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Tendering and Contracting in the People's Republic of China

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SUMMARY

The People's Republic of China (PRC)'s energy demand is one of the fastest growing in the world. The IEA expects that by 2020 Chinese energy consumption will double to 1,940 MTOE, similar in size to that of OECD Europe at that time.

This presents increasing opportunity for Australian companies to invest in or supply to the PRC's growing energy and resources sectors. This opportunity brings with it, however, the challenges associated with dealing with the PRC's tendering, investment and contracting laws and the PRC's regulatory environment. The unusual dispute resolution environment and the requirement in some cases to use Chinese language and domestic PRC arbitration tribunals creates further uncertainty.

This paper draws on the recent experience of foreigners involved in LNG and pipeline gas projects in the PRC to hi-light some of the hurdles that are faced by Australians seeing to invest in or supply to the PRC energy and resources sector. These issues arise in the context of: (a) restrictions on foreign participation; (b) requirement for PRC governmental approvals; (c) regulation of pricing and return; (d) tendering and the requirements of the PRC's Tendering and Bidding Law; (e) contracting issues including requirements for PRC law and/or Chinese language; (f) the liability regime under PRC law; and (g) dispute resolution and enforcement of arbitration awards.

By way of illustration, each of these issues is discussed in detail in the context of liquified natural gas (LNG) terminal and gas pipeline projects, together with examples of solutions that are commonly adopted to mitigate against these restrictions. These challenges are, however, faced by foreign participants in other projects in the PRC energy and resources sector and to the extent that solutions are available these would, in most cases, apply equally to other projects in these sectors.

Through understanding the restrictions imposed by the PRC legal and regulatory regime and the practical solutions that are available to address these restrictions, Australians seeking to participate in the PRC's energy and resources sectors will be best able to equip themselves to mitigate against these challenges.

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RESTRICTIONS ON FOREIGN INVESTMENT

PRC laws and regulations dictate:

- the ability of an Australian entity to participate in a particular business undertaking in the energy and resources sector;
- the level of investment that a foreign entity is permitted to make; and
- the structure of any investment by a foreign entity in particular undertakings in the energy and resources sector.

This paper does not seek to address in any detail the restrictions on and structure of investments by Australian entities in PRC businesses. It is, however, important to note that the ability of an Australian entity to participate in the PRC's energy and resources sector is subject to regulations which implement PRC government policy regarding those businesses which are open to foreign investment and those which should, at the present time, be protected against foreign involvement in order to develop local expertise before opening a particular undertaking up to foreign competition. In addition, for some undertakings in respect of which foreign investment is encouraged, PRC laws and regulations enshrine ongoing local participation by restricting the level of foreign investment and/or by restricting the manner in which foreigners may participate in that undertaking.

Encouraged vs Restricted Investment Categories

Foreign participation in exploration, production and distribution of oil and gas and the development of terminal and gas pipeline projects in the PRC is regulated by a large number of laws and regulations including the 2002 Industry Catalogue for Guiding Foreign Investment (Catalogue). The Catalogue classifies foreign investment in the PRC into four categories:

- encouraged category
- permitted category
- restricted category
- prohibited category.

The inclusion of particular industries in one or the other of these categories reflects the intention of the PRC government to:

- direct foreign investment into areas using advanced technology such as projects in infrastructure, energy, transport and raw materials and projects in the Central and Western regions of China (encouraged); or
- restrict foreign investment in projects using out dated technology or to protect certain projects to PRC investors to be opened up to foreign investment gradually (restricted).

Foreigners are not permitted to participate in businesses which are included in the prohibited category.

As you would expect, investment in a business which undertakes an activity in respect of which foreign investment is encouraged is less regulated and can proceed more quickly. The approval process for foreign investment in projects which are permitted or encouraged is simpler than for restricted projects where the application will be examined with more scrutiny. Encouraged projects also receive preferential treatment under many of the PRC laws and regulations, including tax breaks and exemptions from licensing requirements.

By way of example, set out below are some specific activities in the oil and gas sector which are encouraged and other specific activities which are restricted:

Encouraged activities	**Restricted activities**
Activities in the oil and gas sector which are encouraged include:	Activities in the oil and gas sector which are restricted include:
• exploration and development of oil and natural gas; • low-osmosis oil reserve (or field) development; • development and application of new technology for the collection of crude oil; • development and application of new technology for the oil exploration (including geophysical prospecting, drilling oil wells, survey oil wells, operation in oil wells); • oil processing and coking industry; • construction and operation of natural gas-generated power plants; and • construction and operation of oil and gas pipelines, tanks and terminals.	• construction and operation of oil refinery; • wholesale, retail and distribution and logistics in crude oil; • wholesale of processed oil; • construction and operation of service stations; and • construction and operation of fuel gas pipelines and networks.

Restrictions on Levels of Investment and Investment Structures

The Catalogue also dictates the manner in which investment by foreigners must be made.

Construction and operation of gas pipelines and networks is an encouraged undertaking. Notwithstanding this categorisation, PRC entities are required to hold the majority of the equity in any entity which will construct and operate gas pipelines and networks.

The Catalogue provides that if foreigners wish to invest in ventures for the exploration and development of oil and natural gas, low- osmosis oil reserve (or field) development, development and application of new technology for the collection of crude oil or development and application of new technology for the oil exploration (including geophysical prospecting, drilling oil wells, survey oil

wells, operation in oil wells), that investment is only possible through a co-operative joint venture structure. Notwithstanding that these industries are encouraged, it is not possible for foreigners to undertake these businesses as a wholly foreign owned enterprise (WFOE) or to invest in these businesses by way of equity joint venture.

The Catalogue does not explicitly restrict the percentage shareholding of foreigners in entities which undertake other encouraged activities. However, it is unclear whether WFOEs will be permitted to undertake these activities as the Catalogue does not explicitly specify that WFOEs will be permitted to undertake these activities. It will, therefore, fall to the relevant governmental authorities approving a particular project to determine whether an application for a foreigner to undertake a particular business without any local involvement will be approved.

The PRC's WTO Commitments in the Oil and Gas Industry

It has been reported that the governmental authorities in the PRC are developing a revised Catalogue which will be consistent with China's WTO commitments and new developments in government policies relating to foreign investment. It is unclear when the new version will be released. The PRC's commitments to the WTO will dictate the regulatory requirements relating to foreign investment in the oil and gas industry.

REGULATORY REGIME

The PRC oil and gas industry is heavily regulated with approvals and consents being required from a large number of central and local governmental authorities in respect of the development and construction of oil and gas infrastructure projects and prior to undertaking any activities relating to the exploration, production, importation, processing, distribution or exportation of oil and gas products.

Investors in and suppliers to energy and resources projects in the PRC also need to be aware that the pricing for certain goods and services in the PRC is subject to central and local government pricing policies. In other instances, governmental departments will, through controlling the prices paid by end users, ultimately determine the rate of return available to a project.

