

International Distribution Institute

2013 Annual Meeting

München

Germany

CHOOSING JURISDICTION AND APPLICABLE LAW IN DISTRIBUTION CONTRACTS: STRATEGIES AND RECENT TRENDS

Litigating in "Critical" Countries: Russia, China and India

June 14, 2013

中华人民共和国

People's Republic of China

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A. Introduction

The general perception of foreigners regarding the court system in the People's Republic of China ("PRC") is generally quite negative, but these perceptions are not borne out by systematic factual observations of the actual workings of the system.

Firstly it must be noted that the PRC has a civil law system legal system modeled on that of Germany. A law reform process was initiated in 1902 when the Dowager Empress Cixi, one the last of the Qing Dynasty, was presented with a translation of the German Civil Code¹ that had come into effect in 1900.² Japan had already adopted a civil code based on the German model in 1896. The officials were instructed to prepare a draft code for China and it was presented to the Emperor on October 26, 1911 just weeks before the end of the dynasty. It was not until 1929-30 that a similar form of civil code was promulgated under the 国民党 (Guomindang) administration in Nanjing.

After the Cultural Revolution and with the initiation of the "reform and opening up"³ policies in 1978 China started to rebuild its legal system. One of the first laws adopted was the General

¹ *Bürgerliches Gesetzbuch* in der fassung vom 1 Januar 1900.

² Philip C.C. Huang, CODE CUSTOM AND LEGAL PRACTICE IN CHINA: THE QING AND THE REPUBLIC COMPARED (Stanford: Stanford University Press, 2001) at 16.

³ 改革开放 (Gaige Kaifang), adopted at the December 1978 Third Plenum of the 11th CCP Congress.

Principles of the Civil Law⁴ which still functions as a sort of mini-civil code. To date China has looked to German law and has adopted two of the three major components of a civil code, the Contract Law⁵ and the Property Rights Law.⁶ The section “on persons” and civil rights is still in draft form.

Secondly it should be noted that the World Bank currently rates the PRC as 19th out of 185 jurisdictions with respect to the enforcement of contracts,⁷ based on the costs, time required, and complexity of procedures. By way of contrast, Canada ranks 62nd.

This is particularly noteworthy as there is usually a approximate correlation by GDP per head and the rule of law or effectiveness of the court system. Rich countries have more to spend on the courts. The PRC nominal GDP per capita is ranked about 91st out of some 190 jurisdictions.⁸ In other words, the PRC is a middle income country that has produced a court system that ranks 19th in the world. Its court system is well above the average for its middle income peers, such as Iraq, Turkmenistan, Dominican Republic, Cuba, Algeria, Jamaica and Namibia.

This has not gone unnoticed by the citizens of the PRC, and the primary problem with the PRC court system currently is that its popularity with citizens as a way to resolve disputes has grown faster than the allocation of resources that the court system receives. There are number of ways in which the system is affected by this, and one result has been a drop in its World Bank ranking. It was once as high as 15th.

B. Basic Structure

China has four levels of courts. At the top of the court structure is the Supreme People's Court. Below it at the provincial level are 31 Higher Level People's Courts. Underneath them are about 400 Intermediate Level People's Courts established in provinces, autonomous regions and within centrally administered cities. Finally at the bottom are over 3,000 Basic Level People's Courts. Counties in China can be quite large and as a significant portion of the population is

⁴中华人民共和国民法通则 (Zhonghua Renmin Gongheguo Minfa Tongze) adopted at the Fourth Session of the Sixth National People's Congress on April 12, 1986.

⁵合同法 (Hetong Fa), adopted at the Second Session of the Ninth National People's Congress on March 15, 1999 and came into force on October 1, 1999.

⁶物权法 (Wu Quan Fa) adopted at the 5th Session of the 10th National People's Congress on March 16, 2007, and came into effect on October 1, 2007.

⁷ See <http://www.doingbusiness.org/rankings> last visited May 26, 2013.

⁸ See http://en.wikipedia.org/wiki/List_of_countries_by_GDP_%28nominal%29_per_capita. Last visited May 26, 2013.

rural, these courts have often established branch courts outside the towns in which they may be headquartered. All together China has almost 200,000 judges.⁹

Generally in civil law systems judges do not have the same status as in common law systems. They have a status closer to civil servants and in some countries are unionized in unions with different political leanings.

