-China Trade (NCUST). Established in 1973, the NCUST serves as a conduit for information and advice to facilitate bilateral work. With offices in Washington and Beijing, the NCUST has a wealth of information and expertise available to entities wishing to engage in United States-China trade. \textsuperscript{58}

VI. Business Aspects Unique to United States-China Trade

Any one of a number of factors unique to China trade, if not recognized by the foreign party during the initial negotiation of a business agreement, has the potential for creating otherwise easily avoidable disputes. The foremost factor that should be borne in mind is the tenacity of Chinese negotiators in the process of determining the terms of a contract. Chinese negotiating teams are extremely well-prepared and diligent in their approach to business, and expect contract terms to be taken exactly as written. \textsuperscript{59} Contracts are reduced to writing in English and are straight-forward in nature. The negotiations are highly technical and detailed, so it is important that the negotiators have substantial technical knowledge. At the same time, the Chinese look to cultivate long-term relationships and are quite patient in negotiations. \textsuperscript{60} The Chinese can take a long time to make decisions, since negotiators typically must clear their actions with higher authorities. \textsuperscript{61} Patience is thus a necessity for the American side.

Negotiations are frequently conducted in two steps. First the technical, working level discussions are held, and if successful, discussions move on to the business aspects. \textsuperscript{62} Although some have expressed concern that the Chinese object to legal counsel's presence


\textsuperscript{58} A brochure describing the functions of the National Council is available from NCUST at 1818 N Street, N.W., Washington, D.C. 20036.

\textsuperscript{59} For an excellent discussion of considerations involved in Chinese contract negotiations, \textit{see} Theroux, \textit{supra} note 2, at 210-12.

\textsuperscript{60} \textit{See} R. Tung, \textit{U.S.-CHINA TRADE NEGOTIATIONS} 69 (1982).


\textsuperscript{62} Technical seminars often pave the way for negotiations. \textit{See id.} at 55. Once negotiations begin, the Chinese often wear down the other side with technical questions. \textit{Id.} at 59. In practice, it is often difficult to keep the technical and business negotiations separate. \textit{Id.} at 60. \textit{See also} \textit{INTERNATIONAL TRADE ADMINISTRATION} (ITA), \textit{DOING BUSINESS WITH CHINA} 14 (1983).}
during negotiations, this generally has not been the case. 68 Since most negotiations are conducted in China, 64 the practice of negotiating technical aspects first, followed by price and terms, can pose problems if the American technical team leaves and the commercial team is not familiar with the technical aspects. The commercial team must be sure not to disturb the technical agreement and the technical team must be aware that its promises of performance will be noted by the Chinese and could very well become a warranty in the contract.68

Warranty and quality terms of contracts are crucial to the Chinese and often subject to dispute; therefore the contracting parties must strive for precision with respect to these terms. Optimally, the parties should be prepared to demonstrate all warranties and qualities using agreed-upon tests.66

All contracts covering the importation of goods or merchandise to China will call for inspection and acceptance to occur in China by the China Commodities Inspection Bureau.67 The Bureau is noted for its meticulousness in inspections and adherence to the details of the contract. 68 As for contracts covering exports from China, claims for damaged goods arriving in United States ports will be rendered invalid if the Chinese present a certificate of final inspection showing the goods were in good condition upon departure from China.69 This uneven treatment might lead to disputes between trading partners, particularly where a United States firm is involved in both importing and exporting.

A similar disparity in application has traditionally existed in the interpretation of force majeure clauses included in contracts.70 Export contracts from China will relieve the seller from liability should force majeure intervene and make performance impossible. However, in import contracts, the Chinese have typically been more restrictive in their view as to what qualifies as a force majeure. American terms referring to “acts of God” were not viewed as effective to the Chinese because as one party was told: “He’s your God, we’re

