

# Governing Financial Disputes in China: What Have We Learned From the Global Financial Crisis of 2008?

Robin Hui Huang<sup>\*</sup> and Shahla F. Ali<sup>\*\*‡</sup>

*In light of the recent global financial crisis of 2008, this article critically compares how China's national arbitration commissions and local courts are responding to new challenges brought about by an increase in the number of banking related disputes. Drawing on comparative case analysis, the article examines the operation of the China International Economic and Trade Arbitration Commission (CIETAC) and the Shanghai Courts' financial dispute resolution mechanisms in resolving financial disputes. Drawing on insights from selected case findings, it provides insight into which institution is best positioned to handle financial-related cases, discusses prospects for coordination between the two, and sets out proposals for further reform. Initial findings suggest that given CIETAC's limited exposure to banking and financial sector disputes, in the immediate term parties should seek resolution through local financial division dispute resolution mechanisms, such as the financial division of*

---

<sup>\*</sup> Associate Professor, Faculty of Law, Chinese University of Hong Kong (Conjoint Professor, Faculty of Law, University of New South Wales, Sydney, Australia). Ph.D., University of New South Wales; B. Eng., LL.B., LL.M., Tsinghua University (China). This paper draws on sections of a revised paper presented at the 6th Asian Law Institute Conference in Hong Kong in May 2009, and I thank the participants for their comments.

<sup>\*\*</sup> Assistant Professor and Deputy Director, LL.M. in Arbitration and Dispute Resolution, Faculty of Law, University of Hong Kong. B.A., Stanford University; M.A., Landegg International University, Switzerland; J.D., Boalt Hall School of Law, University of California at Berkeley; Ph.D., University of California at Berkeley.

<sup>‡</sup> The authors thank the Government of Hong Kong's University Grants Committee for its kind support through its Public Policy Research Grant (HKU7001-PPR-10). Research support was also received under the Australian Research Council Discovery Grant entitled 'Regulatory Responses to the Global Financial Crisis.'

*the Shanghai Courts. In the long term, prospects for greater strengthening of national mechanisms such as CIETAC and the Securities Dispute Resolution scheme will provide additional avenues of recourse.*

I. INTRODUCTION .....	197
II. A HISTORICAL OVERVIEW .....	197
A. Before 1978: Limited Financial Dispute Resolution Mechanisms .....	197
B. 1978–1992: Market Regulation and Dispute Resolution ..	199
C. 1992–Present: Multiple Sectors-based Regulators and the Emergence of CIETAC .....	201
III. THE CURRENT STRUCTURE OF FINANCIAL GOVERNANCE IN CHINA .....	202
Financial Regulatory Oversight .....	202
Resolution of Financial Disputes .....	203
A. Institutional Arbitration—CIETAC .....	203
1. Chinese Arbitration Commissions .....	204
2. Financial Dispute Resolution System Through CIETAC ..	205
3. Examining CIETAC’s Financial Arbitration Rules .....	205
<i>a. First Case Accepted by CIETAC Tianjin International Economic and Financial Arbitration Center .....</i>	<i>207</i>
<i>b. Recent CIETAC Financial and Commercial Dispute Resolution Cases .....</i>	<i>207</i>
i. <i>Dispute over Capital Contribution in a Joint Venture (Published 2009) .....</i>	<i>207</i>
ii. <i>Dispute over a Contract for the Sale of Goods—Contract Revision and Reserving the Right to Seek Compensation for Damages (Published 2009) .....</i>	<i>208</i>
iii. <i>Lease Contract Dispute—Obvious Loss of Fairness and Exercise of the Right to Revoke a Contract (Published 2009) .....</i>	<i>209</i>
iv. <i>Execution of Duties of a Contract for the International Sale of Goods .....</i>	<i>210</i>
<i>c. Assessment of Cases .....</i>	<i>211</i>
B. Shanghai Courts—Financial Division .....	211
Case Handling .....	211
Relevant Cases .....	212
1. <i>Abuse of Majority Shareholder Power (Published 2008) ..</i>	<i>212</i>
2. <i>Request for Winding Up of Company (Published 2006) ...</i>	<i>213</i>
3. <i>Fraudulent Shareholder Investment .....</i>	<i>213</i>
4. <i>Breach of Fiduciary Duty by Management .....</i>	<i>214</i>

5. <i>Company Refusal to Award Shareholder Dividends</i> .....	214
6. <i>Company Deregistration Prior to Liquidation</i> .....	214
C. Summary .....	215
IV. LESSONS FROM THE GLOBAL FINANCIAL CRISIS .....	215
V. CONCLUSION .....	220

## I. INTRODUCTION

The recent global financial crisis has called into question the adequacy of financial institutions and dispute resolution at both the national and supranational level.<sup>1</sup> Although China has certainly been one of the many nations to suffer from this crisis, it has fared relatively well. However, it has not been completely immune from the fallout. Thus, it is imperative that China's financial regulatory regime and systems of financial dispute resolution be improved to meet the need for more efficient financial structures.

This article will proceed as follows. First, Part II provides a historical background of the development of China's system of financial governance. Part III proceeds with a more detailed discussion of the current Chinese financial system, including a review of the China International Economic and Trade Arbitration Commission (CIETAC) and various financial dispute resolution cases handled by the Financial Division of the Shanghai Courts. This article then examines possibilities for financial governance sector reform. Part V concludes with the suggestion that, for the near future parties can seek resolution through institutions like the Shanghai Courts.

## II. A HISTORICAL OVERVIEW

China has made significant advancement in recent years with respect to its systems of financial governance. This is apparent by examining the historical development of its financial governance mechanisms.

### *A. Before 1978: Limited Financial Dispute Resolution Mechanisms*

After the founding of the People's Republic of China (PRC) in 1949, the Communist Party of China gradually moved toward a centrally planned economy, similar to that of the Soviet Union.<sup>2</sup> As a result of this

---

<sup>1</sup> Hui Huang, *Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis*, 10 J. CORP. L. STUD. 219 (2010).

<sup>2</sup> *Id.* at 220.

“Socialist Transformation” policy, private businesses became collectively owned and eventually state-owned.<sup>3</sup> As the economy grew more centralized, there was a decreased need for financial markets to fund businesses and allocate resources.

Thus, the financial markets were slowly dismantled. In 1952, all stock exchanges ceased operation, putting an end to the securities market.<sup>4</sup> In 1959, the People's Insurance Company of China (PICC) was shut down, which was quickly followed by a closure of the insurance market altogether.<sup>5</sup> Finally, the People's Bank of China (PBC) became the only bank left in China that operated both as the central bank and a commercial bank.<sup>6</sup> Although the PBC provided the traditional services of saving and lending, it functioned more as a governmental instrument rather than a commercial bank.<sup>7</sup> It was used primarily as a conduit through which state money was channeled to fund state-owned enterprises (SOEs). In sum, there was little to no financial regulation at the time.

Formal legal institutions were largely dissolved prior to 1978. The official view was that “justice should not be separated artificially from the masses of ordinary people by the barriers of lawyers, laws, and law courts.”<sup>8</sup> In contrast, “the people in their masses could judge and decide questions of policy as well as the concrete disputes arising in everyday life.”<sup>9</sup> Formal legal systems were not viewed as “flexible enough to meet the needs of struggle under rapidly changing revolutionary conditions,”<sup>10</sup> but rather as “an instrument for the oppression of antagonistic classes.”<sup>11</sup> From 1949 to 1978, people's mediation was encouraged as the primary means of resolving civil and commercial disputes. Focused on infusing Socialist ideology and reinforcing class

---

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> Linbo Fan, *The Insurance Market System*, in FINANCIAL REGULATION IN THE GREATER CHINA AREA: MAINLAND CHINA, TAIWAN AND HONG KONG SAR 157, 158 (Joseph J. Norton et al. eds., 2000).