In China, it is the courts that are seen as independent, rather than the judges. The work of individual judges is subject to review by an internal committee and their performance is assessed in part through quotas. Corruption is a problem, primarily in the lower courts and primarily in criminal and real estate cases. Problems are greater also in the less developed provinces.

Aside from the Supreme People's Court, the judges are not appointed by the central government. Rather they are appointed by the people's congress and the equivalent standing committee at the same level as the court. They do not have security of tenure and this is one of the reasons that they are more susceptible to local influences.

One of the questions often asked by franchisors considering doing business in China is whether the courts and judges are reliable and effective, and whether there is a bias against a foreign party in a Chinese court. Concerns are often expressed about the quality of the judges, about “local protectionism”¹⁰ and about the transparency of the system.

The short answer is that Chinese courts and judges are significantly better than most foreigners expect, and are improving rapidly. Empirically it is harder to detect a bias against foreigners than it is to suggest one in favor of foreigners.

Firstly under China's Civil Procedure Law¹¹ major cases involving foreign elements are commenced in the Intermediate Level People's Courts,¹² in the place of the defendant's residence. In franchising this usually means one of the major cities. Thus the case starts in a higher and more sophisticated court. Appeals are to the Higher Level People's Courts, of which there are only 31 in the country. Thus an appeal will be heard by a limited number of China's more sophisticated judges.

⁹ Jerome Cohen, Statement for the Congressional-Executive Commission on China Hearing, July 26, 2005; as reprinted in People's Daily at: http://english.people.com.cn/200508/15/eng20050815_202556.html.

¹⁰ Known in Chinese as 地方保护主义 – difang baohu zhuyi.

¹¹ 中华人民共和国民事诉讼法 – Zhonghua Renmin Gongheguo Minshi Susong Fa, adopted at the Fourth Session of the Seventh National People's Congress on April 9, 1991, Article 19(1).

¹² Art. 18(1) of the Civil Procedure Law.

China has also raised the qualifications for becoming a judge in the amendments to the Judges Law in 2001.¹³ In an effort to combat local protectionism the central government has allocated funds for the payment of judges to make them less dependent on the local government.

As in other civil law countries becoming a judge is usually a career choice made upon graduation from law school. The younger judges are better trained and appear to advance quickly. One of China's most famous cases involving local protectionism was decided against the local government by a 30 year old woman judge.¹⁴ The local government tried unsuccessfully to get the decision overturned.

In the last few years the Chinese courts have been posting an ever increasing number of their decisions online.¹⁵ While these posted decisions do not have precedential value they contribute greatly to the transparency of the legal system. Further judges are starting to use these decisions to help them in deciding cases.¹⁶

Some might even say that Chinese courts favor foreign parties. After the patent ran out on Lego's "brick" it was able to protect the design on two grounds in China whereas in most other countries, including the United States and Canada, it obtained no further protection.¹⁷

C. Civil Procedure

Civil Procedure in the PRC is governed by a national law, the 中华人民共和国民事诉讼法, that is variously translated as the "PRC Civil Procedure Law" or the "PRC Civil Litigation Law"

¹³ 中华人民共和国法官法 – Zhonghua Renmin Gongheguo Faguan Fa, adopted at the 12th session of the Standing Committee of the 8th National People's Congress on February 28, 1995; and amended at the 22nd session of the Standing Committee of the National People's Congress on June 30, 2001.

¹⁴ Known as the Luoyang Seed Case in 2003, it involved a choice between provincial and national laws. The judge followed the Legislation Law and ruled in favor of the national law, and the foreign party, against a local company. See Jim Yardley, *A young judge tests China's legal system*, THE NEW YORK TIMES, November 28, 2005.

¹⁵ For example, there are thousands of intellectual property cases posted at: <http://ipr.chinacourt.org/>; and the decisions of the Beijing courts are posted here: <http://bjgy.chinacourt.org/cpws/>.

¹⁶ Liebman, Benjamin L. and Wu, Tim, *China's Network Justice* (January 9, 2007). Columbia Public Law Research Paper No. 07-143 Available at SSRN: <http://ssrn.com/abstract=956310>.

