Arbitration Clauses – lessons for small and middle sized Chinese companies

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As China is involved more and more in international transactions, litigations against Chinese companies have arisen tremendously. Data have show that about 11.5% of Hong Kong and Chinese companies listed in New York Stock Exchange were involved in class actions. And in NASDAQ, the percentage is even higher, which is 17.2%.

Most lawsuits against Chinese companies involve breaching of contracts, intellectual property infringements, violation of Securities Law and anti-dumping investigation. However, very few small and middle sized companies will defend themselves in the US court due to expensive attorney fees, language barrier and lack of knowledge about US laws. Moreover, Chinese believe that "harmony is a virtue" and usually will not resolve problems through legal channel. Although some Chinese companies have learned lessons from former experiences and started to protect themselves by legal methods, such as arbitration[1], preventing those disputes from the beginning of a transaction is essential.

One way to avoid future disputes is to spend more time on drafting initial agreement, especially for small and middle sized companies which do not have strong financial support for international lawsuits. Bad example is companies spent over two

[1] Hangzhou Wahaha Group Co. Ltd filed arbitration again Dannon because of trademark disputes in 2007 and won the arbitration.

years arguing what law should apply because of an arbitration clause which is vague and poorly written.[2] Both parties were exhausted and the business went down very quickly. Small companies may even bankrupt because of those lawsuits.

It is hard for Chinese to change their philosophy, but there are some lessons they can take from the example above. Do not enter into a deal so quickly. Small and middle sized companies should have more confidence in their capacities and believe that they have equal power when negotiating with foreign parties. So do a due diligence investigation of the foreign partner if possible and search a win-win situation when negotiating.

One thing to keep in mind is that written agreement is the key and guideline to solve any future disputes. It will be a benefit for Chinese companies to choose Chinese law as the governing law and make sure the arbitration clause is specific, clear and precise. In addition, Parol Evidence Rule[3] prohibits simultaneous and prior oral terms be admitted into evidence when there is a written agreement. Therefore, Chinese companies need to make sure the final agreement includes everything you negotiated before. Do not leave anything open. Another lesson is to put any communications between you and your foreign partner in writing. Most small trade

[2] Example of the arbitration clause: "any doubts or disagreements will be resolved by arbitration in that city in which the party requesting the arbitration so submits its claims, provided that this is conducted in one of the headquarters cities of the parties and pursuant to applicable norms and laws regularly applied in the normal course of business in said locality."

[3] UCC 2-202

companies lost their case because of lack of evidence on oral modification.[4]

Suppose Chinese companies decide to respond to those lawsuits, choosing a good attorney is the first step. Trial is expensive and time consuming, so the ideal scenery will be using the litigation strategy to force the other party to settle. Get a settlement that both parties can live with is the best ending for a lawsuit. So listen to the attorney's strategy first and evaluate how effective that is and whether you will get a satisfied settlement. Take culture background into consideration as well. Western culture is different from Eastern cultures in many perspectives. Language is also a concern. Therefore, find someone that can understand your business and also explain the legal system in that foreign country is crucial.

[4] Case scenery is foreign companies make oral changes to the original contract. Chinese companies did not put the modification in writing. So if dispute arise based on that modification, Chinese companies cannot prove the content of such modification on paper.