Clarity on Guanxi, Cultural and Media Issues in China

By Randall Lewis (lewis_randall18@hotmail.com), Danone

Even though China claims to have embraced the rule of law and became a member of the World Trade Organization, it remains an investment destination fraught with significant risk. Companies investing in China should be aware of corruption, corporate fraud, risks related to a system that heavily favors local citizens and local PRC entities, risks related to basic enforcement of contracts, risks related to the judiciary and the Chinese legal profession as a whole, and risks related to potential media (especially Weibo, which is the Chinese Twitter) manipulation of public opinion designed to interfere in judicial and arbitral decisions. Regardless of the risk, however, in today’s global business world, entering into China is no longer an option.

This article will illuminate three risk areas that are not well understood or discussed openly by your external counsel and advisors. The information in this article is based upon my own personal experiences gained over a 15-year period of living and working in China. While the information in this article does generalize, I believe generalizations (in this context) are useful in order to provide you with a starting point to conduct further discussions and analysis of your unique China strategy and relationships.

Corruption in China’s legal system

There is the common belief that corruption in China is rampant and that corruption seriously undermines the ability to receive a fair result in a Chinese court or before a China-based arbitral body. While I generally believe that corruption does exist throughout China (more so in China’s second- or third-tier cities), I am not convinced that the label “corruption” is entirely accurate.

For the sake of accuracy, I need to point out that numerous scholars have written about the fact that China ranks high on the index of corruption and that in the KPMG Global Anti-

Bribery and Corruption Survey 2011, China had the third highest “corruption perception score.” It has also been noted that China’s judges are susceptible to corruption, because of being “underpaid and generally treated like other officials rather than instilled with a distinctive professional and ethical spirit,” and that “stories abound of various forms of judicial malpractice such as judges demanding bribes, meeting ex parte with parties in restaurants or Karaoke bars, and demanding the parties to fund lavish ‘investigation trips.’” While I do not doubt the accuracy of any of these statements, corruption (as that term is generally known) should not be your main concern when you find yourself in a China-centered dispute.

Your concern should be on a more subtle form of influence that is pervasive in Chinese society in general: “guanxi.”

“Guanxi” is a relationship — a direct personal relationship with a person or a friend of that person. Clearly, guanxi can factor into a judicial or arbitral decision, but that does not necessarily mean that a traditional bribe, payment or “gift” has been exchanged. What is really happening here is that decisions are sometimes made (or heavily influenced) based upon personal networks rather than the facts or the law.

A close friend of mine is a successful Chinese lawyer. He is successful not because of his legal acumen (he is highly skilled, actually) but due to his relationships (or guanxi) with various public officials, judges and administrative personnel throughout China. His clients are mostly Chinese citizens and Chinese companies. Sometimes, when a dispute is important, he is retained as legal counsel in order to access some of his friends to help resolve a problem. He does not pay anything, he does not give gifts and he does not “bribe” anyone. He simply is
good friends with people in various locations and positions who would like to help him out. For example, if he happens to have a case in front of a judge that he has a good relationship with (neither he nor the judge are obligated to withdraw for ethical reasons nor disclose their relationship), that particular judge may view the evidence in a manner that will eventually lead to a decision for his friend. Our ethical obligation to avoid even the “appearance of impropriety” does not exist in China, as far as I know. At times, this does lead to judges viewing cases and evidence from a non-impartial view.

That having been said, this friend does spend a large amount of money building these relationships over the course of years (high-end clubs, drinking French wine and high-dollar bottles of single malt, karaoke etc.). Although not necessarily unique to China, senior lawyers and management at a number of major PRC law firms are understood to hold important positions solely on the basis of their family members holding high positions at governmental bodies and agencies. Clearly, these relationships are not fostered or initially generated during a live dispute; they exist prior to a dispute being born. As you can see, this is an extremely grey area, but not necessarily corruption as foreigners traditionally envision (i.e., packets of cash being exchanged to sitting judges). While it is easy to criticize China’s judges, keep in mind that this problem is culturally and historically rooted based on an old system that is in an active state of evolution. The judges at this time simply know nothing else.