Set out below, by way of illustration of the complexities of the regulatory regime and the issues which could arise in the context of that regulatory regime, is a snap shot of the regulatory regime as it applies to the LNG and gas industry in the PRC.

Exploration and Production

The principal legislation regulating upstream activities in the oil and gas industry are the PRC Mineral Resources Law and its implementation rules. The Ministry of Land and Resources is responsible for the granting of mineral exploration and production licences to companies which have been approved by the State Council to engage in the exploration for, and production of, oil and gas.

Importing and Exporting

Importing of raw oil and processed oil must be operated by state-owned or non-state-owned trading companies approved by the Ministry of Commerce, subject to quota certificates and importation permits. However, importation in bonded zones or bonded warehouses or export-oriented processing zones is not subject to the importation regulations, but is subject to customs supervision.

Importation of raw oil for processing trade is subject to separate regulations regarding processing trade, however, the importation is still subject to a quota and permit system.

An export permit is required to export processed oil.

Project Approvals

The discretion afforded to the relevant governmental authorities in granting the approvals required to undertake any activities relating to the exploration, production, importation, processing, distribution or exportation of oil and gas products and the potential for political interference creates uncertainty. The preparation of the relevant applications and supporting documentation in Chinese is time consuming. In addition, the requirement to obtain these approvals and consents from a wide range of different governmental authorities has the potential to result in considerable delays in the start up of oil and gas projects.

It is important, therefore, that, prior to entry into binding arrangements, the overall project has been approved in principle by each of the relevant governmental authorities. Subsequent to the project proposal being approved in principle, the contractual arrangements must be in place and will be reviewed as part of the overall review of the feasibility of the project. It is important that any contractual arrangements include adequate conditions precedent and that the commercial start date of the project is assessed bearing in mind the approval process and the potential for delays in obtaining those approvals.

By way of illustration of the complexity of the approval process for a major energy or resources infrastructure project, set out below is a summary of the nature of the approvals required for an LNG terminal or gas pipeline project:

Project proposal approval

A general project proposal must be submitted to the State Development and Reform Commission (SDRC) for approval. The SDRC works with all other relevant government authorities to examine and verify the proposal to issue a general approval of the project. This approval generally takes a minimum of three months but may be substantially delayed.

Project feasibility study report

A feasibility study report must be prepared for the project and approved by either the provincial Development and Reform Commission, the SDRC or the State Council, depending on the amount of the total investment. Approval of the Feasibility Study Report normally takes three to six months. The Feasibility Study Report must include details of all aspects of the development, construction, operation and financing of the project including proposals for obtaining land, construction, environmental compliance, safety, LNG/gas procurement, gas sales, market analysis of demand and financing. In reviewing the Feasibility Study Report, SDRC or the State Council will liaise with each of the central level government authorities with responsibility for regulation of the various aspects of the project to confirm, prior to approving the Feasibility Study Report, that all consents and approvals required by the project are achievable.

Establishment of the joint venture project company

Assuming that the project company is to be established as a joint venture, the usual approvals will be required from the Ministry of Foreign Trade and Economic Co-operation and the State Administration of Industry and Commerce to establish the joint venture entity and issue a Business Licence. This will generally take up to four months. The joint venture will also need to register with each of the relevant authorities including the local Customs Authority, Local Finance Bureau, Local Statistics Bureau, Local Science and Technology Department and Local Public Security Department.

Land

In the PRC, there is no private land ownership. The facilities will be built on granted land. The grant land use rights are similar to leasehold under common law. If the construction of the facilities is to occur on arable land, the arable land must first be converted into construction land. Approvals must be obtained from the State Council and Land Administration Department for conversion and expropriation of land and for use of any land which is within the scope of an urban zoning plan. Land Administration Department approval is also required for the right of the temporary use of land for the purpose of construction, repair and maintenance of the trunkline.

In the PRC land use rights regime, there is no concept of easement. The project company could acquire land use rights for the trunkline. However, this is unlikely

to be economically viable. Chinese authorities, such as the SDRC, have recognised that a new land use rights policy should be formulated to solve the problems which arise in respect of the land required for the development of gas and oil trunklines in the PRC generally.

Construction

Separate approvals must be obtained in respect of the construction of the terminal and trunkline facilities, gas pipelines and networks, submarine pipelines and port facilities:

- The SDRC or the provincial DRC and the Construction Commission and Urban Planning and Zoning Authority must approve the design and grant a Construction Planning Permit, Construction Engineering Planning Permit and a construction permit to build the terminal facilities and/or trunkline.
- The Urban Planning Authorities must approve any proposal for gas pipelines or networks. When new gas pipelines are built across existing infrastructure, such as roads, railways or pipelines, approvals must be obtained from the relevant authorities.
- Any submarine pipelines require a wide range of PRC consents and approvals including approval of the route of the pipeline by the State Marine Affairs Administration, approval of the Environmental Impact Statement by the State Environmental Protection Administration and certification of the quality of the submarine pipeline issued by a competent quality examination agency. Prior to putting the submarine pipeline into use the Submarine pipeline operator must obtain a Submarine Pipeline Use Permit from the Offshore Oil Operation Safety Office under the State Economic and Trade Commission.
- Construction of the port facilities must be approved by the Ministry of Commerce if the capacity to be built is 10,000 tons or more. Approval for use of the coastline must also be obtained from the relevant local Port Authority.

Environmental

An Environmental Impact Statement and he Environmental Protection Preliminary Design must be approved by the State Marine Authority and the State Environmental Protection Bureau. After the completion of the construction, the Local Environmental Protection Bureau must examine and approve the environmental protection facilities within three months of the date of the project entering into trial production.

Dumping or discharging permits must be obtained from the Local Marine Affairs Authority if industrial wastes will be discharged into the sea.

Safety

The Local Public Security Fire Prevention Authority must approve the fire protection design of the terminal and the port facilities and the Labour and Health Authority must approve the Industrial Safety and Labour Health Design. In addition, the Provincial Construction Committee must undertake a Seismicity Evaluation.

Price Regulation and Regulation of Project Rate of Return

Fixed pricing

The pricing for certain goods and services in the PRC is subject to central and local government pricing policies. Under the current pricing catalogues, the retailing and wholesale prices for raw oil and processed oil and natural gas produced from onshore oil and gas fields are subject to central government and local government pricing. The SDRC fixes an ex-factory price. Foreign-invested enterprises are subject to these pricing policies when they sell processed oil and gas.

In addition to the pricing restrictions imposed by the central government, the local governments are required by the PRC Pricing Law to issue local pricing catalogues, which, must include pricing guidelines for locally produced goods and services that are subject to government pricing policy.

Project rate of return

Natural gas produced in China is ordinarily subject to a fixed price at the well which is imposed by the Commodity Pricing Bureau (Bureau). Natural gas sold by a terminal which is produced from imported LNG is not, however, subject to the Bureau's price fixing. The price charged by a terminal to its customers in these circumstances will, nonetheless, be subject to approval by the Bureau. The natural gas price must be negotiated and agreed with it.