<sup>6</sup> Huang, *supra* note 1, at 221.

<sup>7</sup> *Id.*

<sup>8</sup> YAN WANG, CHINESE LEGAL REFORM: THE CASE OF FOREIGN INVESTMENT LAW 22 (Routledge 2002).

<sup>9</sup> RALPH H. FOLSOM, LAW IN THE PEOPLE'S REPUBLIC OF CHINA: COMMENTARY, READINGS AND MATERIALS 12 (Ralph H. Folsom & John H. Minan eds., 1989).

<sup>10</sup> CARLOS WING-HUNG LO, CHINA'S LEGAL AWAKENING: LEGAL THEORY AND CRIMINAL JUSTICE IN DENG'S ERA 9 (1995).

<sup>11</sup> Mao Zedong, *On People's Democratic Dictatorship*, in 4 SELECTED WORKS OF MAO TSE-TUNG 418 (1977).

struggle,<sup>12</sup> people's mediation became an informal means of promoting "correct thought" (*sixiang*) in the context of resolving civil disputes.<sup>13</sup>

*B. 1978–1992: Market Regulation and Dispute Resolution*

In 1978, the Third Plenary Session of the 11th National People's Congress introduced an economic reform policy, marking an important watershed in the development of China's financial markets.<sup>14</sup> First, the banking system was reformed to keep up with the transition to a market-oriented economy.<sup>15</sup> The "Big Four" state-owned banks were established or reopened to provide specialized services, including the Agricultural Bank of China (ABC) for the agricultural sector in February of 1979, the Bank of China (BOC) for foreign exchange businesses in March of 1979, the Construction Bank of China (CBOC) for big construction projects in May of 1983, and the Industrial and Commercial Bank of China (ICBC) for taking over the commercial activities of the PBC in January of 1984.<sup>16</sup>

Banks were set up at both the national and local level, most of which were jointly owned by the state and private investors.<sup>17</sup> This was done to increase market competition in the banking sector.<sup>18</sup> In 1994, three policy banks (the China Development Bank, the Agricultural Development Bank of China, and the Export-Import Bank of China) were set up to free the "Big Four" banks from the provision of policy loans, enabling them to function as real commercial banks.<sup>19</sup>

Other aspects of the financial system also experienced significant reforms. The securities market was revived in the early 1980s, culminating in the establishment of the Shanghai Stock Exchange and the Shenzhen Stock Exchange in 1990 and 1991, respectively.<sup>20</sup> Likewise, the insurance market was brought to life with the reopening of the PICC in 1980 and the formation of more insurance companies thereafter.<sup>21</sup>

---

<sup>12</sup> See Stanley Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CAL. L. REV. 1284, 1306–09 (1967) (examining the political and revolutionary function of mediation during the early years of Communist rule, focusing on how disputes on a community wide basis were resolved).

<sup>13</sup> *Id.*; see also 3 SELECTED WORKS OF MAO TSE-TUNG 117–22 (1965) (stressing the importance of the propagation of correct ideas and the correction of mistaken viewpoints through rectification movements in Communist leadership).

<sup>14</sup> Huang, *supra* note 1, at 221.

<sup>15</sup> *Id.*

<sup>16</sup> Yangxin Huang, *The Banking Market System*, in FINANCIAL REGULATION IN THE GREATER CHINA AREA, *supra* note 5, at 25, 27–28.

<sup>17</sup> Huang, *supra* note 1, at 221.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

As a consequence of the reform, the PBC took on a dual role in financial regulation. First, it performed the major functions of the central bank.<sup>22</sup> Second, it supervised and regulated the entire financial system, including banking, securities, and insurance.<sup>23</sup> Thus, the PBC operated, essentially, as the single financial regulator at the time.

In 1978, the flourishing of China's market economy brought with it the proliferation of both formal and informal legal institutions including arbitral tribunals and mediation services. A number of new laws such as the Laws on Economic Contracts, the Company Law and the Labor Laws were developed to govern the development of China's market economy.<sup>24</sup> In conjunction with the creation of a framework for direct foreign investment, the role of agencies like the CIETAC was expanded.

A significant number of new laws were passed in the period from 1978 to 1981. During this time over 200 economic and commercial laws were passed.<sup>25</sup> The rationale for the proliferation of such laws was to "regulate the relationships among different subjects in [the] market . . . [and] promote harmonious economic development."<sup>26</sup> As a result of open market policies, dispute resolution became less centralized. Reflecting this change was the movement away from managerial dispute resolution under a planned economy to increasingly decentralized, court-centered litigation.<sup>27</sup>

As laws proliferated, so too did the need for legal institutions to resolve an increasing number of disputes. In the period between 1990 and 1994, civil disputes—largely cases involving contract, property and tort law matters—increased from 2.4 million to 3.5 million.<sup>28</sup> Decision making devolved outside of factory managerial oversight committees to external agencies such as CIETAC and regional arbitral bodies.

Alternative forms of dispute resolution continued to proliferate as formal legal regulations multiplied. Mediation was to be conducted according to the law as described in the Chinese Civil Procedures Code of

---

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> John A. Spanogle, Jr. & Tibor M. Baranski, Jr., *Chinese Commercial Dispute Resolution Methods: The State Commercial and Industrial Administration Bureau*, 35 AM. J. COMP. L. 761, 773–76 (1987) (describing the increasing number of laws and economic policies promulgated by China in the late 1970s and early 1980s).

<sup>25</sup> *Id.* at 774.

<sup>26</sup> *To Establish the Legal Framework of Socialist Market Economy: Interview with Qiao Shi, Member of the Standing Committee of the Political Bureau of the Central Communist Party Committee and Chairman of the Standing Committee of the National People's Congress*, 1 CHINA LAW 8, 10 (1994).

<sup>27</sup> Minxin Pei, *Citizens v. Mandarins: Administrative Litigation in China*, 152 CHINA Q. 832, 862 (1997).

<sup>28</sup> STANLEY B. LUBMAN, *SINO-AMERICAN RELATIONS AND CHINA'S STRUGGLE FOR THE RULE OF LAW* 30 (1997).

1991.<sup>29</sup> In the mid-1980s, mediation helped to settle more than 90 percent of civil cases<sup>30</sup> and nearly 60 percent of civil cases were resolved in this way by the late 1990s.<sup>31</sup>

*C. 1992–Present: Multiple Sectors-based Regulators and the Emergence of CIETAC*

In the 1990s, China embraced financial regulation by sector,<sup>32</sup> establishing separate regulators for banking, securities, and insurance.<sup>33</sup> In April 1998, the China Securities Regulatory Commission (CSRC), which had been founded in 1992, was vested with the exclusive authority to regulate the securities market;<sup>34</sup> the China Insurance Regulatory Commission (CIRC) was established in November 1998 in response to a robust insurance market; and in April 2003, the China Banking Regulatory Commission (CBRC) took over the responsibility of direct banking regulation from the PBC.

These three regulatory commissions, along with the PBC acting as the central bank, constituted China's financial regulatory framework, often referred to as “*yihang sanhui*” (i.e., one bank, three commissions). This model of regulation by sector reflects a policy commonly known as “*fenye jingying, fenye jianguan*,” or “separate operation, separate regulation.”<sup>35</sup>

While in-court litigation continued to develop following the 1980s Open Door Policy, arbitration institutions likewise developed an expanding case load. The CIETAC has handled over 10,000 international arbitration cases since it opened in 1956. More than 700 cases, largely

---

<sup>29</sup> See generally Fu Hualing & Richard Cullen, *From Mediator to Adjudicator Justice: The Limits of Civil Justice Reform in China*, in CHINESE JUSTICE: CIVIL DISPUTE RESOLUTION IN CONTEMPORARY CHINA 25–27 (Margaret Woo & Mary Gallagher eds., 2008) (describing the shift from adjudicatory justice to mediatory justice during Xiao Yang's tenure as President of the Supreme People's Court).

