Danone v. Wahaha: who laughs last?

Article (Published Version)

Danone v. Wahaha: Who Laughs Last?

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Abstract

Multinational Companies may result in culture clashes, incompatibility of Western corporate governance and legal resolution strategies. As one of the most successful joint venture models, the high-profile Danone/Wahaha dispute has been accelerated into a two-year legal feud against the infringement of the famous brand of *WAHAHA* across jurisdictions. The case represents a significant watershed which reflects the *status quo* of controversies over cooperation and competition in China. Under the current legal framework, Danone's withdrawal would serve as a wake-up call for both foreign investors and Chinese companies in the dramatically increasing cross-border merger & acquisitions. The seminal case perfectly illustrates unwritten issues about public opinion, nationalism and the rule of law. *Danone v. Wahaha* has also been commonly conceived as a landmark case through which Chinese side may verify the fairness of the Western judicial system, while the European party may regard it as a touchstone for China's investment environment as well as the specific sphere of contract spirit. It also offers myriad lessons, including the need for watertight contracts, IP rights, and international arbitrations.

A. Introduction

Multinational Companies (MNCs), like the French Food Company Danone Group (hereinafter referred to as Danone), have established manufacturing facilities around the globe seeking to leverage cost differentials. In 1996, Danone entered into a joint-venture (JV) contract with a Chinese beverage company Wahaha Group (Wahaha). At the initial stage, Zong, Wahaha's chief executive officer, cried for capital, technology and the Sino-Foreign JV's policy to survive while competing with global giants, such as Coca-Cola and Pepsi Co. Danone invested $45 million with a prerequisite trademark transfer agreement purported to assign the Wahahah trademark to the JV. While the JV sought for recording the trademark assignment with the China Trademark Office (CTO) in 2007, it did not make it but instead had the simple version of the license agreement approved.

With the indispensable support of Danone, Wahaha has become fully fledged as one of the most valuable brands. The JVs owed a combined share of 16% in China's non-alcoholic beverage market.[1] China had become Danone's third-biggest market after France and Spain before the dispute became public in 2007. In

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1 'Wahaha-Danone Feud Highlights Pitfalls', *Forbes Magazine,* 17 July 2007.

2006, the JVs produced a sales turnover of €1 billion, representing approximately 5% of Danone's worldwide revenue.[2] The honeymoon period ended resulting from Zong's creation of parallel firms selling Wahaha-branded products in direct competition with the JV.[3] Rather than initiating litigation for the resolution immediately, Danone sought to acquire non-JVs' majority stake in late 2006, so as to ensure the company could gain from the profits to be made in the future. In April 2007, the turndown of Danone's hostile takeover of a 51% share at a cost of ¥RMB 4billion (£400 million) has triggered a long-standing legal wars across jurisdictions.[4] That the internal conflicts have been escalated into dozens of multi-jurisdictional legal battles has become one of the most controversial JV disputes in China's history.[5]

It seems that the JV Agreement clauses should have entailed Danone of the exclusive entitlement to corresponding revenues, including those generated from the unorthodox non-JVs but using the Wahaha brand and the network of distributors and suppliers. Thus, Danone initiated the legal war by accusing its partner of setting up independent firms and selling products identical to those sold by the JV. Wahaha asserted that there had been no concealment of its non-JVs as Danoen had always been aware of them at the outset. Furthermore, Wahaha attempted to justify its use of the trademark based on a paradoxical fact that the transfer had never been valid due to the legal deficiencies involved. Danone has lost more than a dozen lawsuits under both Chinese and foreign jurisdictions. The most fateful one before the Arbitration Institute of Stockholm Chamber of Commerce (SCC) was filed on the basis of Zong's trademark infringement and non-competing breaches. A most straight but controversial issue to be adjudicated legality of non-JV products being branded "Wahaha", virtually dependant on whether the trademark assignment signed in 1996 was valid or not. The long-awaited pyrrhic victory in favour of Danone cannot not help it rescue the inviable joint ventures. Through the landmark case, Chinese companies may verify western judicial systems, whereas European side may regard it as a touchstone for China's investment environment, with a particular facet of the spirit of contract.[6]

The paper starts with an examination of the SCC's ostensibly decisive arbitration. Secondly and almost most meaningfully, the paper attempts to serves a wake-up

2 *See* H. Szmytko, 'Danone v Wahaha: Joint Venture Gone Sour', *The Epoch Times*, 12 May 2007, available at <http://en.epochtimes.com/news/7-5-12/55180.html>.

3 See X. Chen, 'Wahaha Interests in the Dispute can Restore Logic', *21st Century Business Herald,* 13 April 2007. There were a total of 61 Non-JVs with total assets of RMB 5.6 billion, and total profits of RMB 1.5 billion by April 2007.