The rate of return to the terminal itself is not fixed but is variable and adjusted from time to time. In making its determination of the fixed price to be charged to the terminal's customers, the Bureau will take into account the overall price of natural gas in the PRC at the time and the ability of the market to accept the price proposed by the terminal. This will include a comprehensive consideration of all factors including social welfare rather than ensuring a guaranteed return to the terminal.

Once the natural gas price has been approved by the Bureau, it will be fixed for a period until future review. As the costs of production and processing of natural gas and other factors relevant to the natural gas price are variable, but the price to the terminal's customers is fixed, the rate of return to the terminal will fluctuate. The terminal has no right to adjust the natural gas price to achieve a specific rate of return without further approval of the Bureau.

The price charged by the terminal to its customers will be subject to review by the Bureau from time to time. It is unclear how often this review will occur. As a result of the pricing review, the natural gas price may be subject to change. This could lead to adjustments to the rate of return.

TENDERING FOR PRC PROJECTS

The PRC's Tendering and Bidding Law

Unlike many other jurisdictions in Asia, procurement and tendering procedure in the PRC is governed by particular laws. The relevant laws and regulations include the Law of the PRC on Tendering and Bidding, adopted by the National People's Congress (NPC) on 30 August 1999 and effective from 1 January 2000 as supplemented by certain circulars issued by the SDRC and the PRC Contract Law (together the "Tendering and Bidding Law").

Application of the Tendering and Bidding Law

Under the Tendering and Bidding Law, the exploration, design, construction and supervision of the following projects are subject to tendering, as well as the procurement of the important equipment and materials in connection with them:

- large infrastructure and public utilities facilities which relate to public interest and public safety, such as natural gas fields, pipelines and supply of natural gas;
- projects utilising in whole or in part state capital (which term includes funds of a state-owned enterprise which also enjoys control of the proposed project), or financing through the state (which includes project finance and BOT projects); or
- projects utilising loans from international organisations or foreign governments or aid funds; and
- a single construction contract that has an estimated value of RMB 2 million (US$250,000) or more;
- a single procurement contract for the supply of important equipment and materials that has an estimated value of RMB 1 million (US$125,000) or more;
- a single contract for the provision of exploration, design or supervision services that has an estimated value of RMB 0.5 million (US$75,000) or more, or
- although each contract has an estimated value less that those stated above, the total investment of the project amounts over RMB 30 million (US$3.6 million).

Consequences of Tendering under the Tendering and Bidding Law

If a project falls within the scope of the Tendering and Bidding Law, the Tendering and Bidding Law imposes procedural restraints on the tender process

and the manner in which a decision to award a tender is made. It also includes a liability regime for bidders acting as a consortium and for bidders who withdraw from the tender process. The issues which arise from a bidder's perspective if a tender is conducted in accordance with the Tendering and Bidding Law are discussed in detail below.

If the sponsors of a project in the PRC enter into a tender process with respect to a project which is not included within the scope of the Tendering and Bidding Law, the tender process may be determined by the project sponsors. Of course it is always open for the project sponsors to adopt the tendering procedure set out in the Tendering and Bidding Law not withstanding that the Tendering and Bidding Law's application is not mandatory in the context of the particular project.

In most instances, however, if it is not mandatory to conduct the tender in accordance with the Tendering and Bidding Law the project sponsors prefer the greater flexibility available if the tender process does not need to comply with the procedural and legal restraints imposed by the Tendering and Bidding Law.

Exemptions from Mandatory Application of the Tendering and Bidding Law

The Tendering and Bidding Law may be disregarded in favour of another process at the insistence of a major provider of funds for the lender, such as the World Bank. In determining whether the Tendering and Bidding Law will apply to a particular project it is, therefore, important to determine whether any donor funding is being made available. In any event, the procedures set out in the Tendering and Bidding Law are not, in substance, substantially different from that required by the World Bank, albeit less transparent and more vague.

The tendering requirements may be waived if the exploration or design of the project requires a particular patent or proprietary technology or it has a special artistic style requirement.

Application of the Tendering and Bidding Law to Energy and Resources Projects

Investment in project infrastructure

The tender for selection of an equity joint venture partner for a project is generally considered to be a tender only for equity participation. Whilst the tenderers will participate in a project which itself would fall under the Tendering and Bidding Law (ie a tender for contractors to construct an LNG terminal or pipeline must be conducted in accordance with the Tendering and Bidding Law), the tender for equity participation in the project joint venture would arguably not constitute a tender for "exploration design, construction or supply". Unless the sponsors of a project seeking an equity participant choose to adopt the procedures of the Tendering and Bidding Law, the requirements of the Tendering and Bidding

Law would, most likely, not apply to a tender for selection of an equity joint venture partner for a resources project.

Supply

The tender for supply of resources such as oil, gas or LNG is clearly not "equipment and materials" in the ordinary sense. There is, however, an argument that, given the importance of the resource to an overall project, the tender for supply should be subject to the Tendering and Bidding Law. The SDRC have, to date, not been prepared to confirm that it is not mandatory for a tender for the supply of resources such as natural gas to be conducted in accordance with the Tendering and Bidding Law. That said, the recent tenders for the supply of natural resources to Chinese projects have not been conducted in accordance with the Tendering and Bidding Law. Of course, it is open for the project sponsors to elect to conduct their tender for supply in accordance with the procedures and requirements of the Tendering and Bidding Law. However, as discussed above, in most cases the project sponsors will prefer the greater flexibility available to them if the tender process is not conducted in accordance with the procedural and legal restraints imposed by the Tendering and Bidding Law.

Exploration

Tenders in respect of exploration for oil and gas are within the scope of the Tendering and Bidding law and must be conducted in accordance with its requirements.

Construction

Tenders for the construction of major infrastructure such as an LNG terminal or natural gas pipeline are clearly within the scope of the Tendering and Bidding Law and must, therefore, be conducted in accordance with it.

Implications for Tenderers if the Tendering and Bidding Law Applies

The Tendering and Bidding Law provides a basic framework for the tendering for projects regarding:

- the conduct of tendering and of the project sponsors and bidders;
- submission of bids;
- opening of bids;
- review of bids;
- deciding on and announcing successful bids; and
- the final contract concluded between the project sponsors and the successful bidder.

The law also provides for liabilities and penalties for breach of the tendering and bidding process, as well as the final contract between the owner and the successful bidder.

The following particular issues are worth highlighting regarding the Tendering and Bidding Law as they relate to energy and resources projects in the PRC.

Tendering through invitation to bid

The Tendering and Bidding Law provides for two types of tendering:

- public bidding; and
- invitations to bid.

Public bidding applies to those projects that are subject to mandatory tendering by law, that are fully funded by State capitals or where State capitals hold a controlling interest. In the case of projects subject to public bidding, the project sponsors or the tendering agent must publish the tendering announcement in at least one designated media. If the primary media is in print form, a copy of the tendering announcement must be posted on a designated website.

