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**Case study in ADR**

Factors affecting international commercial dispute-resolution negotiations in China

Jieyin (Candy) Li

Introduction and background to a major commercial dispute

With rapid economic development in China, international commercial negotiation is prevalent throughout the country. The first step in preparing for negotiation should include consideration of the context and circumstances in which the negotiation would take place. This article seeks to discuss factors that affect the progress of negotiations in China, by analysing a famous pending case.

French food group Groupe Danone (Danone) is the third largest food business in Europe. The group, which first built its factories in China in the 1980s, is currently one of the world's leading global corporations in fresh dairy products and bottled water. The other party, Chinese beverage giant Wahaha Group (Wahaha), was established in 1987 in an east Chinese city Hangzhou and is now the biggest food and beverage enterprise in China.

The cooperation between Danone and Wahaha started in 1996. That year, Danone SA (together with Hong Kong Peregrine Investments Holdings Limited) and Hangzhou Wahaha Group Co Ltd paired up to sign an agreement to form five joint venture companies.¹ They appointed Mr Zong Qinghou, the chairman of Wahaha, as chairman of the board of directors of the five joint ventures. At the beginning when the joint ventures were founded, Wahaha Group also set up five non-joint ventures that produced beverage products. Following the financial crisis

in Asia, Peregrine went bankrupt and its 10% share was purchased by Danone in 1998. As Danone accounted for a 51% stake of the joint ventures, it gained the controlling interest. As expected, the joint venture grew, with 39 sub-joint ventures and controlling market share in China's beverage business to date.

A Trademark Transfer Agreement between Danone and Wahaha to the newly-formed joint venture was reached in 1996 when their cooperation started. However, the Trademark Bureau of China did not formally respond to this agreement. In 1999, instead of calling it a 'transfer', the parties signed two separate trademark licence agreements, titling both of them 'Trademark Use Agreement', one of which was sent for record purposes to the Trademark Bureau of China and the other was kept by the parties. One thing that needs to be pointed out is that the agreement kept by the parties contains a clause stating that the trademark of 'Wahaha' can only be used for the joint ventures; while the one kept as a record in Trademark Bureau of China doesn't have that clause.

At the same time Mr Zong Qinghou reorganised Wahaha Group, and established some non-joint ventures on the basis of shares from the workers and staff. The total number of these ventures has now reached 61 with total assets reaching 5.6 billion Yuan (AU\$1.12 billion), and in 2006 alone total profits reached 1.04 billion Yuan (AU\$208 million).



Things went well for seven years until 2006 when Danone considered that some of the minority shareholders, along with other connected persons, had illegally set up numerous companies which manufactured and sold products that were identical or similar to those sold by the subsidiaries, and were making unlawful use of the subsidiaries' trademarks, distributors and suppliers, so that it was not getting all the money that it should have, and that its Chinese partner was competing against the joint ventures. To end the problem Danone decided to buy out the Chinese partner. Danone requested to buy out a 51% share of the Wahaha non-joint ventures for an under-priced payment of 4 billion Yuan (AU\$800 million). The proposal was firmly rejected by Wahaha Group. Hence, the dispute between the two parties came to the table.

Because of the complexity of the dispute, from late 2006 till now, the parties have gone through negotiation, litigation and arbitration, back to negotiation and mediation, and then to a truce situation.

Determinant factors

Chinese negotiators are more concerned with the means than the end, more with the process than the goal. Eight elements that underpinned the Chinese negotiation style are (1) Personal connections, (2) The intermediary, (3) Social status, (4) Interpersonal harmony, (5) Holistic thinking, (6) Thrift, (7) Endurance and relentlessness, and (8) 'Face' or social capital. Buttery and Leung added that Chinese prefer establishing complicated relationships while Westerners pay more attention to procedure. Therefore more factors than the eight named will affect the progress in Chinese negotiations. In light of the Danone–Wahaha case, I propose to modify the eight elements above for the determination of the progress of negotiation between disputing parties in China:

(1) Likelihood of legal success, (2) Public opinion, (3) Government conduct, (4) Involving other kinds of dispute resolution, (5) Relationship value, (6) The intermediary,

(7) Expenses, and (8) Ethical problems — aggressive behaviour.

Likelihood of legal success

In dispute resolution negotiations the alternative to accepting settlement via negotiation is to go to court. In negotiation, lawyers will settle if they think that what is offered is worth equal to or more than what they could realistically get if the matter went to court, bearing in mind the risks and expenses involved in litigation.

