

CHAPTER-12

MATTERS FOR SPECIAL ATTENTION IN INTERNATIONAL TRADE WITH CHINESE PARTNERS

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I INTRODUCTION

China has no doubt become a big “cake” attracting more and more foreign investors to compete for a share of it. This situation may be attributed to China’s competitive production cost, sound macroeconomic policies, strong economic growth, and favorable business environment. While sharing such a big “cake”, however, particular attention must be paid by the foreign traders to the potential “pitfalls”. Prevention is better than cure. For foreign traders doing business with Chinese, a little more knowledge about some key legal issues in China can help a lot. Thus, this chapter is going to firstly disclose some legal pitfalls for companies dealing with China so that due diligence against the counterparties should be exercised before making the contracts. Secondly, it will turn to the validity of some main clauses in the international contracts under Chinese law. Finally, it will conclude with an overview of security for claims, when disputes must be solved in China.

II DUE DILIGENCE BEFORE MAKING INTERNATIONAL CONTRACTS

With the vast growth of Chinese economy in the world for the past decades, China is fast becoming the global investment hotspot and more and more foreign companies are doing business with Chinese parties. An international contract is commonly defined in China as a contract that involves so-called “foreign elements”. In general, a contract that has a “foreign element” is referred to either of the following: (1) a contract in which at least one of the parties to the contract is a foreigner, stateless person, foreign enterprise or organization, (2) a contract that is concluded or performed in a foreign country or outside the territory of China, or (3) a contract that contains the subject matter located in a foreign country or outside the territory of China¹. For historical reasons, Hong Kong, Macao and Taiwan are treated differently from Mainland China, and the term “foreign” in China may also include these three unique regions². When doing international business with Chinese parties, some business

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¹ Mo Zhang, *Chinese Contract Law Theory and Practice* (Martinus Nijhoff Publishers) 327.

² Interpretation of the Supreme People’s Court on the Application of the Civil Procedure Law of the People’s Republic of China, art 551.

practice taken for granted by the foreign parties may just become the legal pitfalls of which the Chinese parties could take advantage to evade liabilities in the future. Let's have a look at the following case.

2.1 Case Study

A company incorporated in Dubai would like to order some stainless steel from a Chinese company named Top Steel Co., Ltd ("Top Steel") and thereby starts to make enquiries via email. Amy Wang is the sales manager representing Top Steel to negotiate and sign the contract with the UAE Company. As it is an international contract, all the email exchanges and the draft contract are in English.

The above contract making process is very common in the real international business life, but from the perspective of a Chinese legal counsel, the following issues must be double checked at the first place: -

- (1) What is the Chinese name of Top Steel?

In China, only the Chinese name of a company is the formal name registered with the relevant authorities, while the English names are not legally required and thereby could not be used to identify a legal person in China. Sometimes, a Chinese company would have an English name far different from its Chinese name so as to prevent the foreign counterparties from locating it, when disputes arise therebetween. Thus, it is very important to write the official Chinese name of this so-called Top Steel as the Seller in the Sales Contract.

- (2) Whether this Chinese company is legally incorporated in China.

There was a case where the foreign buyer wanted to sue the Chinese supplier for breach of contract, while it was found later that this so-called Chinese company was never registered in China but an offshore company incorporated in BVI actually. Thus, exercising a company search against the counterparty before making the contract could probably prevent a foreign company from being cheated by a company that does not even legally exist in China. Nowadays, the Chinese companies' registration information (except the financial statement) could be obtained from the official data base online, which will be introduced in detail below.

- (3) Who is Amy Wang?

If Amy would sign the contract for and on behalf of Top Steel, was Amy duly authorized to do so? Again, English name is not the official name of either legal person or natural person in China. Therefore, in the absence of a power of attorney duly issued by Top Steel to Amy, the contract would not necessarily have binding effect on Top Steel only by a signature of "Amy Wang" unless Top Steel is willing to ratify the same later, which is rarely seen when disputes have already arisen between the parties.

- (4) Would Top Steel's corporate seal also be affixed on the contract?

Compared with the western business practice, in China the corporate seal takes a more important role than an authorized signature does in respect of

representing a company. If the contract was just signed by Amy without Top Steel's corporate seal affixed thereon, when disputes arise, it would be very easy for Top Steel to deny the contractual relationship with the UAE Company in excuse that there was never an employee named Amy in the company, let alone that Amy is not even an official name.

2.2 Company Search

As we discussed in the above case, those legal pitfalls that are likely to be omitted by a foreign company may just become a big risk for the fulfillment of the contract in the future. Thus, due diligence exercised against a Chinese company before making the contracts becomes necessary. The due diligence or as we normally call it company search process generally starts when parties to a transaction sign a letter of intent, or framework agreement, or a conditional investment agreement. These documents provide for a time frame and the scope within which due diligence is to be conducted. The foreign companies through their counsel are expected to work closely with the business advisers, investment bankers, accountants, lawyers and other professionals. Qualified translators may often be required, as most of the documents and records are in Chinese only.

Generally, a company search report would contain the basic registration information, the credit references, the effective rulings or judgments involving the target company as a litigant and the courts' enforcement records (if any), among which the following information should be highlighted due to their importance.