Invitations to Bid may be used for projects designated by the SDRC or local provincial governments as "state key projects" or "local key projects" which are "not suitable for public bidding". These projects may, with approval from the SDRC or local provincial governments, be exempted from the public bidding requirements and instead be subject to an invitation to bid.

This is an important issue for Australian entities seeking to bid on a PRC energy or resources project which is to be put out to tender. If public bidding is not required for the project or if the project sponsors have received the required consents for a project to be tendered through an invitation to bid procedure rather than a public tender, it is fundamental for entities who wish to bid to develop and maintain close relations with the project sponsors to ensure that they are invited to bid.

Opportunity for negotiation of tender terms

The tendering process adopted in the PRC does allow some room for negotiation prior to the winning bidder being announced. The Tendering and Bidding Law provides that the bid review panel may require a bidder to clarify or explain any content in the bidding documents that is ambiguous. However, that clarification or explanation may not be extended beyond the scope of the bidding documents or change the material terms of the bidding documents. In practice this clarification and explanation process is the process which may determine the successful bidder. It is at this time that the project sponsors will get "better acquainted" with bidders. A bidder may use this opportunity to underline the strength of its bid through marketing and, in particular, negotiation beyond that set out in the bidding documents. This process is, however, inconsistent with the

prohibition in the Tendering and Bidding Law against the project sponsors entering into negotiation on the material terms of the bid.

Criteria for tender award

Under the Tendering and Bidding Law, the winning bid must meet one of the following requirements:

- it can satisfy each comprehensive review standard specified in the tendering documents to the greatest extent possible; or
- it can satisfy the material requirements of the tendering documents with the lowest price among the bids so reviewed (except for below cost bid price bids).

Clearly these requirements are vague and inconsistent and afford the project sponsors discretion in making their decision.

Joint and several liability

Under the Tendering and Bidding Law, a bidder must be a legal person or organisation which possesses the capability to undertake the project and meets the qualifications required by the law or the tender documents. Two legal persons or other organisations may form a consortium to bid for a project. In these circumstances, each party to the consortium is required to possess the capability to undertake the project and must meet the qualifications required by law or the tender documents.

The Tendering and Bidding Law requires that the parties to a consortium bidding for a project governed by the Tendering and Bidding Law must do so jointly and severally. The Tendering and Bidding Law also requires that the agreement ultimately signed must prescribe that the consortium members will be jointly and severally liable under it.

Bid bond

The Tendering and Bidding Law does not specifically provide for the provision of bid security by bidders. However, the Interim Provisions indicate that it is anticipated that bid bonds may be required of bidders.

In our experience, project sponsors in the PRC usually require a bid bond. That said, a bid bond has not been required in recent supply tenders in the PRC.

Consequences of withdrawing a bid

It is unclear what liability would attach to a bidder if it revokes its bid prior to tender award. There is no clearly developed principle under PRC law such as that developed under Australian common law whereby by submitting a tender under a set of rules a bidder is entering into a "*pre-contract contract*" based on those rules. It is, therefore, unclear whether a PRC court would find that by submitting a bid the bidders have entered into a contract and may be liable for breach of that

contract upon revocation of their bid. PRC law does not impose that liability but the matter has not been decided by the PRC courts.

Under the Tendering and Bidding Law itself, the notice of winning bid will be legally binding on both the owner and the successful bidder. The project sponsors will be held liable if they instead seek to announce another winning bid. Conversely, the successful bidder will be held liable if it abandons the project.

The Tendering and Bidding Law requires the project sponsors and the winning bidder to into a written contract within 30 days after the notice of successful bid is given. Both parties are prohibited from entering into other agreements deviating from the "material" terms of the contract.

The Interim Provisions specifically provide that a successful tenderer who fails to enter into a contract with a project owner will forfeit its bid bond (if any) and will be required to compensate the project owner for any loss suffered by the project owner which exceeds the bid bond. Again, this compensation could include additional costs incurred by the project sponsors in procuring supplies or investment at a greater price from an alternative bidder.

The Tendering and Bidding Law also provides that in some circumstances where a successful tenderer fails to perform its obligations under the contract entered into with the project sponsors in circumstances which do not constitute force majeure, the tenderer will be disqualified from tendering for projects which are required by law to be put to tender for a period of between two and five years.

Legislative uncertainty

Tendering is relatively new in the PRC and the law relating to tendering is, consequently, undeveloped. The Tendering and Bidding Law is, of itself, vague and imprecise. Whilst it does have the same basic framework as that contained in tendering laws of a number of other jurisdictions, it does not have the detail that promotes the level of transparency that Australian bidders would ordinarily be used to.

GOVERNING LAW

Foreign investors in a PRC joint venture often find themselves as parties to contracts which are governed by PRC law. As discussed below, this is unavoidable as a matter of PRC law either because the foreigner is a party to a joint venture agreement, which is required to be governed by PRC law, or because the foreigner is a participant in a Sino-foreign joint venture which is regarded as a PRC entity for the purpose of determining whether PRC law permits a contract to be governed by a law other than PRC law.

Preference of Foreigners for a Law other than PRC Law

The systems of law in common law jurisdictions such as Australia have been developed by both the courts and the legislatures over many years. As a result, the rule of law is generally strong in such jurisdictions and the quality and consistency of judicial decision making relatively high. By comparison, whilst it is a grossly unfair generalisation to suggest that the "rule of law" does not exist in the PRC, the PRC's legal system is at an earlier stage in the development cycle, particularly in relation to dealing with foreign corporations and contracts prepared in accordance with principles more commonly found in common law jurisdictions.

Frequently, the project documentation for major infrastructure projects including those in the energy and resources sectors involving foreign participants is prepared by the foreign participants and foreign lawyers. Consequently, the contractual documentation expresses the rights and obligations of the parties in the terms generally adopted under the common law. These expressions have been considered by courts in common law jurisdictions and are therefore susceptible to professional advice as to their likely interpretation in those jurisdictions. For example, the expression "reasonable endeavours" is understood in common law jurisdictions to be a qualitatively different standard than "best endeavours". It is far from certain that a Chinese court would interpret and apply those terms in a similar manner to a court in a common law jurisdiction.

For that reason, foreign participants in energy and resources projects in the PRC, understandably, prefer for the project documentation to be governed by laws other than PRC law.

Requirement for a Contract to be Governed by PRC Law

Foreigners may, however, be required to enter into contracts which are governed by PRC law in the following circumstances:

- where both of the parties to the contract are PRC entities. Note that a Sino-foreign joint venture which includes a foreign joint venture party is considered a PRC entity for these purposes;
- where PRC law requires that the contract is governed by PRC law;
- where, notwithstanding that PRC law does not require that the contract is governed by PRC law, the undertakings governed by the contract are most closely associated with the PRC and the contracts governing those undertakings are, adopting conflicts of laws principles, most appropriately governed by PRC law; and
- where, even in circumstances where PRC law or the laws of conflict do not require that PRC law be adopted as the governing law of a contract, the Chinese counterparties in a transaction, as a commercial matter, require that PRC law is adopted as the governing law.

