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Planning for the Worst

As more U.S. and Chinese companies enter into business relationships, contractual arbitration provisions are becoming more important. Susan Leader, Brett Manisco, and Kristen Chin of Akin Gump Strauss Hauer & Feld LLP consider the differences between U.S. and Chinese litigation in court and private arbitration.

Chinese companies have become significant players in many industries in the United States. For example, Chinese and American companies frequently collaborate in the entertainment sphere, including on the co-production, licensing, and distribution of international films. Likewise, the American real estate industry has seen Chinese investors and state-owned conglomerates invest tens of billions of dollars in American real estate over the last five years, purchasing iconic buildings and development projects in major cities such as New York, San Francisco, and Los Angeles. Meanwhile, in China the government has recently taken steps to encourage investment in advanced technology, leading to a dramatic surge in outbound Chinese investment in American biotechnology start-up companies in 2018. Moreover, Chinese manufacturing within the United States will likely become more common as the costs of land, electricity, distribution, and raw materials in China continue to rise.

The ensuing business relationships in these (and other) burgeoning industries will require Chinese and American companies to enter into a range of contracts, many of which will contain provisions that require mandatory arbitration of disputes arising out of that contract. As a result, more Chinese and American parties will end up resolving their disputes in private arbitration rather than before U.S. state or federal courts.

While arbitration provisions are rarely an area of focus when negotiating contracts, they will certainly impact a company's rights and potential liabilities if a dispute arise. Considerations such as who will arbitrate your dispute, in what forum and under what rules or guidelines are generally included in an arbitration provision. In-house counsels will want to ensure that they draft and negotiate provisions that are tailored to their company's needs to ensure that the company is well-positioned if a dispute ever arise. It is also important to have in mind the key similarities – and differences – between arbitration in the United States and in China and Hong Kong.

Preparing for arbitration in the U.S.

Arbitration is commonly used in the United States, as well as internationally, to resolve business disputes outside of a formal courtroom. In China, arbitration has been gaining popularity as the preferred method of dispute resolution. According to data published by the China International Economic and Trade Arbitration Commission (CIETAC), Chinese arbitration committees administered 208,545 cases in 2016, an increase of 52% from the previous year. The overall disputed amount rose by 14% to Rmb469.5 million (USD 68.8 million) in 2016 compared to 2015. Similarly, arbitration in Hong Kong is another popular venue for resolving disputes involving U.S. and China. The Hong Kong International Arbitration Center (HKIAC) reported an increase of 16% in new cases in 2017 compared to 2016.

In arbitration, parties to a contract agree to submit current or future disputes to a neutral third person (the arbitrator), or in some cases a panel of arbitrators, who eventually make a binding decision on the merits of the dispute. Arbitrations are typically conducted through private arbitration service providers, and the governing rules vary based on which provider is administering the arbitration. While there are a number of providers in the United States and China, this article focuses on the two key providers:

JAMS and the American Arbitration Association (AAA). The governing rules for the two are similar, with some significant differences which are noted below.

It is important to note that arbitration, in both China and the United States, is not a negotiation (like mediation). Rather, it is an adversarial process in which the parties present evidence which results in a binding decision. Since arbitration awards are generally final with only limited opportunities for appeal, it is critical that companies understand the arbitration process before entering into an agreement that contains an arbitration provision. And though there is much to cover on how arbitrations are initiated (and how parties may challenge arbitration provisions), this article focuses on issues that a company may face once an arbitration is initiated.

Initial choices: Providers, arbitrator(s) and governing rules

When considering and negotiating an arbitration provision, there are a number of basic questions that should be considered, including: Which provider is going to administer the arbitration? What rules will govern the arbitration? Who can be chosen as an arbitrator? How many arbitrators will decide your dispute? A well-drafted arbitration provision reflects careful consideration of all these questions.

Arbitration services providers: Different providers employ arbitrators that have expertise in certain subject matters. For example, AAA employs a number of currently practicing and retired attorneys (many of whom have expertise in particular subject areas such as construction or real estate), while JAMS employs a large number of retired judges, whose services might be desirable for a dispute that centers on a legal, rather than factual, issue. Likewise, because different providers have different basic rules, the choice of one provider over another will lead to varying rules about who decides the case, whether and to what extent proceedings will remain confidential, the amount of discovery allowed, and what evidence will be admitted––all critical considerations for a commercial dispute.