63. Theroux, supra note 2, at 210.
64. Most negotiations are conducted in either Peking or Guangzhow, de Pauw, supra note 61, at 56, though some contracts have been negotiated by telex. Id. The Guangzhow Trade Fair has typically been an important method for making contacts with the Chinese. See Ministry of Foreign Economic Relations and Trade, Guide to China’s Foreign Economic Relations and Trade: Import-Export Special 367 (1984).
65. See Theroux, supra note 2, at 213.
66. Id. at 223. The Chinese also typically attempt to incorporate servicing arrangements into contracts.
67. Id. at 221.
68. Id.
69. Id. at 222.
70. Id. at 225-26. Such clauses in U.S.-China trade typically do not specify the events constituting a force majeure. See Doing Business with China (ITA) supra note 62, at 15, 16.
not responsible for him." 71 This attitude has changed and some Chinese FTCs now will agree that conditions beyond the control of the parties, including acts of God and labor unrest, may constitute a valid force majeure.72

Clauses excusing performance for labor strikes are generally not recognized where the strike is against the party in the contract. This stems from the Chinese view that unions would not be striking if the management had been proper in its conduct of business. Therefore, the Chinese view a strike as a matter within the control of the contracting party.73 On the other hand, strikes against a sub-contractor may be viewed as sufficient excuse for non-performance.

Divergent views regarding the valuation of contributions to a joint venture also are likely to result in disputes. The contributions of each party need not be cash, but may be in goods, knowledge, or services as well. Unless parties are clear in their definition of the means for evaluating these contributions, disagreement may arise over the actual value which should be used. Whereas the American company may present audited books or financial statements to justify the value of its contribution, the Chinese are critically short of accountants74 and their books might very well be state secrets that cannot be disclosed.

Because each of these aspects of business with China represents a considerably different approach to business than American companies might be accustomed to, the potential for serious disputes over simple misunderstandings exists. Parties entering into trade with China therefore must utilize counsel experienced in China trade or seek advice from an entity such as the NCUST prior to entering into contract negotiations. Disputes can be minimized through conducting informed discussions prior to entering into a contract, rather than allowing a vague term to remain in the contract to expedite negotiations.

VII. Philosophical Concepts Underlying Foreign Trade with China

China’s approach to dispute resolution cannot be fully understood by reference alone to its unique perspective on legal systems. In reality, several factors merge to create an integrated mechanisn. While broken down here into separate concepts to aid discussion,
China's holistic philosophy is indivisible and more accurately represented by the dialectic theory explained above. The first three concepts discussed are the guiding principles of the arbitration commissions, FETAC and MAC, although they are not limited to those contexts but pervade the Chinese view of foreign trade. Though once thought derived from the principles of "foreign policy given by Chairman Mao, these concepts have retained their importance in the Post-Mao era." The remaining concepts apply generally to the Chinese attitude toward dispute resolution in an international context.

A. Independence

Independence requires that the initiative be kept in China's control and that ideas and policies should not be forced on China from outside. It permits the adoption of foreign ideas and practices, so long as they are not coerced and China's best interests are served.

B. Consistency with International Trade Practices

This policy acknowledges that trade objectives are often accomplished through accommodating other nations' interests by requiring evaluation of and conformity to standard international practices whenever possible. At times compliance with this policy may require that China's independence be sacrificed.

C. Equality and Mutual Benefit

Balancing China's interests with those of its trading partners is paramount. Exploitation of a trading partner is frowned upon and fairness is a prime consideration. This policy serves as a reiteration of the inter-related nature of the first two concepts and the constant juxtaposition of thesis and antithesis.

D. The Courts as Dispute Resolution Forums

Although the focus of this paper is on the alternatives to the

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75. Id. at 200-01. See supra note 16 and accompanying text.
76. Holtzmann, supra note 16, at 267; McMillan, supra note 50, at 3. Another important attitude of the Chinese is a desire for their trading partners to realize a reasonable profit on any transaction. As contrary as this might seem to the Marxist view that profits represent exploitation by the capitalists of the masses, the reasoning behind the Chinese view is very pragmatic. They fear that if their trading partner is not satisfied with the contract profits, then the partner will not perform in a satisfactory manner, resulting in poor service for the Chinese. Chiang interview, supra note 56. See also U.S. Helps Chinese With Managerial Skills, J. Comm., Mar. 4, 1987, at 4A (quoting the Dean of a Chinese business school as saying, with respect to all businessmen, that "profits are the major measure of performance.").
77. Holtzmann, supra note 16, at 279.
79. McMillan, supra note 50, at 4, 8.
80. Chew, supra note 16, at 250-51; McMillan, supra note 50, at 4, 8.
court system, the court system is a potential means for solving disputes. One commentator has pointed out that "[n]othing in the [United States-China] Trade Agreement prevents Chinese foreign trade organizations or American corporations from litigating in American or Chinese courts." 81 Although the Chinese are averse to litigation, Ren Jianxin told an ABA delegation that "[i]f either of the parties wishes to approach the court, we have no objection." 82 China has created "Economic Courts" within the People's Courts for the purpose of handling disputes over economic matters including foreign trade.83

