

FINANCE ASIA

Volume 4 Issue 4 February 2000



The Last \$candal of the millennium

SUBSCRIPTIONS

Per Year: US\$295/HK\$2286
Single copy: US\$30/HK\$230

www.financeasia.com

The Dalian Verdict

A groundbreaking victory by Citibank in China is nothing short of a revolution

by Lotte Chow

By all accounts, Citibank Shanghai did a good job for Wafangdian Ballbearing Group in Dalian, northern China. Back in 1996 when the ballbearing manufacturer wanted an investment bank to help it formulate a financial plan to raise funds, Citibank Shanghai offered help. The bank found a bonafide investor for Wafangdian and steered the company to a successful IPO on the Shanghai Stock Exchange. The once cash-strapped company suddenly became cash-rich.

But Wafangdian didn't want to pay for Citibank's service.

"They didn't pay anything," says David Buxbaum, senior partner at Brand Farrar Buxbaum and legal counsel for Citibank's Shanghai branch. "The firm received money from the strategic investor and the public offering, but they didn't pay Citibank."

Citibank took Wafangdian to court.

"Citibank didn't want to go to court," explains Buxbaum. "Most foreign companies operating in China prefer to have good relationships with Chinese firms. We do, too. We tried to settle out of court, but Wafangdian wouldn't budge. They didn't come up with anything that was remotely reasonable to us."

That left Citibank with no choice.

"The thing is this, if Citibank had done all this work, done all the things that its client asked it to and did it wonderfully, and it didn't get pay anything, that would set a terrible precedent in

China," Buxbaum says.

"It would be as if to say, you can get a financial plan for free, a wonderful investor for free and go public for free. What a terrible situation it would be," he adds.

It wasn't meant to be that way. When Citibank agreed to be Wafang-

dian financial adviser, helping the company to improve its financial structure, both parties were enthusiastic about the venture. Senior officials from the two companies met frequently and worked closely.

determining a proper level of indebtedness and even the number of shares to be issued. The bank also assisted Wafangdian in investor negotiations and drafted all necessary documents.

In return, Wafangdian would pay Citibank an annual fee of \$20,000, an achievement fee of 2.5% of the amount of funds raised via issue of stocks and other securities, and all service-related expenses.

These terms were stipulated in a contract signed by Citibank's Shanghai manager Zhong Minmin and Wafangdian's chairman and president Yu Jie.

But after Citibank came up with the goods, Wafangdian declined to pay.

"Wafangdian never denied Citibank did a lot of work," Buxbaum says. "It just didn't pay."

Why didn't Wafangdian pay?

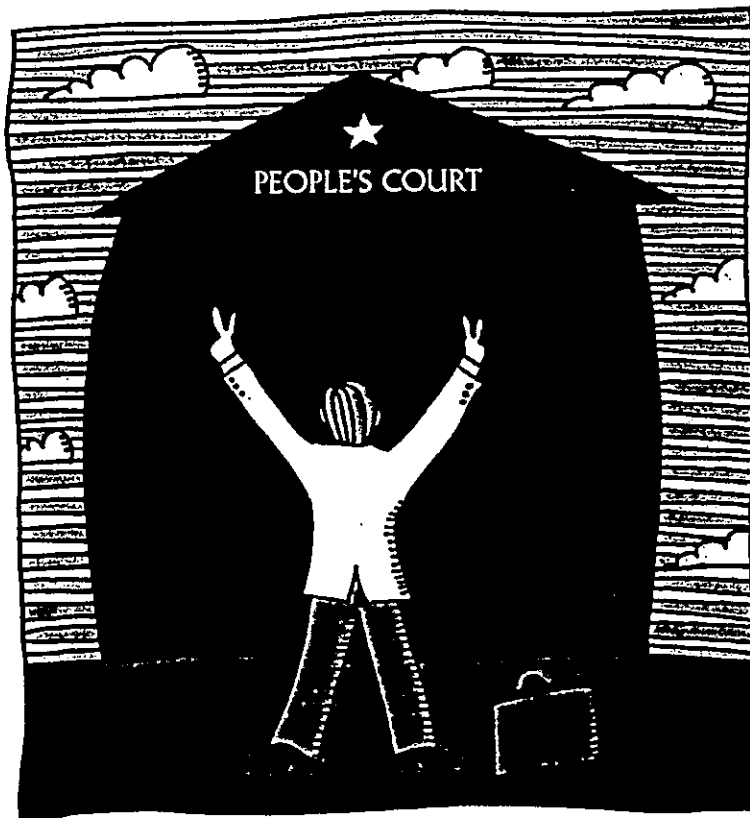
An oversight? Not familiar with the ways of the world? Believed they could get away with it in China's transition from socialism to a market economy? Who knows.