<sup>30</sup> *Id.* at 23.

<sup>31</sup> LAW YEARBOOK CHINA (Zhongguo Falü Nianjian She 1983–1995).

<sup>32</sup> See generally Huang, *supra* note 1 (noting the inadequacies of China's traditional sectoral system of financial regulation).

<sup>33</sup> For a fuller discussion of the development of China's financial reforms after its WTO accession, see, e.g., FINANCIAL RESTRUCTURING AND REFORM IN POST-WTO CHINA (James Barth et al. eds., 2006).

<sup>34</sup> HUI HUANG, INTERNATIONAL SECURITIES MARKETS: INSIDER TRADING LAW IN CHINA 18–19 (2006).

<sup>35</sup> See Huang Hui (黄辉), *Jinrong Jianguan Xiandai hua: Yingmei Faxi de Jingyan yu Jiaoxun* (金融监管现代化: 英美法系的经验与教训) [*Financial Regulatory Modernization: Experiences and Lessons from the U.S. and UK Common Law Jurisdictions*] 1 GUANGDONG SHEHUI KEXUE (广东社会科学) 181, 185 (2009) (describing the development of sector-based financial regulation in China).

international in nature, are handled by CIETAC on an annual basis.<sup>36</sup> Beyond in-court litigation and CIETAC arbitration, financial disputes may be resolved through recourse to provincial arbitral bodies such as the Shenzhen Arbitration Commission (SAC) and local mediation services.

### III. THE CURRENT STRUCTURE OF FINANCIAL GOVERNANCE IN CHINA

#### Financial Regulatory Oversight

The PBC is responsible for monetary policy and market stability, while the CBRC, the CSRC, and the CIRC are responsible for the regulation of the banking, securities, and insurance sectors, respectively. These four regulatory bodies will be discussed *infra seriatim*.

The PBC is the central bank in China, as dictated by the Law on the People's Bank of China (PBC Law).<sup>37</sup> The PBC's mandate is to formulate and implement monetary policies, guard against financial risks, and maintain financial stability under the leadership of the State Council.<sup>38</sup> Thus, the PBC performs three roles, which are common to most central banks: (1) it issues currency (i.e., the Renminbi); (2) it operates as a lender to banks; and (3) it operates as a bank to the government.<sup>39</sup> Instead of direct market intervention, the PBC seeks to stabilize the currency and the financial system through indirect, macroeconomic means, such as deposit reserves, the rediscount rate, interest rates, and open market operations.<sup>40</sup>

The CBRC came into existence in 2003, assuming the monitoring responsibilities of the PBC. The Law of the PRC on Commercial Banks<sup>41</sup> and the Law of the PRC on Banking Regulation and Supervision<sup>42</sup> govern

---

<sup>36</sup> *China International Economic and Trade Arbitration Commission*, BIZCHINANOW (Mar. 11, 2001, 2:09 PM), [http://bizchinanow.com/Contents/Channel\\_1847/2007/0828/60510/content\\_60510.htm](http://bizchinanow.com/Contents/Channel_1847/2007/0828/60510/content_60510.htm).

<sup>37</sup> *Zhongguo Renmin Yinhang Fa* (中国人民银行法) [Law on the People's Bank of China] (promulgated by the Nat'l People's Cong., Mar. 18, 1995, effective Mar. 18, 1995, amended by the Standing Comm. Nat'l People's Cong., Dec. 27, 2003, effective Dec. 27, 2003), art. 2 (China).

<sup>38</sup> *Id.*

<sup>39</sup> *See id.* art. 4. It should be noted that the State Administration of Foreign Exchange is a government agency under the leadership of the PBC and it acts as the implementation branch of the PBC in relation to foreign exchange administration and supervision.

<sup>40</sup> *Zhongguo Renmin Yinghang Fa*, *supra* note 37, art. 23.

<sup>41</sup> *Shangye Yinhang Fa* (商业银行法) [Law on Commercial Banks] (promulgated by the Standing Comm. Nat'l People's Cong., May 10, 1995, effective July 1, 1995, amended by the Standing Comm. Nat'l People's Cong., Dec. 27, 2003) (China).

<sup>42</sup> *Yinhang Ye Jiandu Guanli Fa* (银行业监督管理法) [Law on Regulation and Administration on Banking Industry] (promulgated by the Standing Comm. Nat'l People's



the CBRC, which operates as a ministry unit under leadership of the State Council. The CIRC was established in 1998 under the Insurance Law of the PRC.<sup>43</sup> The CIRC regulates market conduct within the insurance sector. The Securities Law of the PRC (Securities Law) set up the regulatory framework for the securities market.<sup>44</sup> Established in 1992, the CSRC, which is responsible for securities regulation in China, is the oldest of the three sector-specific regulatory bodies. The Securities Law's scope is expansive, authorizing the CSRC to regulate all financial instruments, including equities, bonds, and derivative instruments.<sup>45</sup>

### Resolution of Financial Disputes

Within the various sectors described above, dedicated financial dispute resolution can be conducted through CIETAC or the courts.<sup>46</sup> In the sections that follow, these schemes will be described alongside a detailed case analysis of the types of cases handled by these bodies.

#### A. Institutional Arbitration—CIETAC

Within China, arbitration continues to be among the more favored mechanisms for financial dispute resolution.<sup>47</sup> Institutional arbitration is the sole option for disputants as ad hoc arbitration has no legal standing according to Chinese law.<sup>48</sup> Therefore, parties to an arbitration in China will be required to select a recognized domestic arbitral institution and select the specific arbitration format from among those listed on the institution's rosters.

---

Cong., Dec. 27, 2003, effective Feb. 1, 2004, amended by the Standing Comm. Nat'l People's Cong., Oct. 31, 2006, effective Jan. 1, 2007) (China).

<sup>43</sup> Baoxian Fa (保险法) [Insurance Law] (promulgated by the Standing Comm. Nat'l People's Cong., Jun. 30, 1995, effective Oct. 1, 1995, amended by the Standing Comm. Nat'l People's Cong., Oct. 28, 2002, effective Jan. 1, 2003, amended by the Standing Comm. Nat'l People's Cong., Feb. 28, 2009, effective Oct. 1, 2009), art. 9 (China).

<sup>44</sup> Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective July 1, 1999, amended by the Standing Comm. Nat'l People's Cong., Aug. 28, 2004, effective Aug. 28, 2004, amended by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (China).

<sup>45</sup> *Id.* art. 2.

<sup>46</sup> See *Dispute Avoidance and Dispute Resolution*, EXPORT.GOV (Apr. 15, 2011), [http://export.gov/china/doingbizinchina/riskmanagement/eg\\_cn\\_028283.asp](http://export.gov/china/doingbizinchina/riskmanagement/eg_cn_028283.asp) (explaining the primary methods of avoiding and resolving disputes in China).

<sup>47</sup> Shoushuang Li, *Insight into Commercial Dispute Resolution in China*, HONG KONG LAWYER (Jan. 2004), [http://www.hk-lawyer.com/InnerPages\\_features/0/1068/2004/1](http://www.hk-lawyer.com/InnerPages_features/0/1068/2004/1).