(1) Business Scope

First is the business scope. In China, a contract would not necessarily be considered invalid, where the contracting party exceeds its business scope to operate the proposed transaction unless such operation exceeding business scope violates the provisions relating to restrictive business, franchise or business forbidden by law and administrative regulations³. Hence, it is very important for the foreign traders doing business with Chinese partners to examine in advance whether their Chinese partners are approved to do the subject business so as to ensure the validity of the underlying contract.

(2) Corporate name

Again, only Chinese name is officially registered, while English name is not even required by law.

(3) Legal representative

It is a legal definition under Chinese law referring to the entity's President, CEO, Chairman of the Board, Executive Director, Managing Director, General Manager or the other individual who is appointed or authorized by the entity's supreme authority to act for and on behalf of the entity, and officially registered

³ Interpretation I of the Supreme People's Court of Several Issues concerning the Application of the Contract Law of the People's Republic of China, Article 10.

with the company registry for effect of demonstration. Since the legal representative's signature could of itself represent the company even without the company's POA, knowing who the legal representative of the company will assist to figure out the signatory's authority and whether a POA should be required.

(4) Place of registration

In the absence of the parties' choice of forum, this information could help to locate the jurisdictional court, when disputes arise between the parties. Article 21 of the Civil Procedure Law of the People's Republic of China ("CPL") provides that "*A civil action instituted against a legal person or any other organization shall be under the jurisdiction of the people's court at the place of domicile of the defendant*". And the judicial interpretation of the CPL interprets that the domicile of a legal person or any other organization refers to the place of its principal business establishment, and if the place of principal business establishment is unascertainable, the place of registration should be the place of domicile⁴.

(5) Registered capital

The latest Company Law of the People's Republic of China was revised in 2013 and has entered into force as of March 1, 2014. Compared with the old Company Law, the new Amendment deletes the requirements for minimum registered capital of a company limited by liability or by shares, which means the initiators of the companies are free to choose the type of the company without limitation of the capital requirements, unless otherwise provided by other laws, administrative regulations and the decisions of the State Council⁵, so technically it is possible to establish a "one-dollar company limited by liability or shares" in China.

(6) Contributed capital;

According to the revised Company law, unless otherwise provided by other laws, administrative regulations and the decisions of the State Council, there is no more requirements of the initial ratio of paid-in capital and the time limitation of full contributions for either a company with limited liability or a company limited by shares, and the shareholders or promoters could agree in the articles of association of the company when and how much they should pay the capital contribution⁶. Thus, a company's contributed capital may be far less than its registered capital.

(7) Corporate seal

As mentioned above, in China the corporate seal is more important than an authorized signature (except the legal representative's signature) in respect of representation of the company. Thus, when making a contract with a Chinese

⁴ Interpretation of the Supreme People's Court on the Application of the Civil Procedure Law of the People's Republic of China, Article 3.

⁵ Company Law of the People's Republic of China 2013, Articles 26 and 80.

⁶ Ibid Articles 28 and 83.

company, please make sure to have the Chinese company's corporate seal affixed thereon in addition to the authorized signature.

The above basic registration information of a Chinese company is published on the National Enterprise Credit Information Publicity System online. Everyone having access to internet could obtain that information, but the problem is that they are in Chinese, so a Chinese company could be searched only by its Chinese name, and a qualified translator would be of assistance. In summary, the company search report to be provided by the local counsel should generally clarify the following key issues of the Chinese company:

- (a) Whether the Chinese company is duly incorporated and validly existing;
- (b) Who are the legal and beneficial owners of the Chinese company;
- (c) Who is the "legal representative" or the authorized signatory of the Chinese company;
- (d) Whether the name of the company written on the contract is the name duly registered with the relevant authority;
- (e) Whether the Chinese company is doing the business within its registered business scope and period, or in other words, whether the licenses of the Chinese company contain any restrictive provisions in relation to a proposed transaction; and
- (f) Whether the Chinese company is financially capable of fulfilment of the proposed transaction in view of its registered capital, credit references and the pending courts' enforcement cases.

III TO FORM A VALID CONTRACT

3.1 Contract Law in General

The existing Contract Law of the People's Republic of China was adopted by the National People's Congress on March 15, 1999 and came into effect on October 1 of the same year, and then became one of the most significant legislations regulating civil and commercial affairs in the nation. Except the general provisions on the basic principles and standard for construction of contracts, there are several chapters establishing specific rules for 15 types of contracts like Contract for Sales, for Donation, for Loans, for Lease, for Financing Lease, for Construction Projects, for Transportation, etc. Under the Chinese terminology, the 15 contracts listed in the Contract Law are the "named contracts", and any others will then be deemed "unnamed contracts". Literally speaking, the named contracts are considered as being used more frequently than the unnamed contracts, and with regard to the law applicable to the unnamed contracts, the Contract Law adopts a doctrine of "application by analogy"⁷. According to Article 124 of the Contract Law, *any contract that is not addressed explicitly in the Specific Provisions of this Law or in other laws shall apply the provisions of the General Provisions of this Law; and the most similar provisions in the Specific Provisions of this*

⁷ Zhang (n 1)11-12.

