

# BECKER MEISEL ATTORNEYS AT LAW

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## Planning for Successful Business Transactions in China

Livingston, N.J., February, 2014 – Preparation in the commercial exchange process followed by a well-designed and enforceable contract increases the likelihood of success when dealing with commercial counterparts in China. Despite how deeply intuitive this statement is, a significant number of US-based parties fail to live up to this goal, exposing themselves to unnecessary risk.

As in any economy, the legal, regulatory, and commercial environment of China has unique characteristics. Successful or experienced commercial parties in China are likely to have an organic awareness of these characteristics, whereas non-Chinese parties are likely to be unaware; making errors that are painfully obvious in hindsight.

*“A well-designed contract can become a platform from which to mitigate risk and establish and maintain a healthy commercial relationship with your counterpart in China.”*

A well-designed contract can become a platform from which to mitigate risk and establish and maintain a healthy commercial relationship with your counterpart in China. If used properly, it can also serve as a tool to conceptualize the

commercial exchange, set the tone of a commercial relationship, better understand the counterpart, and a go-to mechanism to enforce and protect rights.

### PREPARATION

Parties should understand and assess the detailed elements of the commercial exchange prior to entering negotiations. Considerations include steps in the commercial exchange, regulatory compliance, intellectual property, enforcement, and due diligence.

#### Steps in the Commercial Exchange

Clear understanding of the steps in the commercial exchange will discipline parties to conceptualize the respective obligations and risks inherent in each step. Thus, parties will make better decisions about how to allocate and mitigate risk – e.g., how to place an order to ensure there is written evidence of what was ordered, when to agree on an inspection agency to ensure inspection reports are available as evidence. The conceptualization of the commercial exchange builds the framework for subsequent negotiations and drafting.

#### Regulatory Compliance

Commercial exchanges often intersect with regulatory issues. It is important to know about such intersections in advance, and to discern when a counterpart is strategically claiming there is a regulatory issue, but is actually camouflaging a commercial issue as a regulatory one in the hopes of forcing the agreement. In multiple

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occasions a potential joint venture partner insists on using a form joint venture contract issued by the local approval authorities, insisting that only such form contract will be valid. Although this may have been the case two decades ago, it is not the case today.

### Intellectual Property

A commercial exchange exposes trademarks, trade secrets, and other intellectual property to many other parties. Parties should consider measures to secure relevant intellectual property prior to entering into a contract, and even prior to engaging in dialogue about the contract. For example, it is critical to register your trademark prior to engaging a factory to provide original equipment manufacturing (“OEM”) support for your branded product. If not, your OEM manufacturer may be the first to successfully register the trademark in China and, thereby, be the only manufacturer with the exclusive right to use such mark in manufacturing in China.

### Enforcement

Assessing enforcement at the outset of a commercial exchange may seem unduly pessimistic or fraught with self-fulfilling mistrust; nevertheless, an experienced party will soberly assess the comparative power of the contracting parties (e.g., a small private company and a regionally influential state owned enterprise; methods to identify assets of the commercial counterpart; distinctions between relevant courts and arbitral bodies; forum shopping; governing law; governing language; documentary evidence). An early and robust focus on all the mechanisms and instruments needed to make enforcement a likely scenario molds the treatment of the entire commercial exchange.

### Due Diligence

Parties should conduct due diligence on commercial counterparts before entering into negotiations, or even before drafting of the agreement. Due diligence in the China context may involve confirming proper registrations, business scope, business license, seals, and binding signatory. Additionally, it will involve confirming ownership of assets that may become relevant to enforcement, as well as the reputation of your commercial counterpart.

## **NEGOTIATION**

Negotiation and discussion of key contract terms is not only essential to develop an effective written document, but can also be an indicator of the tone of the commercial relationship. A non-Chinese party that demonstrates strong awareness of China’s legal, regulatory and business environment during negotiation lessens the perceived power disparity that may exist between it and a party that has organic knowledge of China. This can be critical in setting a healthy, balanced relationship. Additionally, how a party engages in the substance of the contract can be an important indicator of its intentions. Business-savvy parties welcome negotiation as a method to better understand and add depth to the ongoing commercial dialogue.

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## **DRAFTING**

Clear drafting enhances the value of any commercial contract; however, the importance of drafting takes on added significance in the China context due to considerations such as bilingual documentation, preferred governing language, and the common practice of courts adhering to literal interpretations of terms and conditions (without taking license to add terms and conditions that may be customary in other jurisdictions).

## **EXECUTION**

A properly executed contract prevents the counterpart from raising a technical defense of non-formation. In China, written contracts are valid when signed by each counterpart's legal representative and sealed with official company seal. Therefore, the signature and seal information gathered during the due diligence process must precisely match that in the contract (as should the registered name of the commercial party, the registered address, etc). Additionally, if the content of the contract is of sufficient importance, parties may consider investing in resource-intensive notarization, which ensures admissibility of the agreement as evidence in court or arbitration.

In sum, U.S. parties should consult with the proper professionals early on in the process when considering undertaking commercial activities in China. Understanding the commercial exchange process and the requirements of valid enforceable contracts in China are vital to the success of any venture by U.S. parties transacting business in China.

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