<sup>48</sup> *Id.*

### 1. Chinese Arbitration Commissions

China is home to a large number of arbitral organizations. Among the most prominent is the China International Trade and Arbitration Commission (hereinafter CIETAC). Largely handling commercial and economic cases, CIETAC most recently in 2003 adopted a set of Rules pertaining to Financial Dispute Arbitration which covers disputes between parties arising in connection with financial transactions.<sup>49</sup> Plans are under way to further develop the rules for financial disputes and proposals for such provisions have been solicited.<sup>50</sup>

The mission of CIETAC since its founding in 1956 has been to provide a forum for resolving economic and trade related disputes.<sup>51</sup> In addition to its central location in Beijing it has branch offices located throughout China including Tianjin, Shanghai and Shenzhen. Its headquarters in Tianjin are known as the CIETAC Financial Arbitration Center.<sup>52</sup> At present, there are over twenty-one branch offices serving the needs of various business sectors in China. Each branch is governed by a secretariat which helps coordinate the activities and cases handled within each branch.<sup>53</sup>

Beyond CIETAC, more than 140 provincial arbitration commissions operate in over 140 cities including Shanghai, Guangzhou, Beijing and Shenzhen.<sup>54</sup> Of these commissions, a large number have also established financial arbitration services in response to the growing need for a forum to handle banking-related disputes. For example, a large number of such commissions, primarily those located in financial centers such as Shanghai, established financial arbitration commissions beginning in 2007. Later similar programs were established in Chongqing, Hangzhou, Guangdong and Wuhan.<sup>55</sup> Such centers have been established

---

<sup>49</sup> Financial Disputes Arbitration Rules (promulgated by the China International Economic and Trade Arbitration Commission, revised and adopted by the China Council for the Promotion of International Trade/China Chamber of International Commerce on Mar. 17, 2005, effective May 1, 2005) CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION, art. 1, available at <http://www.cietac.org/index/rules/47607aa1ab746c7f001.cms>.

<sup>50</sup> See *Guanyu Xiuding "Zhongguo Guoji Jingji Maoyi Zhongcai Weiyuan Hui Zhongcai Guize" Zhengxun Yijian de Tongzhi* (关于修订《中国国际经济贸易仲裁委员会仲裁规则》征询意见的通知), CIETAC (Dec. 7, 2009), <http://cn.cietac.org/NewsFiles/NewsDetail.asp?NewsID=896> (Chinese) (calling for submission of comments and suggestions to the CIETAC Arbitration institute).

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> EXPORT.GOV, *supra* note 46.

<sup>55</sup> See Jiang Yaya, Liu Ying & Lu Yibo (蒋娅娅, 刘颖 & 陆一波), *Shanghai Jinrong Zhongcai Yuan Chengli* (上海金融仲裁院成立) [*Establishment of the Shanghai Financial Arbitration Commission*], SHANGHAI ZHONGCAI FA YANJIU ZHONGXIN (上海仲裁法研究中

to provide a space for citizens to seek out assistance when faced with abusive practices by banking institutions.<sup>56</sup> The Shenzhen Arbitration Commission has also recently developed a similar financial arbitration service.<sup>57</sup>

## 2. Financial Dispute Resolution System Through CIETAC

CIETAC, beyond helping to resolve a large number of commercial and economic cases, has established a financial dispute resolution mechanism to handle banking-related disputes within China. It has established a set of Rules which aim to provide speedy and competent case handling for financial related disputes.

## 3. Examining CIETAC's Financial Arbitration Rules

CIETAC issued the "China International Economic and Trade Arbitration Commission Financial Disputes Arbitration Rules" (hereinafter the Rules) in March of 2005. These rules came into force on May 1, 2005, after being revised by the China Council for the Promotion of International Trade/China Chamber of International Commerce. The Rules were created in order to facilitate the "impartial and prompt resolution of disputes arising from financial transactions between the parties."<sup>58</sup> The scope of disputes covered by the Rules include those "arising from, or in connection with, financial transactions between the parties."<sup>59</sup> "Financial transactions" are defined as:

transactions arising between financial institutions *inter se*,  
or arising between financial institutions and other natural  
or legal persons in the currency, capital, foreign exchange,  
gold and insurance markets that relate to financing in both

---

心) [SHANGHAI ARBITRATION LAW RESEARCH CENTER] (Dec. 19, 2007), [http://www.arsh.sjtu.edu.cn/view\\_news.jsp?newsid=77](http://www.arsh.sjtu.edu.cn/view_news.jsp?newsid=77) (Chinese) (announcing the inauguration of the Shanghai Financial Arbitration Court).

<sup>56</sup> *Yu Chengli Xibu Shoujia Jinrong Zhongcai Yuan, Shu Guonei Di Er Zhuanmen Jigou* (渝成立西部首家金融仲裁院, 属国内第2专门机构) [*The Establishment of the First Arbitration Institution in the West of China, Chongqing, the Second-largest Specialized Institution in the Country*], CHONGQING DAILY (July 29, 2010), [http://www.cq.xinhuanet.com/business/2010-07/29/content\\_20471602.htm](http://www.cq.xinhuanet.com/business/2010-07/29/content_20471602.htm) (Chinese).

<sup>57</sup> *Shenzhen Jinrong Zhongcai Yuan Jianjie* (深圳金融仲裁院简介) [*Introduction to the Shenzhen Financial Arbitration Commission*], SHENZHEN ZHONGCAI WEIYUAN HUI (深圳仲裁委员会) [SHENZHEN ARBITRATION COMMISSION] (Jan. 12, 2011), <http://www.fabao365.com/news/657785.html> (Chinese).

<sup>58</sup> Financial Disputes Arbitration Rules, *supra* note 49.

<sup>59</sup> *Id.* art. 2.

domestic and foreign currencies, and the assignment and sale of financial instruments and documents denominated in both domestic and foreign currencies . . . .<sup>60</sup>

When bringing a dispute under the Rules, disputants must specify whether they intend to use mediation or arbitration. If arbitration is selected under the Rules and no institution is specified, then the assumption is that the parties intended CIETAC.<sup>61</sup> Therefore, CIETAC is among the most frequently used institutions for the resolution of financial disputes.

In addition to permitting parties to specify their selected method and location for the resolution of financial disputes, the Rules permit them to select an arbitrator from a specialized Panel comprised of experts within the financial industry. The final approval of the arbitrators rests with the CIETAC Chairman. Parties may also select the number of arbitrators (either one or three) and where parties have not made a prior determination, the CIETAC Chairman will make a determination according to Article 12. The specialized financial arbitration panel is comprised of over 100 individuals from diverse backgrounds including experts from Canada, the United States, EU countries including France, the UK and the Netherlands, as well as mainland China, Macau SAR and HKSAR. Many of these panel members have expertise in finance as well as Banking Law, Arbitration Law, Company Law and Contracts.

When determining the final award, the Panel will look to the language of the contract, industry standards, and principles of reasonableness and fairness. In some cases, foreign law may be selected as the substantive law of the arbitration if the case involves a foreign element. However, the final selection of the substantive law to be applied rests with the arbitral tribunal. In the event that a particular case or issue is not covered by the Financial Arbitration Rules, then reference will be made to the general CIETAC Arbitration Rules.

With respect to the issuance of the final award, Article 12 of the Rules states that the award is to be issued within 45 days from the constitution of the tribunal, unless the parties agree otherwise. This period may be extended by up to 20 days as needed with the consent of the Secretary-General.

---

<sup>60</sup> *Id.*

<sup>61</sup> Financial Disputes Arbitration Rules, *supra* note 49.

*a. First Case Accepted by CIETAC Tianjin International Economic and Financial Arbitration Center*

The CIETAC Tianjin International Economic and Financial Arbitration Center accepted its first case in 2008.<sup>62</sup> The case involved a nine million *yuan* sale of goods dispute. The Tianjin office was set up to serve Tianjin's rapidly developing financial sector in providing a neutral forum for the resolution of disputes.

*b. Recent CIETAC Financial and Commercial Dispute Resolution Cases*

Below is a selection of CIETAC's recent financial and commercial cases. What can be observed from these cases is the following: most all of the cases involve issues relating to the sale of goods, capital contributions, lease contracts, etc. As a result, CIETAC has had limited exposure to banking related cases. Nevertheless, for the cases it has handled, it has achieved a relatively uniform process of case handling through reference to commercial agreements, existing law, and trade practice.

