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Guide on Arbitration and IP for EU SMEs

CHINA IPR SME HELPDESK

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Imagine a situation that you signed a licensing agreement with your Chinese business partner. At the beginning, all looks very promising, but after a few months, your business partner is not paying due fees for the use of the license. You are sending emails to urge the other party to pay immediately. That is, however, unsuccessful. You wonder what step to take next, and it seems that the only way is to go to a Chinese court to resolve this dispute. Yet, that does not have to be the only way to resolve your IP-related disputes. This Guide introduces you to the use of an alternative way, arbitration, in the context of IP-related disputes with China.

Already when entering into any business transaction, you should be aware of the risk of disputes that this transaction may bring. Facing a legal dispute is not a pleasant thing in any scenario. It can, however, get even more complicated if it is to take place in a foreign country, like China, and/or against a foreign party, like a Chinese party. There can be numerous concerns, just to name a few: high expenses related to resolving disputes, lack of understanding of local language and procedure, perceived bias of local courts, etc. Some of these risks can be, at least to some extent, mitigated at the initial stage of business. Therefore, despite the fact that no one likes to think about the divorce when entering into a promising marriage, it is worth to anticipate possible dispute resolution options already at the stage of planning a particular transaction.

The same applies also to intellectual property (IP) -related disputes. Generally, there is a number of dispute resolution methods that European SMEs can resort to in the Sino-foreign context. Each of them has its own advantages and disadvantages. This guide concentrates specifically on arbitration as one of the methods. It introduces the concept of arbitration; analyses the advantages and disadvantages of arbitration – in particular when compared with resolving disputes in front of the state court; and explains the key procedural aspects of arbitrating in China.
2. What Actually Is Arbitration?

Arbitration is a private method of resolving disputes. It is a way alternative to litigating in front of a state court. In arbitration, arbitrators selected by disputing parties, after hearing the parties’ arguments, render an arbitral award that is final and binding upon the parties.

Arbitration is consensual. This means that for arbitration to happen, parties have to reach an arbitration agreement, in which they clearly specify that they wish to submit their disputes to arbitration. Such an agreement is normally a part of the whole contract addressing the business transaction. If you find arbitration to be a good way to resolve your future disputes, you should think about it already at the stage of negotiating the contract. The arbitration agreement can theoretically be also concluded once a dispute occurs. However, when parties are already in dispute, it is usually difficult to reach any consensus, especially if your counterpart finds it more convenient to resolve the dispute in front of a state court, and not in arbitration.

When preparing an arbitration agreement, there are a few important elements that it should include:

- Parties should clearly stipulate which disputes they want to resolve through arbitration. A typical arbitration clause says broadly: “All disputes arising out or in connection with this contract should be resolved via arbitration [...].”
- If arbitration is to take place in China, it is essential to designate a specific, domestic arbitration institution, as it is required by Chinese law. Otherwise, the arbitration agreement may be found invalid and the dispute may then land in front of a state court.
- There is a number of additional elements that the parties can include in their arbitration agreement. This could be, for example, the number of arbitrators that will resolve the dispute (usually one or three arbitrators) or arbitration proceeding language.

In order to avoid problems where the poor drafting of an arbitration agreement leads to doubts whether it is valid, it is recommended to use sample arbitration clauses offered for free by arbitration institutions on their official websites. Here is how a sample arbitration clause can look like:

“All disputes arising from or in connection with this contract shall be submitted to Beijing Arbitration Commission / Beijing International Arbitration Center for arbitration in accordance with its rules of arbitration. The arbitral award is final and binding upon both parties.”

The sample clauses provided by institutions have been tested over the years. As such, they should not lead to problems in practice. Using a model clause not only helps to prevent potential difficulties with the validity and the need to interpret the clause, but also can significantly reduce the time that would be otherwise spent on the negotiation of its content.

3. The Most Important Features of Arbitration

Arbitration has a number of advantages, in particular when comparing it to resolving a dispute in front of a state court. Arbitration can, however, also have some drawbacks. Both are discussed below.

Advantages of Arbitration

Neutrality

One major advantage of arbitration is increasing the neutrality in resolving disputes. Fairly commonly, European SMEs are concerned when their dispute is to be resolved in front of a Chinese court. This typically relates to the fear of local favoritism of the opponent by its own local court. In addition, parties may worry about their lack of understanding of Chinese court procedures and Chinese language, in which the proceeding would be conducted.