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¹⁷ See for China - 英特莱格公司 - Yingte Laige Gongsi (Interlego S.A.) v. 克告(天津)玩具有限公司 - KeGao (Tianjin) Wanju Youxian Gongsi (KeGao (Tianjin) Toy Company), Beijing Higher People's Court, File No. 279, 2002-12-18; for Canada - Kirkbi AG v. Ritvik Holdings Inc., [2005] 3 S.C.R. 302 • (2005), 259 D.L.R. (4th) 577 • (2005), 43 C.P.R. (4th) 385; for the U.S. – Tyco Industries, Inc. v. LEGO Systems, Inc. and INTERLEGO A.G., Tyco Industries Inc. v. Lego Systems Inc., 5 U.S.P.Q.2d 1023 (D.N.J. 1987); affd 853 F.2d 921 (3d Cir. 1988); cert. denied 488 U.S. 955 (1988).

(“Civil Procedure Law”)¹⁸ It was last amended in August 2012. However local courts are free to set their own rules in so far as they do not contradict the principles of the general law.

1. Jurisdiction

The rules for determining which court has jurisdiction are set out in Article 21 to 38 of the Civil Procedure Law. The rules regarding territorial jurisdiction govern the geographical distribution of cases, and the rules on subject matter jurisdiction govern the level of court in which an action may be commenced. There are also rules based on the nature of the dispute.

The basic rule is that actions must be commenced in the court of the domicile of the defendant.¹⁹ However in personal relationship actions, if the defendant is not domiciled in the PRC, then the action is to be commenced in the plaintiff’s home jurisdiction.²⁰ The parties to a contract do have some latitude for choosing the court that will hear their disputes. Article 34 sets out the options as follows:

第三十四条 合同或者其他财产权益纠纷的当事人可以书面协议选择被告住所地、合同履行地、合同签订地、原告住所地、标的物所在地等与争议有实际联系的地点的人民法院管辖，但不得违反本法对级别管辖和专属管辖的规定。

(Article 34: The parties in a contractual dispute or other dispute over rights and interests in property may agree in writing to choose the people’s court of a place that has an actual connection with the dispute, such as the place where the defendant is domiciled, where the contract is performed, where the contract is executed, where the plaintiff is domiciled or where the subject matter of the dispute is located, to be the competent court, provided that the provisions of this Law on levels of jurisdiction and exclusive jurisdiction are not violated.)

The subject matter jurisdiction based on the amounts in dispute are usually set by regulation.

There is a separate chapter in the Civil Procedure Law for disputes involving foreign parties.²¹ Where the foreign party does not have a presence in the PRC, Article 265 provides that “the action may come under the jurisdiction of the people’s court of the place where the contract was executed, the place where the contract was performed, the place where the subject matter of the

¹⁸ *Supra*, note 11.

¹⁹ Article 21.

²⁰ Article 22 (1).

²¹ Articles 259 to 284.

action is located, the place where the seizable property is located, the place where the tort was committed or the place where the representative office is domiciled.”

2. Recognition of Foreign Court Awards and Arbitral Awards

The PRC does not enforce foreign judgments on the basis of comity, rather only on the basis of reciprocity.²²

There are a limited number of countries that have treaties with the PRC on the reciprocal enforcement of judgments.²³ The treaties vary in the type of judgments to which they apply. Furthermore it is very hard to find any evidence that the enforcement has ever occurred under any of these treaties in a commercial matter. Note that no common law jurisdictions have such a treaty with the PRC.

With respect to arbitral awards, the PRC is a party to the New York Convention on the Enforcement of Arbitral Awards. Under Article 273 for PRC arbitral institutions or Article 283 for foreign arbitral awards, after an award has been made the party shall apply to a PRC court for enforcement. With respect to PRC arbitral institutions Article 274 sets out the grounds under which a court may refuse to enforce an arbitral award. They are (1) lack of agreement on arbitration; (2) lack of service or the defendant was otherwise unable to participate due to reasons not attributable to that party; (3) the composition of the arbitration tribunal or the arbitration procedure was not in conformity with the rules of arbitration; (4) matters decided in the award exceed the scope of the arbitrator’s authority; and finally, public policy.

In practice awards are almost never refused as being against public policy. Further if a court decides to refuse an award it must give notice of such refusal to the higher courts. Arbitral awards are usually attacked on the failure to specify an arbitral institution in the agreement, a requirement under PRC law; or the contract itself not having been properly executed in accordance with PRC contractual formalities. The PRC courts are quite strict on matters of evidence and generally foreign parties should be aware of this and plan for this at the time that they propose to enter into a contract with a PRC party.

Overall about 70% to 80% of arbitral awards submitted to the PRC courts are accepted for enforcement. The cost of such recognition is roughly between \$10,000 to \$15,000 USD in PRC legal and court fees, or only about 25 to 30% less than a first instance hearing.

