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**FOCUS ON**

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## **In China, You Play By Another Set Of Rules**

When you are doing business in China, the rules, timing, manner and substance of your transaction are unique

*By Ashley Wald*

**A**s the entire world observed in August at the 2008 Olympic Games in Beijing, China has emerged with unparalleled force onto the world stage. Most businesses are aware of the lure of the Chinese market, and stories abound of unbridled opportunities and potential for financial gain. But with all great opportunities come significant risks. My experience practicing at an international law firm in Beijing, China, taught me first-hand that not every business can, or should, go to China. This experience also helped me gain some insight as to what any attorney advising a client about doing business in China should keep in mind.

### **Engage Competent Counsel**

If you are advising clients about doing business in China, it is essential you ensure that your clients engage with counsel that is able to handle both foreign (non-Chinese) and domestic issues, from drafting sophisticated agreements, often governed by laws outside of China, to submitting the right forms to the appropriate Chinese governmental entities and obtaining the proper licenses or permits. Because the quality and competence of law firms in China can vary tremendously an attorney should do appropriate due diligence about the law firms and the lawyers to whom a client is being recommended.

Large cities like Beijing and Shanghai have been inundated by foreign law firms (American, British, Canadian, and German, to name a few) that employ both Chinese and foreign attorneys, as do many well-established Chinese law firms. Many of the Chinese attorneys employed at either of these types of firms have obtained both a Chinese law degree and a degree from a foreign country, in particular from the United States (with a license to practice in New York or California). Either type can also provide a variety of corporate services to foreign clients. Keep in mind that foreign

firms are prohibited from actually practicing Chinese law, which means that even if you engage a foreign law firm, it is likely that a Chinese law firm will eventually need to be involved. For example, if you need a legal opinion, the Chinese firm will need to provide it.

## **Structure The Business Deal**

While China's legal system has rapidly developed to accommodate a tremendous influx of foreign investment, significant gaps in both the language of the laws themselves and their enforcement still remain. Chinese businesses are heavily regulated and there are various restrictions that foreign investors must be aware of. For example, China restricts or even prohibits foreign investment in certain industries, and the Chinese government exerts significant control over the flow of foreign currency.

Of particular concern to clients, the remedies that a foreign party can seek in the event that the Chinese party breaches an agreement are somewhat limited. For example, in the event of a breach, attempting to enforce a contract in a Chinese court can be a daunting task. The judges are not bound to any kind of precedent, and many foreign companies believe that Chinese courts are inherently biased against them. In the event that a judgment outside of China is obtained, it may not be possible to get a Chinese court to recognize the judgment, making it basically unenforceable. Good legal counsel can help protect your client at the outset, and good advice can help prepare clients in advance for legal realities that may be quite different from what they have experienced elsewhere.

## **Five Tips Will Help Prepare You To Do Business In China**

Here are a few tips for advising your clients about entering the Chinese market.

Before you make a deal:

Make sure that you and your client observe some of the most basic Chinese rules of business etiquette. For example, always present and accept a business card with two hands—and do not shove someone's business card into your back pocket! When dealing with a sophisticated entrepreneur, small gestures that demonstrate a basic understanding of what is considered polite can go a long way towards impressing potential business partners and can distinguish your client from competitors. When working with a businessperson who has had less exposure to other cultures, observing basic rules of etiquette is essential to allow your client to get his or her foot in the door in order to begin to establish a professional relationship.

Do not assume that a business deal will proceed in the same manner as it would in the United States. The Chinese legal system is unique, newly-developed and constantly changing. In 2008 alone, the employment law in China and the entire tax code were both revised. In the field of foreign investment, various changes to the laws significantly altering the way that transactions must be structured have been going on since 2005. Your client should not be surprised if some things take longer to accomplish than expected, or are handled in a way that is different from what he or she had

anticipated.

## Negotiating the Business Deal

Maneuvering the Chinese legal system, whether to complete the paperwork needed to obtain a mandatory license or to ensure that one's employment contracts are in compliance with Chinese law, requires significant, highly-specialized expertise. Good legal counsel will not only be able to handle these tasks, but will also help your client understand the unique legal risks of doing business in China, including, for example, the risk of working with an ever-evolving body of laws (including laws that have retroactive effect). Counsel should also help your client to anticipate the sometimes vastly different understandings parties may have of the most basic business and transactional terms, including at what point have the parties reached an agreement, and whether a contract represents the beginning or the end of negotiations.

Do not underestimate the importance of good due diligence and reasonable time lines. I have seen many investors rush to complete a business deal with a Chinese company only to discover, too late, that the company had significant accounting, intellectual property, or other issues that could easily have been uncovered—and handled—with basic due diligence. One common phenomenon, for example, is that Chinese companies keep two sets of records, one for the authorities, and one with the "real" numbers. Practices like these, and the fact that most of the due diligence is conducted in Chinese, help to demonstrate the extensive time and effort that may be needed to do a thorough job investigating a potential Chinese business partner.

Be aware that corruption remains an on-going concern in China despite massive reforms undertaken by the government to try to eliminate the most abusive practices. The recent, terrible scandals involving baby formula or toys made in China highlight the extent and gravity of the problem of corrupt officials. Good legal counsel can help prepare clients to anticipate and avoid this, and similar problems.

My favorite adage about China is that the foreigner who travels to China for a week believes that he fully understands everything about the country. The foreigner who stays in China for a year thinks that he knows a little bit. And the foreigner who lives in China for decades recognizes that he does not understand China at all, but certainly enjoys trying! In other words, while many aspects of doing business in China are similar to those in other countries, China presents some unique challenges, and clients need to be fully aware of these.