4 Apart from the ongoing arbitration in the Arbitration Institute of Stockholm Chamber of Commerce (SCC), Danone filed more than thirty lawsuits accusing Wahaha of contractual breaches, with a particular illegal use of the Wahaha trademark in France, Italy, and U.S. China and so on.

5 *See* J. Tao & E. Hillier, 'China's Economic Decision-Makers', available at <www.chinabusinessreview.com/public/0805/commentary.html>.

6 'An International Litigation Draws Attention from China and Europe-Danone/Wahaha Feud: The Cornerstone of World Equality', available at <http://eupolitics.einnews.com/article.php?nid=166776>.

call, which may be conducive for those MNCs to facilitating their global strategies while expanding their marketing share in China. In view of the discrepancies between corporate and legal cultures between the West and China, of utmost importance is to integrate MNC's global management strategies into the local social operational settings. Notably, to conclude an agreement marginalising a grey area will risk jeopardising potential legal remedies. The paper continues to consider a fidelity duty, as a double-sword, which would compromise Danone's legitimate claim, despite various interpretations under certain equivalent circumstances. The paper finally challenges whether Danone would be genuinely remedied resorting to the SCC, had it been behaving inconsistent with the above warnings. A conclusion is followed after examining implications behind the unusual settlement that has been made on the same day when the SCC's award was granted.

A. A Pyrrhic Victory: SCC's Arbitration

The SCC Arbitration[7] represents one of the most embarrassing foreign-investment failures in China.[8] As discussed above, Danone submitted the whole dispute to the SCC on 9 May 2007, which would adjudge whether the Danone or Wahaha should own the rights to the well-known Wahaha brand. Danone attempted to justify its claim to Stockholm Arbitration Tribunal on the basis of the infringement of clauses, such as the non-compete and the trademark transfer, enshrined in the JV Agreement. As a result, Danone won a partial victory against Wahaha in a confidential arbitration decision that was handed down on the same day that both parties agreed to settle the matter.

I. Ex Ante SCC's Arbitration

With arbitration becoming an essential part of the dispute resolution fabric in China, SCC's neutrality is very appealing to Chinese business clients. Of utmost importance is that the SCC, apart from its highly qualified dispute resolution practitioners and non-interventionist style of court process, is not seen as favouring one side rather than the other.

1. Why Arbitration?

Foreign investors have long been reticent about getting involved with Chinese courts, with particular concerns about improper influence and the risk of incomplete adjudication. Arbitration is supposed to offer an efficient solution to design their own dispute resolution mechanism, providing greater procedural flexibility with lower costs and less delay than traditional litigation. It can only be made mandatory via special clause, which should specify the arbitration body, location, language, applicable procedural rules and so on. As a usual practice, Danone and Wahaha have drafted arbitration clauses in their JV contracts and agreed to settle

7 SCC V (061/2007).

8 *See* T. Mitchell & G. Dyer, 'Danone Learns Perils of Business in China', *Financial Times,* 10 November 2009.

disputes in Stockholm. SCC's arbitration was regarded as the most critical trial in the Danone/Wahaha feud. Accusing Wahaha's horizontal competition and fraud, Danone petitioned SCC to stop Wahaha from infringing further and claimed a punitive damage of up to €890 million in the remaining contractual term of thirty-nine years.

2. Interim Measures

During the lengthy legal war, Danone requested that the SCC tribunal order Wahaha not to establish any new companies and increase the production capacity of existing non-JVs, and to ensure that Danone should be granted access to all JVs' premises. Upon the request, The SCC tribunal should decide whether it was appropriate to grant an interim order in support of Danone's substantive claim against the respondents, i.e. Zong and Wahaha. The UNCITRAL Model Law specifies the purposes for which interim measures should be granted.[9] Despite the lack of explicit criteria that need to be satisfied by the applicant prior to the interim order being granted, the tribunal recognised that it was necessary to take into account factors, such as urgency of the relief due to an irreparable harm otherwise and the perpetration of wrongful acts that would render, which were recognised in Swedish law. In fact, the SCC rules empower the tribunal to grant any interim measures.[10]

The SCC tribunal's delivery of a procedural order in July 2008 has witnessed the milestone for the dispute. The ruling implicated that the tribunal should not delve into the merits of the case at an interim stage of the proceedings and therefore was not in a position to make an order in response to Danone's request. However, the tribunal did order the respondents to ensure that Danone had free and unencumbered access to all of the JVs' premises. Furthermore, the tribunal refused to order that Danone provide a monetary security as required by Wahaha, but ordered instead that Danone provide an undertaking over damages. The interim order showed the SCC tribunal's attempt to strike a balance between competing interests. Although the tribunal was reluctant to prejudge certain substantive issues at the interim stage, it noted in some length that the evidence presented by Danone gave rise to real concerns of irreparable harm. The interim order was not legally binding but, but put the parties toward resolving the situation themselves in a commercial and reasonable manner.