*i. Dispute over Capital Contribution in a Joint Venture (Published 2009)<sup>63</sup>*

One case involved a dispute between two parties who signed an agreement to establish a limited liability entertainment company. The contract required both parties to contribute capital, including a one-time payment of registered capital made within five months of acquiring the necessary license to conduct business. The claimant alleged that the respondent was unable to fulfill its obligations because the property it intended to provide as capital belonged to the government of the district where the joint venture was located and the government had already mortgaged it to a bank. The respondent counterargued that the claimant had not fully contributed the amount of capital required by the contract: the foreign exchange that it had originally promised to contribute was not paid and the equipment provided fell short of the required amount.

---

<sup>62</sup> *Maozhong Tianjin Guoji Jingji Jinrong Zhongcai Zhongxin Shouli Diyi An* (贺仲天津国际经济金融仲裁中心受理第一案) [*The First Case Accepted by Tianjin International Economic and Financial CIETAC Arbitration Center*], TIANJIN INTERNATIONAL ECONOMIC AND FINANCIAL ARBITRATION CENTER OF THE CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION (Dec. 10, 2008), <http://www.cietac-tj.org/newsfiles/NewsDetail.asp?NewsID=45>.

<sup>63</sup> *Dispute Over Capital Contribution in a Joint Venture*, CIETAC (July 15, 2009), <http://www.cietac.org/index/references/cases/47603791dea0167f001.cms>.

According to the terms of the contract, the claimant referred the matter to CIETAC for arbitration. The arbitral tribunal found that the respondent did not have legal rights to the property that was to be used as its capital contribution and hence did not carry its investment obligations. The claimant also did not completely execute its investment obligations under the terms of the contract. Therefore, the tribunal determined that the joint venture contract should be terminated and the claimant's requests for compensation should be rejected.

Here, the subject matter of the dispute—a capital contribution agreement—was more commercial, rather than financial, in nature. The case determination was made primarily on the basis of the terms of the contract. Therefore, parties are advised to consider such terms carefully, in light of future adjudication.

ii. *Dispute over a Contract for the Sale of Goods—Contract Revision and Reserving the Right to Seek Compensation for Damages* (Published 2009)<sup>64</sup>

Another case involved a dispute between the claimant and respondent French company, who signed a contract for the sale of glass production equipment which the claimant intended for resale to its partner companies in China in February 1996. The contract required the claimant buyer to open an irrevocable letter of credit for the full contract price with the respondent seller 60 days before loading. The claimant opened a letter of credit as required by the contract but the respondent failed to deliver the equipment according to schedule. When the respondent finally delivered the equipment one and a half months later, the claimant demanded that the respondent pay penalties according to the contract for late delivery of goods, and sought additional compensation on the basis that the respondent's late delivery had caused the claimant to violate its resale contracts with its partner companies as well as the cost of altering the letter of credit. The claimant argued that revision of the letter of credit was independent of the main contract and therefore it did not amount to revision of the contract, while the respondent argued that the revision of the letter of credit extended the original date of delivery in the contract.

The arbitral tribunal found that although the letter of credit existed independently of the main body of the contract, it still originated from the contract. Generally speaking, revision of the major articles of a contract, such as the date of delivery of goods, should be viewed as equivalent to the revision of the contract itself. A party may agree to revise a letter of credit with or without conditions, but it should protect its right to seek

---

<sup>64</sup> *Dispute Over a Contract for the Sale of Goods—Contract Revision and Reserving the Right to Seek Compensation for Damages*, CIETAC (July 15, 2009), <http://www.cietac.org/index/references/cases/47603791dcfea17f001.cms>.

compensation by expressly reserving its right to seek compensation later based on the provisions of the contract. If a party seeks to revise a letter of credit without reservation, it abandons its right to seek compensation in the future. Therefore, the claimant lost its contractual right to seek compensation from respondent based on late delivery of goods, as the respondent delivered the equipment within the time limit set by the revised letter of credit.

Here CIETAC primarily considered the parties initial and subsequent revisions to its contract and reasoned that revision to the letter of credit (LOC) without conditions amounted to a change in the underlying contract itself and therefore that the claimant was not entitled to damages.

iii. *Lease Contract Dispute—Obvious Loss of Fairness and Exercise of the Right to Revoke a Contract* (Published 2009)<sup>65</sup>

The claimant, a Hong Kong citizen, and the respondent, a Beijing-based real estate company, signed a contract in 1996 where the claimant agreed to lease to the respondent its property in Beijing. Before the contract was signed, the respondent agreed to sublet the property to a department store. According to the contract, if the rent obtained by the respondent from subletting the property exceeded a certain minimum amount, the respondent could claim the remainder, and if the rent fell under the minimum amount, the respondent was required to pay the remainder to the claimant. In 1999, the claimant applied to CIETAC for arbitration on the basis that the respondent failed to pay the required amount of rent. The respondent argued that the sum it was required to pay by the contract far exceeded the amount of rent it obtained from the sublease, therefore the contract had lost its fairness under Article 5 of the Contract Law of PRC and should be revoked.

The arbitral tribunal found that, as the contract contained explicit provisions regarding the calculation and payment of rent, the respondent still had the obligation to pay the minimum required rent to the claimant regardless of how much rent the respondent obtained from the sublease. When the respondent signed the lease contract with the claimant, it had already agreed to sublet the property for a third party for an amount less than the rent it would have to pay to the claimant so the respondent was clearly aware of the price differential. Also according to Articles 54 and 55 of the Contract Law, if a contract loses equality, a party has the right to request that the court or arbitral tribunal permit modification or revocation

---

<sup>65</sup> *Lease Contract Dispute—Obvious Loss of Fairness and the Exercise of the Right to Revoke a Contract*, CIETAC (July 15, 2009).

of the contract within one year of when it knew or should have known that it had cause to do so. As the respondent did not attempt to exercise its right until three years after signing the contract, the respondent had lost its right to seek revocation even if the contract had actually become unfair.

This case, which involved a lease and sublease agreement, primarily revolved around the running of a limitations time period. Because the respondent waited until three years after signing the contract, he lost his right to seek revocation.

*iv. Execution of Duties of a Contract for the International Sale of Goods*<sup>66</sup>

The claimant seller and the respondent buyer signed a contract under which the claimant agreed to supply the respondent with five thousand tons of peanuts. The contract required the buyer to open an irrevocable, transferable letter of credit with the seller as beneficiary fifteen days before the loading date. The respondent failed to open a letter of credit and cancelled the contract on the ground that there was insufficient time to arrange the loading of the ship. The claimant sought compensation for damages. The respondent's failure to open the letter of credit and arrange shipping forced the claimant to convert the product into peanut oil, resulting in financial losses. The respondent counterargued that examination of the goods before the loading period indicted that the product did not meet the required standard and hence it did not open a letter of credit.

The arbitral tribunal confirmed the claimant's request for compensation resulting from the respondent's fundamental breach of contract from failing to open the letter of credit. Regardless of the claimant's usual practice to open a letter of credit only after the parties examined the product together and determined the required standard was met, contractual obligations will always supersede an implicit understanding.

Here CIETAC relied first on the contract as stated, as opposed to industry practice. Because the opening of a letter of credit was not contingent on product quality, the respondent was contractually bound to open the letter of credit. As he failed to do so, he was in breach of the contract.

---

<sup>66</sup> *Problem in the Sequence of the Execution of Duties in a Contract for the International Sale of Goods*, CIETAC (July 16, 2009), <http://www.cietac.org/index.cms>.