The practical problem with guanxi is that if you happen to be in-house counsel for a US or European entity, for example, the risk of violating the 2010 UK Bribery Act (the Act) or the US Foreign Corrupt Practices Act (FCPA)
The practical problem with guanxi is that if you happen to be in-house counsel for a US or European entity, for example, the risk of violating the 2010 UK Bribery Act (the Act) or the US Foreign Corrupt Practices Act (FCPA) is greatly increased.

is greatly increased if you approach a dispute in China from the angle that increases your odds of success (i.e., utilize guanxi). The key difference between the Act and the FCPA as related to “bribing” foreign public officials (PRC judges for example) is that in the Act, the offender need not seek to induce a public official to improperly perform his duties. Rather, the offender must only seek to influence that official in the performance of his duties. The FCPA would allow reasonable and bona fide hospitality or business expenses (speaking loosely here), while under the Act, such expenses may be viewed as intended to influence and are problematic. (In March of 2011, however, Justice Secretary Kenneth Clarke did assure companies that the Act would be implemented in a “workable, common sense” manner.) A word of caution here: If you are in-house counsel for a US company and think the Act does not apply to your entity, think again. The Act applies to any company that carries on any business in the United Kingdom, or has a close connection to the United Kingdom, any individual holding a UK passport or any individual ordinarily resident in the United Kingdom (this is very broad indeed).

Putting aside the UK Bribery Act and the FCPA, if it is publicly released that your company has directly or indirectly engaged in this type of activity, the media fallout and criticism would be severe, both at home and in China. The Chinese press are much more harsh and critical of foreign companies’ activities in China than they are local companies engaging in reprehensible behavior.

Cultural and generational issues effecting contractual performance in China
For a few generations, under communism, the Chinese population was not instilled with any real religious values that determined right and wrong. I have heard it said that God did not exist in China after the Cultural Revolution and neither did a legal profession exist in any respect. In addition, under the communist model of a planned economy, Chinese people were deprived of virtually all material wealth and comfort. When Deng Xiao Ping, who was instrumental in reforming China into a socialist market economy, opened up China to this new system and encouraged people to go out and find their fortunes, it was, for many people, an admission that a planned economy was a failure. Deng Xiao Ping once said, “It does not matter whether the cat is black or white, only that it catches mice,” and “To be rich is glorious.” Many people in China interpreted him to mean that it does not matter how you achieve your wealth, only that you achieve it. They were unprepared to navigate this new market economy and simply went forth with the goal to gain as much wealth as they could, unburdened by the value system that people in the United States (for example only) use to generally guide their actions.

It is not uncommon to meet people in China who admire wealth and the person who secures a fortune, regardless of how that fortune was gained. In general, a person is considered business-savvy if he broke agreements or cheated, without penalty, to become wealthy. In dealing with the Chinese, it is possible that your idea of how they will behave in certain circumstances does not comport with reality.

In your business dealings in China, there are generally three different groups of people (or entities, as the case may be) that you will be dealing with. Those three groups are: 1) State-owned entities and the people running them (SOE); 2) Older generation Chinese entrepreneurs, who are generally older than 50 (Older Generation); and 3) Younger generation entrepreneurs, who are in their mid 40s or younger (Younger Generation). Doing business with each of these groups has its own set of risks to consider.

The SOE: Through the ’90s and into the new millennium, if you wanted to enter into China,
clarity on Guanxi, cultural & media issues in China

Economy model and were the primary beneficiaries of Deng Xiao Ping’s reformations. It is likely that because of educational and cultural issues, these people do not fully understand the true meaning of a contract, and as a result, it is likely that they will not fully read or analyze one before proceeding to an execution. It is also likely that once your business starts to grow in profitability and size, there will be a divergence of business and financial interests. In my experience, this group, in a general sense, will create ways in which to rebalance the financial landscape in a manner that best fits their intrinsic vision as to which party deserves more, or less, based upon factors that have relatively nothing to do with any written agreement you may have executed. It is also my experience that in a conflict situation, this group is more likely to utilize guanxi and other non-standard methods to achieve their goal, and to be aggressive during any settlement or other negotiations.

The Younger Generation: This group comprises the bulk of today’s successful entrepreneurs in China. These people were born, raised and educated under the old communist-planned economy model and were the primary beneficiaries of Deng Xiao Ping’s reformations. It is likely that because of educational and cultural issues, these people do not fully understand the true meaning of a contract, and as a result, it is likely that they will not fully read or analyze one before proceeding to an execution. It is also likely that once your business starts to grow in profitability and size, there will be a divergence of business and financial interests. In my experience, this group, in a general sense, will create ways in which to rebalance the financial landscape in a manner that best fits their intrinsic vision as to which party deserves more, or less, based upon factors that have relatively nothing to do with any written agreement you may have executed. It is also my experience that in a conflict situation, this group is more likely to utilize guanxi and other non-standard methods to achieve their goal, and to be aggressive during any settlement or other negotiations.