Law or in other laws. Furthermore, the relevant judicial interpretations may be applicable under certain circumstances.

The legal requirements for a valid contract in China are similar to those in the United States, Europe, and Singapore. Virtually all commercial contracts are strongly suggested to be in writing and there must be a valid offer and acceptance⁸. The written contract becomes effective when it is signed by the legal representatives or duly authorized signatories of the contracting parties with stamping their respective corporate seal⁹. Of course, the parties may agree on conditions or a conditional time period as to the effectiveness of the contract¹⁰. Furthermore, certain contracts may not become effective until completion of approval and registration procedure according to the provisions of laws and administrative regulations¹¹.

3.2 Incorporation Clause

In China, a commercial written contract will contain the following main clauses: title or name and domicile of the parties; object of the contract; quantity and quality; price or remuneration; time limit, place and method of performance; liability for breach of contract; and applicable law and dispute resolution¹². However, for the sake of efficiency in the international trade, it is commonly seen that the parties only reach a very simple Purchase Order with the general terms and conditions (“GT&Cs”) provided by one party to be incorporated by reference in the underlying PO or contract.

Unlike the common law, the Chinese law does not specifically provide the validity of an incorporation clause, so whether the GT&Cs are validly incorporated into the underlying contract should be decided on a case-by-case basis. Generally, the GT&Cs are categorized into a “standard or format contract” under Chinese law, which is unilaterally made by the contract maker for repeated use purpose, so the contract maker is obliged to reasonably call the counterparty’s attention to any exemptible and restrictive clauses in the standard GT&Cs regarding the counterparty’s liabilities, and any clauses in the standard GT&Cs that would exempt the contract maker’s obligations and/or increase the counterparty’s obligations shall be null and void¹³. There is a precedent, where the contract incorporating the seller’s GT&Cs was made through faxes and emails without signatures or stamps by the parties, but the reason for the court to still consider this contract and the incorporated GT&Cs effective was that the parties acknowledged the same in the meeting minutes signed by both parties¹⁴. Therefore, the judicial practice inclines that for a valid incorporation of the GT&Cs provided by one party, the other party’s written acceptance or acknowledgement of the same is necessary.

Moreover, we found another case of jurisdictional objection, where the Supreme People’s Court held that the trial court did have jurisdiction over the instant

⁸ Contract Law of the People’s Republic of China, Article 13

⁹ Ibid Article 32.

¹⁰ Ibid Articles 45-46

¹¹ Ibid Article 44.

¹² Ibid Article 12.

¹³ Ibid Article 40.

¹⁴ *Australia CBH Cereal Co., Ltd. v Hebei Sihai Development Co., Ltd.* [2013] Shi Min Wu Chu Zi No. 00525.

case because the arbitration clause contained in another contract had no binding effect on the parties to the subject contract without the parties' express and specific acknowledgement in writing even though the parties did agree the incorporation of the terms and conditions of another contract by a general reference¹⁵. The rationale behind this decision is that the arbitration clause is regarded as independent of the entire contract and would come into effect only upon the parties' express agreement in writing, so the arbitration clause contained in other documents would not bind the parties to the underlying contract unless expressly and specifically acknowledged by the parties. In other words, a general reference is insufficient to incorporate the arbitration clause contained in the GT&Cs. Likewise, for many cases regarding the incorporation of charter-party into the Bill of lading (B/L), one of the main views is that the arbitration and applicable law clauses contained in the charter-party should be expressly and specifically incorporated into the B/L, e.g. "*All terms and conditions, liberties and exceptions of the Charter Party, dated as overleaf, including the Law and Arbitration Clause, are herewith incorporated*"¹⁶, otherwise only those clauses in respect of the subject matter such as shipment, carriage and delivery would be incorporated into the B/L by the general reference¹⁷.

In summary, if a foreign party would like to incorporate its GT&Cs into the underlying contract or purchase order concluded with the Chinese party and such GT&Cs contain an arbitration clause, it is essential to make sure to reasonably call the Chinese party's attention to the incorporation clause (e.g. to highlight the clause in bold) and have its written acceptance or acknowledgement of the GT&Cs incorporated. Most importantly, the arbitration clause contained in the GT&Cs should be incorporated by express and specific reference.

3.3 Arbitration Clause

As mentioned above, the precondition for the parties to initiate an arbitration proceeding is a written arbitration agreement or an arbitration clause contained in their contract¹⁸. In fact, a quite large number of international contracts in China contain a special clause calling for arbitration under the consideration of the enforcement issue

¹⁵ *Shenyang Highway Construction Development Parent Company v Qinhuangdao Qinlong International Industrial Co., Ltd and China Heilongjiang International Economic and Technical Cooperation Company* [2014] Min Si Zhong Zi No. 43.

¹⁶ CONGENBILL 1994 adopted by the Baltic and International Maritime Council (BIMCO), Clause (1) on the back of B/L.