The Contract Law provides that the parties to a contract may choose for their contractual arrangements to be governed by a law other than PRC law where a contract is foreign related, for example, where one of the parties to the contract is a foreign entity. There are, however, certain exceptions to this right to choose a law other than PRC law as the governing law. In the context of contracting in the energy and resources sectors in the PRC, the contractual arrangements which must be governed by PRC law include the following:

- contracts in relation to the establishment of joint ventures; and
- sino-foreign co-operative contracts for the exploration or exploitation of natural resources within the territory of the PRC.

The contractual arrangements with respect to investment by foreigners in joint ventures with PRC entities for the conduct of business in the energy and resources sectors in the PRC will, therefore, be subject to PRC law.

Consequences of Failure to Specify a Governing Law

If the parties fail to provide for a governing law, the PRC courts will apply principles which are similar to those of common law to decide which law should be the governing law.

CONTRACT LANGUAGE

Save for certain specific contracts, it is possible for contracts with PRC entities relating to PRC projects to be executed in English. The need for the contract to be reviewed by PRC governmental authorities or to be submitted to a PRC court, or a commercial requirement of the PRC contracting party, often results in the contract being executed in both English and Chinese. As discussed below, care needs to be taken to ensure that it is clear on the face of the contract that, in the event of inconsistency between the English language version and the Chinese language version of a contract, one version will prevail.

Right to Provide for English Language Versions of Contracts to Prevail

The Contract Law permits the parties to a contract to choose the language in which the contract will be executed, or, if a contract is to be prepared and executed in more than one language, the language version which will prevail. This is subject to the PRC Sino-Foreign Joint Venture Law (Joint Venture Law) which requires that joint venture agreements are entered into in Chinese.

Requirement for Chinese Language Versions of Contracts

As a matter of practice, however, contracts in respect of projects in the PRC will need to be prepared and executed in Chinese in the following circumstances:

- where the contract must be submitted as part of an application for governmental approval of the project, for example as part of a feasibility study report submitted to the SDRC. In most cases, the PRC governmental authorities will only approve Chinese language versions of documents and may require that those Chinese versions are executed;
- for the purpose of registration with PRC governmental authorities such as the Foreign Exchange Authority to enable payment of foreign exchange to the foreign participant. In most cases, the PRC governmental authorities will only approve Chinese language versions of documents and may require that those Chinese versions are executed;
- where a PRC court is being asked to determine a dispute or, possibly, when it is asked to enforce an arbitral award in respect of that contract. Even if the contract has been executed in English, the PRC court will require that a translation of that contract is prepared for the purpose of submission into evidence in the PRC court; and
- where, notwithstanding that PRC law does not require that the contract is executed in Chinese, the Chinese counterparties in a transaction, as a commercial matter, require that the contract is executed in Chinese.

Execution of Contracts in both English and Chinese

In cases where it is necessary to execute the contract in Chinese, it is possible for the contract to be executed in both English and Chinese. Commercially, if the foreign party does not agree to the Chinese language version prevailing, the PRC contracting parties will prefer that the contract state that both languages will have equal validity. This is also important for the purpose of submitting the executed agreement to PRC governmental authorities, who will be concerned to ensure that the version of the document that is reviewed by them is binding on the parties to it.

There is, however, a very real risk of inconsistency between the English translation and the Chinese translation. Translation of complex English documents into Chinese is not straightforward and translation is not an exact science. In particular, the Chinese language is interpreted differently depending on the origins of the interpreter.

It is important, therefore, that notwithstanding that the contract provides that each of the English language version and the Chinese language version of the contract will have equal validity, the contract state clearly which language version will prevail in case of inconsistency. Particularly where the commercial and contractual terms have been negotiated and agreed in English, with a Chinese

translation of the negotiated agreement being prepared subsequently, it is important that the contract provide that, in case of inconsistency, the English language version will prevail.

In practice this is dealt with by including a provision in each of the English and Chinese language versions of the contract to the effect that:

- each of the English and Chinese language versions of the contract have equal validity;
- in the event of inconsistency between the English and Chinese language versions of the contract, the parties will agree on the correct interpretation; but
- prior to reaching agreement on the interpretation the English language version will prevail.

This is permissible as a matter of PRC law and is acceptable to the PRC governmental authorities who are relying on the Chinese language version of the contract for the purposes of granting approval.

LIABILITY REGIME UNDER PRC LAW

Australian entities entering into contracts which are governed by PRC law are, naturally, concerned to understand the liability regime which will attach to that contract. This paper does not seek to review this liability regime in detail but, through hi-lighting some of the key components, seeks to illustrate that, in general terms, the remedies available under common law are available under PRC law. As with the common law, however, there are restrictions on a contracting party's ability to recover damages. These restrictions are discussed below.

Liability for Breach or Anticipatory Breach

PRC law provides that liabilities of a party to contract will arise when:

- an obligation in a contract is breached (either by non-performance of obligations or performance which does not comply with the contractual obligations); or
- a party manifests, expressly or by its conduct, that it will not perform its obligations before the expiration of time for performance.

Liabilities for breach of contract will accrue when a breach takes place or at the time when one party states expressly, or makes it clear through its conduct, that it will not perform its contractual obligations even before the expiration of the performance of its obligations.

Force Majeure Relief

The Contract Law provides that parties are excused from performing their contractual obligations upon the occurrence of force majeure events.

Parties may not contract out of the force majeure provisions included in the Contract Law and contractual provisions preventing parties from relying on force majeure events will be void. Even if force majeure relief is not specifically provided for in a contract, the parties may still be able to rely on the Contract Law to exempt them from their contractual obligations upon the occurrence of force majeure events.

Where the scope of force majeure events provided in a contract is narrower than the scope of the Contract Law, the parties may rely on the broader relief provided by the provisions of the Contract Law. Conversely, if the parties to a contract agree to a broader range of force majeure events than the force majeure events provided for by the provisions of the Contract Law, the parties will be entitled to rely on the additional relief agreed contractually between them.

Remedies Available under PRC Law

Contractual remedies available under PRC law include:

- specific performance;
- remedial measures; and
- compensatory damages.

Specific performance

Specific performance is only available for non-monetary obligations. Specific performance is not available under PRC law in the following circumstances:

- legally and practically the contractual obligation is not able to be performed;
- the subject matter of the obligation is not fit for specific performance or the cost associated with the specific performance is too high; or
- the obligee has not demanded performance within a reasonable period of time.

Remedial measures

PRC law entitles the non-defaulting party to reasonably choose to demand that the defaulting party assumes its liabilities by taking certain remedial measures. This would include repairing, exchanging, re-working, return of goods for refunding, reducing the agreed price or fees, etc.