Similarly, in China and Hong Kong, arbitration providers have different basic rules, employ different arbitrators, and sometimes specialize in specific geographical regions or sectors. For example, CIETAC is one of the major arbitration providers for economic and trade disputes involving international parties, while the China Maritime Arbitration Commission (CMAC) focuses on domestic and international disputes related to admiralty, maritime, and logistics issues.

Governing rules: Another key deciding factor should be which rules are best suited to govern any dispute that may arise. Most commonly in the United States, companies provide that the rules of a specific provider will govern. But this may not be specific enough: both AAA and JAMS have several different rules (including commercial, consumer, labor and employment, and international dispute resolution procedures). It is therefore best to specify the exact rules of a particular provider. Because arbitration is a flexible process, a different provider's rules can be selected; alternatively, an arbitration provision may specify that a particular U.S. state's statutes (the California Arbitration Act or New York's Revised Uniform Arbitration Act being common choices) will apply to an arbitration that is administered by JAMS or AAA. It should not be assumed that the international rules of a service provider will automatically apply to a company because it is headquartered outside of the United States. Again, parties can choose which rules apply and it is simply a matter of determining whether international provider rules are best for the company and/or dispute.

Notably, in China, the parties have flexibility on the rules they wish to follow for their arbitration, as long as they come to a consensus. They can pick and choose a set of established rules from a particular arbitration provider, or they can craft their own set of procedures.

Arbitrator selection: It is critically important that parties feel comfortable with the person deciding their dispute. Careful consideration must be given to the arbitrator(s) selection process. Assuming the arbitration provision in the contract specifies that the rules of a particular provider govern, those rules will dictate the selection process. For example, in both AAA and JAMS, the provider will present the parties with a list of possible arbitrators to choose from, or eliminate. Alternately, parties have the option of agreeing to their own, tailored arbitrator selection process (as described in an arbitration provision).

The contractual provision should also dictate how many arbitrators will

decide the dispute. The default rule at JAMS is for one arbitrator to decide a dispute, while AAA designates either one or three arbitrators for a dispute, depending on the amount alleged to be in dispute. However, a different number of arbitrators can be negotiated ahead of any dispute depending on the parties' preferences. This might be the case, for example, where the parties wish only to pay for one arbitrator for their time, although the amount at dispute is high, or where it is felt that more decision-makers should be at the table although the amount in dispute is low.

Conducting an arbitration

After grappling with these foundational issues, another consideration should be other practicalities where arbitration differs from conventional litigation. Arbitration (whether in the United States, mainland China or Hong Kong) can be beneficial because it offers greater confidentiality, more streamlined discovery, and less formal processes to decide disputes. However, it also provides less protection for the company should the arbitrator make an error of law or misconstrue the facts, as discussed further below. Thus, in considering whether (and on what terms) to arbitrate, it is important to consider the type of disputes that could potentially arise and the primary objective of the arbitration outcome.

Confidentiality

One almost universal benefit to arbitration is confidentiality. While state and federal court proceedings in the United States are generally open to the public, arbitrations are private and documents are not publicly filed. Similarly, while litigation in China and Hong Kong is generally open to public (subject to certain exceptions, such as proceedings that involve state secrets and data privacy), arbitration in China and Hong Kong is confidential unless the parties agree otherwise.

It is important to note that different service providers require varying levels of confidentiality. In the U.S., AAA and JAMS offer limited permissive protection of confidential documents and what goes on in the arbitration hearing. However, neither require the parties themselves to maintain confidentiality—only the provider and arbitrator(s) are required to maintain confidentiality. Other providers in the United States, such as the Independent Film & Television Alliance (IFTA), are even less protective of confidentiality. For example, IFTA publicizes the identities of the parties and the results of the arbitration.

In China, generally, the rules of the arbitration providers are more restrictive in terms of confidentiality. For example, where an arbitration is heard on camera, both CIETAC and CMAC require not only the arbitrators to maintain confidentiality, but also the parties and their representatives, the witnesses, the interpreters, the experts consulted by the arbitral tribunal, the appraisers appointed by the arbitral tribunal, and any other relevant persons.