E. Combination of Methods

The Chinese do not view the various methods of dispute resolution as discrete, separable functions. Rather, the least formal method of dispute resolution, friendly negotiations, will be utilized even while the parties have reached the arbitration stage. This belief that the parties should continue to resolve their differences at the lowest level in the hierarchy of legal forms allows negotiation and conciliation to continue as dispute resolution progresses to the next method. Howard Holtzmann, a noted scholar on Chinese trade, described this blending as similar to "a fine Peking glass bottle, there may be several layers, each with a different hue, each visible as a separate entity, yet all blending together to create a total pattern."84 Holtzmann attributed the unusually high percentage of settlements prior to arbitration to the concept of combination.85

F. "Seeking Truth Through Facts"

This principle is inherent in all types of dispute settlement in China. The fact finding or investigation of the parties and the conciliators, mediators or arbitrators is extremely important to arriving at a just solution. Holtzmann suggests that parties involved in conciliation will do better to "marshall their facts" than to rely on rhetoric.86

G. Not Disturbing the Relationship

Rooted in the tradition of harmony with the universe, the Chinese view toward friendship is extremely important in trade. The

82. Id.
83. These courts have not had a significant impact in the foreign trade sector. See supra note 55.
85. Id. at 255-56.
86. Id. at 280.
concept of an "old friend" is especially strong in the Orient and encompasses a broad view of loyalty and trust. The development of a friendly relationship should be of vital concern to American parties seeking to enter into China trade. The Chinese are extremely loyal customers and once faith is gained in a trading partner, the negotiation of contracts and settlement of potential disputes can be shortened considerably. For example, the Chinese trading corporations frequently are unable to agree to a monetary damage settlement of a present contract due to budgetary constraints, but will assure their partner that a future contract will be made more advantageous to make up for their inability to settle on this contract. This concern with the long range effects contrasts sharply with the typical American desire for short-range settlements.

H. "Dividing One into Two"

An essential concept to conciliators in China trade is that of "dividing one into two." This concept stresses that there are usually two points of view regarding each element of dispute, with the role of the conciliators being to educate the parties regarding the points of view that they may be considering. The Chinese view this as one of the most important functions of the conciliators. The application of this concept is demonstrated by one of the telexes sent by the Chinese during the joint conciliation conducted by FETAC and the AAA:

We are of the opinion that it is unreasonable for only one side to claim against the other without considering the case of loss and the fact that both sides have sustained losses. Under these circumstances both companies should proceed in the spirit of friendship, cooperation and mutual understanding not only taking the interests of one's own side into consideration, otherwise it would be quite impossible to resolve the dispute, what is more it would not be beneficial to the future development of friendship and trade relations between both sides.

87. *Id.* at 282. The same point was discussed during Chiang interview, *supra* note 56.

88. Holtzmann, *supra* note 16, at 301. See Chew, *supra* note 16, at 268-69; McMillan, *supra* note 50, at 9. For a step-by-step description of one of the only two conciliations conducted in U.S.-China trade, see Holtzmann, *supra* note 16, at 291-317. Holtzmann was an observer during the conciliation. One interesting point was a comparison of the fact statements filed by the two parties. The American party filed a brief that was 45 pages long and supported by 14 exhibits citing numerous related legal principles and facts, and prepared as if to enter American style litigation. On the other hand, the Chinese statement was a short, simple description of the facts with brief references to any evidence supporting them. It also emphasized the concepts of Chinese dispute resolution. *Id.* at 299-300.
VIII. Methods of Dispute Resolution