9 Art. 17 UNCITRAL Model Law on International Commercial Arbitration: "UNCITRAL Model Law on International Commercial Arbitration Power of arbitral tribunal to order interim measures- Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute. The arbitral tribunal may require any party to provide appropriate security in connection with such measure."

10 Art. 32 SCC Arbitration Rules.

B. Stockholm Chamber of Commerce's Arbitration Institute: Arbitration V (061/2007)

The long-awaited award was delivered on 30 September 2009 and three member of the SCC ruled that Zong had breached confidentiality and non-competition agreements. The tribunal also ordered that Zong

> "cease forthwith using, or assisting in/procuring any unauthorised usage of the Wahaha Trademarks and any other intellectual property rights which belong to the[joint venture], and ordered that Zong transfer them to or cause their transfer to the [joint venture]"[11]

Apparently, the SCC tribunal recognized that Zong's Wahaha has sold identical products and diverted substantial dividends without the board's approval.[12] Although Danone had publicly alleged that Zong undermined the JVs by establishing a parallel production and sales network, neither the extent of Zong's parallel operations nor Danone's self-professed ignorance of them, in spite of its controlling stake, has been made public. The allegation that Zong had defrauded the JVs was not upheld either. Unexpectedly, while the panel quietly issued a "partial award" perceived as pyrrhic victory in favour of Danone on 30 September 2009, both parties agreed to settle their dispute out of court, which has, as a matter of law, superseded virtually the award. Even the People's Court had yet to have a chance to review the award upon a party's application for setting aside or enforcement.[13]

I. Settlement

Both parties reached the amicable settlement on the same day a confidential arbitration decision was handed down, under which Wahaha agreed to pay Danone €300m ($450m) for its controlling 51% stake in the JV operations, amounting up to 10% of its total global sales. The settlement has terminated one of China's most high-profile and acrimonious conflicts that had sparked over two-year legal proceedings. Superficially, it might be the case as observed by Mochari:

> "Danone's bungled approach to the formation of corporate alliances probably resulted in the destruction of several billion dollars' worth of market capitalization."[14]

11 *See* SCC V (061/2007).

12 'Danone, Wahaha Both Claim Win in Ruling on Dispute', available at <www.blackseagrain.net/agonews/13890>.

13 Art. 258 Civil Procedure Law (PRC) sets out the grounds of setting aside or refusing enforcement of foreign-related awards, while Art. 213 PRC and Art. 58 Arbitration Law provide grounds under which domestic awards may be set aside or refused.

14 *See* U. Wassmer, P. Dussauge & M. Planellas, 'How to Manage Alliances Better Than One at a Time', 53 *MIT Sloan Management Review* 2010, p. 74 *et seq*. (cited as: '*How to Manage Alliances Better*').

It is worth scrutinizing some impediments to a more strategic approach to configuring coherent and effective alliance portfolios.

In retrospect, Danone must be aware that it would be very unlikely to realise its legal strategies. Firstly, it would be impossible to press Zong to return to the negotiating table for reconciliation after the two-year legal feud. There would be no any possibilities to restore trust within the decade-old joint ventures, rendering retrieval of the Wahaha brand and exercise of real power. Secondly, SCC's awards would be dealt with pursuant to the international treaties entered into by China, or under the principle of reciprocity. Arbitration awards are generally governed under the *New York Convention*,[15] which has been ratified by more than 135 countries including China. Put differently, the enforcement of SCC's award would revert to the local courts in China,[16] without the settlement. Notoriously, an award is not enforceable across borders to the same extent as in Europe.[17] As is well-known in China: "in China, on can win a trial but to have the judgement implemented is another matter."[18] In this vein, such an award may only be embodied with nominal sense lacking substance, as a real success of Danone would be to have award enforcement effectively in China. However, it would be stuck with endless legal mire and uncertainties given the pyrrhic victory were to be brought to China local court for enforcement. The case may raise a potential issue as to the competency and impartiality of China's judicial institutions and the equally important question of whether they can actually see to enforcement.[19] Positively, the developing law and legal structures emerging would indicate China's legal system is adopting western notions of law and the institutions that are required to enforce them effectively.

Thirdly, Danone would be able to concentrate its integration strategy from the time-consuming and costly distraction in the Asian-Pacific market. The corporate image could be restored by ending with such an olive branch by taking the advantage of the moral strength resulting from SCC's award. Such a U-turn agreement has also saved face about which most Chinese are concerned traditionally. Of strategic essence through the mutually beneficial manner with certain compromise is to enable Danone to peruse and dedicate on its long-term development in China. As Rovnick observed that:

15 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 10 June 1958, available at <www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html>.

16 The award would be enforced by the court in Hangzhou, the city where both the joint venture and the Chinese partner are located, had it not been for the settlement.

