How to Manage a Dispute in China

By Randall Lewis

Managing a dispute in China begins long before a potential issue arises. The key for any foreigner doing business in China is to be prepared and appreciate the cultural, historical and political differences that create an interesting, if not challenging, business landscape. This article offers practical tips to assist you in tackling a China-based dispute or, better yet, avoiding one altogether.
Seek balanced legal advice when entering into any deal

When entering into any contract involving China, especially one involving a joint venture or intellectual property, seek out balanced legal advice. Breaches of contract in China are inevitable. Therefore, when you enter into a deal using only the services of a corporate attorney, you may not be getting the advice you need on how to prepare for potential litigation. When doing a deal in China, you must always view every provision from the aspect of litigation risk (a key component is negotiating an offshore [non-China] dispute resolution mechanism, i.e., arbitration in Singapore, Hong Kong, Sweden, etc.). Corporate M&A counsel may not always view your contract from this perspective. As a result, if you do not have an extensive litigation background yourself, I always advise that you run any contract (in the process of negotiation) by litigation counsel for a quick opinion.

A quick example will illuminate part of the issue. Last year, I was negotiating a joint venture in Asia (not China) and faced an issue over what should have been a routine provision. I was negotiating a deal where we would have an evenly split board and a 50/50 shareholding structure. I drafted a quorum provision such that if a quorum was not reached after three validly called meetings were attempted, then a quorum would be achieved at the fourth validly called meeting if three out of the six total directors were present. The opposing attorney explained that never under any circumstances could a quorum be achieved if one of their directors did not appear. I explained that in China, protracted litigation ensued because one shareholder’s appointed board members refused to attend validly called board meetings, effectively preventing a quorum from being achieved indefinitely. This nullified

exclude any prior discussions not specifically outlined in the agreement. This may work in countries applying common law principles but is not entirely effective in China, a civil law jurisdiction. The Chinese view a contract as an evolving document, and the way they behave post-execution will likely reflect what they subjectively view as “the deal” and not what was signed.

Proper internal corporate governance of your partnerships

• To minimize disputes, establish a system of checks and balances to enable an effective separation of power between the board of directors and general management of your business. In China (as well as in other Asian countries), it is not uncommon to entrust your partner to run and operate your business. For example, if your joint venture partner has appointed their general manager (GM) (regardless of your involvement in the initial choice), and that GM, who happens to be a “bad actor,” is tasked with reporting financial data and performance results to the board, the board cannot effectively review and challenge management decisions. In short, always ensure that you have trusted employees in your business

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THERE WAS MOLD. THERE WAS MILDEW. THERE WAS SCUM. IT WAS DISGUSTING.

The documents we needed for our case had been sitting in a damp warehouse basement for decades. They were foul and contaminated. They had fumes that made them unsafe. Did it gross us out? Yes. Did it stop us? No. We got rubber gloves and masks. We wore coveralls and goggles. We used lab hoods and respirators. Then we sorted through the rotting paperwork and we cleansed, dried and pieced things together. In the end, we were able to resolve the case for our client.

Usually, that calls for a celebration. In this case, it also called for a long, hot shower.

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The Golden Rule is this: Settle. You have very little to gain in seeing Chinese litigation through to a decision and into the process of possible enforcement activities. Don’t be emotional — just find a mechanism to settle.

who are actively involved in day-to-day operations, and that those employees regularly report back on the happenings on the ground.

- Constantly monitor and update all intellectual property rights to ensure that all registrations and assignments are legally completed and approved by all governmental departments. Do not completely entrust your Chinese partner to ensure that all of these matters are completed.

- If R&D is a key component of your business growth, work with an R&D facility separate from your joint venture. In other words, do not include R&D inside of a joint venture. It is always risky to allow your joint-venture employees (or wholly foreign-owned-entity employees for that matter) to do things the “Chinese” way (i.e., emphasis on guanxi, gentlemen’s agreements and to enter into business decisions on an informal basis without proper documentation).

- Conduct ongoing investigative due diligence (DD) on your Chinese partners. Investigative DD is different from standard legal or operational DD. When in China, you need to regularly conduct searches at the various Administration for Industry & Commerce (AIC) offices to discover (as one example) entities that are competing with your company by using your trade name as part of their own name.