There are essentially four methods of dispute resolution, excluding the courts, available in United States-China trade. These methods, known by various names, represent isolated points along a continuum of methods. For the purpose of this discussion, we consider the four alternatives to be: (1) friendly negotiations or consultations; (2) conciliation; (3) joint conciliation with non-binding recommendations for settlement; and (4) arbitration. Standard form contracts provided by the FTCs frequently state that disputes will be resolved through friendly negotiations, and failing there, they may be resolved through arbitration. 89

The two steps of conciliation are not required, 90 but are strongly encouraged, and in view of the aversity of the Chinese toward litigation and other forums which impose solutions on the parties, it can reasonably be assumed that prior to reaching arbitration a dispute will first pass through the other stages. These methods are discussed sequentially, bearing in mind the concept of combination which tends to blur the demarcation of each method. 91

A. Friendly Negotiations

As distinguished from contract negotiations, "friendly negotiations" or "consultations" are terms of art referring to the process of exchanging letters, telexes and visits in an attempt to resolve disputes between two parties, with no involvement by an outside party. 92 Experience has indicated that friendly negotiations can be lengthy, but the concept is based on the assent of both parties to

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89. See, e.g., Ellis & Shea, supra note 14, at 161. Examples of such clauses, from the SHANGHAI OVERSEAS INVESTMENT UTILIZATION MANUAL (1985), at 495, follow:

Any disputes arising from the execution of, or in connection with the contract shall be settled through friendly consultations between both parties. In case settlement cannot be reached through consultations, the disputes shall be submitted to the Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade for arbitration in accordance with its rules or procedure. The arbitral award is final and binding upon both parties.

or.

Any disputes arising from the execution of, or in connection with the contract shall be settled through friendly consultations between both parties. In case no settlement can be reached through consultations, the disputes shall be submitted to ________________________ Arbitration Organization in ________ for arbitration in accordance with its rules of procedure. The arbitral award is final and binding upon both parties.

A more extensive sample dispute resolution clause can be found in Surrey & Soble, Recent Developments in Dispute Resolution in The People's Republic of China, in Legal Aspects of Doing Business with China 375, 428-30 (J. Cohen ed. 1983).

90. Ellis & Shea, supra note 14, at 162.

91. See supra notes 84-85 and accompanying text.

92. See Chew, supra note 16, at 267; Klitgaard, People's Republic of China Joint Venture Dispute Resolution Procedures, 1 UCLA PAC. BASIN L.J. 1, 6 (1982); McMillan, supra note 50, at 7, who groups friendly negotiations together with conciliation.
their continuation, and should one party wish, conciliation may be initiated.93

The prime function of these negotiations is to "seek truth through facts" so as to enable the parties to search for a settlement that honors the contract terms and the law. When these objectives are met using this process, then it is very effective, particularly since the parties reach the settlement themselves. In one instance of friendly negotiations, a dispute involving the cancellation of two orders for wheat and cotton by the Chinese party, the settlement arrived at was for the Chinese party to pay "cover" damages, as in the Uniform Commercial Code. 94 If on the other hand the parties cannot settle their dispute without the assistance of a third party, conciliation may be conducted.

B. Conciliation

Similar to conciliation conducted in the United States, this method involves the use of a third party or parties to assist the disputants in reaching a settlement. At this stage, the conciliators do not suggest settlements, but act as intermediaries for the disputants, seeking facts and presenting them to the parties. The AAA and FETAC have acted in this capacity and their agreement on joint conciliation very likely will continue to be a vital means for parties to conduct conciliation. Reflecting the Chinese attitude toward combining, this stage has been referred to as "friendly negotiations with the assistance of conciliators."95

C. Joint Conciliation with Non-Binding Recommendations

Although there have been few reported instances where this process was used, it appears that this method will be more important than arbitration in the near term.96 One conciliator is selected by each party and the conciliators attempt to reach a settlement proposal that will be acceptable to both parties.97 The recommendations made are non-binding in nature and as such are more palatable to the Chinese. The agreement between AAA and FETAC for joint conciliation facilitated the settlement of two disputes using this method, although in one case it took nearly three years from the

93. See Lockett, supra note 1, at 260.
94. Id. at 261. The confidentiality of alternative dispute resolution settlements makes it extremely difficult to determine the details of any particular settlement. Hence, most discussions of settlements are vague and inconclusive.
97. Wetter, supra note 54, at 268-69, suggests that this stage consists of a more informal process whereby any conciliator will do.
initiation of the friendly negotiations to the arrival of a settlement. Three years is still far too long for this method to be considered an efficient means of dispute resolution. However, the uncertainty with which both parties proceeded was due in large part to their unfamiliarity with the process. Holtzmann believes the process would run more smoothly if a uniform set of rules was in place. To this end he suggests adoption of the UNCITRAL Conciliation Rules, which were pending at the time of his book.