In the Danone–Wahaha case, the main legal issues are: Is the 1996 trademark transfer agreement legitimate and binding? If both parties signed two trademark licence agreements, one of them being registered and the second not, which one is legally effective? According to relevant Chinese statutes, the action of the Trademark Office² was incorrect, and whether an agreement is recorded or not, does not have any effect on the validity of the agreement. Although legal practitioners were arguing about the legal effect of the unrecorded agreement, it seemed that Danone had a more favoured position from a legal point of view.

On 3 April 2007 the Economic Information Daily unexpectedly reported the article, 'Mr Zong Qinghou has regretted', which abruptly revealed the acquisition and anti-acquisition between Wahaha and Danone to the public indicating that Mr Zong Qinghou realised Wahaha's disadvantageous position in the trademark dispute. Knowing the opponent's thought and getting the support from some legal practitioners, Danone had more ability to influence Wahaha. Thus, Danone posed a credible threat in that it had less to lose from failing to reach agreement than Wahaha did, as Danone had a greater chance of winning in court. In addition, the power and psychological edge gave Danone an advantage over Wahaha, and Danone would want to use it to secure a greater share of the outcomes or achieve its preferred solution; it therefore, would hardly make concessions.

In this case, Danone used its favoured position and power, and evaluated any offers from Wahaha

against the chances of winning/losing at trial and what was likely to be won or lost. So the French food giant rejected the solutions offered by some third parties in which Wahaha showed its interest. Meanwhile, Danone issued an ultimatum, giving its Chinese partner 30 days to end the feud, otherwise Wahaha's businesses that were established outside the joint venture would be sued. When Wahaha announced its negative response at a press conference, Danone issued a brief announcement expressing strong dissatisfaction with Wahaha's decision, reminding the Chinese company of the deadline for solving the problem two days later. Obviously, Danone wanted to use its power to add pressure to Wahaha in order to solve the dispute in a short period of time.

However, this action was risky. It might speed up the negotiation process, but it also might lead to a breaking down of the negotiation. The party whose claim seemingly has more legal support needs to constrain having advantages over the other party, otherwise the plus factor in negotiation is likely to be the fatal factor for the suspending or termination of the negotiation progress.

Public opinion

Chinese people are famous for their strong nationalism, and Wahaha is now a famous national brand among Chinese. The core issue of the dispute is whether the transfer or use of the trademark contract is legitimate and binding. Who will finally get the trademark became the concern of the whole nation. As to businessmen, the consumers are their final clients. Hence, the public opinion is extremely important to the enterprises as bad opinion can destroy the image of enterprises, and losing the public support may result in losing in the whole market. This is invisible pressure on the party concerned when at the negotiating table.

Many scholars in both China and the US argue that many enterprises tactfully use the media to influence public opinion. Although public opinion will not affect the judge's recognition of the case facts, nor will it influence the judgment, it can affect the



negotiations. If the products are distributed on the Chinese market, the enterprise needs to be concerned about its public image. In this situation, as the weaker party realises that it will probably lose more than it estimated if both parties continue their negotiation, more often than not the weaker party makes a concession and tries to restore its image with the public. Hence, unequal public opinion in China will always promote the progress of negotiation.

In this case, Danone used the media to report that the joint-venture agreement does not allow Wahaha to create new businesses that exclude the French company, but Wahaha has set up a series of independent companies that compete with products made by the joint venture. Danone's proposed acquisition was lawful. Wahaha responded to that allegation by saying Danone has done even greater damage to the partnership by investing tens of millions of Yuan in numerous other competing beverage makers in China.³

From all the news reported in China, it seemed that Wahaha won in the war outside of the negotiating room. According to a poll conducted by a portal website 'sina', 90% of Chinese citizens clearly opposed Danone's acquisition of Wahaha, and most of them believed Danone violated the Statute of Monopolies and might destroy 'Wahaha' as it did to other famous national brands a few years previously. Furthermore, the public boycotted the goods produced by Danone, putting the company in an awkward situation. Thus Mr Emmanuel Faber⁴ sought assistance from the Hangzhou municipal government to stop both parties making remarks to the media, and Danone indicated that it was willing to return to the negotiating table.

Government conduct

International commercial negotiation is one kind of international communication. Because the business relationship is part of the economic relationship between states or regions, the negotiation is often related to political relations and diplomatic relations. International commercial negotiation in China can be strongly

characterised by national policy, so government interference could affect the negotiations. Another fact is that some judges in China would on occasion be open to being directly influenced by the national and local government. For this particular case, it has drawn government attention in both states and centres to ownership of the Wahaha brand and the legality of dozens of non-joint ventures set up by Mr Zong Qinghou. Therefore, the government's attitude toward the dispute heavily affected the negotiations.