*c. Assessment of Cases*

As can be seen from the above sample of CIETAC cases, the majority of those cited deal with some variation of a contractual dispute, whether it be for the sale of goods, the opening of a letter of credit, subleasing agreements or product quality. None of the cases reviewed above directly involve banking- or financing-related disputes. While CIETAC maintains a list of highly qualified and well established financial dispute resolution practitioners, given the limited number of finance related cases thus far referred to CIETAC, a question arises as to the preparation of CIETAC on the whole to handle financial- and banking-related matters.

Why might the number of financial dispute resolution cases brought to CIETAC be low? In general, CIETAC is among the most well known arbitral institutions in China and the first to introduce a financial dispute resolution system. Therefore, it is not the lack of awareness or the absence of a specialized program that has deterred users. One reason might be that CIETAC case handling fees are less expensive when compared with other international arbitration venues, but relative to general income levels in China, CIETAC fees can still be high. As a result, case fees may serve as a deterrent to midsize businesses and sole proprietorships.

*B. Shanghai Courts—Financial Division*

The Shanghai Courts have handled a wider range and larger number of financial and banking related cases than CIETAC. As will be seen below, the Shanghai Courts have had more extensive experience handling financial and corporate claims.

Case Handling

A recent study conducted by the Shanghai High Court analyzed the case intake and disposition of financial-related cases.<sup>67</sup> The study found that the Court handled over 1,165 financial criminal cases in 2010 (an increase of 38.3 percent from the previous year), and 22,278 financial and commercial civil cases (an increase of 29.6 percent from the previous year). The total case value exceeded 6.4 billion RMB. The civil cases involved loan agreements, insurance contracts, securities, financial leasing

---

<sup>67</sup> *Woyuan Juxing Xilie Shenpan Baipishu Fabu Hui* (我院举行系列审判白皮书发布会) [Press Conference on the Issue of White Papers], SHANGHAI NO.2 INTERMEDIATE PEOPLE'S COURT, <http://www.shezfy.com/view.html?id=55150> (last visited Aug. 26, 2011).

arrangements, credit cards and trust funds, while the criminal cases involved issues such as credit card fraud, bill fraud and sales.<sup>68</sup>

### Relevant Cases

Below is a sample of relevant cases handled by the Financial Division of the Shanghai Courts. The sample illustrates the growing depth and breadth of experience in handling financial-related issues and the use of mediation in some cases.

#### 1. *Abuse of Majority Shareholder Power* (Published 2008)<sup>69</sup>

This case involved a plaintiff and defendant who were originally the only two shareholders in a company with registered capital of 21 million RMB, respectively holding 15 percent and 85 percent stakes. Under the pretext of addressing company liquidity problems, the defendant, who was also the majority shareholder, held several shareholder meetings between April and September 2005 to approve the injection of capital by itself and a third party “strategic partner” company. The capital injection allowed the defendant to increase his stake in the company to 73.7 percent and the third party “strategic partner” company obtained 20 percent while the minority shareholder’s stake was reduced to 6.3 percent. The plaintiff sued the defendant for abuse of the position of majority shareholder.

The appellate court, in consideration of the deteriorated relationship between the two parties, persuaded them to reach a mediation agreement where the defendant agreed to purchase the plaintiff’s entire equity interest and pay the plaintiff a one-off compensation of 6.1 million RMB.

---

<sup>68</sup> Ying Yilin (应一琳), *Xinyong Ka Zhapian Cheng Jinrong Fanzui Zhongzai Qu* (信用卡诈骗成金融犯罪重灾区) [*Credit Card Fraud Becomes the Most Common Financial Crime*], SHANGHAI BUSINESS DAILY (Mar. 11, 2011), <http://finance.sina.com.cn/roll/20110311/11109512831.shtml>.

<sup>69</sup> *Dong Li yu Shanghai Zhida Jianshe Fazhan Youxian Gongsi deng Gudong Lanyong Gudong Quanli Peichang Jiufen Shangsu An* (董力与上海致达建设发展有限公司等股东滥用股东权利赔偿纠纷上诉案) [*Appeal on Dispute Between Dong Li and Shanghai Zhida Jianshe Fazhan Co., Ltd. and Other Shareholders Over Compensation for the Abuse of Majority Shareholder Power*], SHANGHAI NO.2 INTERMEDIATE PEOPLE’S COURT (Sept. 3, 2008), <http://www.shezfz.com/view/jpa/detail.html?id=175> (last visited Aug. 26, 2011).

### 2. *Request for Winding Up of Company* (Published 2006)<sup>70</sup>

This case involved a claim by plaintiff subsidiary company against the defendant parent company. The plaintiffs claimed that the defendant parent company refused to hold shareholder and director meetings resulting in severe difficulties in the management and normal operation of the company.

After a review of the facts, the court held for the defendant, indicating that the plaintiffs should also bear responsibility for the unfavourable state of management of the company which was partly attributed to their breach of contract.

### 3. *Fraudulent Shareholder Investment*<sup>71</sup>

One case involved a joint venture agreement entered into by two defendants in June 1999. Although the official registration records indicated that the company had registered capital of 5 million RMB, the two defendant shareholders had in fact paid nothing. In 2004, the company increased its registered investment capital to 10 million RMB, with the two shareholder's funding obligations still unfulfilled. A debt crisis hit the company and the suppliers, bank and other debtors sued the company and its two shareholders.

The court held that shareholders were required to pay the full contribution in order to set up a company. As the company's actual capital was below that of the legal minimum, its corporate status was not established and the defendant shareholders were, as a result, jointly and severally liable for the company's debts.

---

<sup>70</sup> *Shanghai Boxing Jiyin Xinpian Youxian Zeren Gongsi, Shanghai Bode Jiyin Kaifa Youxian Gongsi, Bohai yu Shanghai Sanmao Qiye (Jituan) Gufen Youxian Gongsi deng Gudong Qingqiu Jiesan Gongsi Jiufen An* (上海博星基因芯片有限责任公司、上海博德基因开发有限公司、董海与上海三毛企业(集团)股份有限公司等股东请求解散公司纠纷案) [*Dispute Over (Shareholders') Request to Dissolve the Company*] (Sept. 8, 2006), SHANGHAI NO.2 INTERMEDIATE PEOPLE'S COURT, <http://www.shezfz.com/view/jpa/detail.html?id=111> (last visited Aug. 26, 2011).

<sup>71</sup> Eight cases on financial and investment risks were heard by the Shanghai High Court on September 19, 2010. See Gao Yuan (高远), Shanghai Gaoyuan Tongbao Baqi Fengxian Jingshi Anli (上海高院通报8起风险警示案例) [Shanghai High Court Report on 8 Typical Cases on Financial and Investment Risks], SHANGHAI FINANCIAL NEWS (Oct. 12, 2010, 1:17 AM) <http://www.shfinancialnews.com/xww/2009jrb/node5019/node5036/node5048/userobject1ai66151.html> (discussing eight companies involved in litigation in the Shanghai Higher People's Court).

#### 4. *Breach of Fiduciary Duty by Management*<sup>72</sup>

This case involved a dispute between a defendant manager for a foreign company responsible for the company's sales in the South China region and the foreign company. In the course of his employment, the defendant obtained profits for himself through side dealing and fraudulent means. The company dismissed the defendant and sued him for compensation of losses suffered by the company.

The court held that the defendant owed duties of loyalty (including a prohibition against self-dealing) to the company. As a result of the defendant's breach, the court ordered him to disgorge any profits and compensate the company for the losses it suffered.

#### 5. *Company Refusal to Award Shareholder Dividends*

This case involved a dispute between a shareholder (the plaintiff) and his company (the defendant). In January 2008, the plaintiff was arrested and held in custody for a crime that he was subsequently acquitted of. During the period of custody, the defendant company distributed shareholder dividends for the year of 2007 to all shareholders except the plaintiff. The plaintiff sought a payment of his dividends after his release.

