

Demand letters matter in China

by Kelly Bai

While a common practice, many international businesses are skeptical about the use of sending a demand letter (or in China, "lawyer's letter") to an opposing party after a dispute has occurred. It is often argued that Chinese managers will just ignore such a letter; or worse, the letter could forewarn them on any actions that are being prepared. In practice, however, well-written demand letters can be of tremendous help in settling a dispute. In fact some international legal practitioners have observed that demand letters have a much greater chance of success than in most other jurisdictions, including in the United States (see www.chinalawblog.com: Cultural Norms As Law Enforcement Mechanism. Why Demand Letters Still Work In China).

Introducing demand letters

The demand letter refers to correspondence from a lawyer on behalf of a client, in which the payment or fulfillment of another obligation (e.g. continuing performance of a contract, ceasing to infringe IP rights etc.) is demanded. Further action is threatened if the demand is not met within a limited period of time. The demand letter usually states the facts relating to the issue at hand, and offers a legal analysis of the dispute issues from the lawyer's point of view, including a clarification of the legal basis (in laws, contracts) of the demands.

The best demand letters are brief and to the point, clear and convincing. As the object of the demand letter is for the opposing party (the recipient) to take it seriously, it should be issued by a law firm that can take further action, such as filing a lawsuit or applying for preliminary injunctions.

Where the counterpart is Chinese, it is strongly recommended to have the letter sent by licensed Chinese lawyers and in the name of a Chinese law firm (excl. Hong Kong law firm), and in the Chinese language; and it should be sent to the legal representative or senior management of the target company.

Benefits of the Demand Letter

The most common international trade disputes arise from just a limited number of causes, for example:

- I. the purchaser receiving goods that failed to meet the agreed quality requirements or specifications, or not receiving the goods in the right quantity (or at all); or
- II. the vendor shipped the goods as agreed, but the purchaser failed to make due payment in full.

Other disputes could relate to intellectual property, agency & distribution problems, and shipment costs. When issues arise, the disadvantaged party will often try to negotiate a solution first, but if these discussions drag on for a long time without a resolution, a more drastic step should be considered. While it is possible to immediately file a claim in court or arbitration, instructing a lawyer to first send a demand letter may be more cost-effective and could bring the following benefits:

I. Bringing the Dispute to the Next Level

Negotiations over a dispute often take place between the sales / purchase staff of the parties, however these persons often do not have decision-making power, and could have an interest in delaying the matter to avoid responsibility within their own organization. Sending a demand letter thus ensures that senior management is aware of the threat. This is important because senior management will be more sensitive to the threat of legal action, and may prefer to resolve the dispute amicably to protect future business opportunities.

Note that a demand letter in China still leaves ample room for the parties to negotiate a face-saving solution to the outstanding problems - which would be more difficult to reach once one of the parties files his claim in court or arbitration.

On the other hand, the demand letter remains a sign that the injured party takes the matter seriously and is willing to spend money to have the dispute resolved. This threat is much more credible coming from a lawyer than from a company's employee.

II. Helping Parties to Reach an Agreement

Another accepted function of the demand letter in China, and perhaps the most important one for many international businesses, is that it clarifies the dispute and - often - opens a new channel for negotiations. The Chinese litigation environment is often difficult and costly to navigate, with as particular challenge the high burden of evidence on the claiming party to prove its case. In practice, most disputes are resolved through a settlement: whether before a claim is formally filed, or even during litigation / arbitration. The demand letter can be the opening bid for such a settlement.

III. Extending the Time Limit for Proceedings

Where a dispute involves parties in different jurisdictions, it is common to see that the injured party takes a long time to consider whether or not to file a lawsuit or claim in arbitration, also because negotiations can be particularly cumbersome. Under the provisions of the PRC General Principles of Civil Law, a time bar will be interrupted by the receipt of a demand letter. In other words, sending a demand letter ensures that a new period of either 2 years (general) or 4 years (for international trade contracts)

commences before the injured party must decide whether or not to file a formal claim in litigation or arbitration.

IV. Fulfilling Notification Requirements

Under some contracts, an injured party has the obligation to send a notification to its counterpart. Some examples:

- to confirm an act of agency where such agency was not authorized;
- to claim the invalidity of a contract, or exercise a right to terminate the contract.

On the latter point in particular, Articles 93, 94 and 96 of the PRC Contract Law provide that certain contracts can be terminated by notice to that effect; in case the recipient disagrees, it should petition the court or arbitration tribunal within a certain time limit to confirm the validity of the contract.

Conclusion

The mentioned reasons, and the fact that instructing a law firm to review the case file and send a demand letter is relatively inexpensive, are generally sufficient for companies in a dispute to consider this option seriously. Some may argue that a business letter (i.e. issued by injured party directly) could have the same effect, however the lawyer's demand letter is a legal evaluation and risk assessment made



by lawyers based on their experience and professional knowledge; therefore it can be more effective in putting pressure on the recipient to compromise as long as the letter is well-written and contains convincing wording, logic and arguments.

At the same time, there are situations where a demand letter is not worth the limited cost. Companies should always assess the chance that a demand letter will be effective, whether to resolve the dispute or at least to be taken more seriously in negotiations. When making this consideration, one should always keep in mind the complexity of forcing a resolution through courts or arbitration, the demand letter is not easily ignored, and the fact that that demand letters do often help to resolve disputes in China.

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