- Another goal of investigative DD is to check the ownership structures of competing companies to see if there are any connections with people running or operating your own businesses. Unfortunately, it is not uncommon in China to be competing against your business partner and have no idea you are not dealing with legitimate third-party competition. In my experience, even conducting regular AIC checks is not in itself enough to minimize the risk in this area, as many people in China are quite sophisticated at using offshore holding companies and straw men to obfuscate their ownership of various entities for both legitimate and non-legitimate reasons.

- Be sensitive to the local corporate culture, but ensure that your expectations regarding how a business operates is aligned with the actual practice on the ground. It is always risky to allow your joint-venture employees (or wholly foreign-owned-entity employees for that matter) to do things the “Chinese” way (i.e., emphasis on guanxi, gentlemen’s agreements and to enter into business decisions on an informal basis without proper documentation).

- Keep in mind that it is common for employees of your joint venture, who were previously employed by your partner, to be previously unexposed to Western-style management processes and procedures. Anti-foreigner sentiments can easily be created among your joint venture’s employees to the benefit of your partner. Therefore, implement training seminars and conduct internal PR for your company in relation to Chinese employees.

- Create a small team to fully discuss brewing problems with your board members so that you can develop strategies early to approach and discuss concerns with your joint-venture partner.

- In-house attorneys not only need to act as consultants to board members on legal issues, but they must also act as a sounding board for strategy and guidance on relationship management.

- Do not rely too heavily on financial or management data specifically prepared for the board by your joint venture partner.

- Ensure that you are properly documenting and recording any and all variances from contractual and legal obligations.

Managing a dispute in China should one arise

This section offers my insight into how to manage a dispute in China should one arise. While there is certainly no one-size-fits-all panacea, if you at least consider the issues I point out below (which are primarily based on facing large-scale, high-dollar, complex disputes), you may find yourself better positioned going forward.

The Golden Rule is this: Settle. You have very little to gain in seeing Chinese litigation through to a decision and into the process of possible enforcement activities. Don’t be emotional — just find a mechanism to settle.

The following tips are designed to facilitate settlement discussions, and to motivate a Chinese party to actually desire sitting down at a settlement table.

If a dispute arises, try to get a good feel of your counterparty as soon as possible. Don’t assume they will approach the issue from the same
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— John Scanlon, Attorney, Axiom

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perspective. Ask yourself (and your business team) what is their motivation: Is it money or is it personal? Is there any underlying concern that can be addressed? Is there a genuine desire to settle from the other side? Is there any scope to salvage the relationship?

Take active steps to manage the dispute immediately to avoid letting it get out of control. Conventional wisdom is to slowly escalate the dispute from transactional team to senior management, and then to in-house and external counsel. However, it is best to take control (from a legal perspective) earlier to obtain an accurate assessment of the merits and the scope of the problem. The real goal in many instances is to salvage a relationship and to use caution that a commercial/business relationship is not strained to the extent that it is all but impossible to bridge the gap between the parties before you develop and implement a plan to amicably (and privately) resolve your conflict.

Problems in China are larger and more complex than they first appear. It is nearly impossible to negotiate a real resolution until you understand the scope of the problem. It is quite common for sophisticated Chinese parties to use offshore entities, friends and associates to compete against your venture, or to take actions that they themselves may not be contractually able to take. For example, you believe your partner is in violation of a non-compete obligation, and you identify one or two companies associated with your partner to establish this fact. If you negotiate on the basis that there are only two competing entities when, in fact, there may be 20 scattered throughout China (that are managed or controlled by your joint-venture partner), you have no effective way to negotiate. If you end up in litigation (which happens) and your goal is to eventually enjoin the infringing activities of all illegally competing entities (exploiting your trademarks, violating your IP or which are operated by your JV partner), at best, you will only achieve part of your goal if numerous entities are not covered by a judicial decree or judgment.