When commenting on the dispute, on 11 April 2007 a spokesman for China's Ministry of Commerce said that the ministry would handle the issue according to the country's existing rules and regulations on foreign acquisitions. This press conference indicated that the government attitude towards the foreign acquisition was neutral. Danone held another press conference targeted at Wahaha immediately after the Ministry of Commerce expressed its attitude. In the conference, Danone emphasised that it would sue Wahaha if the latter denied its proposal. In such cases, a neutral attitude of the government could play a positive role in the negotiation progress as no party could take advantage over the other.

In this case, another form of government conduct changed the situation of the negotiation. The rules in force stipulate that trademark transfer agreements must be approved by the National Trademark Bureau, while local government powers are limited to a veto. Although the National Trademark Bureau did not approve or dismiss the agreement 12 years ago, the transfer was denied by the National Trademark Bureau according to the rule safeguarding national assets in June 2007. In addition, Danone withdrew the suit against the National Trademark Bureau in September of that year. Subsequent actions were friendly and took an active approach to bring the parties back to the table. Danone even invited the French President to be the intermediary when he visited China.

The local government of Hangzhou believed in less administrative interference and more freedom of



enterprises and higher capital liberalisation. This kind of attitude is praiseworthy and should be recommended in most international commercial negotiations. Nevertheless, the government policies related to the negotiation are not always negative. The point is that both parties must understand how the official policies affect the negotiation progress and make correct strategies and tactical choices to overcome the influence of policy.

Involving other kinds of dispute resolution

In every dispute the chances of succeeding in court are not equal for each party. However, it can be extremely difficult at times to know whether it is better to accept what is on the table in negotiation or go to court. Litigation is risky, meaning there will not be win-win solutions any more. Once a party turns to litigation or arbitration, following a negotiation break up, all the hard work and achievements become in vain.

Apparently Danone attempted all of the three primary ways to resolve the dispute, namely negotiation, arbitration and litigation. Since May 2007 the two companies have filed numerous complaints and lawsuits in Chinese and foreign jurisdictions.

Pursuant to various joint venture agreements and a services agreement, all of which included an arbitration clause in the event of a dispute, on 9 May 2007⁵ Danone filed various requests for arbitration based on numerous alleged breaches of the joint venture agreements and a request for arbitration against Mr Zong Qinghou⁶ based upon numerous alleged breaches of his services agreement, all with the Arbitration Institute of the Stockholm Chamber of Commerce. In addition on 4 June 2007 Danone filed a complaint in the Superior Court of the State of California against Ever Maple Trading Limited (BVI), Hangzhou Hongsheng Beverage Co Ltd and their legal representatives and/or shareholders⁷ due to activities taken in the United States on various tort bases, as well as on the basis of unfair and fraudulent competition.

While Danone had been seeking justice against Wahaha and Chairman Zong in the international arena, Wahaha embroiled Danone in multiple attacks at a local subsidiary level. On 13 June 2007 Wahaha filed an arbitration action with the Hangzhou Arbitration Commission seeking a declaration that the Trademark Transfer Agreement which transferred ownership of all the Wahaha trademarks to Danone's first Wahaha joint venture (established in 1996) was void and/or terminated. In July 2007 certain minority shareholders in the subsidiaries filed derivative suits against Danone-appointed board members of several subsidiaries, based on various alleged violations of Chinese law.

Outside of China the lawsuits haven't resulted in any decisions, while Wahaha won all the three suits within China. The case study indicates that in the bulk of lawsuits the court's actual function is not to render a binding decision but to serve as a background for settlement negotiations.

Usually parties should avoid using arbitration/litigation because this detracts from the involvement of parties and their commitment to the decision-making process. However, in the particularities of this case⁸ both parties felt pressure coming from the courts' decisions. Invoking litigation and/or arbitration was a turning point for both parties in their going back to negotiation.

Relationship value

China is a nation that stresses relationship, reasoning and credibility.⁹ Thus long-term cooperative relationship is highly valued by Chinese enterprises.

When negotiating in the context of an important relationship, relationship issues could dramatically change the parties' approach to negotiation strategy and tactics. Therefore, the process could be promoted through a more harmonious negotiating environment.