¹⁷ *Reply of the Supreme People's Court to the Request for Instructions on the Jurisdictional Challenge in the Case of the Appellor Wugang Group International Economic and Trade Head Company v the Appellees Fuzhou Tianheng Shipping Co., Ltd. and Fortune International Shipping Co., Ltd for Dispute over a Contract of Carriage of Goods by Sea*, [2009] Min Si Ta Zi No. 36; *Reply of the Supreme People's Court to the Request for Instructions on Issues concerning the Validity of the Arbitration Clause in the Case of Hangzhou Longda Differentiation Polyester Co., Ltd. v Yongji Marine Co., Ltd. and Zhoushan Yongji Shipping Co., Ltd. for Dispute over a Contract of Carriage of Goods by Sea*, [2008] Min Si Ta Zi No. 33; *Reply of the Supreme People's Court to the Request for Instructions on Issues concerning the Validity of the Arbitration Clause in the Case of the Plaintiff Ping An Property & Casualty Insurance Company of China Ltd., Dalian Branch v the Defendant COSCO Shipping Co., Ltd. and Guangzhou Ocean Shipping Company for Dispute over a Insurance Subrogation of Contract of Carriage of Goods by Sea*, [2006] Min Si Ta Zi No. 49.

¹⁸ Arbitration Law of the People's Republic of China, Article 4.

in the future, because most of the countries in the world including China are the parties to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958 New York Convention).

Under the Chinese law, an arbitration agreement or arbitration clause contained in a contract must embody express and specific intention of the parties and the matters for arbitration. In addition, the parties shall make a clear reference to the arbitration institution¹⁹.

Note that under the Arbitration Law of the People's Republic of China, there are two types of cases that may not be arbitrated. The first type includes disputes pertaining to personal relationships such as marriage, adoption, guardianship, and succession, and the second type consists of the disputes of administrative nature that should be handled by administration agencies as provided by law²⁰.

Here is an example of arbitration clause: “*Any dispute arising from or in connection with this Contract shall be submitted to international arbitration in Shanghai.*” Is this arbitration clause valid?

First of all, Chinese law does not recognize *ad hoc* arbitrations²¹, but only institutional arbitrations²². Second, there are several international arbitration institutions in Shanghai such as the CIETAC Shanghai Office and the Shanghai International Economic and Trade Arbitration Commission (Shanghai International Arbitration Centre, SHIAC), so it is not certain which arbitration institution was actually agreed by the parties as the arbitration clause only refers to “international arbitration in Shanghai”. Therefore, in the absence of the parties’ supplementary agreement on an exact arbitration institution, such an arbitration clause is invalid under Chinese law²³, and the parties have to go to the court for dispute resolution.

Another typical example of invalid arbitration clause is that it refers to “arbitration or litigation”. Such an arbitration clause is normally considered as uncertain because it would require the parties’ further agreement on which dispute resolution, they exactly choose to solve the dispute. However, when disputes have already arisen between the parties, it is very difficult for the parties to agree on arbitration in writing anymore, so the parties have to go for litigation in the absence of a valid arbitration clause.

3.4 Jurisdictional Clause

Like in many other countries, the choice of forum is allowed in China, but on a limited basis. Article 34 of the CPL provides that: “*The parties to a contract may*

¹⁹ Ibid Article 16.

²⁰ Ibid Article 3.

²¹ Ad hoc arbitrations are arranged solely between the arbitrators and the parties. They may adopt a ready-made set of arbitration rules such as the Rules of London Maritime Arbitrators Association (LMAA) or be conducted under the rules drawn up by the parties.

²² Institutional arbitrations are administered by an arbitration institution, such as the China International Economic and Trade Arbitration Commission (CIETAC). Typically, proceedings are conducted under the arbitration rules devised by each institution, for instance, the CIETAC Administered Arbitration Rules.

²³ Arbitration Law of the People's Republic of China, Article 18.

agree to choose in their written contract the people's court in the place where the defendant has his domicile, where the contract is performed, where the contract is signed, where the plaintiff has his domicile or where the object of the action is located or any other people's court that has actual connection with the disputes to exercise jurisdiction over the case, provided that the provisions of this Law regarding jurisdiction by level and exclusive jurisdiction are not violated." Accordingly, the choice of forum is permissible, but subject to three conditions: (1) the agreement of choice of court must be made in writing; (2) the court so chosen must have "actual connections" with the disputes; and (3) the provisions regarding jurisdiction by level and exclusive jurisdiction are not violated.

The "jurisdiction by level" refers to the jurisdiction of the people's courts at different levels and it tells at which level of the people's court, a particular case shall be filed within the first instance of trial. There are four tiers in the system of Chinese people's courts: the Supreme People's Court, the provincial high people's court, the intermediate people's court (prefecture city level), and the district people's court (county level)²⁴. Note that the judicial proceedings in China are conducted under a system called "two instance trials" under which in any given case, there are one trial and one appeal only, and the judgments or rulings of second instance issued by the intermediate people's courts, the high people's courts and the Supreme People's Court and the judgments or rulings of first instance issued by the Supreme People's Court shall be final and binding²⁵.