To grasp the scope of an issue (and to determine if you are dealing with the right people to resolve your issue, which is not easy in China), you must conduct an in-depth investigation prior to alerting the other party that a lawsuit or arbitration is pending. Preparation is absolutely key, because once proceedings are commenced in China, there will be a tight timetable, no discovery, limited or no access to witness evidence, and limited or no cross examination. It is highly likely that your only chance to go through a discovery process is to conduct an initial investigation prior to those avenues of investigation being "closed."

You will need to immediately hire and retain both an investigator and an accounting firm (sometimes, they can be one and the same, depending on your scope of investigation), to achieve the following. Note: This is a non-exclusive listing, which is highly dependent upon your particular circumstances.

- Search all AIC records in a large selection of provinces in China where you believe infringing products or activities are taking place, to uncover competing entities and their shareholding structures;
- Conduct a market analysis of products on the shelves in various locations and the source of those products;
- Conduct internal and external investigations on the financial data surrounding your business, and a re-analysis of production data (raw material purchases, utilities, etc.) versus sales and market penetration;
- Conduct a full investigation of your potential adversary;
- Create a relationship chart to show connections, both familial and business, between your joint-venture partner and all related persons and entities that appear as shareholders on the various AIC records you have previously recovered (it is not uncommon to uncover raw-material suppliers to your venture that are connected to your Chinese partner or his family);
- If necessary (and it usually is), conduct an offshore investigation to follow the ownership chain of discovered offshore entities and the physical location/nationality of people associated with those offshore entities; and
- Conduct an analysis of the financial data disclosed on the AIC corporate records (typically, this indicates

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gross sales reported for tax reasons and is usually unreliable as there are sometimes two sets of books. This financial analysis, if compared to your known cost of goods sold, can give you a rough idea of the scope of infringing sales of competing entities.

Following your investigation, consult with Chinese and foreign litigation counsel about all litigation options. If you have uncovered a “network” of infringing activity, your litigation options may be much more extensive than just launching a suit under one joint venture agreement. Develop a global “potential” litigation chart that brings everyone possibly involved in the wrongdoing into the matter.

Guanxi is a key tool for Chinese to obfuscate, diffuse and deflect (as that relates to business associates and partners as the notion of guanxi extends much deeper than most people realize). As guanxi is based upon relationships, one of your litigation strategies is to upset this personal network of acquaintances such that everyone scrambles at the same time. If, for example, you uncover a network (which is in effect a relationship network) of individuals or companies owned/controlled by identified individuals, and you launch lawsuits against everyone in the network on the same day, the pressure on the key player to negotiate a settlement will be much greater than if you simply launch one lawsuit under a single breach of a joint venture agreement. Completely upsetting the guanxi network will result in the application of a great amount of pressure and more likely lead to settlement.

If, during and after your investigations, you have not been able to facilitate genuine settlement discussions, be prepared to launch all possible lawsuits in order to facilitate the desire to settle. However, a word of caution: Only launch those lawsuits that are supported by the law and the facts, and which you believe you have a real chance of winning. The Chinese media can be ruthless in their criticism of foreign companies and negative media reports in China can cause an immediate drop in sales if you are in (for example) a consumer goods business.

Other tips include:

- Use caution when you negotiate. The concept of “face” is still important to Chinese parties, and foreigners who fail to appreciate this find it impossible to reach an agreement. You must also be aware of negotiations turning sour and the Chinese party taking it personally.
- Instead of using the original business team, consider using a new team to try to negotiate a settlement. There may be historical animosity between the original team and the counterparty, which may prevent a productive settlement discussion.
- Do not be overly fixated on your point of view or approach (do not focus only upon the written contract) but look at matters from the other side and see if any compromise is possible. Sometimes (I know this sounds simplistic, but it is true), all the counterparty requires is an acknowledgement that its position is legitimate, which may pave the way to a settlement.
- Do put in place a proper media management team to deal with potential media leaks, which will include understanding and communicating your corporate guidelines for media communications internally.
- Last, use caution when developing your overall negotiating strategy and analyzing the data from your investigations, and consider whether you are negotiating with the right person to resolve your problem. Sometimes, this may be the toughest issue you face.