Citibank calculated it was owed \$950,000 for services provided between 1996 and 1997. That comprised a \$20,000 annual fee, \$750,000 in achievement fees and \$180,000 in expenses.

After exhausting all channels for payments, the bank went to court.

Hence at the People's Court in picturesque Dalian, Liaoning province, the case was heard before a panel of three judges.

The case was tried in public, with



China loves a pyrrhic victory

Citibank's victory shows how far China's legal system has come. As a point of comparison consider this case from 1949:

In January 1949, the trading company, Jardine Matheson, had given £30,000 to a Chinese merchant, Mr Sung, to buy silk cocoons.

But the Communist revolution led by Mao was disrupting business in the silk-growing areas of Shantung in eastern China, and Sung was unable to buy any silk cases.

"Just return the £30,000, and we'll try again next time," said the head of Jardine's Silk Department when Sung showed up empty-handed in his office one day.

"Sorry, money is all gone," replied Sung.

Shocked and befuddled, Jardine decided to sue.

Hence, at a Shanghai courtroom built in the days of the International Settlement and furnished like a British Court, three judges sat in a box to hear the case. The case was swiftly described, the deposition studied and the testimony heard.

Sung was asked if he accepted the statements made against him. He answered yes.

The judges then banged down a red-ink chop on the case's documents, announcing that Jardine had won.

The Jardine staffers were elated and celebrated with a few drinks, thinking that they had won against a Chi-

nese defendant in the Chinese People's Court.

The weeks flew by, and no money was paid by Sung.

"Why don't you pay?" Jardine asked Sung.

"No money" was the reply. Sung said his house in Soochow needed alterations and his living expenses needed to be paid.

"Back to court" Jardine fumed.

Okay, the judges said, Sung would go to prison if he did not pay. However Jardine would have to pick up the tab for his food and lodging - at \$50 a day.

In those days, \$50 a day would pay for a luxury hotel suite.

"But we are trying to get my money back, not to pay it out," Jardine expostulated.

To which the judge replied, "China is desperately short of foreign exchange. Mr Sung here has gained £30,000 of British currency, without parting with any of our produce. To us, he is a hero and has every right to be treated with every consideration.

"You, however, have been cheated of some money - a fraction of the wealth which foreign firms have extracted from China over the past century."

The judge added, "You are entitled to seek redress, but there is certainly no reason why the impoverished people of China should pay for the revenge of a foreign firm."

Jardine Matheson dropped the case.

Citibank and Wafangdian officials testifying in three hearings in the Dalian court over a period of six months in 1998. After hearing the testimony and looking at all the evidence, the court decided Citibank performed its duties according to the terms of the contract, while Wafangdian did not.

On December 13, 1999, the court ordered Wafangdian to pay Citibank damages of \$506,540 and Rmb109,387.

The amount fell short of what Citibank had sought. But Buxbaum says he is pleased. "The court gave most of what we wanted. More important, by winning, Citibank made a statement: if you do good work, you expect to be paid and you will get paid," he says.

Buxbaum says the case was significant in several ways.

First, it shows that a foreign entity can go against a major Chinese corporation in China and persuade the court to award damages. Buxbaum says this case stands out because Citibank won against a well-known, well-connected and highly-influential company in the neighbourhood it operates in.

"People are concerned about the legal system in China. Yes, China's legal system is uneven but this is an example of a legal system at its best," says Buxbaum, an expert in Chinese

law who has practiced in China since 1972.

Another significance: the court had acted in a reasonable way. While the judges weren't familiar with investment banking contracts which, unlike loan defaults and company bankruptcy cases, are still a novelty in China, they took the time and efforts to study and understand the case. "They asked intelligent questions and raised good points, legal and factual. We felt the hearings were properly conducted. They were fair and the results were fair," Buxbaum says.

Chinese law experts agree that Citibank's victory signals an improvement of the rule of law in China and is a positive sign for foreign companies operating in China. It shows China's legal system has come a long way since the days of the Cultural Revolution when there were no courts, no lawyers and no law schools under Mao. Even in the early 1970s, there was only a constitution, a counter-revolution law and a marriage law. That was the extent of China's legislation.

Since China's open-door policy began in the late 1970s, the court system has been reinstated, law schools and law departments reopened, lawyers retrained

and new legislation promulgated.

But weaknesses in the system remain - a point on which Chinese law experts agree. For one thing, there aren't enough people trained in law to be judges. Second, judges are paid by the government and often are under pressure not to make judgments against state enterprises.

Buxbaum admits scepticism abounds in regard to China's legal system, especially among foreigners who believe they are discriminated against when they stand in court against a Chinese defendant. Buxbaum's advice: have a good case, with good evidence, good preparations, good presentations and a sound argument.

Buxbaum adds that he doesn't believe the court judgment will sour Citibank and Wafangdian relations "15 or 20 years ago, if you sued a Chinese company, you would sour relations. But there are so many litigations in China today that I don't think Chinese companies would hold it against you.