Damages

Damages are available in addition to specific performance or remedial measures to the extent that a non-defaulting party still suffers loss or damage as a consequence of the breach by the other party.

PRC law provides that damages for breach of contract should be compensatory and not exemplary. The compensatory damages must be fair and reasonable.

Damages available under PRC law include:

- direct losses; and
- indirect losses, including damages for the benefits that the non-defaulting party would have received but for the breach by the contracting party. This would include loss of income and profits.

The damages will, however, be limited to losses that the breaching party foresaw or should have foreseen at the time of execution of the contract.

This can impose limitations on the damages available, in particular under a long-term contract. For example, in a supply contract which is governed by PRC law such as a gas supply contract, it is unclear whether, upon termination due to the default of the offtaker, the seller will be entitled to damages calculated at the amount that would have been payable by the offtaker under a take-or-pay obligation for the remaining term of the contract had the gas supply agreement not been terminated. In these circumstances, the seller may only seek as damages its direct and indirect losses as a consequence of the termination. These losses could include losses associated with resale of the gas at a depressed price, costs associated with the marketing and resale of the gas and the profits that the seller would have obtained if the contract had not been terminated.

Liquidated Damages

PRC law permits the inclusion of liquidated damages in a contract. The contract may include a specified amount payable as liquidated damages upon the occurrence of a breach or a formula to be used to calculate the damages incurred as a result of the breach.

If the liquidated damages included in the contract are, however, less than the loss incurred, a party may petition the court or the arbitration panel to increase the amount. Similarly, if the liquidated damages included in the contract are excessively higher than the losses incurred, a party may petition the court or arbitration panel to decrease the amount. If the parties agree on liquidated damages for delayed performance, the breaching party, in addition to paying the liquidated damages, is still required to perform its obligations.

Liability for Negligence

PRC law imposes civil liability for negligence and both civil and criminal liability for gross negligence.

Civil liability

Civil liability for negligence will result in liability being imposed for all foreseeable loss or damage arising from that negligence. Foreseeable loss or damage includes loss of income and profits. The test for whether conduct is negligent or whether the loss or damage was a foreseeable consequence of that negligence is similar to the common law test.

Criminal liability

Criminal liability for negligence may result in prosecution of a PRC or foreign corporate entity and/or its legal representatives or employees responsible for the work for fines and/or imprisonment.

There is no clear indication under PRC law as to what negligent actions or inactions will result in criminal liability. Usually, however, the conduct will be regarded as a criminal wrongdoing if the consequence is fatal. However, in some cases an action or inaction which does not result in loss of life may be considered to be sufficiently grossly negligent as to give rise to criminal liability.

The criminal liability which is imposed by the PRC courts for gross negligence is very much dependent on the circumstances of the case and is within the discretion of the court. Fines are generally in the order of RMB50,000 to RMB100,000. It is very uncommon for a PRC court to imprison an employee or representative of a foreign company as a result of gross negligence. However, the potential for this does exist as a matter of law.

Joint and Several Liability

The Contract Law is silent on the liability of multiple contracting parties. The parties may agree as to whether that liability is to be assumed jointly, severally or jointly and severally.

Caps on Liability

PRC law permits a party to cap its liability contractually but provides that a clause capping liability will be inoperative and unenforceable where:

- there is personal injury;
- there is loss to property as a result of an intentional act or gross negligence; or

- a party is entitled to damages on the basis of either contract or tort and that party elects to proceed on the basis of the tort rather than the contract.

It is important that any contractual limitations on liability specifically exclude limitations on liability in these circumstances.

DISPUTE RESOLUTION

The uncertainties associated with litigating in the PRC courts mean that parties to contracts for major projects such as in the energy and resources sectors in the PRC will ordinarily elect to resolve disputes through arbitration. To avoid a dispute ultimately being resolved in the PRC courts, care needs to be taken to ensure that that election to arbitrate is valid and enforceable.

Provided that a foreign party is involved in the dispute, PRC law permits arbitration in accordance with international arbitral rules such as UNCITRAL or ICC. The increased certainty afforded by these rules and the greater neutrality of the arbitrators is generally regarded as preferable to arbitration by domestic PRC arbitral bodies. However, where all of the parties to a dispute are domiciled in the PRC it is not certain that a PRC court will uphold an arbitral award by an international arbitral body. In circumstances where an Australian entity is a participant in a Sino-foreign joint venture it may have no option but to resolve disputes using a domestic PRC arbitral tribunal. Measures can be adopted to enhance the neutrality of an arbitral decision by a domestic PRC arbitral tribunal.

Mediation

PRC law does not include any specific rules for mediation. The PRC government has, however, recently developed the concept of government sponsored mediation. It is anticipated that this will encourage mediation as an option for resolution of disputes arising in respect of PRC projects. A mediation agreement is not, however, enforceable summarily in the way that an arbitral award is enforceable. Rather, the mediation agreement must be enforced as an agreement between the parties. For that reason, most disputes arising out of major PRC projects such as energy and resources projects are resolved by means of arbitration.

Parties to contracts in the PRC do, however, tend to provide for a consultation process or for more formal mediation by a third party as a precursor to arbitration.

Court Proceedings

It is generally believed that it is preferable to arbitrate disputes between foreign and Chinese parties rather than to resolve the dispute in a court, irrespective of

whether the court is in the PRC or a foreign jurisdiction. The disadvantages of attempting to litigate between Chinese and foreign parties generally include:

- there is no procedure or reciprocal enforcement of judgments process which would permit a judgment obtained, for example, against a Chinse party in Australia to be enforced in the PRC or to register a PRC judgment in Australia;
- arbitration is more appropriate for disputes of the nature which will arise in respect of energy and resources projects. The judiciary will, in most cases, lack the technical experience and knowledge required for determination of these disputes;
- litigating requires at least one of the parties to submit to practices and procedures which it is not familiar with in the jurisdiction in which the litigation takes place;
- it is not possible to elect the language in which the court proceedings will be conducted; and
- litigation tends to take longer to finalise as the parties are subject to the workload of the court system.

The judicial system in the PRC is generally considered to be far less transparent and the outcomes far less certain than in countries such as Australia. Generally, foreigners prefer to avoid submission to the jurisdiction of the PRC courts given the deficiencies in terms of the consistency in the outcomes and the quality of its decision-makers. The reasons for this are broadly categorised as follows:

- disputes which are to be resolved in the PRC courts will be heard by local courts. This encourages protectionism of local economic interests and there is a risk that the judiciary are subject to local influence;
- foreign lawyers are not permitted to appear in PRC courts. Selection of competent local counsel may result in significant delays due to the need to prepare and arrange for notarisation by the Chinese consulate in the relevant foreign country of a power of attorney; and
- as you would expect, the working language of the PRC courts is Chinese. It is, therefore, necessary for all of the documentation to be translated into Chinese for submission into evidence and foreigners will need to rely on translations of the court proceedings. This is inappropriate, particularly in circumstances where English language is the prevailing language for the contract.