Similar to many countries in Asia, China is fraught with potential litigation risks. A business’s financial success is one of the greatest risks to both its business and contractual enforcement effectiveness in China. Therefore, it is my belief that if a foreign business understands and preemptively manages other risks prior to a China-centered dispute arising, both the business and its legal counsel will be better positioned to minimize the disruptions to business, management and the bottom line. ACC

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We make sure you’re ready. Before you even realize you need to be.

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* IT IS A FAUX PAS IN CHINA, TO STAKE CHOPSTICKS IN A RICE BOWL. THE ACT SYMBOLIZES DEATH.
30-SECOND SUMMARY Western companies entering Asia for business should consider the following. Always try to privately negotiate a settlement. There is nothing to be gained by following arbitration or litigation through to a decision or judgment with the intention of enforcing that award. The mediation route is the most recommended course of action because it preserves long-term business relationships. Personal relationships are more important to your business success than any written agreement and should not be underestimated. Because relationships can take time to foster, recognize that deals in Asia take longer than in many Western countries. Never force a deadline if things are generally progressing forward.

WHAT YOU NEED TO KNOW ABOUT

Doing Business In Asia

By Iohann Le Frapper and Randall Lewis

Between the two us, we have over 25 years of legal experience in Asia, specifically China. Over the years, we have both witnessed avoidable and costly mistakes made by very savvy Western business leaders in regard to their businesses throughout Asia. The missteps and errors are continuing to this day, and it seems as though several Western companies are still entering into Asia with their eyes wide shut due to either over-exuberance or simply poor advice. Whatever the cause, we both felt the legal community would benefit from a simple checklist of considerations and concerns (and of course, our pointed and wise advice) that your company (and its operations) will face in any Asian nation. While this listing does contain some generalizations, the benefit of this listing is to save you the trouble of ferreting out the same takeaways gleaned from 20+ lengthy articles.
Avoid signing any agreement, whenever possible, that provides for local litigation or arbitration (e.g., CIETAC) in mainland China (with some minor exceptions not discussed herein). While we will admit that the implementation of the rule of law and the judiciary in China is improving, the system is still fraught with non-standard behavior that results in arbitral and judicial decisions based upon factors not associated with your written agreement. In our experience, for low-dollar disputes, disputes that do not implicate any State interest and disputes that have very low public interest, fair impartial decisions can be rendered in a Chinese court or through CIETAC arbitration. When entering into a contract, the basic assumption is that you will be a success and your venture will be wildly profitable. Therefore, there is no reason to contractually subject yourself to a dispute resolution mechanism that could destroy the basis of your bargain. Arbitrating in Singapore (SIAC) or in Hong Kong (HKIAC) is always our preferred dispute resolution mechanism and the enforceability of such arbitral awards in China is well established.

Don’t assume that the agreement you have signed will be interpreted or enforced as written. In many Asian countries (China in particular), contracts are interpreted based upon course of dealing, taking into account the evolution of various external factors. Remember that your contract is only your understanding on the day of signing, and not on the day you sit down to resolve a dispute. Any informal waiver or deviation in practice from the initial terms of the agreement, which is not rare, is likely to have very significant weight on the future interpretation of the deal terms. Betting that you are better off not to memorialize such variation may cost your company greatly the day you opt to revert back to the initial terms of the agreement.

Always try to privately negotiate a settlement. There is nothing to be gained (in most cases) by following arbitration or litigation through to a decision or judgment with the intention of enforcing that award. The mediation route is the most recommended course of action, particularly for preserving a long-term business relationship and everyone’s corporate reputation, although outside counsel may have a different position (often driven by self-interest). In other words, the litigation route implies that the company (and not a manager for a matter of principle) has come to the conclusion that there will be no further business dealings with that partner, vendor or customer.

If you negotiate contracts and agreements as you would back home (i.e., creating lengthy documents that cover any and all contingencies), you may unintentionally alienate your new business partner and start your commercial relationship off on the path to failure. Further, a few months after a strategic deal has been signed off, taking the stance that your Asian partner can only blame itself for having accepted unfavorable terms and conditions (e.g., arguing that they should have read carefully all exhibits to the main body of the agreements prior to signing off on the deal) can be tempting but may not pave the way to a successful and sustainable relationship. This might sound odd, but it is true: You cannot assume that people in Asia (China in particular) have read and understood all the terms and conditions contained within a contract. It is possible, even today, that key people sign contracts in China based upon mutual trust rather than a careful reading of an agreement.