The parties in this case were trying to get things done through collaboration as they want to have a long-term cooperative relationship with each other. As to Danone, getting the trademark 'Wahaha' is not only for profit; Wahaha is part of its global strategy. However, without Zong Qinghou, Wahaha is no

more than a shell firm, and 'Wahaha' is merely a brand which the nation resists. The acquisition will be meaningless to Danone. As to Zong Qinghou, establishing a new brand in the market is by no means an easy job. If he loses in court, the trademark will no longer belong to him. He needs to constantly contribute huge financial and material resources, as well as more time and efforts, to make the new brand acceptable to the public. Neither of the parties wants to see this outcome.

However, even between parties which value the relationship, there are still problems. Negotiators fear that if they push too hard to get as much as possible now, they may jeopardise their company's ability to do business with the other party in the future, or may end the cooperative relationship with the other party. Or they fear that if they pay too much attention to the relationship, they will end up giving away too much and make a lousy deal. It is obvious that the parties in this case know each other's concerns well and both of them used this bargaining chip, namely that the opponent needs the relationship, against each other. Not surprisingly, Zong Qinghou resigned from the head of the joint ventures in order to put more pressure on Danone, while Danone issued an ultimatum. The almost equal relationship value began the negotiations again.

In most international commercial negotiations, if the relationship is finally broken there is a successful party in name only and no real winner.

The intermediary

Traditionally negotiations are conducted between individuals or groups. Simple negotiation with your partner is usually the best method of dispute resolution. However, negotiations are difficult when begun in a situation of conflicting ideals, cultures, values and expected outcomes. This case is an international commercial dispute resolution situation, which means that it is a most complex negotiation that may involve all the factors listed above. In legal practice, negotiations to settle disputes often fail. A structured approach would help parties re-evaluate their commitment to



standards, identify and collect information, and assist parties with further efforts at brainstorming solutions. The absence of these can bring negotiations to an impasse.

When involving intermediaries such as a mediator, many texts focus on the mediator's qualifications, experience and professional background as factors in selecting a mediator. However, regardless of the personal skills of the mediator, I propose that the intermediary's social status may contribute to the negotiation progress in China.

Because of the great influence of the case study parties in the Chinese market, many third parties were involved to help resolve the conflict. At first, some domestic consulting firms tried to propose various transition plans to the parties, but were rejected by Danone for the reason that they were not professional enough. Those essential to promote the negotiation process are French President Nicolas Sarkozy and China's Ministry of Commerce. Danone and Wahaha negotiated for another round before President Sarkozy visited China in late November 2008. The talks, however, were fruitless. Then Danone, and Wahaha with Zong Qinghou, were bound by guidelines laid down by Nicolas Sarkozy and his Chinese counterpart, President Hu Jintao: notably, that they settle the dispute in a 'speedy and amicable manner'. The Ministry of Commerce stepped in as mediator invited by the Presidents in December. The good news was that the parties agreed to 'call off all lawsuits and arbitrations provisionally and stop all aggressive speeches against the other party, in order to create a friendly atmosphere for peace negotiation' on 24 December 2008. That was a huge contribution to promoting the negotiation progress.

In Chinese culture, people respect the government, the rich and the famous. It's particularly important to select the right intermediary to push forward the negotiations.

Expenses

Whether successful or not, bargaining has its costs. The costs always include time and effort, and often include out of pocket expenses for research, personnel,

consultants, presentation materials, telecommunications, and the like, a large potential sum in total. Expenses are extremely important to businessmen, and no shareholder in a company wants huge amounts of money spent on settling disputes. However, research shows that the more that is invested in conflict resolution, the greater will be the desire to resolve the conflict. The expense factor in this case is most dramatic in affecting the negotiation progress.

Danone had previously brought accusations against Wahaha at some 10 judicial institutions in and out of China, all of which ended in favour of Wahaha. As a result, all the legal costs were assumed by Danone. It is reported that Danone had spent up to 570 million Yuan (AU\$114 million) in its one-and-a-half-year-long legal dispute with Wahaha. According to an internal source, as all the lawyer teams and accounting firms serving the company are global leading teams, their legal fees were paid by Danone in advance. Danone's high-profile legal actions worldwide have also been questioned by shareholders as the company's abuse of laws directly led to falls in its earnings and damage to its shareholders' interests.

Referring to its legal expenses, Riboud, President of Danone, said he was aware of the issue, and all shareholders wished to resolve the dispute satisfactorily and quickly. On 16 December 2007 Danone offered a truce in its legal battle with Wahaha Group, in an effort to resolve their long-running dispute. Subsequent news was that Danone and Wahaha agreed to a truce and legal ceasefire.

Large expenses and greater budget allocations for dispute settlement can make a party re-evaluate the negotiation targets and make additional compromises to bring the negotiations to a successful conclusion.