Thus, to ensure that the dispute will be kept confidential by adversaries, consider including a confidentiality clause in the arbitration provisions conforming to the chosen provider's rules.

Discovery

A huge cost of litigation in the United States is the discovery process (known as 'disclosure' in many other parts of the world), which allows parties in litigation to request and receive relevant information and documents from one another (as well as third parties), either by writing or by oral deposition. One benefit of arbitration is that the discovery process (as outlined in service provider rules) is streamlined and parties can further agree to limit the scope of discovery. This is also true in Chinese arbitration—while discovery in litigation in China is less stringent and drawn out than in the United States, discovery in Chinese arbitration is much less formal.

In the United States, parties in arbitration are generally entitled to the exchange of non-privileged documents relevant to the disputed issues, but the scope of discoverable documents is more limited than in state or federal court. Both JAMS and AAA essentially require the parties to exchange "relevant" documents and this exchange is much more informal than in court. Additionally, in contrast to U.S. federal court (where parties are entitled to take ten depositions as a matter of right), AAA grants the arbitrator discretion on how many depositions each party can take, and JAMS generally limits each side to just one. Parties can also agree to further expedite discovery, which may save time and money at the risk of impairing the parties' ability to fully present their cases.

Finally, where a potential dispute turns on information in the hands of third parties (i.e. non-parties to the dispute), care must be taken as to how

to approach an arbitration provision. This is because it is more difficult to get information from third parties in arbitration than it is in court. It is generally understood that the U.S. *Federal Arbitration Act* (the FAA) provides that arbitrators may summon a third party to provide testimony and documents at an arbitration hearing itself, but courts in various jurisdictions disagree as to whether the FAA gives arbitrators the power to conduct third-party discovery pre-hearing (see 9 U.S.C. § 7). Therefore, depending on where the arbitration is taking place, it may not be possible to compel a third party to sit for a deposition or produce documents before the hearing. Compelling a non-party to sit for a deposition or produce documents will be even more difficult if they are located outside of the United States and the reach of the United States judicial system.

Motion practice

In United States federal and state courts, litigants are typically permitted to file dispositive motions, such as summary judgment motions which can help dispose of a legal dispute on which there is no factual disagreement. Such motions are also allowed in Hong Kong courts (where they are referred to as "summons for summary judgment"). This, however, is not available in China.

It is important to note that the right to file a dispositive motion is not necessarily guaranteed in U.S. arbitration, whereas in Hong Kong and China, dispositive motions are generally not available in arbitration. AAA rules allow the arbitrator to hear dispositive motions only where the moving party can show that the motion is likely to succeed and dispose of or narrow the issues in the case. JAMS allows an arbitrator to consider summary judgment motions, provided that the other interested parties have reasonable notice to respond. In order to preserve the right to file for summary judgment and/or make any other dispositive legal motions, a party to an arbitration should consider negotiating or otherwise making it clear in the agreement that they wish to preserve this right.

Merits hearing

After the initiation of arbitration, discovery and any motion practice, the day of the arbitration merits hearing finally arrives. What is that like? Arbitration hearings are much less formal than court proceedings. In the U.S., they are generally held in a conference room, with both parties' representatives and lawyers sitting around a table. Upon the parties' requests, both parties will likely be afforded the opportunity to give opening statements to the arbitrator as a way of framing their case. However, nothing in either AAA or JAMS rules state that parties have a right to give opening statements, so it is a matter left to the arbitrator's discretion.

Similarly in Hong Kong, under the HKIAC rules, the arbitral tribunal has the power to decide whether to hold oral hearings for the presentation of evidence or for oral arguments, or whether the arbitration shall be conducted on the basis of documents and other materials. Notably, however, under CIETAC rules in China, the arbitral tribunal is required to hold oral hearings unless the parties agree and request for the case to be decided on the basis on documents.

It is important to note that the rules of evidence that govern litigation in courts are generally not applied strictly in arbitration. This gives the arbitrator much more discretion and latitude in terms of the evidence that he or she can consider during the hearing. Generally, arbitrators lean towards allowing most evidence into the proceedings, including evidence that is only tangentially relevant or that would typically be excluded in state or federal court as hearsay.