In most developing nations, personal relationships are more important to your business success than any written agreement. That having been said, great agreements are always doomed to fail if you do not take the time to build real and long-term relationships with your local partners. For example, if you believe that it does not matter that a deal is mutually beneficial to both parties as long as you manage to impose your terms and conditions even to the detriment of your Asian counterpart’s interests (e.g., “We won and they lost”), your company may encounter some serious difficulties at a later stage. Your short-term business win or your one-off successful M&A deal may not compliment the strategic goals of your company in a specific market, especially if it...
Deals in Asia often take much longer than you will expect. Never allow your internal financial or strategic goals to drive artificial deadlines to secure agreements or close deals. Cool down the expectations from senior management about the realistic timeline of deals in Asia. Long-term costs may greatly outweigh short-term gains. In our experience, quite a few Western companies have paid a high price in making hasty, last-round concessions that significantly reduced the profitability of the business or the protection of their technology crown jewels, simply because the time pressure was too high to close negotiations in line with senior management’s expectations. For in-house counsel, the challenge will be to manage commercial expectations and offer clear explanations of risks should a transaction be accelerated.

• It is usually a good long-term strategy to make concessions in the interest of preserving a commercial or business relationship, even if such an accommodation would not be proper in your home country. Aggressiveness and strict adherence to contractual compliance in Asia can sometimes alienate your business partners and result in bad publicity that harms your ability to secure future relationships. However, each side should make concessions to reach a win/win trade-off outcome. But keep in mind that making any unilateral concessions may not lead to gaining any respect or future return from your business partner who might believe that you are just a fool.

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• Companies in Asia who face less short-term pressure from their shareholders, and often focus more on their long-term strategic plans, can be extremely skillful in their negotiations. This is very pronounced when those same Asian companies are negotiating with listed entities in the United States or Europe that must deal with financial disclosure and market expectations every three months, and may be under pressure to close deals or agreements on set timelines.

• In a nutshell, everything in Asia takes longer than at home. Use caution when setting deadlines and expect unforeseeable delays. Never force a deadline if things are generally progressing forward.

• If your business becomes profitable, use caution to ensure that your local partner is not privately manufacturing ways to rebalance the financial landscape in a manner that fits their idea of fairness (i.e., look at your suppliers, raw material purchases and competitors to ensure they are not connected to your partner or his family/friends). In short, do not assume that because you are profitable that your local partner is necessarily satisfied with his revenue stream.

• Business success in Asia is measured by your public image, and not only by your gross revenue or sales.

• Financial projections in China and some other Asian geographies (excluding possibly Hong Kong or Singapore) are just projections. Take them with a grain of salt. If you want profitability, create a good market-entry strategy that focuses on gaining brand recognition and good support from your strategic partners. Instead of focusing on a financial target, set market and soft factors as measures of success. If you are entering into any new foreign market, you need to think long term, rather than only two or three years out.

• Train, monitor and guide local agents closely, and do not assume that their motivations are aligned with your obligations in your home country and your internal policies. Sometimes, people who promise success due to their local connections will expose you to US Foreign Corrupt Practices Act and UK Bribery Act violations, and possibly violations of local laws as well. Use caution when dealing with local agents and employees.

• Training of local employees with regard to your preferred business practices is important. Local employees who are aware of your internal policies may not always understand how to implement them or understand why they exist. This is especially true in China (for example only), where it is possible that some of your employees may never have been exposed to foreign management or foreign companies. They may continue to do business on the basis of gentlemen’s agreements and in a non-standard manner that exposes you to risk.

• Do not assume that local employees understand your employment manuals or other policies, which should also be available in key languages where your company operates. Always conduct training
Don’t assume that because local government officials, officers or people are friendly that they will support you or your business.

programs for all levels of staff, including local general managers, business partners and senior executives. Deliver your trainings (face-to-face or online) using the audience language as much as possible. For example, a training in English for the benefit of your Chinese staff will not be as effective as a training in Mandarin (the same is true for back-up slides).