The court held that shareholder rights are not affected even when a shareholder is under custody by the police. The defendant was ordered to pay the plaintiff his dividends accordingly.

#### 6. *Company Deregistration Prior to Liquidation*

This case involved a plaintiff real estate company, which was set up in 1999 and deregistered in March 2006. During the period when the company was in operation, it purchased 0.5 million RMB worth of construction materials from the defendant, which remained unpaid at the time of deregistration.

The court held that, even after a company is deregistered and wound up, the shareholders are still under the responsibility to liquidate the company according to law. The court ordered the shareholders to compensate the defendant for any losses suffered due to the non-payment for the materials.<sup>73</sup>

---

<sup>72</sup> *Id.*

<sup>73</sup> Song Xuan (宋璇), *Weiji Xia Shanghai Jinrong Anjian Jizeng* (危机下上海金融案件激增) [*Surge in Financial Litigation as Financial Crisis Hits Shanghai*], PEOPLE.COM.CN, (May 21, 2009), [http://paper.people.com.cn/gjrb/html/2009-05/21/content\\_257709.htm](http://paper.people.com.cn/gjrb/html/2009-05/21/content_257709.htm).

### C. Summary

From a review of the case intake of the Financial Division, it is clear that the Shanghai Courts have extensive exposure to financial related cases.<sup>74</sup> Overall, given its low case intake fees in comparison with CIETAC and its more extensive case exposure, it would appear that in the short term, parties may be best served by reference to specialized financial court dispute resolution mechanisms, while in the long term, as arbitral bodies gain greater exposure to financial- and banking-related disputes, such mechanisms will provide additional viable options for disputing parties in the future.

## IV. LESSONS FROM THE GLOBAL FINANCIAL CRISIS

What lessons can be learned from the global financial crisis? How can such lessons be applied to the development of China's financial governance systems in the future? Although China's financial markets and institutions have been affected by the global financial crisis, the impact appears less direct and less severe than is the case with overseas markets.<sup>75</sup> The Chinese financial system as a whole has survived the crisis in relatively good shape: no major financial institutions have fallen and no major scandals over transactions involving complex financial products have occurred. The losses suffered by Chinese financial institutions are essentially the consequence of their ill-fated investment in and exposure to overseas markets rather than domestic markets. Further, the overall risk exposure of China's financial institutions and listed companies in overseas markets is quite limited and manageable.

However, one would be wrong to conclude, judging from the relatively good health of the Chinese financial markets following the financial crisis, that China's financial regulatory system is problem-free. Rather, a closer examination reveals the irony that the good fortune of China's financial system in this financial crisis is largely attributable to the relative simplicity of its financial products and isolation from the global economy.

To begin with, the Chinese financial markets continue to have much room for development. At present, the financial products traded on the Chinese financial markets are limited and the technology of securitization is yet to be widely used. There are some traditional financial derivatives in China such as options and warrants, but they are

---

<sup>74</sup> See *Shanghai Fayuan Falü Wenshu Jiansuo Zhongxin* (上海法院法律文书检索中心), <http://www.hshfy.sh.cn:8081/flws/list.jsp> (last visited Dec. 26, 2011) (listing cases that have been adjudicated by the Shanghai Courts).

<sup>75</sup> Hui Huang, *China's Legal Responses to the Global Financial Crisis: From Domestic Reform to International Engagement*, 12 AUSTL. J. ASIAN L. 157.

far fewer than those found in overseas markets and far less sophisticated than their overseas counterparts, including collateralized debt obligations (CDOs), collateralized loan obligations (CLOs) and synthetic CDOs. As securitization and complex financial instruments have now been identified as one of the core causes of the current financial crisis,<sup>76</sup> it is not hard to understand why China's financial system has not suffered any homegrown problems.

On the other hand, the isolation of the Chinese financial system from the outside world has helped to stop the flow-on effect of the financial crisis in China. Although China has worked to open up its financial markets since its accession to the WTO, this process has been gradual, cautious, and ongoing. For the time being, foreigners have limited access to the Chinese financial markets. For example, foreign investors cannot trade in China's stock market except through several designated means such as the program for Qualified Foreign Institutional Investors (QFII).<sup>77</sup> Further, the Chinese government still exerts tight control over its currency policy. For instance, there are restrictions on capital accounts; the Chinese currency, the Renminbi or *yuan*, is not fully convertible yet; the exchange rate is set in a managed floating range.<sup>78</sup> All these measures have collectively operated as a firewall to insulate China's financial system from the spills of the financial crisis overseas.

China can take some comfort from the fact that its financial system has sustained relatively modest losses in the current financial crisis. However, it should not be overjoyed about its lucky escape, overlooking the real problems it has faced. As observed by the People's Bank's Governor, the fault of the previous crisis was "not in the technical sophistication of the products"<sup>79</sup> but rather arose from "problems in information disclosure or the pricing mechanisms."<sup>80</sup> Others have observed that the technology of securitization and financial derivatives, if

---

<sup>76</sup> See e.g., John C. Coffee, Jr., Adolf A Berle Professor of Law at Columbia Law Sch., Keynote Address of the Third Annual Supreme Court/Law Society Conference on Corporate Law 2008: Financial Crises 101: What Can We Learn from Scandals and Meltdowns—from Enron to Subprime? (Aug. 2008), available at [http://sydney.edu.au/law/news/docs\\_pdfs\\_images/2008/2008RossParsonsAddressPodcast.mp3](http://sydney.edu.au/law/news/docs_pdfs_images/2008/2008RossParsonsAddressPodcast.mp3).

<sup>77</sup> See HUI HUANG, *supra* note 34, at 12–13 (describing the QFII mechanism and other means for foreigners to invest in China's stock market).

<sup>78</sup> See *China to Make RMB Convertible on Capital Account in 5 Years*, CHINA DAILY (Jan. 19, 2011, 9:28 AM), [http://www.chinadaily.com.cn/bizchina/2011-01/19/content\\_11878739.htm](http://www.chinadaily.com.cn/bizchina/2011-01/19/content_11878739.htm) (discussing China's plan to make its currency convertible on the capital account).

<sup>79</sup> LEO F. GOODSTADT, *RELUCTANT REGULATORS: HOW THE WEST CREATED AND HOW CHINA SURVIVED THE GLOBAL FINANCIAL CRISIS* 12 (2011).

<sup>80</sup> Zhou Xiaochuan, Governor, People's Bank of China, *Instability and the Evolution of the Financial System*, Speech at the Global Management Forum (Oct. 30, 2007), available at <http://www.bis.org/review/r071213a.pdf?frames=0>.

used and regulated properly, can make the market more efficient and effective.<sup>81</sup> China is thus best advised to further develop its financial markets by investigating the applicability of such financial tools, while at the same time strengthening its regulatory system to avoid abuse.