Arbitration, to a great extent, can help eliminate these fears. In arbitration, generally, parties have quite a wide range of choices that they can make. As such, specifically in the Sino-foreign context, parties may choose to arbitrate in front of a particular arbitration institution, which they see as credible. Furthermore, parties can choose arbitrators that will resolve their disputes. By way of example, in a scenario where there are three arbitrators, each of disputing parties normally selects one arbitrator, and the third one is selected by both parties together or by an arbitration institution. If, further, the neutrality of arbitrators is still of
concern, parties can specify that, for example, the presiding arbitrator should not be of the nationality of any of the parties. Such choices are, generally, much more limited when comparing it to resolving a dispute before a state court.

**Expertise**

IP disputes can be heavily knowledge-based. Arbitration can offer a high level of expertise on the side of arbitrators. By way of example, if a dispute refers to very technical aspects of technology transfer, parties may be interested in having specialists in the field resolving their dispute. In arbitration, parties have the right to choose adjudicators that they find to be best equipped to handle a particular dispute: whether it is a question of contract interpretation or a sophisticated technology-related issue. To assist the parties in making informed choices about potential arbitrators, arbitration institutions prepare the panels of arbitrators, in which they describe the profiles and expertise of potential candidates.

**Confidentiality**

Both arbitration proceedings and arbitral awards are confidential. This may be of particular importance if parties are concerned about their technology or other sensitive information that could be exposed to the public eye in the course of a dispute.

**Flexibility**

Parties can, to a large extent, design how they would like their arbitration proceeding to look like. As already mentioned above, parties have a good level of flexibility in choosing their arbitrators. They not only have the right to actually select specific persons, but also can provide for their number (typically one or three arbitrators) of desired qualifications that arbitrators should possess, such as the expertise in IP-related matters. Further, parties can also decide that the arbitration proceeding should be conducted in English. This is not available in Chinese courts.

The other important aspect is the possibility for European parties to be represented by their own foreign lawyers in China. On the contrary, this is not possible when a dispute is resolved by a Chinese court, where there is an obligation to be represented by a Chinese lawyer.

It is worth to mention that if parties have some specific wishes as to the procedure, such as the language, they should specify it in their arbitration agreement.

**Finality**

An arbitral award rendered by arbitrators is normally final and binding upon the parties. That means that parties need to comply with the decision of arbitrators and they do not have the right to appeal. This allows for a shorter, one-shot proceeding, which can be relevant for IP-related disputes, where having a quick result can be of special importance.

Nevertheless, it is important to stress that although parties do not have the second chance to discuss the case merits and law in a regular appeal, they still have procedural safeguards that can lead to cancelling of the award if there were significant procedural irregularities. This could be the case where, for example, a party was not properly notified about arbitration, did not attend the proceeding and, therefore, was unable present its side of the story.

**Enforcement**

Finally, arbitration can have greater prospects for successful enforcing of the outcome of the proceeding. At the end of the day, what parties want is their money and not the piece of paper when they win the case. It is not uncommon that a losing party refuses to pay what it is due and then, you will need a workable tool to force it to pay.

The vast majority of countries in the world are parties to a special convention (the New York Convention) that obliges the signatory states to recognize and enforce arbitral awards, and permits only limited grounds for the enforcement’s refusal. All the EU member states and China are among the New York Convention signatories. There is no comparable international convention of that wide reach for the enforcement of state court judgements. This is an important factor for the successful enforcement of foreign arbitral awards in China. Plausibly, the enforcement of Chinese domestic arbitral awards should not be problematic either.

The question of the successful enforcement mechanism may be of lesser relevance if a dispute is to be resolved in front of a Chinese court. This is because, the winning party would seek to enforce the court judgement where the losing party has its assets. Thus, if the court proceeding takes place in China, the judgement enforcement should not be problematic. On the other hand, however, if a state court judgement was rendered by, for example, a Croatian court, and the winning Croatian SME company would need to coercively enforce such court judgement in China, the problems may arise.

This is because, only a limited number of EU member states concluded with China a special agreement that facilitates the mutual enforcement of state court judgments. Following the example given above, Croatia does not have such an agreement with China. As such, Chinese courts are not obliged to help the winning Croatian parties with enforcing the Croatian courts’ judgements. Such problems with the enforcement can be minimized if parties choose arbitration.
4. Arbitration Procedure: What Does It Look Like?

Where to arbitrate?