²² Articles 280 and 281.

²³ The countries are: France, Poland, Mongolia, Romania, Italy, Spain, Russia, Turkey, Ukraine, Cuba, Belarus, Kazakhstan, Egypt, Bulgaria, Greece, Cyprus, Hungary, Morocco, Kyrgyzstan, Tajikistan, Uzbekistan, Vietnam, Laos, Tunisia, Lithuania, Argentina, United Arab Emirates, North Korea, Kuwait and Brazil. In addition there is an arrangement with the Hong Kong SAR for the reciprocal enforcement of certain types of judgments.

3. Proceedings

Proceedings in the PRC are comparatively fast, even with the delays caused by the large increase in litigation. Those from common law jurisdictions should note that like other civil law jurisdictions there is no discovery in the PRC and each party is responsible for the production of their own evidence. Consequently most plaintiffs spend a considerable amount of time assembling their evidence before filing proceedings. These costs are largely not recovered and are not counted in the calculation of the PRC legal fees for litigating a claim.

(a) Evidence

The Civil Procedure Law does not cover matter related to the nature and quality of the evidence to be presented, and at present the PRC does not have a law regarding evidence, although one is being prepared. At present guidance is obtained from rules issued by the Supreme People's Court in 2001.²⁴

Those mostly familiar with common-law systems should note that evidence is not entered through the oral testimony of a witness, such as an executive, and thus the weight given to each piece must be determined by other means than the demeanor and testimony of a witness. PRC courts are also quite strict about requiring the originals of documents so that they may assess the authenticity of the document.

The most common way that this is achieved is through the use of a notary. When collecting evidence in the PRC it is normal for the lawyer or investigator to be accompanied by a notary that they have hired, and all items collected are given to the notary who then prepares a report that can be used in court. The notarization process can be carried years before any dispute is contemplated, and basic agreements are often notarized after execution.

For evidence originating outside the PRC, all evidence is required to be notarized in its country of origin and to be legalized by the government of that jurisdiction and the embassy of the PRC in that jurisdiction. This can add to the cost and delay for foreign parties, and some courts and tribunals have informal rules allowing the submission of photocopies before the deadline for evidence provided that the notarized and legalized originals are submitted later but before the evidentiary hearing.

In all jurisdictions, judges view evidence in their own cultural context, and culturally the PRC is probably more distinctive than most jurisdictions that foreign parties will encounter. An example

²⁴ 最高人民法院关于民事诉讼证据的若干规定 (Zuigao Renmin Fayuan Guanyu Minshi Susong Zhengju de Ruogan Guiding – Supreme People's Court On Evidence Rules in Civil Cases) adopted on December 6, 2001 by the 1201st Meeting of the Judicial Committee of the Supreme People's Court, and promulgated and in effect since April 1, 2002.

of this is the weight given by the PRC courts to opinions from trade associations. Historically trade associations in the PRC had a quasi-official role in policing their industry group. However in some other jurisdictions a trade association has little status and may indeed be looked on with suspicion with respect to restricting competition.

(b) Filing the Statement of Claim

The Statement of Claim in a PRC proceeding is a comparatively brief document that sets out the main cause of action and the laws that will be relied upon. When you sue someone in a Chinese court, your complaint must first pass through a gatekeeping procedure in which a special division of the court (the case filing division [立案庭]) decides whether or not to accept (受理) and docket (立案) the case. According to Art. 119²⁵ of the Civil Procedure Law, courts must, unless an exception applies, accept cases that meet the following standards:

1. the plaintiff has a direct legal interest (a term of art) in the case;
2. there is a specific defendant;
3. there are specific claims, facts, and causes of action; and
4. the lawsuit is within the court's geographical and subject-matter scope of jurisdiction.

While in practice this stage has been used as a chokepoint in certain types of sensitive cases, it does not appear to have caused problems in cases initiated by foreigners. The court has seven days in which to reject a case.²⁶

Within five days of the acceptance of the case and placing it on the docket, the court must serve the defendants. In practice at that time the parties are also served with a notice of the deadline for the submission of evidence. At this stage the deadline is set at 30 days from the date of the notice, however it is not difficult for the defendant to seek an initial extension of time. It is also common to allow foreign parties additional time to submit evidence.