17 *See* C. Crowe, 'Asia's Arbitration Explosion', 64 *International Bar News* 2010.

18 *See* B. Ams, *Doing Business in China*, 2009, p. 171.

19 *See* Q. Bu, '*Danone v Wahaha*: If not a War against Foreign Acquisitions, What else?', 21 *Australian Journal of Corporate Law*, 2007, p. 183.

> "If a major multinational like Danone can lose its way so spectacularly, then other international firms seeking Chinese partners should think carefully before heading down the same route". [20]

Finally, the SCC was under immense pressure due to its desire to maintain its status as the leading arbitration centre for Asian-Pacific disputes. Given the high-profile case where nationalistic sentiments were high, the SCC was expected by all parties to the dispute to feel the pressure and decide in a certain way.[21] It is noteworthy to consider what lessons the potential foreign investor may learn from the Danone/Wahaha dispute.

C. Lessons from *Danone v. Wahaha*

There are myriad lessons to be learned from the high-profile case. Among other things, the four most controversies are to be explored below: i.e. how to integrate MNCs' global governance regimes into the local operational settings, avoid concluding agreements in the marginally grey areas, avoid using the sort of double-edged sword to compromise MNCs' own proper claims and finally how to subtly maximize their benefit associated with a forum-shopping strategies.

I. Cultural Integral Failure

One of the discrepancies stemmed in part from a lack of shared ideology and clash of management culture that Zong had grown frustrated with Danone's relatively conservative attitude against JV's ambitious expansion. The clash of cultures may undermine joint ventures. It could never be overestimated to stress the importance of integrating an MNC's global governance regimes into the local operating settings, which has been perfectly embodied in the dispute between Danone and Wahaha. Unfortunately, Danone seems to have made no attempt to integrate itself within the JV and failed to control the JVs effectively and visibly, which is always crucial in ensuring the overall effectiveness of the alliance portfolio. In consequence, Danone has suffered as a result of taking flawed strategies of localisation, in spite of its controlling the JVs at the board level. Sull opined in furtherance of such an argument:

> "Multinationals often flounder in emerging markets, such as China, because key decision makers failed to immerse themselves in the local situation, instead attempting to run a local subsidiary from headquarters."[22]

On the other hand, that Danone gained 51% control of the JV through a technical legal manoeuvre may work in the West but set the JV off on a rocky start. Danoen

20 *See* N. Rovnick, 'China: Danone Lawsuit Offers Lessons', 19 *Asia Money* 2008, p. 4.

21 *See* A. Ross, 'The Sino-Swedish Connection', 5 *Global Arbitration Review* 2010, p. 22 *et seq.*

22 *See* D.N. Sull, 'Made in China: What Western Managers Can Learn from Trailblazing Chinese Entrepreneurs', *Harvard Business Press* 2005, p. 70 (cited as: '*Made in China*').

should have kept track of the JVs as it evolved over time and managed the balance between local problem solving and overall global governance arenas.[23]

a. Incompatibility of Western Corporate Governance: A 51% Ownership Interest ≠ Effective Control

Corporate culture differs enormously between in the West and China, which is particularly reflected in different notions of daily operational control as opposed to ownership control.[24] As Andrews and Tomasic held that:

> "…foreign and Chinese companies often hold different views on how a controlling interest should function…the Chinese usually hold control no matter who the majority owner is."[25]

There are substantial risks through relying on control of the board of directors as a means to exercise control over the JV. The foreign party must actively supervise in the day-to-day management of the JV rather than rely heavily on *de jure* control. Ambler and Witzel accounted for such a phenomenon that:

> "the Chinese are just proud of their long history and great cultures and expected foreigners to respect these things… In a neo-Confucian society, the ideal of the family is translated naturally to business."[26]

A director is a father figure who cares for his employees and, who are expected to give him/her their loyalty as a return.[27] Danone's complete surrender of management to Zong has rendered substantial loss of material control of the JV. Zong had been dominating at various managerial approaches, representing a true reflection of Danone' preferring *de jure* control of the shareholding to *de facto* control over JVs' operation. Despite Danone's legal control *de jure* out of its 51% stake in the JV, it is Zong's *de facto* control through the daily management that has enabled Wahaha to make unlawful advantage of JV's trademark and network of distribution and supply.[28] In substance, Zong's family-style management has materially excluded Danone from the operation of the joint venture.

The deep-rooted management cultural difference has considerably jeopardised Danone's ability to gain control on key decisions through its majority ownership. The inefficient application of the Western corporate governance has also been verified by Zong's creation of a string of parallel firms constituting vicious compe-

23 *See* Wassmer & Dussauge & Planellas, *How to Manage Alliances Better*, *supra* note 14.

24 Chinese may not see a fundamental difference between 51/49 and 50/50 joint venture, *see* SM. Dickinson, 'Danone v Wahaha', *China Economic Review,* 8 October 2007.