What is required is a more effective regulatory framework that can take on the increasingly complex challenge of providing coordinated supervision of innovative financial products and multi-service financial groups. This challenge has been acknowledged worldwide, as U.S. federal regulators now admit in relation to the most recent financial crisis that “neither the investors, nor the rating agencies, nor the regulators, nor even the firms that designed the securities fully appreciated the risks those securities entailed . . . in part because the regulators—like most financial firms and investors—did not fully understand or appreciate them.”<sup>82</sup>

As discussed earlier, China presently adopts a traditional sectoral system of financial regulation, which has exhibited several inadequacies in meeting the regulatory challenges in a rapidly changing market. This author has discussed the issue elsewhere through a comparative analysis of the relevant experiences in some advanced economies including the U.S., the UK and Australia. Each of these jurisdictions represents a different regulatory approach, namely the ‘multiple-regulators’ model or ‘sectoral regulation’ model in the U.S., the ‘single-regulator’ model or ‘integrated regulation’ model in the UK, and the ‘twin peaks’ model or ‘objectives-based regulation’ model in Australia. When looking to overseas regulatory models for guidance, one must take into account not only the advantages and disadvantages in doing so, but also of the local conditions in China. This author suggests that “the U.S. model merits consideration in the short term, [and that] with further growth of China’s financial markets in the long run the Australian model provides the preferred direction for reform.”<sup>83</sup>

With regard to China’s systems of financial dispute resolution, following the financial crisis, China saw the emergence of CIETAC’s financial dispute resolution mechanism. However the use of this mechanism has been minimal. Why might that be? In general, CIETAC is amongst the most well known arbitral institutions in China and the first to introduce a financial dispute resolution system. Therefore, it is not the

---

<sup>81</sup> See generally Christina A. Johnson, *At the Intersection of Bank Finance and Derivatives: Who Has the Right of Way?*, 66 TENN. L. REV. 1 (1998) (discussing securitization and derivative transactions); Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369 (1991) (discussing securitization’s role in broadening borrower access to the capital markets and reducing borrowing costs).

<sup>82</sup> Ben S. Bernanke, Chairman, Fed. Res. Bank, Remarks at the Dallas Regional Chamber, Economic Challenges: Past, Present, and Future (Apr. 7 2010), <http://www.federalreserve.gov/newsevents/speech/bernanke20100407a.pdf>.

<sup>83</sup> Huang, *supra* note 1, at 254.

lack of awareness or the absence of a specialized program that has deterred users: one reason might be that while CIETAC case handling fees are less expensive when compared with other international arbitration venues, CIETAC fees in domestic cases can be high.<sup>84</sup> As a result, case fees may potentially cost out midsize businesses. A sliding scale fee for midsize businesses may make CIETAC financial arbitration more attractive for such entities. In addition, because pre-dispute arbitration clauses in standard form contracts can be held invalid in a number of circumstances under the PRC Law,<sup>85</sup> this presents an additional barrier to CIETAC use by small and midsize businesses. It is possible to “tick the box” to select arbitration, but in practice, few people choose to do this. Therefore, greater awareness is needed among small businesses regarding the benefits of arbitration as well as a commensurate sliding scale fee to make the arbitration process more accessible.

---

<sup>84</sup> See *Arbitration Fee Schedule*, CIETAC <http://www.cietac.org/index/applicationForArbitration/47601fd5a0e7e87f001.cms> (listing a schedule of fees charged for cases accepted for arbitration based on the amount in dispute) (last visited Aug. 26, 2011).

<sup>85</sup> See Application by Qiu Donglan and Wu Feng for Confirming Validity of an Arbitration Agreement (Kunming Interm. Ct., First Civil Div. Jan. 21, 2009) (initial ruling, Case No.1); see also Kunming Intermediate People's Court Civil Ruling (上海高院通报8起风险警示案例) CHINALAWINFO (2009), <http://fjthk.now.cn:7751/vip.chinalawinfo.com/newlaw2002/slc/slc.asp?db=fnl&gid=117599234> (last visited Feb. 21, 2012) (discussing the hearing for Qiu Donglan and Wu Feng). In that case, the applicants and the respondents were parties to a contract for sale and purchase of commodity housing, of which Article 14 was a standard arbitration clause submitting the dispute to Kunming Arbitration Commission. Although the Court held that Article 14 was valid, it suggested that a standard arbitration clause could be invalidated if there was evidence indicating that:

- (1) the scope of the arbitration agreement exceeded that permitted by law, any of the parties concerned was incapable of concluding the arbitration agreement, or the agreement was obtained by coercion (Art. 17 of the Arbitration Law of the PRC);
- (2) the arbitrable matters and the choice arbitration commission were not clearly specified (Art. 18 the Arbitration Law of the PRC);
- (3) the arbitration agreement excluded the liabilities of the party supplying the agreement, increased the liabilities of the other party, or deprived the other party of any of its material rights (Art. 40 of the Contract Law of the PRC);
- (4) the agreement was obtained by fraud or duress, the parties colluded in bad faith, the parties intended to conceal an illegal purpose, the agreement was harmful to the public interest, or the agreement violated any law or administrative regulation (Art. 52 of the Contract Law of the PRC);
- (5) the agreement excluded liabilities for personal injury or liabilities for property loss caused by intentional misconduct or gross negligence (Art. 53 of the Contract Law of the PRC).



Despite handling a limited number of cases, CIETAC has been generally effective in providing a forum for the resolution of commercial disputes, while its hearing of financial-related disputes continues to have much scope for growth. In order to further strengthen CIETAC's role in providing a venue for the resolution of financial related disputes, there is a need to provide further training to arbitrators so that they become well versed in financial systems, laws and regulations.<sup>86</sup> In addition, CIETAC may consider drafting a general model clause for use in financial product sales contracts. This will make CIETAC a more attractive venue of the resolution of financial disputes.

On the other hand, the Financial Division of the Shanghai Courts has had extensive exposure to financial and commercial cases. It has handled more than 260,000 civil and financial-related cases.<sup>87</sup> Comparing case intake and exposure with that of CIETAC, it is clear that the Shanghai Courts have developed extensive familiarity with financial related disputes.

With respect to both CIETAC and the Financial Division of the Shanghai Courts, further training and development is necessary. It is suggested that a comprehensive financial dispute resolution training program consider the inclusion of both a course-based program followed by an examination and an in-person evaluation program. The course content could include topics such as the arbitration process, ethical considerations, how to determine potential conflicts of interest, managing the hearing process, fairness and impartiality, determining the facts of a case and the relevant law, and drafting an award. Such a training program will enhance the competency of the arbitrators and the confidence of the parties in the proceedings.

In addition to a comprehensive training program, providing potential parties with a draft clause to include in their contractual agreements will provide a clear route to resolution. The following essential elements must be included in a valid arbitration clause: the administering institution, the arbitration rules, reference to any dispute arising out of the agreement, the place (seat) of arbitration, the number of arbitrators, the method of selection and replacement of arbitrators, the language of arbitration and the rules of law governing the contract. In addition to these essential elements, the parties may also consider including terms such as the allocation of costs, time limits and discovery considerations.

---

<sup>86</sup> See also Shahla F. Ali & John Koon Wang Kwok, *After Lehman: International Response to Financial Disputes—A Focus on Hong Kong*, 10 RICH. J. GLOBAL L. & BUS. 151, 166–67 (2011) (discussing basic training methods and programs in the mediation scheme).

<sup>87</sup> *Shanghai Fayuan Falü Wenshu Jiansuo Zhongxin*, *supra* note 74.

The authors are of the view that given CIETAC's limited exposure to banking and financial sector disputes, in the immediate term, parties are advised to seek resolution through reference to local financial division dispute resolution mechanisms such as the financial division of the Shanghai Courts. In the long term, prospects for greater strengthening of national mechanisms such as CIETAC and the Securities Dispute Resolution scheme will provide additional avenues of recourse.

## V. CONCLUSION

This article has shown that China's systems of financial dispute resolution and regulation have undergone significant changes since economic reforms in the late 1990s. The current Chinese regulatory regime is broadly similar to its United States counterpart, adopting a traditional sectoral regulatory structure. It comprises the PBC as the central bank and three sector-specific regulators, namely the CBRC, the CSRC, and the CIRC responsible for banking, securities and insurance respectively. Similarly, its financial dispute resolution structures are just emerging at the provincial level as specialized programs within courts and arbitral tribunals.

The authors recommend that in the short term, given CIETAC's limited exposure to banking and financial sector disputes, parties seek resolution through reference to local financial division dispute resolution mechanisms such as the financial division of the Shanghai Courts. In the long term, prospects for greater strengthening of national mechanisms such as CIETAC and the Securities Dispute Resolution scheme will provide additional avenues of recourse.