One important aspect of arbitration is to select an arbitration institution that will be tasked with administering the case. Arbitrators will make a decision as to the dispute, but the institution will facilitate the proceeding by providing a set of procedural rules on “A to Z” of conducting the proceeding. Such rules include, for example, all deadlines for filing of written documents, the mechanism for selecting arbitrators or challenging them if they seem not to be independent. The arbitration institution also provides the hearing facilities and handles the procedural fees. As to the cost of arbitration specifically, numerous institutions provide on their website the calculation tools that help estimate the cost of the proceeding, based on the amount in dispute.

Generally, parties can choose the arbitration institution that they prefer most, be it a Chinese or a non-Chinese one. However, in the context of Sino-foreign disputes, a couple of things need to be taken into account before making the choice. First, there typically is a question of bargaining powers of parties, and, without a surprise, Chinese parties normally prefer a Chinese arbitration institution. Second, in some instances, you may have to arbitrate in China and in front of a Chinese arbitration institution. This can be the case if, for example, a European SME uses a company registered in China, the other party in dispute is Chinese, and there are no specific foreign elements that would allow to take the dispute outside of China.

Concerning the Chinese arbitration institutions, there are a few typical choices in the context of Sino-foreign disputes. One of them is the China International Economic and Trade Arbitration Commission (CIETAC), which is based in Beijing and has its sub-commissions in major Chinese cities. Some other choices worth considering are the Beijing Arbitration Commission/Beijing International Arbitration Centre (BAC/BIAC) or the Shanghai International Arbitration Centre (SHIAC). All of these arbitration institutions offer extensive panels of arbitrators to choose from, and that includes both Chinese and foreign arbitrators. Their arbitration rules and model clauses are available both in English and Chinese. In any event, choosing a reputable arbitration institution located in one of the major Chinese cities will help secure more professionalism and independence of the proceeding.

When the alternative to a Mainland Chinese institution is sought (and possible, as pointed out above), the most common choices for Sino-foreign disputes are Hong Kong and Singapore. Hong Kong and Singapore are more willingly accepted by Chinese parties due to their geographical and cultural proximity. Both the Hong Kong International Arbitration Centre and the Singapore International Arbitration Centre have rich experience in addressing such disputes. It is worth pointing out, however, that arbitrating outside of China may be more expensive when comparing it to arbitrating in China, which can be of importance to SMEs.
There is one special issue worth paying attention to when choosing where to arbitrate. Namely, the access to interim measures. An interim measure means a temporary decision that helps preserve the property or evidence, or orders the party to act or stop acting in a particular way – before the main dispute is decided, which can take some time, while it may be urgent to have such a temporary decision. By way of example, an interim measure can be helpful if the case claimant is concerned about the other party trying to hide its assets, which could undermine the subsequent execution of the arbitral award (again: parties want money and not a piece of paper). The other example could be an injunction ordering the infringing party to stop its infringing behavior until the dispute is decided. In China, interim measures can only be ordered by Chinese courts. In this context, as of today, Chinese courts will provide their assistance only to arbitration conducted in mainland China and Hong Kong.

So We Have a Dispute – What Next?

Once a dispute occurs and there is an arbitration agreement between the parties, the party initiating the dispute (claimant) files its request for arbitration, in which it describes its claims and introduces the evidence to support its position. The other party (respondent) will then file its response to that request. At this stage, the parties also select their arbitrators. Next, there typically is a hearing in which the parties meet in front of arbitrators to discuss the disputed matters and evidence, as well as answer the arbitrators’ questions. After that, the arbitrators make a decision and render an arbitral award. The award is binding upon the parties. Either the losing party pays voluntarily what it is due or; if it does not happen, the winning party needs to approach the court in the place where the losing party has its assets, and the court will assist it with the coercive execution of the award.

Special Features of Arbitrating in China

- You need to designate an arbitration institution for an arbitration agreement to be valid. While in other countries, it is possible to have, so called, ad hoc arbitration, without the involvement of an arbitration institution, this is not available in China.

Furthermore, this needs to be a Chinese institution. This is because, as of today, China, generally, does not support arbitration taking place in China, but administered by a foreign arbitration institution. Therefore, by way of example, a clause selecting the France-based Arbitration Court at the International Chamber of Commerce (ICC) and the arbitration place in China (“The parties shall have their disputes resolved by the ICC in China”) will likely lead to problems. The other party may challenge the validity of such a clause and instead – seek to resolve the dispute in other forum. Therefore, these types of clauses should be avoided.