For Citibank and Wafangdian, I don't think there is personal hostility between them. It's a normal commercial decision, no spite, no mutual antagonism."

Wafangdian could lodge an appeal and not pay the damages, but will it? FA

U.S. Software Makers Win First Copyright Ruling in China

By a Staff Reporter

BEIJING — In a major victory for the U.S. software industry, a Beijing court has ruled that a Chinese company infringed on intellectual property rights when it sold pirated software.

Beijing Juren Computer Co. illegally distributed software that is copyrighted by Autodesk Inc., Microsoft Corp. and Novell Inc., according to a ruling by the Intellectual Property Chamber of the No. 1 Beijing Intermediate People's Court. The court hasn't yet decided on damages to be awarded to the plaintiffs.

Dong Yongsan, the lawyer representing Beijing Juren, said the company accepts responsibility for its employee selling pirated software.

"The worker broke the rules by selling the software, and Juren is willing to take responsibility for that according to Chinese law," Mr. Dong said.

But he added that Beijing Juren disagreed with several aspects of the case. For one, the prosecution's way of gathering evidence "wasn't very appropriate," he said.

He said a company hired by Microsoft to gather evidence against Beijing Juren lured the company employee into selling the pirated software by saying that it wouldn't buy Beijing Juren's computers unless it also provided such software. The prosecution also asked the court to seize all of Beijing Juren's software made by the three prosecuting companies — even those which it had obtained legally and weren't involved in the case.

And the prosecution has demanded compensation of \$150,000, much higher than the actual damages it sustained, he said.

The Business Software Alliance, a Washington-based industry group, said this is the first case it has won in China. In June, it settled a similar case with Gaoli Computer Co. in Beijing.

In February, the U.S. and China signed a broad agreement on mutual recognition of intellectual property rights. BSA estimates that last year, the industry lost \$527 million in potential profits due to software piracy in China.

Chinese Firms Named in Suit Over Software

Associated Press News Service

BEIJING — In a precedent-setting case, three U.S. software companies have filed suit charging that five Beijing firms illegally copied, displayed and sold their software, an official report said.

The suit, brought by Microsoft Corp., Lotus Development Corp. and Autodesk Inc., alleged 10 separate incidents of copyright infringement, resulting in millions of dollars in lost profits, the China Daily newspaper reported.

The U.S. companies are demanding between \$10,000 and \$30,000 in compensation for each case of copyright infringement, but "total damages will be far higher than that," said Stephanie Mitchell, vice president of the Business Software Alliance. The Washington-based group is representing the American companies.

The newspaper said the Intellectual Property Rights Chamber under the Beijing Intermediate People's Court is investigating the case and is expected to hold a public hearing in September before making a final judgment.

The lawsuit follows a joint raid in June by the Business Software Alliance and Intellectual Property Rights Chamber in one of the first major actions taken against alleged software pirates.

More than 300 pirated software disks and six hard disks were seized in the raid against the five companies named in the suit. The five are the Gaoli Computer Co., Sanhua Electronics, Huili Computer Co., the Huiqin Computer Shop and the Beijing branch of Giant Group, one of China's largest computer-software retailers.

Such cases must become routine if China is to effectively combat software piracy, Ms. Mitchell said. The alliance estimates that more than 90% of all software in China today is pirated.

Foreign software makers are worried that 26 compact-disk factories in south China suspected of producing pirated goods could switch production to computer software, Ms. Mitchell said.

The Chinese government is under pressure to close down the CD and CD-ROM factories or face U.S. trade sanctions. A Chinese foreign trade ministry official said that four of the 26 CD factories already have been shut down.

But Zhang Yuejiao, deputy director of the ministry's treaty and law department, urged the U.S. not to apply pressure on the issue of enforcing intellectual property rights protection, calling it "unfair and ineffective."

South China Morning Post

Business Post

HONG KONG, THURSDAY, JUNE 22, 1995

People's Court enforces IPR

Software pirate makes
US\$78,276 settlement

By DUSTY CLAYTON
and Reuter

A BEIJING computer company has paid the Business Software Alliance (BSA) US\$78,276 in damages and court costs for illegally reproducing and selling copyrighted software products.

In what is believed to be the mainland's largest copyright settlement, Beijing Gaoli Computer Co agreed to apologise publicly to Microsoft Corp, Autodesk Inc, Lotus Development Co, Novell and the Word Perfect Application Group.

In return, the plaintiffs, all foreign, will withdraw their lawsuits from the intellectual-property chamber of Beijing's Intermediate People's Court.

BSA vice-president Stephanie Mitchell said: "This is a concrete sign that the Chinese are serious about enforcing the protection of intellectual property as they agreed to with the signing of the Sino-US agreement on IPR [intellectual property rights] protection earlier this year."