D. Arbitration

Should the parties fail to reach a settlement through the first three techniques, arbitration is available. Although arbitration in United States-China trade is the subject of numerous law review articles, there are apparently no reported cases of arbitration. Nonetheless, arbitration serves a valuable function by providing a familiar approach to dispute resolution for American companies unaccustomed to the voluntary methods employed by China.

Parties are free to develop an arbitration clause which suits their particular needs and desires, and a broad variety have been used in China trade. Initially, the most common clauses called for arbitration in Beijing using FETAC rules. Although these rules have been unchanged since they were promulgated in 1956, they are somewhat similar to rules used by the AAA. Arbitration by FETAC is not restricted to use of its own rules, yet no instances have been reported of FETAC using other rules. Recent trends indicate an increasing flexibility regarding the rules and location to be used for arbitration.

Indicative of this flexibility is the increase in the use of "third country" arbitration clauses. Both the 1979 Trade Agreement and China's Joint Venture Law contain language approving the use of arbitration in a third country of the parties' choice, using the rules of that forum, UNCITRAL or those rules expressly agreed to by the parties. The standard form contracts of the FTCs also reflect an acceptance of third country arbitration. These clauses appear to

100. E.g., Klitgaard, supra note 92; Chew, supra note 16 and infra note 106; Lockett, supra note 2; Theroux, supra note 56; Theroux, supra note 2; Ellis & Shea, supra note 14; Comment, supra note 5. For a thorough if slightly outdated view of arbitration procedures used in the case of disputes involving foreign entities, see Hsiao, China's Foreign Trade Organization, 22 Vand. L. Rev. 503, 514-18 (1969).
102. Article 14 of the Joint Venture Law, supra note 39.
103. See Theroux, supra note 2, at 239-40, 250.
104. See supra note 90.
be replacing the previous standard clauses specifying arbitration in the country of the defendant, a practice which had become a standard in international trade prior to the growth of the independent arbitration bodies such as the International Chamber of Commerce, the Stockholm Chamber of Commerce (SCC) and the acceptance of the UNCITRAL arbitration rules. The arbitration clauses in some standard contracts also indicate a desire to make the arbitration decision binding and not subject to appeal.

IX. Evaluation of the Alternatives: Efficient Techniques or a Hobson’s Choice

As can be seen from the flexibility accorded parties to arrange arbitration to suit their needs, the availability of arbitration in United States-China trade is becoming representative of modern international trade practices. One would assume that if the methods are efficient, then the methods would be used when parties had disputes. To what, then, can the absence of arbitrations, particularly in the early years of United States-China trade, be attributed? Is it the efficiency of the other methods available, the aversion to arbitration, a simple lack of disputes, or perhaps a combination of these and other factors?

A method for dispute resolution is efficient if it allows two reasonable disputing parties to reach a just settlement in a reasonable efficiency of the other methods available, the aversion to arbitration, a simple lack of disputes, or perhaps a combination of these and other factors?

A method for dispute resolution is efficient if it allows two reasonable disputing parties to reach a just settlement in a reasonable

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105. Clauses specifying arbitration in the country of the defendant are not advised. These clauses provide an incentive for parties to breach contracts or otherwise attempt to position themselves as the defendant in any prospective dispute.