- When creating important policies — the violation of which can have a huge financial pain (FCPA, UK Bribery Act, competition law, antitrust issues) — circulating these policies and conducting training programs is not enough to ensure people really understand. Create mini quizzes that are sent to all staff, along with a confirmation upon completion. This is the only way to really ensure that people have not only read the policy but have also been forced to actively think about and consider real-life scenarios in practice. Last but not least, face-to-face trainings are by far more effective than online trainings, as they enable people to speak up and share their experiences and specific dilemmas.

- Don’t assume that because local government officials, officers or people are friendly that they will support you or your business. Being friendly is far from being supportive. Local protectionism is also alive and well in Asia (but, of course, not specific to Asia). Do not be lulled into thinking your business or staff is somehow immune from this reality.

- Always ensure you have in-house regional counsel with experience in dispute resolution. This does not mean litigation experience. The keyword here is “resolution” and not litigation.

- Always have a good corporate social policy and programs to help disadvantaged people in your key countries of operations. In many Asian nations, the concept of charity or social activities by local companies may be lacking (although one could list quite a few local companies may be lacking of charity or social activities by most of society to either act or refrain from acting (as the case may be) based upon that personal relationship. The label “corruption” is not entirely accurate in this context. For the sake of clarity, guanxi may have positive or negative bearings depending on the circumstances in which one person is leveraging his network, what is the goal (legitimate or not), which favours are sought, etc. Please see the article in ACC’s March 2013 Asian Briefings titled, “Clarity on Guanxi, Cultural and Media Issues in China.”

- Creative structuring of a business or acquisition may look great on paper. However, no matter how beautifully structured your deal is, it is doomed to fail if you do not have trusted employees and management in your business with the right to influence and control decisions on the ground. We would rather have an inefficient corporate structure but great board and management control of operations.

- Competition is fierce in Asia. Do not underestimate the power of existing players to take unexpected action in order to force you out of the market or to make your business more challenging (e.g., artificial manipulation of the media and online discussion forums,
customs inspections, regulatory inspections, visits from tax officials, compromising your employees, industrial espionage, etc.). Also, don’t assume that your competition is legitimate. It is also possible that some of your employees or their friends/relatives may be invested in, control or manage your competition.

- Always have in place a good government relationship team that is regularly reaching out to key government players in your industry. However, do not assume that government lobbying alone will result in the alleviation of any of your legal troubles in any Asian country.

- Always have in place a good media management team that is well versed and prepared to assist in the event your company finds itself in the press or the subject of local social media criticism.

- When in China, if a local government offers your business tax or other incentives, never assume that these are ironclad. Frequently, in second-, third- and fourth-tier cities, local officials will grant promises and incentives that are not supported by PRC laws or regulations at central level. If the local officials are shuffled or certain inspections take place, you will not be able to rely upon concessions granted which were not supported by national policies at the time granted.

While our listing of advice and considerations may appear daunting, do not fret. Asia is an amazingly exciting place to do business, and even though fraught with hidden risks, those risks are relatively containable with a little forethought, planning and management. Please do not hesitate to contact either of us if you have any further thoughts on this article. 

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Companies seeking to expand operations in Asia should consider the unique aspects of hiring senior executive staff able to navigate the Asia Pacific market. Staff should understand the broad range of differences among countries and regions that may be close geographically but are worlds apart in terms of local practices and laws. For example, Hong Kong is not the same as mainland China and fluency in Mandarin or Cantonese does not equal an understanding of local culture and business practices. A cross-cultural mindset can make the difference between success and failure for regional staff.
In today’s global marketplace, entering into Asia is not optional if a company desires to access a booming consumer market, seize new growth opportunities, compete with both existing and new Asian-born competitive threats, and most important, satisfy its shareholders. In fact, it is quite rare to run across a senior executive in any major corporation that does not have a strategic plan to expand operations into Asia or, more specifically, China.