For these reasons, the majority of contracts for energy and resources projects in the PRC provide for resolution of disputes by arbitration rather than in the courts.

Arbitration

PRC Contract Law provides that the parties to a contract governed by PRC law may agree to resolve disputes through arbitration.

Where there is a valid agreement to arbitrate (whether in a separate arbitration agreement or contained within the primary contractual agreement between the parties), neither of the parties may submit the dispute to the courts for resolution of the dispute.

Where the contract does not provide for arbitration or the parties do not agree to arbitrate once a dispute has arisen or where the arbitration clause is determined to be void, the dispute will be resolved through litigation.

Access to International Arbitration Tribunals

To achieve consistent, justifiable results in arbitration of disputes arising in respect of contracts with respect to PRC projects, ideally that arbitration should be conducted using internationally accepted arbitration rules such as the UNCITRAL Rules or the ICC Rules. The domestic PRC arbitration centres which apply their own arbitration rules are not generally considered to produce results which are consistent with these international standards because of a lack of clarity in their rules and deficiencies in the consistency in the quality of its arbitrators.

Arbitration involving a foreign party

Where at least one of the contracting parties is a foreigner, the parties to the contract are free to elect for the arbitration to be conducted outside of the PRC using international arbitration rules such as UNCITRAL or ICC. In these circumstances the award from the foreign arbitral centre will be enforceable as discussed below. This is true where the contract is governed by a law other than PRC law or where it is governed by PRC law.

Arbitration involving only PRC domiciled parties

It is unclear whether an arbitral award by a foreign arbitral centre adopting international arbitration rules such as UNCITRAL or ICC will be enforceable where both parties are domiciled in the PRC.

Although, as discussed below, the PRC is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, this applies only to enforcement of "*international*"arbitral awards. There is some risk that a PRC court will not consider that an arbitration is "*international*" in nature where both parties are domiciled in the PRC.

There are two definitions that are generally applied as to what constitutes an "*international"* arbitration:

- one definition applies the location or seat at which the arbitration is conducted;
- the other definition applies the nationality of the parties to the arbitration proceedings.

It is currently not clear what definition the PRC courts consistently use. It may be possible to continue to apply international arbitration rules but have the location of the arbitration in, say, Hong Kong on the basis that would produce an "*international"* arbitration notwithstanding that all of the parties are PRC entities.

Given the uncertainty of which definition a PRC court may apply, it is not possible to conclude that a PRC court will enforce an award from an ICC or UNCITRAL arbitration conducted in Hong Kong or elsewhere outside of Mainland China where both parties are domiciled in the PRC. Clearly, attempting to create an "*international"* arbitration by arbitrating outside of Mainland China using ICC or UNCITRAL rules, carries with it a serious risk that when PRC domiciled parties seek to enforce an arbitral award which is handed down under international arbitration rules, the PRC court does adopt the alternative definition of *"international"* and determines that, given that the parties are all PRC entities, the arbitration clause is invalid. This will have the adverse consequence that any dispute will be ultimately determined by a PRC court.

The ICC rules for arbitration are usually applied to international arbitrations, although there is provision to apply them to domestic PRC arbitrations as well. That said, given the risk of not being able to enforce an ICC award issued in Mainland China where all of the parties are domiciled in the PRC, the ICC does not recommend the holding of arbitrations and the rendering of ICC awards in Mainland China.

In order to best ensure that an arbitral award in respect of a dispute between PRC domiciled entities is enforceable, that arbitration should be conducted in accordance with PRC domestic arbitration rules.

Domestic PRC Arbitration Tribunals

CIETAC is generally recognised as the fairest and most impartial tribunal for arbitration conducted in accordance with the PRC Arbitration Law and its arbitration rules. This reputation is largely based on the fact that the panel of arbitrators includes a number of foreigners.

However, whilst CIETAC is moving closer towards international standards for dispute resolution, it still has some deficiencies in terms of the clarity of its rules and consistency in the quality of its arbitrators. Generally CIETAC is not viewed by foreigners as an optimal forum for arbitration.

The Arbitration Law provides that the arbitration tribunal may be composed of three arbitrators. Arbitration provisions commonly provide for three arbitrators with each party appointing one arbitrator and the third arbitrator-in-chief selected by agreement between the parties, or in the absence of agreement, appointed by the Chairman of CIETAC.

If arbitration is to be conducted by CIETAC in accordance with the PRC Arbitration Law and the arbitration rules, it is important to ensure that protection

is built into the procedures contemplated by the PRC Arbitration Law. For example, it will be important to ensure that the third arbitrator-in-chief is one that would be acceptable to the foreign party. This can be achieved by prescribing that if the arbitrators chosen by the parties fail to reach agreement on the identity of the third arbitrator-in-chief, then the arbitrator-in-chief to be appointed by the CIETAC Chairman must have not less than 10 years experience in international arbitration relating to the relevant industry, and must not be a citizen or resident of the PRC. We would expect that the Chinese counter-party would also require that arbitrator-in-chief may not be a citizen or resident of the country of origin of the foreign participant.

Protecting the Election to Arbitrate a Dispute

If an arbitral award is to be enforced in the PRC, it is important to ensure that the dispute resolution provisions are carefully drafted so as to avoid the arbitration provision being rendered unenforceable. As a matter of PRC law, this could occur if there is no clear trigger for the commencement of arbitration proceedings or if the parties submit to the non-exclusive jurisdiction of a court in addition to providing for arbitration.

Importance of a clear trigger for arbitration proceedings

It is common for contracts relating to projects in the PRC to provide for consultation as a precondition to the right to commence arbitration proceedings. Commonly, these clauses do not include a time limit for any disputes "which cannot be resolved by discussion in good faith between the Parties" to be referred to arbitration. The Parties' obligation to seek a settlement through consultation is therefore not limited in time and it is unclear how long any consultations should last. As a matter of PRC law this would render the arbitration provision unenforceable. It would be open to a respondent in arbitration proceedings to argue that the arbitration tribunal lacks jurisdiction on the ground that the agreed-upon precondition has not been satisfied, perhaps because the claimant has not acted in good faith or because consultation has not been exhausted. A time limit for consultation needs to be included.

Exclusion of submission to the jurisdiction of the courts

If a contract is governed by PRC law, the inclusion of a clause which provides for submission to the jurisdiction of a particular court will render any arbitration clause in the contract ineffective, even if the submission to the jurisdiction of the court is stated to be non-exclusive. If the contract is governed by PRC law and the parties wish to provide for resolution of disputes by arbitration, the choice of law provision should not include any reference to submission to the jurisdiction of a court.