106. Arbitration decisions are final and binding under FETAC rules. See Mitchell & Stein, United States-China Commercial Contracts, 20 INT’L LAW 897, 911 (1986). Over 90% of United States-China contracts provide for Beijing or Stockholm as the situs of arbitration. Id. A questionnaire on arbitration by the NUSTC to its members revealed that of 29 respondents who had dealings with China, 26 members had entered into contracts with dispute settlement clauses. Of these 26 clauses, 10 provided for Sweden as the place or arbitration. Questionnaire Responses: Dispute Settlement and Penalty Clauses in U.S.-P.R.C. Contracts, National Council for U.S.-China Trade (April 15, 1981) [hereinafter NCUST Survey]. Of these 10, four of these contracts provided, in addition for the use of the rules of the Stockholm Chamber of Commerce, for use of “Swedish Arbitration Procedure,” one provided for use of the “laws of Sweden,” one provided for use of the “laws of Sweden,” and one provided for use of UNCITRAL rules. These results are consistent with the survey results of Rosalie Tung. See Tung, supra note 60, at 56-73 (1984). The Chinese preference for Sweden as the preferred locale of third-country arbitration may result from Swedish rules that apply the law of the country with the closest contacts to the contract, which will usually be China in the U.S.-China trade context. Other factors, such as the reputation of the Swedish for neutrality and the historical acceptance of Sweden as an arbitration locale by the U.S.S.R., may also contribute to the Chinese preference for Sweden. See Chew, A Procedural and Substantive Analysis of The Fairness of Chinese and Soviet Foreign Trade Arbitrations, 21 TEX. INT’L L.J. 291 (1986).

107. For instance, in the NCUST Survey, supra note 106, none of the respondents reported any experience in the application of arbitration clauses. FETAC has become an increasingly popular arbitral forum in recent years. See supra note 56. But as of 1986, there were still no reported arbitrations involving U.S. firms. See M. Ferguson, supra note 54, at 22; see also Surrey, Dispute Settlement in U.S.-China Trade — Another Look in Legal Aspects of Doing Business with China 279, 287 (1985).
period of time, with a minimum of intervention, while preserving their relationship and ensuring that the needs of both parties are recognized and honored.\textsuperscript{108} If evaluated against this standard the options available in United States-China trade are very efficient. If improved by the implementation of rules on conciliation as suggested by Holtzmann, the increased certainty might streamline the conciliation process even more, resulting in more prompt settlements. Even though the methods are efficient, conciliation has not been used to any great extent, so the lack of arbitration cannot be attributed to the smooth functioning of conciliation or joint conciliation with non-binding recommendations. By the same token, no matter how efficient "friendly negotiations" might be, they are not so unique as to cause the elimination of so many disputes that only two disputes progressed beyond that stage.

Notably, the Chinese disinclination toward arbitration appears to have received more attention by commentators \textsuperscript{109} than it may merit. Given their penchant for abiding by the terms of a contract and the law, it is inconceivable that they would consistently agree to arbitration terms were they not ready to submit to arbitration, should the need arise. The growing acceptance of the Stockholm Chamber of Commerce and its rules and the UNCITRAL rules reflect Chinese confidence in the fairness of arbitration, as well as a pragmatic acceptance of current international trade practices. While the Chinese may be mildly opposed to arbitration, and the concept of combination dictates that conciliation and friendly negotiations continue during arbitration, neither of these factors is so unusual to cause the settlement of over ninety percent of disputes prior to arbitration for all cases involving China's trade with other countries. Nor does it explain why there have been only two reported instances of joint conciliation, because the Chinese are clearly not averse to such method of dispute resolution.

Perhaps, then, the most significant factor contributing to the lack of arbitrations and conciliations is simply the lack of disputes. If one accepts the postulate that the shortage of arbitrations and conciliations is due not to shortcomings in the methods of dispute resolution, but instead to a shortage of disputes, then the inquiry must shift to the root question: Why are there so few disputes?

\textsuperscript{108} The concepts of principled negotiations suggested by Fisher and Ury are also helpful in determining whether an alternative dispute resolution technique is in fact principled. The standards for principled negotiation are described in R. Fisher and W. Ury, Getting to Yes: Negotiating an Agreement Without Giving In, 11-14 (1981).

\textsuperscript{109} See supra note 100.
X. Factors Mitigating Against Disputes

Determining the cause of disputes and predicting areas over which disputes are likely to develop is a relatively easy task. One can ask the parties what they disagree over or what was the most difficult clause to reach an accord on during contract negotiations. One can examine contractual language and determine disparate treatment which is likely to cause future problems. The confidentiality of friendly negotiations, conciliation and arbitration tends to limit the amount of information available to the researcher or counsel seeking to determine precedent or obtain background information, but predicting likely areas of dispute in particular cases is not difficult.