The Older Generation: This group comprises the bulk of today’s successful entrepreneurs in China. These people were born, raised and educated under the old communist-planned economy model and were the primary beneficiaries of Deng Xiao Ping’s reformations. It is likely that because of educational and cultural issues, these people do not fully understand the true meaning of a contract, and as a result, it is likely that they will not fully read or analyze one before proceeding to an execution. It is also likely that once your business starts to grow in profitability and size, there will be a divergence of business and financial interests. In my experience, this group, in a general sense, will create ways in which to rebalance the financial landscape in a manner that best fits their intrinsic vision as to which party deserves more, or less, based upon factors that have relatively nothing to do with any written agreement you may have executed. It is also my experience that in a conflict situation, this group is more likely to utilize guanxi and other non-standard methods to achieve their goal, and to be aggressive during any settlement or other negotiations.
of China at some point, were raised in today’s modern China (socialist market system), have access to the free flow of new ideas on the internet and through western media, and in general, find it easier to adapt themselves to new ideas and thoughts. This group of people are easier to rationalize with, more likely to adhere to a written agreement, and in a general sense, more willing to negotiate a fair settlement in a dispute that would be a true compromise.

Media impact on disputes in China

Something not widely discussed in legal circles, is the impact of the media on business and disputes in China. Here, I will share some experience in this area and identify a risk that is not normally well understood.

Previously, I was engaged in a complex litigation matter involving various joint ventures scattered throughout mainland China. Early in the development of the dispute, the matter was picked up by every newspaper and publication in China. The media reported so widely on the dispute because the disputed China businesses were very successful, it exploited one of China’s most iconic brands, and the joint ventures had been widely touted for years as the model of success for foreign investment in China.

To make a long story short, the Chinese media was brutal. Immediately after the first news reports on the dispute became public, the press reports were republished in various blogs and chat rooms throughout China. Thousands of news reports based on false or questionable information evolved. Reports sensationalized the fact that we were a foreign company and that characterized us as foreign invaders, which resulted in country-wide prejudice against us. Live television shows analyzed our case and claimed that we had no prospects of recovery in any legal battle. And, at least two full books are being written about the subject, and damage to our good image in China. In a period of more than two years, it was common to have days when more than 60 news stories were published on the dispute throughout China, Asia and the world. Nothing was out of bounds; everything was reported in the press.

The problem we faced here was multi-faceted. First, as with most publicly traded companies, we do not air disputes with our partners or over our businesses in public. Second, we underestimated the impact of the media on judges and judicial bodies throughout China, and on certain PRC government officials who were tasked with assisting us to find a resolution to our underlying dispute. Third, we were under strict confidentiality orders with regard to certain issues in various arbitrations and lawsuits throughout the globe, which prevented us from revealing facts that would undermine a lot of the inaccurate negative press reports and help to restore our public image. Fourth, the negative media reports influenced our image in many Asia-Pacific countries and caused other partners, and potential partners, to be wary of our business. Fifth, during the course of our dispute, the media problems were exacerbated when a Chinese lady in a wheelchair carrying the Olympic torch was attacked in Paris, and the Mayor of Paris met with the Dalai Lama to make him an honorary citizen. With regard to this fifth problem, it also resulted in the French supermarket giant, Carrefour, to be targeted by boycotts, and widespread public protests in at least 10 cities throughout China. It was widely rumored on the internet that the retailer supported the Dalai Lama.

While the traditional press is organized and monitored by the State, and it is widely known that China does not enjoy freedom of the press (as we understand that concept in the West), the Chinese press is relatively free to criticize and sensationalize disputes (especially disputes involving foreigners) when those reports will likely stir up feelings of nationalism. In my opinion, the Chinese press will literally print most anything, no matter how ridiculous, as long as they have someone to quote.

In addition, due to the emergence of new media (blogs, Weibo, online chat rooms and other internet-based communication tools), it is now common for your competitors (or anyone with
the proper funding and motivation) to organize, artificially influence and artificially manipulate online dialogue with the goal to disparage and inflame passions against your products or company. These forums allow messaging to instantly reach an online population of at least 457 million\(^{19}\) people. While governmental organization of the traditional press is true, it is also reality that the initial posting and discussions in the new media are not initially censored. While the Chinese government does have online monitors and firewalls, which are meant to remove or censor online postings and discussions not in line with Chinese laws and regulations, these efforts are usually implemented after the postings have become public and the damage suffered.