The second part of the exclusive jurisdiction of Chinese people's courts is the exclusion of the jurisdiction of any foreign courts. The CPL expressly denies foreign courts' exercise of judicial power over the civil actions involving the disputes on the contracts of foreign investment enterprises ("FIE"). Article 266 of the CPL provides that the people's courts of China shall have the jurisdiction over the civil actions brought on disputes concerning the performance within China for contracts of Chinese - foreign equity joint ventures, Chinese - foreign contractual joint ventures, or Chinese - foreign cooperative exploration and development of the natural resources. Theoretically, Article 266 itself does not have the "long arm" enough to prohibit a foreign court from taking the case that concerns an FIE contract either initiated by foreign plaintiff against Chinese defendant or referred by the consent of the parties. But the practical problem is that the judgment so obtained will not be enforced in China because under Chinese law, a foreign court lacks the jurisdiction over the cases as such.

Let's see whether the following choice of forum clause is valid or not: -

"In case of any dispute arising from this Contract, it should be referred to the people's court at the place where the breaching party is domiciled."

Who is the breaching party? It is never the parties' position to determine who breached the contract before the case is adjudicated by the court. Therefore, such kind

²⁴ Organic Law of the People's Courts of the People's Republic of China, Article 2.

²⁵ Ibid Article 11.

of jurisdictional agreement would be held void due to its uncertainty and the jurisdiction over this contract dispute should be decided by law.

IV SECURING CLAIMS IN CHINA

In case disputes between the parties could not be avoided eventually, and the foreign party has to go for legal proceedings against the Chinese party in China, in order to secure the enforcement in the future, it is advisable to obtain security from the opponents in advance.

4.1 Property Preservation Measures for Civil Claims

As a matter of Chinese law, the property preservation measures are used to preserve the opponents' assets or status quo in order to secure the claims, similar to the "interim measures" or "Mareva injunction" in the laws of other jurisdictions. Such measures under Chinese law will be implemented in the ways of freezing the opponents' bank accounts, attaching or sealing off other assets such as real estate, ships, vehicles, cargo in warehouse or floating under the opponents' name, or even seizing the monies payable by a third party to the opponents²⁶.

According to the CPL, the property preservation measures shall be applied by the Chinese court limited to the following circumstances²⁷: -

- (1) In duration of a legal proceeding ongoing in the Chinese court, which may be decided by the court/panel's authority or subject to the litigant's application;
- (2) In duration of an arbitration proceeding in China on a domestic or foreign-related case, subject to the parties' application for the property preservation measures conveyed by the arbitral tribunal to the Chinese court;
- (3) Prior to the court or arbitration proceedings, which means that a party may apply to the competent Chinese court for property preservation measures in advance of commencement of legal action or arbitration in emergency but shall file the legal proceedings to the court or submit for arbitration within 30 days of the Chinese court's ruling on the measures, failing which the Chinese court shall release the assets so preserved.

Moreover, the applicant is required to provide the court with the counter security at the time of application. Please kindly note that the amount and form of counter security are fully subject to the court's discretion, and different local courts may have their own practice in this regard probably in accordance with the pattern of the applications they most often deal with. Basically, the counter security amounts to 30% of the preserved amount, and cash deposit is always acceptable.

However, in terms of international business, it is very common that the parties will choose a foreign arbitration or foreign court to exercise jurisdiction over the disputes arising from or in connection with the subject contract. If a foreign party would like to pursue its Chinese partner according to the arbitration agreement or jurisdiction

²⁶ Civil Procedure Law of the People's Republic of China, Article 103.

²⁷ Ibid Articles 100-101.

agreement referring to a foreign arbitration or foreign court while the Chinese party has assets only in China, whether this foreign party is entitled to apply to a Chinese court for preservation measures against the Chinese party's property located in China in order to secure the arbitration or action brought outside the territory of China. The following two cases may give a more vivid picture of this question.

Case 1: A foreign Buyer filed arbitration in London against a Chinese Seller for non-conforming goods so supplied according to the arbitration clause agreed in the sales contract. In order to secure the arbitration claims, the Buyer would like to apply to the Chinese court to preserve the Seller's only property in China. Is it possible under Chinese law?

Case 2: A foreign bunker supplier filed arbitration in London against a Chinese shipowner for the outstanding bunker charges according to the arbitration clause agreed in the bunker contract. For securing the arbitration claims, the bunker supplier would like to apply for arrest of the shipowner's only ship in China. Is it possible under Chinese law?

For Case 1, the answer is no, while for Case 2, it is yes. Why? Because in Case 1, it is a civil claim, and there is no legal basis for the Chinese court to order property preservation measures for securing the civil claims in an overseas action or arbitration which is ongoing. The "action or arbitration" secured by the property preservation measures under the CPL only refers to a domestic or foreign-related action or arbitration brought in China. However, there is only one exception for maritime claims according to the Special Maritime Procedure Law of the People's Republic of China 2000 ("SMPL 2000"), namely a party is entitled to apply for preservation measures with a Chinese maritime court to secure a foreign action or arbitration in respect of maritime claims, but the assets allowed to be preserved for a maritime claim are limited to ships, goods carried on board ship, bunkers and other ship supplies. Although lots of obstacles would be encountered in practice, application for preservation measures in the cases like Case 2 above is legally possible in China.