- Arbitration in China is largely document-based. That means that parties prepare their evidence to support their own claims and submit them for the arbitrators’ assessment. It is, therefore, a good practice to keep well all documents related to a particular business, professional email exchanges etc.

- There is typically one hearing, unless there is a need to have more of them.

- According to arbitration rules of the leading Chinese arbitration institutions (CIETAC, BAC/BIAC, SHIAC), an arbitral award should be rendered within 6 months after the tribunal of arbitrators was formed.

- The elements of mediation are common in arbitration practice in China. This means that arbitrators may try to see whether there is a chance to resolve the dispute through mediation. In mediation, parties try to reach a settlement themselves, with the assistance of a third party. Using mediation within the arbitration procedure can help save time and money, as well as preserve a good relationship between the parties.

5. Think About Your Future Disputes Ahead

Arbitration is a popular method of resolving disputes in the Sino-foreign context. This results from the key advantages of arbitration: its neutrality, expertise, flexibility, finality, confidentiality and enforcement regime. Arbitration can be a viable solution also for IP-related disputes specifically.

Among other possible methods to resolve Sino-foreign IP disputes are mediation and litigation (also in front of specialized Chinese IP courts). They all have their own advantages and disadvantages, the analysis of which, however, is beyond this guide’s content.

In any case, it is advisable to consider the mechanism for resolution of disputes right at the beginning of a new business relationship. Although nobody likes to think about the divorce strategies before getting married – one saying is of particular relevance here: “better safe than sorry”.

How to Search for Basic Chinese Company Information to Protect your IP
6. Case study

A European SME high-tech company entered into a licensing agreement with a Chinese company. It was of crucial importance to have all the information confidential and therefore, the European SME insisted on having arbitration. After the long contract negotiations, the parties managed to also agree on the following arbitration agreement:

“All disputes will be resolved through arbitration in China. Three arbitrators speaking both German and Chinese, with at least 10 years of professional background in IP law area will decide the disputes”.

When the dispute occurred, the Chinese party saw its better chances in resolving the dispute before the Chinese court and challenged the validity of this arbitration agreement. It pointed out to the fact that the clause does not provide for an arbitration institution, which is required if arbitration is to take place in China. The European SME company was trying to ask the Chinese counterparty to modify this agreement once it became aware of the mistake, but the Chinese party was not willing to do that.

7. Lessons learned

The drafting of an arbitration agreement is of crucial importance. While, the parties made an effort to conclude an agreement in the case above, the agreement had some shortcomings. In this specific scenario, one essential element required under the Chinese law – the designation of an arbitration institution was missing – and this led to the problem with the access to arbitration.

It is worth noting that in this clause another problem would likely arise in practice: it could be simply difficult to find such three arbitrators ready to decide your dispute. Arbitration agreements have to have their minimum elements, but also should not be too specific. It is better to keep them simple, because at the time of drafting, you do not necessarily know what type of disputes you may potentially have five years later. Finally, if you have doubts as to drafting, use a sample clause or ask a specialist for help.

8. Key Take-Away Messages

To arbitrate, you need an arbitration agreement

Arbitration is a consensual method and if you want to use it, you have to have an arbitration agreement with the party against which you will seek to enforce your rights. It is much easier to agree to arbitration at the stage of negotiating and drafting of the entire contract, as opposed to when the dispute already exists.

Drafting of an arbitration agreement is essentially important

An arbitration agreement needs to have a number of important elements to be valid. For arbitration in China specifically, you need to designate a Chinese arbitration institution. If you are not sure how to draft an arbitration agreement – use sample clauses provided by arbitration institutions or consult a specialist. Badly drafted clauses can lead to problems.

Select a reputable arbitration institution

Whether in China or elsewhere, choose a major, reputable institution that will be able to support your proceeding well. CIETAC, BAC/BIAC or SHIAC can be some of your choices in China. If you consider the options beyond China, make sure first that your dispute can be arbitrated outside of China at all.

Arbitrating in China can be a good solution

Arbitrating in China does not have to be something to be afraid of. You can have a good level of control over the proceeding through a careful drafting of an arbitration agreement and subsequent choices made in the proceeding. Quite to the contrary, arbitrating in China can have its benefits that can be missed when arbitrating outside of it. This will be the case when, for example, the access to interim measures is sought.

9. Think About Your Future Disputes Ahead

China IPR SME Helpdesk: http://www.china-iprhelpdesk.eu/


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