25 *See* N. Neil & R. Tomasic, 'Directing China's Top 100 Listed Companies: Corporate Governance in an Emerging Market Economy', 2 *The Corporate Governance Law Review*, 2006, pp. 245-309.

26 *See* T. Ambler & M. Witzel, *Doing Business in China,* 2nd edn, London, 2003, p. 38.

27 *See* J. Yao, 'Why Danone's Ventures Failed', 27 *International Financial Law Review* 2008, p. 46.

28 *See* J. Pla-Barber & E. Sanchez-Peinado & A. Madhok, 'Investment and Control Decisions in Foreign Markets: Evidence from Service Industries', 21 *British Journal of Management* 2010, p. 738.

tition against the JVs. Critically, it could also be said that it is Danone's blatant lack of due diligence that has led to inefficient control over the JVs and the failure to detect Zong Zong's non-JVs until it was too late! Furthermore, running the JV assiduously in a family management style helped Zong gain overwhelming sympathy and support at the expense of the ultimate interests of the JVs, even to the detriment of other minority shareholders. Nevertheless, the management and other employees have remained loyal to Zong throughout the lengthy legal feud. JVs' personnel saw themselves as working for Zong and Danoen was perceived as passive foreign absentee owners or merely a capital benefactor who was always taking credit without making efforts. The public in China also labelled Danone as a "hypocritical, bullying and malicious imperialist".[29] This perception, to a greater extent, has destroyed Danone's confidence to recover their position and thus resulted in the settlement.

b. Legal Culture on Lawsuits

That lawsuit can be an excellent way to gain leverage and bring the adversary back to negotiation but seldom works in China. The dispute reflected clearly varying approaches to resolving disputes when they occurred. Characterised by strong aversion to litigation, Chinese legal tradition has forged a legal and commercial community that strives for harmony instead of confrontation. As Sanderson said: "avoiding conflicts is a key ideal of much Chinese philosophy…"[30] Filing the case in the West is conceived as a proper tactic to bring an adversary back to the negotiation table,[31] which may account for why Danone initiated dozens of lawsuits in multi-jurisdictions so as to impose pressure on Wahaha for a settlement. This may produce exactly the opposite effect in China. The initiation of legal actions signals an end to negotiation, constituting a stark contrast to the West perception that lawsuit may set the stage for the out-of-court settlement. Such a philosophy explains perfectly why litigation should always be the last resort, only under the circumstance where all alternative dispute resolutions (ADRs) have been exhausted.

The Danone/Wahaha feud reminds foreign investors that a cultural merger can be more difficult than a balance sheet consolidation. There has been little evidence to demonstrate Danone's strategic integration into China market. Its setback has resulted from failure to integrate its global governance schemes compatibly into the local operation systems, such as China's social, legal and cultural settings. It is the legal cultural clash that has triggered dozens of lawsuits and arbitration cross-jurisdictions. Danone may have been overly aggressive in their

29 *See* B. Krug & S. Rothlin, 'Match and Mismatch: The Wahaha-Danone Dispute', available at <www.ceeman.org/data/files/Teaching_cases/teaching_case_krug_rothlin_match_and_mismatch_the_wahahadanone_dispute_2009.pdf>.

30 *See* J. Sanderson, *Doing Business in China,* 2008, p. 68

31 See J. Perkowski, 'Danone/Wahaha: Learn from Crisis', available at <http://managingthedragon.com/?p=241>.

litigation and dispute resolution strategies,[32] which seems consistent with its global litigation strategies but incompatible while dealing with its Chinese JV partner.

II. Failure to Transfer the Wahaha Trademark to the JV

It has emerged as a crucial facet of the dispute about whether or not the Wahaha trademark had ever been lawfully transferred from Wahaha Group to the joint venture. It is worth clarifying the extent to which the JVs have been on a sound legal basis from the start.

a. The Legal Nature of the Danone/Wahaha Dispute

The legal nature of the conflicts is virtually the dispute of the trademark ownership. The core question herein seems to be beset with the issue of uncertainty of legality with respect of the trademark transfer, which never cast the JV operation on a sound legal basis from the outset. There should be no confusion that Wahaha Group had agreed to transfer the Wahaha trademark largely because it had contributed nothing other than the ownership of the trademark leading to its 49% interest in the JV.[33] At the time of transfer in 1996, The CTO rejected JV's request on the grounds that it is a well-known trademark vested in the state owned enterprise (SOE). The refusal was not well-justified pursuant to the PRC Trademark Law but consistent with China's current policy on the disposition of SOE's assets. That the verdict had been orally delivered to the parties rather than on an official written form could be understood that the CTO may have opted for such an equivocal approach posing the least risk. Subtly, the CTO might have been confronted with mounting political and economic dilemmas paradoxically, i.e. between fostering an attractive investment environment during the middle 1990s and avoiding sparking nationalist sentiment against any takeover of Chinese trademarks to foreign investors.[34] After all, nationalism is always being raised in most countries against foreigners' hostile takeover of a well-known trademark.[35]

The JV should have claimed that the refusal be subject to judicial review at Administrative Tribunal of Beijing Intermediate People's Court. Due partly to the administrative litigation being in its infancy, neither appealed the disapproval in the Chinese People's Court within the two-year period stipulated by the Adminis-

32 *See* P. Ollier, '*Danone v Wahaha*: The Lessons for Trademark Owners', *Manage Intellectual Property* 2009, p. 1.