The reality is that in China’s competitive market, it is not uncommon for your company and products to be the subject of wide online criticism organized by your competitors, or your opponent in litigation, usually on the basis of patently false and misleading gossip. The impact of this is real and does result in an immediate reduction in sales and significant financial loss.

In addition, when you have a lawsuit before a court or tribunal in second- or third-tier cities in China during a time of active negative press and new media postings, it makes it very uncomfortable for a judge to side with a foreigner over a local person or entity.

It is also my experience that if you have a series of related cases pending throughout China at the same time, which can easily happen when dealing with businesses conducting activities in various provinces throughout China, and the press or new media begin to report on your losses (regardless of the reasons for such losses), it makes it even more difficult to receive a favorable verdict in subsequent cases.

While some may view my experience as unique, I would like to point to at least one recent case with a media-influenced outcome, to illustrate that this issue is not so uncommon. In 2007, a man in China was sentenced to life imprisonment\(^{20}\) by the Guangzhou Intermediate People’s Court, due to the theft of approxi-
imately $24,000 from a faulty ATM machine. This sentencing resulted in a flurry of media reports and criticisms on the internet in both blogs and chat rooms. It was generally viewed as an example of common people being punished harshly, while more powerful defendants are either not prosecuted or treated more leniently.21 In 2008, the life sentence was reduced to five years in prison, and the presiding judge in the case, Gan Zhengpei, specifically said that media and public opinion had been taken into consideration in sentencing.22

Putting aside all of the other risks I have outlined in this article, this issue alone (in the right circumstances) can, and will, challenge your public image and your ability to receive a fair decision in any court. It possibly could lead to the loss of any litigation anywhere in China.

Notes
1. Weibo is a new phenomenon that, despite their best efforts, is causing Chinese public authorities to struggle to stay on top of their censorship agenda. Weibo has now become the dominant player in the micro blogging landscape in China in less than 12 months. See, for example, http://wallstreetrun.com/china-web-users-hit-485-million-reuters-2.htm.

2. The corruption index referred to here is compiled by Transparency International and NGO based in Europe, and this index and the ranking is specifically referred to in Minkin Pei. Corruption Threatens China’s Future, Carnegie Policy Brief (October 2007).


7. Referring to US-licensed attorneys and judges here with the use of “our.”

8. I use this term very generally here based upon concepts in the Model Rules of Professional Responsibility, rather than as a reference to any ethical obligations applicable to any particular US state.

9. The new UK Bribery Act came into force on July 1, 2011. This new act appears to be even more expansive than the FCPA and applies to any organization with a close connection to the United Kingdom or which carries on any business in the United Kingdom. This new act (in some instances) removes the need for enforcement authorities to prove conduct was either corrupt or dishonest; removes the need for the offending activity to have any connection to the United Kingdom; subjects companies to an unlimited fine; and individuals can be imprisoned for up to 10 years and/or an unlimited fine.

10. Offender in the Act includes liability for acting through a third party, such as an agent, consultant or even your lawyer ... basically any failure to prevent any company or individual providing services to your company from engaging in offending behavior. This is strict liability.


13. Deng Xiao Ping was the President of the CPC between 1978 and 1989 and is considered the instrumental force in reforming China from a planned economy into a market economy based upon socialist principles.

14. I would like to point out here that I am certainly not a sociologist nor do I profess to have any great insight into the workings of the human mind. I am simply outlining an issue as I see it, and clearly, other people may have different experiences or different conclusions.


16. As of the end of 2010, the number of internet users in China was estimated to be 457 million (including 294 million bloggers), which represents one quarter of the world’s currently connected persons. See: China Internet Network Information Society (CNNIC), CNNIC, 27th Statistical Report On Internet Development In China 12 (2011), http://research.cnnic.cn/images/h000/h12/attach20110121728520.pdf (in Chinese).

17. For more information on this, please see the AFP article located at: http://afp.google.com/article/ALeqM5j_RMPtP3PAeMDXI7qJTu9F8G.


20. Article 264 of China’s Criminal Code states that anyone who steals an extraordinarily large amount of money from a financial institution will face life imprisonment. At the time of the sentence referred to herein, 2007, RMB 30,000 to RMB 100,000 (approx USD $4,200 to $14,200) was considered to be an extraordinarily large amount of money. See generally: Tze-wei Ng, “Ugly Reality Puts Paid to Talk of Rule of Law: Miscarriages of Justice Mock Official Rhetoric,” South China Morning Post, Feb. 2, 2008, at 7.

21. No quotation intended here as this is just a summation of the feeling as espoused generally in the media reports.