4.2 Preservation for Maritime Claims

For securing a maritime claim under the Chinese law, the claimant may apply to the maritime courts for the maritime claims preservation including *inter alia* arrest of a ship, arrest of the cargo carried by a ship and arrest of bunkers.

4.2.1 Arrest of Ships

The arrest of a ship in Mainland China can be used to secure the payment of a variety of claims held by an applicant. The procedure is based upon Chinese law, especially the Maritime Code of the People's Republic of China 1993 and the SMPL 2000.

China is not a signatory of either the International Convention Relating to the Arrest of Sea-Going Ships (1952 Brussels Arrest Convention) or the International Convention on Arrest of Ships (1999 Arrest Convention). But the 1999 Arrest Convention served as a valued model during the process of China's domestic law

enactment. In this sense, anyone who is familiar with that protocol will have a basic understanding of Chinese law and procedures on ship arrest. The jurisdiction of Mainland China does not recognize action *in rem* in its procedure legal framework, but it is noted that the Chinese shipping law takes in bits of the essence of the common law system in this regard.

(1) Maritime claims and ships subject to arrest

The SMPL 2000 calls out criteria, and there are 22 types of claims for which a ship may be arrested²⁸. They are basically the same as those in the 1999 Arrest Convention, enumerated by a closed list. There are no other causes for ship arrest application except in the post-trial enforcement proceedings to enforce judgments, arbitral awards or other legal documents in effect²⁹, while it should be noted where a local people's court needs to detain and auction a ship for the enforcement of an effective legal document, that people's court shall entrust the execution to the maritime court of the place of registry of the ship or of the place where the ship is located³⁰.

(a) Arrest offending ship

Before ships can be arrested, the applicant shall make sure that any one of the following conditions set out in Article 23 of the SMPL 2000 must be satisfied:

- (i) The Shipowner is liable and is the owner of the ship when the arrest is effected;
- (ii) The bareboat charterer is liable and is the bareboat charterer of the ship when the arrest is effected;
- (iii) A maritime claim is based on a mortgage or a charge of the same nature of the ship;
- (iv) A maritime claim relates to the ownership or possession of the ship;
or
- (v) A maritime claim is secured by a maritime lien.

(b) Arrest sister ship

A maritime court may arrest sister ships, namely other ships owned by the shipowner, bareboat charterer, time charterer or voyage charterer who are liable for the relevant maritime claims at the time when the arrest is effected, with the exception of the claims relating to ownership or possession of the ship.

(c) Immune ship

No ship engaged in military or governmental services can be arrested.

(2) Counter security for arrest

²⁸ Special Maritime Procedure Law of the People's Republic of China, Article 21.

²⁹ Ibid Article 22.

³⁰ Interpretation of the Supreme People's Court on the Application of the Special Maritime Procedure Law of the People's Republic of China, Article 15.

The biggest issue confronting an applicant is the very real possibility that the court will ask for counter security before issuing an order for the arrest of a ship. The amount of the counter security as statutorily prescribed shall be equivalent to various maintenance costs and expenses that are possibly incurred during the period of ship arrest, the losses of sailing period incurred from the ship arrest, and the expenses paid by the person against whom the claim is brought for releasing the ship from arrest³¹, which provision is still very general and thereby the available criteria adopted by each court are quite different from one another, varying according to their wisdom. To name just a few, the counter security could be equivalent to the required security amount, or most often 30 days' hire under charter plus maintenance costs and expenses (computed per the market pricing of the ships of the approx. tonnage and same type with reference to the related index), which is sometimes ordered to be supplemented after the case filing period expires while the ship remains arrested³². Some courts apply thoroughly case by case computation to each application filed.

The counter security must be provided in a form that is acceptable to the Court. Cash deposit is always acceptable, of course. But security may also be provided by guarantees issued by first class local banks (or local branches of foreign banks) or acknowledged guarantee companies, or letters of undertaking issued by first class local insurance companies (or local branches of foreign insurance companies). A letter of undertaking from a Chinese P&I Club might be acceptable under some circumstances but recall that it is entirely up to the Court. Sometimes, the Court may ask the applicant to submit the guarantor's latest financial statements for assessment and decision on acceptance before issuance of an arrest order.

For the foreign companies, they may be most interested in the LOG/LOU issued by a local guarantee company because of its high efficiency and convenience. However, the maritime courts are inconsistent with the acceptance of such form of counter security. According to our recent research, some maritime courts will definitely reject the LOG/LOU issued by a local guarantee company, e.g. the Shanghai Maritime Court, the Guangzhou Maritime Court, the Xiamen Maritime Court, the Haikou Maritime Court and the Beihai Maritime Court; some Maritime Courts may leave this issue to be decided case by case, e.g. the Yantai Tribunal and the Weifang Tribunal of the Qingdao Maritime Court, the Tianjing Maritime Court, the Dalian Maritime Court and the Wuhan Maritime Court; and some Maritime Courts only accept the LOG/LOU issued by a company which is on the list of the Court, e.g. the Weihai Tribunal and the Shidao Tribunal of the Qingdao Maritime Court and the Ninbo Maritime Court.