33 Art. 27 Company Law 2006: "a shareholder may make his capital contribution in cash or in the form, at a certain value, of such non-monetary property as physical objects, intellectual property rights, land use rights, etc. whose monetary value can be appraised and that may be transferred in accordance with the law."

34 The economic nationalism has become quite prevalent during the last couple of years, which has been perfectly exemplified by a high-profile case about Carlyle Group's proposed acquisition of China's largest construction equipment company; *See* Q. BU, 'Tighter Control of Merger & Acquisitions (M&As)?', 19 *European Business Law Review* 2008, p. 293 *et seq.*; F. Russell, 'How to Lose in China', *Forbes,* 18 June 2007.

35 *See* M. Deen, 'Danone, Seeking to Avert Takeover, May Buy Partners', *Bloomberg,* 20 July 2005.

trative Litigation Law of China. Procedurally, Danone's rights to appeal against the disapproval was actually forfeited, since it was not until June 2007 that the CTO officially acknowledged that the verdict had been orally delivered to the parties in 1996. Instead, both muddled through the approval issue by entering into an equivalent exclusive license agreement in 1999. With the abbreviated license registered with the CTO, it has remained vague in terms of validity of the transfer. Assumingly, both Danone and Wahaha have circumvented, as a business tactic, to avoid the potential unfavourable impact of an administrative litigation.

It is Wahaha's exploitation of the trademark to compete with the JVs that has led to escalation of the dispute. In this vein, it would be almost impossible to convince the tribunal without diverting the principal contradiction into attacking the legality of the transfer agreement. Zong attempted to shed light on such legal manoeuvres by claiming that Wahaha has been continuing to own the trademark because the CTO had never approved the transfer of the brand to the JV. Such a tactic claiming the trademark transfer being null and void would jeopardise the JV's exclusive right to use the trademark and Danone's legal basis for suing Zong's infringement and non-compete breaches. Danone could have sought damages from Wahaha for its default largely because Wahaha had transferred the trademark into the JVs as its ostensible investment, provided that it had been aware that Chinese law prohibited Wahaha from assigning the trademark. Given the only tangible contribution to the JV is the exclusive trademark usage, Zong's ignorance of the contractual sprit has in substance constituted unfair enrichment, which can by no means be justified either way. The tactical defence has also undercut Chinese investment environment in terms of the contractual repudiation.

b. Poor Legal Risk Management: The Congenitally Deficient Agreement

The core dispute focused on whether the trademark transfer has been legally effective ostensibly. The failure to register a real licence agreement might have not necessarily rendered the JV Agreement null and void, provided that the law does not explicitly so stipulate. However, submitting the simplified version to the CTO with the intention of covering up the exclusive nature may have produced such a result of being invalid. Another controversial issue remained to be addressed as to whether the contract in its entirety will be held as void, given the trademark transfer agreement held invalid.[36] The rest of the JV Agreement should stand and continue to be effective since the Chinese Contract Law allows *per se* illegal clauses to be stricken in an otherwise enforceable contract.[37] The trademark assignment clause enshrined in the JV contract should be inseparable, despite the transfer of the trademark being a precondition for concluding the

36 Art. 28 Company Law 2006: "If the capital contributions are made in non-monetary properties, the appropriate transfer procedures for the property rights therein shall be followed according to law."

37 Art. 56 PRC Contract Law.

agreement. Whatever, the circumvention has put Danone in a most disadvantageous position in the over two-year legal feud.[38]

c. Implications

Wahaha might not have necessarily intended to mislead Danone to conclude the JV Agreement, while navigating the Chinese legal labyrinth. After all, such circumvention did maximize both parties' interests under the subtle business and legal circumstances during the middle of 1990s. At the initial stage, Wahah cried for enjoying Sino-Foreign Enterprises' preferential policies as well as Danone's capital infusion[39] and management skills. Danone was keen to possess Wahaha's distribution networks, land and government contacts that most multinationals have been coveted,[40] so as to essentially gain a solid foothold in the most lucrative but challenging market. As Sull observed:

> "the Chinese partners benefited from Danone's capital, technology, and marketing expertise, while Danone leveraged these entrepreneurs' knowledge of local customs."[41]