Following a bench trial in a United States court, the judge typically writes a decision. In contrast, AAA arbitrators are not required to render their decision in a written award and JAMS arbitrators are required only to give a "concise written statement of the reasons for the award." Those arbitrating under AAA rules should consider requiring a written, reasoned decision as part of the arbitration agreement. This option should be balanced against the cost of the arbitrator's time that will be billed for writing it.

In China, under CIETAC and CMAC rules, there are no requirements for an award to be made in writing, whereas in Hong Kong, under HKIAC rules, all awards shall be made in writing.

Enforcement

After the arbitrator or panel delivers a decision, the arbitral award will have to be enforced, unless the party against whom the decision is entered does not agree to pay the award or otherwise settle the case. In the United States, the prevailing party in arbitration must convert an award to a final judgment, by appearing

in court, before it can attempt to enforce the award.

Notably, the United States, China, and Hong Kong are all parties to the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (often referred to as the "New York Convention"). Under the New York Convention, arbitral awards obtained in the jurisdiction of a signatory party to an agreement are generally recognized and enforceable in jurisdictions of other signatory parties. In China, applications for the recognition and enforcement of foreign arbitral awards should be filed with the Intermediate People's Court where the losing party is domiciled or has assets. However, due consideration should be given to jurisdiction and venue when applying for recognition and enforcement of an arbitral award. For example, a foreign arbitral award in a dispute between a wholly foreign-owned enterprise in China and another Chinese entity may not be recognized and enforceable because Chinese law requires the dispute to be resolved domestically if both parties are domestic.

While enforcements of foreign arbitral awards may be relatively straightforward in China, United States court judgments may not be as readily recognized. There is no treaty between the United States and China regarding reciprocity on court judgments. When a party attempts to have a United States court judgment recognized and enforced in China, a Chinese court will consider whether there is any precedent in a United States court recognizing or enforcing a similar Chinese judgment. Such precedents are rare; although a Chinese court recently acknowledged reciprocity between China and the United States (recognizing a United States civil court ruling), that case was unique in its facts and context and the future of Chinese courts recognizing judgments from United States courts remains unclear.

In Hong Kong, local regulations stipulate that, with certain limited exceptions, arbitration awards may be enforced in the same manner as a judgment of the High Court. Depending on where a foreign court judgment was handed down, recognition and enforcement of the judgment may be governed by either statutory regime or common law.

Appellate rights

Typically, once rendered, an arbitration award in the United States is final and may be converted into a judgment by a federal or state court. Unlike in state or federal court, parties have limited rights to appeal arbitration awards under statute. In China, arbitral awards are similarly binding and are difficult to appeal. The lack of appeal rights is one of the major downsides of arbitration if the result is unfavorable (or alternately, positive if good results are obtained).

The bases to appeal an arbitration award in a U.S. state or federal court is allowed only on the following grounds (all of which are measured to a high standard): corruption; misconduct substantially prejudicing the rights of a party; the arbitrator "exceeded his or her powers" (for example, if the arbitrator ruled on an issue that they did not have power to rule on); the arbitrator refused to postpone the hearing or hear material evidence; or the arbitrator failed to disclose grounds for disqualification (see e.g., 9 U.S.C. § 10(a); Cal Code Civ. Proc. § 1286.2. Note that errors of law (on the part of the arbitrator) are generally not appealable. Similarly, in China, the bases to appeal varies according to the types of arbitral award (awards are classified into three types, each of which is governed by different regulations and subject to different appellate rights), but the standards for review are similarly high and difficult to meet.

Optimizing your chances of success

Arbitration offers the benefits of confidentiality, efficiency and flexibility. However, there are also risks associated with this system of dispute resolution, including the limited grounds to challenge an erroneous decision. To optimize the chances of securing the best possible dispute resolution process, careful consideration ought to be paid to the drafting of an arbitration provision tailored to the contracting party's objectives. Ideally the provision should address who will arbitrate a future dispute, which service provider will be used, what level of confidentiality is required, which procedural rules will govern, which substantive law governs, the scope of discovery and any rights to appeal. Careful consideration of these factors on the front end of a deal could dramatically improve the chances of prevailing if your dispute lands in arbitration in the United States.