Ethical problems — aggressive behaviour

It was reported to China's tax authority that Zong Qinghou had kept secret a large part of his domestic and overseas income. The investigation done by Hangzhou local Taxation Bureau discovered that he evaded tax on the



income he derived from payments made during Wahaha's cooperation with Danone. According to the files provided by Danone, from 1996 up until 2006, Danone paid a total of \$71 million to Zong as service fees, incentive shares in overseas subsidiaries and stock repurchase. Following Zong's demands, these funds were deposited into different accounts. However, Zong did not pay any tax in mainland China, Hong Kong or Singapore, where the accounts are located. China's tax department has not initiated any lawsuits against this popular Chinese entrepreneur as the Chairman Zong paid more than 200 million Yuan (AU\$ 40 million) to the department after the investigation was launched. This brought the amount owed by Zong down to a few million Yuan instead of the nearly 300 Million Yuan he initially owed. Mr Zong successfully resolved his own problem.

The Shanghai Securities News reported in its edition of 15 April 2008 that a spokesperson from Danone didn't deny that Danone reported Mr Zong to tax authorities, and that the tax evasion case is a pressure Danone imposed on Wahaha to push the settlement of the commercial dispute. However, Danone's action has affected the ongoing talks to resolve the equity dispute between Wahaha and Danone. The negotiations have come to a stalemate and Wahaha revealed that it is more willing than ever to simply end their relationship.

Ethics are big problems in negotiation. The *Australian Oxford Pocket Dictionary* defines ethics as 'moral philosophy; moral principles; and rules of conduct.' Most of the ethical issues in negotiation are concerned with standards of truth telling, but some aggressive behaviour related to 'face' issues can also be regarded as an ethical problem in China. Face is a concept which has universal applicability and significance, but it may be argued that it has particular significance for the Chinese. Asian culture favours the avoidance of conflict and not causing someone to lose face. The personal image in terms of approved social attributes is highly

valued in China. Most of the time, the adoption of 'face-giving' and 'face-saving' behaviour in conflict situations is valued as a means to maintain a sense of harmony. However, if one

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party exposes scandals about the other party to the public just for his own benefit, even if the behaviour was lawful, no one would estimate the action to be 'right'. In addition, it is common that the other party ends the negotiation and the relationships, at all costs. There is no way to make up.

Parties must be cautious about the ethical issues, especially moral principles, which are more important than statutes in China. Putting pressure or stress on the other party by aggressive behaviour needs to be carefully considered against the possible reaction of the other party and the public, in other words, do not use tactics that backfire on you. The negotiation will break down and finally lead to lose-lose result.

Conclusions and prospects

Although scholars and governments want to see the dispute resolved harmoniously, both sides now await the arbitration result to be made by the Arbitration Institute of the Stockholm Chamber of Commerce, which is regarded as the most critical trial in the Danone-Wahaha feud. Negotiation is sensitive and fragile. The parties involved need to pay attention to the circumstances in which the negotiation takes place lest it be strangled.

The failure of this negotiation is a lesson to both parties, as well as for all the international commercial negotiations taking place in China. An awareness of the eight factors proposed in this article can contribute positively to such negotiations. ●

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Endnotes

1. Danone controlled 41% of the shares, Peregrine held 10%, and Wahaha held 39%.
2. The Trademark Office did not formally respond to the agreement.
3. The public were surprised to know that in 2000 Danone bought 92% of Wahaha's biggest rival, Guangdong Robust Group, which Wahaha said cost it market share and the loss of 49 million Yuan in profits that year; Danone has a 45.2% stake in Shanghai-based Bright Dairy and Food Co, and a 22% stake in Beijing-based Huiyuan Juice Holdings Co; Danone also set up joint ventures with Mengniu Dairy Co, China's largest liquid milk producer, in which it owns 49% of the stake. All the brands above are famous in China.
4. President of Danone Asia.
5. The second day of the deadline in the ultimatum.
6. The Executive Director of all of the subsidiaries.
7. Ever Maple Trading Ltd is the controlling shareholder of Hangzhou Hongsheng Beverage, which is the parent company of Hangzhou Wahaha Food and Beverage Sales Co, Danone's joint venture partner in China. The legal representatives are Mr Zong's daughter and wife.
8. That is to say, Danone winning lawsuits outside China, Wahaha winning all cases settled by Chinese courts.
9. The Chinese government advocates mutual understanding, mutual trusting, mutual benefit and long-term cooperation as the principles of foreign economic cooperation.