Although it is possible to determine over which areas disputes will occur, only conjecture can be used to reason why disputes have not occurred. Examination of the analogy between a defense contractor seeking development and production contracts and a United States company seeking to develop a long-term relationship with China may help explain the paucity of disputes in the early stages of United States-China trade. In defense contracting, the potential for obtaining a long-term production contract with its associated larger value leads to a tendency to "buy in" to a less favorable development contract. Similarly, large defense contractors are generally reluctant to lodge a protest or claim against the government for fear of damaging their long-term relationship with government procurement officers.

The same factors exist in trade with China. American companies aware of the tremendous potential of China trade and the Chinese loyalty to "old friends" may be avoiding disputes in order to develop long-term trading relationships that ultimately will make up for any losses suffered in the near-term. Similarly, the traditional value the Chinese place on long-term relationships may be a prime factor for their failure to initiate disputes. As simple as this theory might seem, the short trading history between the two countries and the tremendous future potential of bilateral trade readily suggest such a pragmatic approach; however, continued trade experience may reveal a more intricate explanation for the dearth of disputes, or

110. See discussion of unique business aspects of trade with China, supra notes 52-62 and accompanying text.

111. The dollar value of development contracts for a defense project is approximately 10-20% of the total program acquisition cost. Thus a company can afford to make minimal profit to win either the development contract or the early production series contracts in order to gain a competitive advantage for the full-scale production contracts. For example, one contract with which the author is familiar involved approximately $80 million in research and development with nearly $1 billion in production.

112. E.g., Holtzmann, supra note 16, at 276-77.
XI. Conclusion: An Opportunity for Preventive Lawyering

If dispute resolution techniques are not being utilized, then counsel should change the focus of advice for clients seeking to do business with China. Assuming the Chinese are opposed to any litigious proceedings and similarly averse to any form of dispute, the prime function of counsel should be to prevent disputes through the role of "counselor" as suggested by Chief Judge Re. \(^{114}\) Granted, counsel should be familiar with provisions for dispute resolution clauses in contracts. In view of the growing acceptance of arbitration in Sweden under the SCC rules, these clauses should be easily negotiated into future contracts. However, the selection of the proper arbitration clause in a contract will by no means fulfill counsel's obligation regarding dispute resolution.

On the contrary, the selection of the clause should become second nature and part of the standard form contracts. The true role of counselor is only fulfilled through advising the client on how to conduct negotiations and business in such a manner that the arbitration clauses are never used.\(^{118}\) Therefore, among the most important information counsel can provide to clients is that which imparts an understanding of the Chinese attitude toward law and international trade.

The opportunity is available to embark on a new and revolutionary area of lawyering. That almost fifty billion dollars in trade has already occurred without apparently a single law suit and with no reported arbitrations suggests that disputes need not arise at all in order to be resolved. The coming challenge for United States counsel will be to maintain this unusually amicable record as United States investment in and trade with China grows, and while the Chinese themselves grapple to establish a formal legal system.

As investors establish long-term relationships, they may no longer be willing to absorb short-term losses, and disputes may increase. This result, however, is not inevitable. If counsel can provide foreign negotiators with an understanding of the Chinese perspective from the start of negotiations, trade can grow while disputes are avoided. This area of China trade thus presents American lawyers

\(^{113}\) More disputes may arise as U.S. companies establish long-term positions for themselves in China. Companies having an incentive to forsake disputes in the short-term for a larger market share do not necessarily have this same incentive over the long-term.

\(^{114}\) See Re, supra note 8.

\(^{115}\) "The lawyer, when acting as counselor, performs a function that is extremely beneficial to society, in that effective legal counseling minimizes the likelihood of conflict between parties by stabilizing relationships and promoting understanding and cooperation." Re, supra note 8, at 691-92 (emphasis in the original).
with an ideal opportunity to fulfill their role of "counselor," not simply facilitating the resolution of disputes (or sometimes even exacerbating disputes as "advocate"), but preventing disputes from arising in the first place.