The timely capital injection had been indispensable for Wahaha's growth and survival in pierce competition with global giants, such as Pepsi and Coca Cola. On the other hand, there is a longstanding interpersonal relation-orientated society and Chinese tend to walk around legal compulsories to the most extent. That Danone had proceeded with the JV created on a weak and uncertain legal basis finally resulted in inadequate legal remedies. It is implied that the terms were not to be enforced by a Chinese court in favour of, at least, Danone, largely because both parties had taken advantage of the uncertainties to transfer the trademark license in the grey area. Both conflicting parties ought to be liable for failure to meet the compulsory registered capital of the JV.[42] Wahaha's claim that the trademark license being void may not be well-founded, it did provide Zong with excellent leverage against Danone. Subsequently, that the ownership has every bearing on the issue of both Zong and Danone directors' fiduciary duties remains paradoxical, when applied to this case under the JV, which, in China, "used to exist in a separate world of law."[43]

38 *See* S. Lee & M. Tan, 'Joint Ventures in China-Lessons to be Learned from *Danone v Wahaha*', in D. Campbell *et al*. (Eds.), *International Joint Ventures,* Alphen aan den Rijn, 2009, p. 563.

39 The Asian Financial Crisis in the middle of 1990s pushed the state-owned banking institutions to tighten up on lending to private companies, leading to thousands of firms going bankrupt.

40 *See* S. Kaiser, 'Local Sourcing in China', in Roger Strange (Ed.), *Management in China: The Experience of Foreign Businesses*, 1998, p. 83.

41 *See* Sull, *Made in China*, *supra* note 22, p. 2.

42 Art. 31 and Arts. 199-201 Company Law 2005.

43 *See* NC. Howson, 'Dirty Water-The Danone-Wahaha Battle and Law, Politics and Contested Value in the PRC', 6 April 2010, available at <www.ii.umich.edu/umich/v/>.

III. The Double-Edged Sword: Breaches of the Fiduciary Duty

Non-compete clause in the JV Agreement represents another primary issue throughout the dispute. Zong's contravention constituted infringement of the trademark transfer clauses and enormously damaged the integrity of the partnership. Danone filed lawsuits that alleged Zong was in breach of fiduciary duties as a director with the JVs,[44] including the non-compete agreement given that he had set up parallel operations outside the JVs. The non-JVs were using the product lines, suppliers and distribution networks that had been funded by Danone's original investment of $45 million. Zong should have disgorged his illicit gains from taking advantage of his position, acting inconsistently with the obligation of fidelity.[45] On behalf of the JV, Danone could have brought a derivative action against Zong for compensation.[46] Zong did not deny that he built and owned a parallel network of manufacturers and distributors for Wahaha drinks outside the JVs that Danone controlled with a 51% share, but counterattacked that Danone had been an unfaithful partner as well by investing in dairies that compete with Wahaha.[47] In furtherance of retaliation, Wahaha sued several Danone's directors for conflict of interest because of their simultaneous membership on the boards of the Wahaha-Danone JVs and other competing businesses Danone had in China.

Undeniably, several directors affiliated to Danone had participated in unfair competition and breached Chinese Labour Contract Law 2008 as well as Company Law,[48] given that they sat on the boards of rivals to the JVs. Shareholders of Wahaha Group even filed derivative actions against Mr. Qin Peng of Danone in the Intermediate People's Court in Shenyang, Liaoning Province for sitting on the board of other companies in the detriment of the JVs. In addition, Danone invested hugely in rival companies. Until 19 December 2007, Danone held 49% interest in China Mengniu Dairy, 20% in Huiyuan, and maintained "partnerships with several other well-known local firms including Shanghai's Aquarius."[49] Such expansion behaviours did, more or less, undermine the moral strength of Danone's accusation against Zong's creation of his own parallel companies.

44 *See* R. Lee, 'Fiduciary Duty without Equity: 'Fiduciary Duties' of Directors Under the Revised Company Law of the PRC', 47 *VA. J. Int'l L.* 2007, p. 900.

45 Art. 149 Company Law 2006.

46 Art. 148 Company Law 2006: "directors, supervisors and senior officers shall comply with laws, administrative regulations and the company's articles of association and shall bear an obligation of loyalty and care toward the company." Art. 152 indicates that a shareholder owning more than 1% of the company's shares may demand the company to initiate a derivative action, or initiate the action itself if the demand proved to be futile, when a director violates Art. 149.

47 *See* JT. Areddy, 'Groupe Danone Gets a Cool Response in Peace Offering to Partner in China', *Wall Street Journal,* 17 December 2007; J. Wang, *Brand New China: Advertising, Media and Commercial Culture*, Boston, 2008, p. 112.