In domestic disputes the judges are expected to make their initial ruling in six months from the date of filing, failing which they must explain the delay to their supervisory committee. In cases involving foreign parties this deadline does not apply.²⁷

(c) Interim Proceedings

Often in civil law jurisdictions there are no provisions that are similar to the interim injunctions found in common law jurisdictions. Prior to the 2013 amendments to the Civil Procedure Law that was the case in the PRC, except for the specific statutory exceptions for trade-mark, patent and copyright matters, and certain other cases such as employment and family law.

²⁵ Prior to the 2013 amendments these provisions were in Article 108.

²⁶ Art. 123.

²⁷ Art. 149.

The amendments have now broadened the possibility of obtaining a preliminary injunction²⁸ in addition to the traditional advance execution to preserve assets. The court may make orders prohibiting one of the parties from undertaking actions. However judges in the PRC have not historically made extensive use of the previously existing provisions in respect to the intellectual property laws mentioned above, and there is some concern that they will be reluctant to use the new powers, in particular because the additional hearings would delay the prosecution of the case in an already over-loaded system.

Upon receiving an application for an interim preservation measure under this heading the court must make its decision in 48 hours and the award can be enforced immediately. The preservation measures can be instituted before a statement of claim has been filed, however in such cases an action must be commenced in 30 days. The court has the option of ordering security from the applicant, and where the application has been made wrongfully the applicant will be required to compensate the other party.²⁹

As is the norm in civil law jurisdictions the court has the right to make its own investigations even neither party requests such an investigation.³⁰ While historically such investigations were one of the strengths of the PRC system, with the dramatic increase in case loads judges today rarely take such initiatives. They do however appoint their own experts in cases where they are needed, such as patent infringement cases.

Where there is a risk that evidence will be destroyed or will be difficult to obtain in the future, a party may apply to the court for the preservation of such evidence.³¹ However in practice the applicant must be able to clearly specify the documents to be preserved.

(c) Hearings

In practice there are usually two hearings in a commercial trial in the PRC. The first is the exchange of evidence hearing, at which each party has an opportunity to review the evidence presented by the other side and to voice objections as to its admissibility.

Benches are made up of three judges, but only the chief judge will be seriously involved in the case, and will in fact be responsible for writing the opinion. However all will sign the opinion.

In the second hearing the merits of the case are debated. Although witnesses are permitted they are extremely uncommon in commercial cases, and are not used to validate the documentary evidence that is presented. Attorneys for the party opposite may ask questions of witnesses, but only through the presiding judge. In practice it is the judge who asks the questions. At this stage it is normal practice for the judge to request the parties to consider mediation.

²⁸ See Chapter 9, Arts. 100 to 108.

²⁹ Art. 105.

³⁰ Art. 67.

³¹ Art. 81.

In the PRC judges can be actively involved in mediating a dispute, and do use the threat of an adverse ruling to “encourage” settlement. Currently there is an emphasis on mediated settlements as these are unlikely to lead to appeals and are likely to be easier to enforce.

Judgments are usually about 10 pages long and are required to state the basis for the ruling. They also are required to set out the claims of both parties and usually list the evidence presented as well as an indication as to the probative weight accorded to the evidence. First instance judgments must also specify the appeal rights.

(e) Appeals

Litigants in civil law systems are normally afforded two hearings, and the PRC is no exception to this rule. After receiving a ruling from the initial court hearing the parties have 15 days to file an appeal with the same court. The file will then be transferred to the next higher level court for the second hearing.

Although appeals are to be heard in 3 months,³² this period runs from the date that the appeal court set up the tribunal after receiving the file from the lower court. Unfortunately the file transfer process has been known to take several months, thus effectively delaying and appeal, and not introducing the appeal into to the appeal courts quota system.

Decisions of the appeal courts are final. As most foreign related matters start in the intermediate level people’s courts, the higher level courts, of there is one for each province, are normally the appeal courts for foreign related matters. Appeals to the Supreme People’s Court are by leave.

D. Summary

In summary litigation in the PRC is comparatively fast and in terms of PRC legal fees, inexpensive compared to most common law jurisdictions. There is no obvious bias against foreigners and many foreigners use the system each year.

There are currently problems with capacity and that are slowing doing the system. The judges are less experienced with sophisticated commercial cases than judges in more developed parts of the world. This is partly due to the PRC being an emerging economy, and in part to the comparatively recent introduction of a market economy.

However the courts have shown a clear tendency to enforce contracts, and to enforce franchise and distribution agreements in particular. They also have little sympathy for counterfeiters or other intellectual property infringers. In summary, the PRC courts are must better than perceived from outside the country.

³² Art. 176.