Whatever the form the security takes, it seems that the maritime courts would prefer the grantees, if not in the form of cash, from a local/Chinese source. It would be wise for a potential applicant to develop a relationship with an appropriate Chinese financial institution or a local enterprise having business relationship capable of

³¹ Provisions of the Supreme People's Court on Several Issues concerning the Application of Law in the Arrest and Auction of Ships, Article 5.

³² Ibid

providing the guarantee prior to the arrest. Time is short and there may not be adequate time to make arrangements “on the fly” while trying to arrange for the arrest.

(3) Documents required for arrest application

When filing the Application for Ship Arrest, Power of Attorney (POA), Certificate of Legal Representative (CLR) and as well as a copy of the Certificate of Incorporation of the applicant are required to be submitted to the court after they need to be notarized by the notary public at the applicant’s incorporation country and legalized by the local Chinese Embassy or Consulate³³. Due to the urgency normally involved in a ship arrest case, a few courts do not insist on the submission of original copies of the notarized and legalized POA and CLR at the time of application, while normally require them to be supplemented within a prescribed time limit.

On the other hand, the Application for Ship Arrest is required to be submitted in original copies. The applicant shall state in the Application the security it expects from the respondent and the form of the security as well. The security amount can be up to the claim amount but generally not exceeding the market value of the ship. This document will be drafted by local counsels based on the documents received.

The applicant shall also compile and hand in the *prima facie* evidence supporting its claims. The evidence serves to prove that the ship arrest in essence has factual and legal basis. Given the urgent nature of an arrest application, a court may allow the submission of faxed or scanned documents, but it will require that the original documents be followed within a reasonable period of time³⁴. Time is of the essence because the court should render a ruling within 48 hours as of acceptance of the application³⁵.

In addition, all documents in foreign language submitted to the court should be accompanied with their Chinese counterparts, but certified translation is optional³⁶.

(4) Release of an arrested ship

Finally, the ship could be under arrest. Regarding the other side of the coin, it’s also important for an applicant to know when and how the ship may get released. Basically, there are six occasions where the arrested ship can be released.

Two of them depend on the action of the respondent. A ship arrested and moored to a pier does not generate profits and the owner may well have other voyages that must be undertaken, so it is a common practice for a shipowner to speedily arrange for the release of an arrested ship by providing the security as stipulated by the court’s ruling within the arrest period³⁷. Otherwise, the respondent may apply for a review of

³³ Civil Procedure Law of the People’s Republic of China, Article 264.

³⁴ Ibid Article 70; Some Provisions of the Supreme People’s Court on Evidence in Civil Procedures, Article 10

³⁵ Special Maritime Procedure Law of the People’s Republic of China, Article 17.

³⁶ Some Provisions of the Supreme People’s Court on Evidence in Civil Procedures, Article 12.

³⁷ Special Maritime Procedure Law of the People’s Republic of China, Article 18.

the ruling in 5 days after the arrest ruling is served, and if succeeds, the ship will be released³⁸.

Any other relevant interests such as the stakeholders are also entitled to file an objection against the arrest to the court, and if such an objection is upheld because the ship arrest application is viewed as apparently wrong, the ship will also get released³⁹.

There are also two circumstances associated with the applicant's side. One is withdrawal by the applicant of the ship arrest application, mostly as a result of the negotiation or settlement between the applicant and the respondent⁴⁰. The other situation is that the applicant fails to bring the litigation or arbitration based on the same ground of ship arrest within 30 days following the arrest order date⁴¹.

The last and quite unique case of ship release is the judicial sale for the ship. After the auction, the ship will be released to the buyer. The arrested ship will be auctioned if these conditions are all met: (a) the applicant lodges the litigation or arbitration within 30 days; (b) the respondent fails to provide the security; (c) the arrest period expires; (d) the applicant applies for auction of the arrested ship; and (e) the ship is unfit for being arrested longer⁴².

4.2.2 Arrest of the Cargo Carried by a Ship

In addition to the ship arrest, the SMPL 2000 also provides that the applicant is entitled to apply for arrest of goods carried by a ship to secure its maritime claims so long as the goods so arrested are owned by the respondent⁴³ and the value of which is equivalent to the claim amount except that the goods are inseparable⁴⁴.

(1) Definition of “goods carried by a ship”

The “goods carried by a ship” provided by the SMPL 2000 shall refer to the goods which have not been loaded on board, or have already been on board, or have already been discharged from the ship, but must be under the custody of the carrier⁴⁵.

(2) Jurisdiction

Generally, the applicant is entitled to apply for arrest of goods carried by a ship in the maritime court of the place, where the goods are located at the time of the application for arrest, while in case the goods have already been discharged before the action but are still under the custody of the relevant carrier, the maritime court of the port of discharge may also have the jurisdiction⁴⁶.

(3) Procedures

³⁸ Ibid Article 17.

³⁹ Ibid.

⁴⁰ Ibid Article 18.

⁴¹ Ibid.

⁴² Ibid Article 29.

⁴³ Ibid Article 44.