48 Arts. 23 and 24 PRC Labour Contract Law 2008; Art. 149 Company Law 2006: "No director or senior manager may have any of the following acts: without the consent of the shareholders' meeting, seeking business opportunities by taking advantage of his authorities, or operating any like business of the company he works for."

49 *See* D. Kwok, 'Danone Pullout Hits Shares in Top China Milk Firm', *The Guardian*, 19 December 2007.

I. *Forum Shopping*

It is essential that jurisdictions with strong courts have an incentive to attract foreign litigants. The choice of venue issues seems complex in multi-national lawsuits and there is no great statutory relief in certain venues which will protect parties from multi-venue fights. This has proven to be a problem for foreign companies contracting with Chinese entities.[50] To avoid dysfunctional court system, litigants from afflicted nations may have their commercial disputes adjudicated in the courts of other nations that have better-functioning judicial systems. Parties can only choose to arbitrate outside China if the arbitration is "foreign-related", which mean, at least, that one party should be a non-PRC citizen or non-PRC company.[51] In this vein, the case did not demonstrate whether or not China's legal systems are mature and sophisticated enough to handle such kind of international litigation; neither was exposed as to whether the rule of law comes second to vested interests.

Commercial arbitrations are commenced on the basis of arbitration clauses inserted into contracts which bind the parties in dispute. The JV Agreement contained provisions which designate a specific jurisdiction where disputes occur.[52] Otherwise, arbitral tribunals would reach a different conclusion on a similar set of facts and law in view of *lis alibi pendens*, were two arbitrations to be conducted in different jurisdictions. Danone tried to root out Wahaha's home court advantage in China to ensure that disputes were to be dealt with on a strictly legal basis. The pair had agreed to take any dispute to SCC when they formed the JV. The mutually-agreed SCC ought to provide a fairer judgment than results from the Chinese judicial system, given its local protectionism runs rampant and professional standards are notoriously low. Thus, Danone joined Zong personally as a defendant in the Stockholm arbitration in May 2007.

As a strategic response, Wahaha filed arbitration in terms of the effect of the trademark assignment contract in Hangzhou Arbitration Commission (HAC) on 13 June 2007. HAC ruled that the trademark assignment signed between the two parties in 1996 was terminated.[53] Hangzhou Intermediate People's Court upheld the HAC's ruling that "the Wahaha trademark belongs to the Wahaha Company, not to the JV of which Danone is the majority shareholder". Both decisions were based on the lack of official approval by the CTO on the transfer.[54] The ruling in favour of Wahaha's right to the trademark was estimated to be worth at least \$2.4 billion, more than 160 times its value when the JV was established in 1996. A controversial arose as to whether Zong should be allowed to file a parallel arbi-

50 *China National Metal Products Import/Export Company v. Apex Digital*, 379 F.3d 796 (U.S. Ct. App. 9th Cir. 2004).

51 *See* G. Johnston, 'Party Autonomy in Mainland Chinese Commercial Arbitration', 25 *J. Int'l Arb.* 2008, p. 544.

52 Art. 26 of Danone/Wahaha Joint Venture Agreement stipulates that disputes between the contracting parties, if unresolved, are to be arbitrated in the SCC. An arbitral award is binding, final, not subject to review, and not subject to appeal by the courts of any jurisdictions.

53 Art. 38 Trademark Law of the People's Republic of China.

54 Art. 39 Trademark Law of the People's Republic of China.

tration in China while the original joint venture contract designated Stockholm as the venue for mandatory arbitration. Wahaha also impeached Danone's senior officials, alleging them of unfair competition in the same trade and harm the rights of shareholders before several local Chinese courts and won the cases. The verdicts from Chinese courts in the long-running dispute may result in less confidence among the foreign investment community.

D. Conclusion

China is a highly-sought after and one of the most lucrative markets on which foreign investors are keen to gain a foothold. During the last three decades, Chins has been seeking after capital, management experience, brand and high technology that foreign MNCs could bring to the joint venture. However, China's invest environment has taken place substantially. As a classic case, the feud between Danone and Wahaha will have a far-reaching impact on foreign MNCs' future expectation on the risk of contract repudiation and Chinese entrepreneurs' credibility. Both parties' incompatible managerial, cultural and legal discrepancies have led to breakdown in negotiations, and then resorted to dozens of arbitration and litigation across jurisdictions. The bitter legal war will caution foreign MNCs to reassess their expectations and strategies. It is crucial that potential foreign investors attempting to enter the Chinese market make an effort seriously for genuine integration compatibly. They should also adjust their governance approaches to avoid and solve potential conflicts, with a particular regard to the difference between the law-orientated Western approach and the relationship-driven Chinese model. The relationship breakdown between Danone and Zong also offers vital lessons for any foreign investor considering a Chinese JV or business partnership. The wholly-owned foreign enterprise (WOFE) may become a more preferred route to a joint venture in the near future.