Language of arbitration proceedings

Chinese counterparties may seek to have arbitration conducted in Chinese language, or alternatively conducted in both Chinese and English with both languages having equal force and effect. This could result in conflict in the translation and interpretation. To avoid uncertain results, it is important to obtain commercial agreement as to the language of dispute resolution and for that agreement to be included in the contractual terms. In cases where the English language version of the contract prevails, the English language should also prevail for the purposes of any arbitration proceedings.

ENFORCEMENT OF ARBITRAL AWARDS

Enforcement of Arbitral Awards in the PRC

The PRC (like Australia) is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitration Awards (the New York Convention). Therefore, PRC courts will recognise an arbitral award made by a foreign arbitration tribunal under international arbitration rules such as UNCITRAL or ICC without the PRC court revisiting the merits of the case.

The PRC Arbitration Law provides for review of arbitration awards on certain prescribed procedural grounds only.

Parties seeking enforcement of a foreign arbitral award in the PRC are able to do so in a summary manner that is consistent with the New York Convention applying the PRC Civil Procedure Law.

Similarly, the PRC Civil Procedure Law provides for arbitral awards rendered by domestic arbitral bodies such as CIETAC to be enforced by the relevant people's courts. The PRC Arbitration Law and the PRC Civil Procedure Law do not permit the courts to review the merits of the dispute, rather the courts can only conduct procedural review of the disputes.

That said, PRC law does not include specific guidelines as to procedural review of foreign or domestic arbitration awards. The PRC courts seeking to enforce a foreign or domestic arbitral award, therefore, have no guidance as to how to conduct the procedural review. Consequently, there have been several complaints that the PRC courts have undertaken a review of the substantive merits of the case in conducting their procedural review.

Circumstances where a PRC Court may Refuse to Recognise an Arbitral Award

PRC law provides that arbitral awards are final unless revoked upon a procedural review by the PRC courts.

Similar to the position under Australian law, the PRC courts may refuse to recognise a foreign arbitral award where:

- a party to the arbitration agreement was under some legal incapability;
- the agreement to arbitrate was invalid;
- one party was not given proper notice of the appointment of the arbitrator or the arbitration proceedings or was otherwise unable to represent its case;
- the award deals with a matter beyond the scope of the reference;
- the tribunal was not properly constituted or the arbitration proceedings are not in compliance with the arbitration rules; or
- the award has not yet become binding on the Parties.

In addition, an explanatory Notice and Judicial Interpretation issued by the PRC Supreme People's Court (Judicial Interpretation) also provides grounds for refusing enforcement of a foreign arbitral award where it would violate the public interest of PRC society. This clearly provides considerable discretion to the PRC court which is open to abuse. Given that the PRC judicial system is not a common law system, it is not possible to rely on precedent to determine what will be regarded as "public interest". There have been several instances recently where the PRC courts have relied on that discretion to refuse to enforce an arbitral award against a Chinese counterparty.

Measures to Increase Reliability of the PRC Courts' Enforcement of Arbitral Awards

In an attempt to protect against an unwarranted disregard by the PRC courts of the parties' contractual agreement to resolve disputes through arbitration, rather than in a PRC court, the Supreme People's Court of the PRC issued a directive in August 1995 imposing a two stage enforcement denial mechanism. If an Intermediate People's Court decides to refuse to recognise and enforce a foreign arbitral award, it must report to the higher People's Court. If the higher People's Court agrees that the matter should be determined by the courts, it must report that to the Supreme People's Court for confirmation before the dispute can be accepted for trial by the courts. This mechanism is designed to remove (or at least reduce) the incidence of parochialism and local protectionism encountered by foreigners seeking enforcement of a foreign arbitral award in the PRC.

Only upon receipt of confirmation from the People's Supreme Court may the lower court order revocation of the arbitral award or re-submission of the dispute to the arbitration centre for reconsideration.

Enforcement of Hong Kong Arbitral Awards in the PRC

Chinese counterparties will seek in negotiations to obtain agreement to arbitration in the PRC adopting CIETAC rules in respect of disputes arising under a contract with a foreign entity. Commonly, by way of compromise, the Chinese counterparty may accept arbitration outside of the PRC only if that arbitration is to be conducted in Hong Kong.

Prior to 1997, both Hong Kong and the PRC were Parties to the New York Convention (Hong Kong being a Party by virtue of being a territory of the United Kingdom). Post hand-over there was some confusion as to whether Hong Kong arbitral awards (in theory now domestic awards) would be recognised in Mainland China because despite being "one country", two separate legal systems coexisted. To resolve this confusion, the Hong Kong and Mainland China governments concluded the Arrangement on the Mutual Enforcement of Arbitration Awards which resulted in the Arbitration (Amendment) Ordinance (Ordinance) in Hong Kong and an explanatory Notice and Judicial Interpretation issued by the PRC Supreme People's Court (Judicial Interpretation), both in January 2000.

Since the enactment of the Ordinance and the Judicial Interpretation, there are now clear procedures for enforcing Hong Kong arbitral awards in Mainland China.

Hong Kong has an international reputation as being a neutral jurisdiction, underpinned by the common law system that has evolved from English law. Notwithstanding its proximity to Mainland China, it is commonly recognised that there is limited risk that the neutrality of the arbitrators or the arbitration process itself will be compromised.

In any event, and most importantly, provided that the arbitration is conducted in accordance with international rules such as the UNCITRAL Rules or ICC Rules and the arbitrators are selected in accordance with those rules, the location of the place in which the arbitration occurs is largely irrelevant.

It is also believed that where Chinese counterparties agree to foreign arbitration, there may be advantages to that foreign arbitral award being handed down in Hong Kong. This is because, given the relationship between Mainland China and Hong Kong, the PRC courts may be less inclined to refuse to enforce an arbitral award where that award was made in Hong Kong.

Procedure for Enforcement of Arbitral Awards

Applicants must apply to the relevant PRC court for leave to enter judgment in terms of the award by producing a copy of the award and the arbitration agreement. For these purposes both the arbitral award and the agreement will need to be translated into Chinese.

The appropriate PRC court for proceedings to enforce an arbitral award is determined by reference to the location in which the project is located.

A Supreme People's Court circular provides that if the PRC court determines that an arbitral award should be enforced, that arbitral award must be enforced within two months of the date of application for enforcement and, in any event, within six months of the date of the award.

CONCLUSION

Many Australian companies are now investing in or supplying to the PRC's growing energy and resources sectors. That presents challenges in dealing with the PRC's tendering, investment and contracting laws, let alone the domestic dispute resolution environment. The requirement in some cases to use Chinese language and domestic arbitration creates further uncertainty. It is important to be aware of these restrictions and the implications they may have on an Australian entity's participation in projects in the PRC.

In many cases, however, it is possible to mitigate against the impact of these legal and regulatory requirements. That mitigation is achieved, in most cases, through the contractual arrangements entered into with respect to the project. Through understanding the restrictions imposed by the PRC legal and regulatory regime and the practical solutions that are available to address these restrictions, Australians seeking to participate in the PRC's energy and resources sectors will be best able to equip themselves to mitigate against these challenges.

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