⁴⁴ Interpretation of the Supreme People's Court on the Application of the Special Maritime Procedure Law of the People's Republic of China, Article 36.

⁴⁵ Ibid Article 19.

⁴⁶ Ibid Article 20.

The procedures of arresting goods carried by a ship are based on the procedures of arresting ships, however, it should be noted (a) that the time limit for arrest of goods carried out before bringing of an action or arbitration is 15 days; (b) that where the applicant has brought an action or arbitration within 15 days after the arrest, the applicant is entitled to apply for auction of the goods if the respondent fails to provide security and the goods are not suitable for being arrested longer on the expiration of the period of arrest; and (c) that for goods which cannot be stored, or are difficult to be stored, or the storage expense may exceed their value, the maritime claimant may apply for auction in advance⁴⁷.

4.2.3 Arrest of Bunkers

(1) Legal basis

According to Article 50 of the SMPL 2000, arrest of bunkers is permitted under Chinese law and operated in the same way as arrest of goods carried by a ship⁴⁸. This stipulation is useful especially in the case where a time charterer owes funds payable to bunker suppliers or for services rendered to the ship. The documents and counter security required for arrest of bunkers are basically the same as those for arrest of ship as stated above.

(2) Difficulties in practice

Although arrest of bunkers is legally possible in China, it is rarely seen in practice, because firstly, it is difficult to ascertain the ownership of the bunkers especially when the vessel is under a long charter chain; secondly, in order to arrest the bunkers, it is necessary to remove the bunkers from the ship, which would force the applicant to arrange the de-bunkering operations and the costly storage of the bunkers so arrested; and thirdly, even if the order of arrest of bunkers is granted by the court, the arrest is less possible to be operated without the assistance of the port authority and/or the crew on board, however, either of them might be reluctant to assist the operations in absence of a ship arrest order.

Due to the above difficulties in reality, most of the maritime courts in China have little experience in arresting the bunkers and would be much stricter in reviewing the supporting documents submitted by the applicant, in particular, the evidence of ownership of the bunkers, before accepting such an application.

(3) Successful cases

Nevertheless, the difficulties in practice should not deprive of the applicant's rights provided by law. The court must protect the applicant's legal rights and interests on one hand; and will manage to prevent the side-effect that might be caused by the arrest of bunkers on the other hand.

Although very few, we came across an online report on the first successful bunker arrest case in China handled by the Tianjin Maritime Court, Qinhuangdao

⁴⁷ Special Maritime Procedure Law of the People's Republic of China, Articles 46 and 47.

⁴⁸ Ibid Article 50.

Tribunal⁴⁹. It was a claim for the outstanding bunker charges brought by a bunker supplier in Qinhuangdao, China against a time charterer arising from the bunker supply contracts for several vessels operated by this time charterer. In order to secure the claim, the bunker supplier applied for arrest of bunkers on board the *M/V Dong Hong 118* (the Vessel) anchoring in Qinhuangdao, which was one of the vessels accepting the bunkers ordered by the respondent and supplied by the applicant. Upon application for the arrest of bunkers, the presiding judge firstly tried to ascertain the ownership of the Vessel and found that she was owned by a Zhejiang company who had nothing to do with the subject claim, so it was unjustified to take any preservation measures against her. Secondly, the presiding judge further ascertained the ownership of the bunkers not only by reviewing all the evidence provided by the applicant but also by checking the relevant navigation records of the Vessel online and verifying the charter information with the Master on board. When confirming that the bunkers on board were really owned by the respondent, the presiding judge immediately issued a Civil Ruling arresting the bunkers on board.

However, after issuance of the Ruling, unprecedented difficulties mentioned above were encountered by the judges in the practical enforcement. The first resistance was from the impulsive crew who did not know much about Chinese law when the judges tried to serve the Civil Ruling and the order for cooperation on board. Nevertheless, the judges invited the Master and the Chief Engineer of the Vessel to the Tribunal to patiently interpret the relevant Chinese law to them and seriously clarify the consequence of failure to enforce the Ruling due to the crew's resistance. After a long and deep talk, the crew were finally persuaded to assist in the de-bunkering operations. Then, the judges focused on the difficulties in the de-bunkering operations and made a thorough plan to conquer them. On the one hand, the applicant was notified by the judges to get ready the tank truck and the operators; on the other hand, the judges also appointed the professionals in engineering as the counsels of court so as to avoid the pollution caused by the oil leakage; whilst the judges managed to obtain the support from the port authority and arranged the berth for the de-bunkering. With all the above efforts, most of the bunkers were successfully discharged from the Vessel and only some were left on board for the Vessel's safety. Upon the judges' careful, diligent and continuous work, the arrest of bunkers owned by the time charterer was completed within only three days and the Vessel sailed away as scheduled without any delay.

The successful arrest of bunkers by the Tianjin Maritime Court, Qinhuangdao Tribunal not only establishes a good precedent without causing unnecessary losses suffered by the outsider of the case, but also is a meaningful exploration and attempt in solving the same disputes of bunker supply and provides practical experience for other maritime courts handling such cases in the future.

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⁴⁹ The reference number of this case is somehow not disclosed though it is reported that the claim was brought in 2006.

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