Putting commercial issues aside, the key to a sound Asia-Pacific market-entry strategy is to ensure that you hire and retain the right staff. At this point, most of you will probably be thinking that you understand staffing and retention issues and that your human resources department certainly is adept at this task because they do quite well in Europe or North America. However, after many years of working, living and facilitating business operations throughout numerous Asian countries, we have a unique perspective to share on hiring and retention in Asia that probably differs significantly from what you (or your HR department) may be expecting.
Some thoughts to consider:

- Look to hire and retain staff possessing a broad base of experience in various markets (not just China) and with a verifiable track record of navigating different cultures. Do not assume that all Asian countries’ business, commercial and legal practices are homogeneous. There are vast differences between deals taking place in Korea, China, Japan, Hong Kong, South East countries (e.g., Vietnam and Thailand) and India. Just because they may look close on a map, geographically speaking, they are vast worlds apart in terms of culture, politics, local practices and law.

- Hong Kong is not the same as mainland China (i.e., it is one country with two very different legal systems). Do not make the mistake of believing that because someone has practiced law in Hong Kong — and that they speak Cantonese and/or Mandarin — that they understand the unique risks and strategies required to be successful in the mainland.

- The talent possessed by your local or foreign corporate counsel is certainly important. However, personality, international experience and cross-cultural mindset will eventually make the difference between success and mediocrity (or failure) in a regional legal role.

- Due to high demand, it is questionable to assume that the company will achieve cost-savings by hiring a local corporate counsel instead of an expatriate seconded from the United States or Europe. Indeed, the “local compensation package” expected by a very senior Indian or Chinese corporate counsel may not only consist of a generous market-driven basic compensation (in line with US peers), but also of benefits similar to those of an expatriate. Further, the long-term retention of local talent, and corresponding loyalty to the corporation, is quite problematic as the churn-out is very high in countries like India or China. (It is very common for Asia-based in-house counsel to change jobs every two years, and to seek recurring and significant salary increases that are difficult to grant internally.)

- Do not fall into the trap of believing that fluency in a certain language is the key to success regionally or in any particular market. It is more important to secure talented professionals who understand the cultures and business practices, and can strategically navigate the market. Just because your Chinese senior counsel has great China experience or language skills (i.e., Mandarin as a mother tongue), and China is your main market in Asia, does not mean that appointing your Chinese legal counsel as the legal head for the Asia-Pacific region is the best decision. If she out performs on China matters, it is not guaranteed that she will also be effective in any other Asian country. In fact, in most instances, you can assume they will not be as effective. Her staff members in India or Japan may not necessarily enjoy (or worse, may resent) following the advice or instructions from their Chinese boss for a variety of reasons (e.g., historical, geopolitical, management style, etc.).

- Rotating expats to Asia who have no prior experience in the region will certainly cost you in terms of efficiency and risk. Always look for people who have a proven ability to live and thrive in Asia, where one must accept that either the regulatory framework and/or the inconsistent enforcement of the laws and regulations give rise to numerous uncertainties. The ability for corporate counsel to deal with uncertainty and recognize, on a day-to-day basis, that Asia is not a risk-free business environment is essential. It is an obvious statement that reality is neither black nor white; however, corporate counsel are faced with a wide and challenging scope and breadth of gray areas in Asia (compared to North America or Europe).

- In order to be successful, you need to retain your senior managerial staff long term. Rotating senior-level staff in and out of a country or region within periods of two or three years may satisfy the HR corporate policy, but may often result — in addition to an unquantifiable loss of capital knowledge — in a loss of key relationships within the company and with outsiders within the company’s ecosystem. (Relationships in Asia are of utmost importance to your financial success, and take time to build and nurture in order to develop the critical trust between individuals.) Such strong rotation could also
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create a situation likely to lead to a greater risk of financial loss (e.g., breached agreements and poor relationships with employees and business partners, etc.).

- You can send the most brilliant people out to China, Hong Kong or Singapore only to find that they never really adjust to the local culture and practices, or that their families are unsatisfied, all of which create a challenging atmosphere at work and/or a desire to leave the region. Turnover at your senior regional-managerial level (GC and AGC included) will cause more commercial turmoil than you can at first imagine. For example, as the retention of your Indian or Chinese legal team members can be quite challenging in any event due to strong market demand, the loss of your regional legal leader who has developed a personal connection with them (i.e., coached and mentored them in their professional development and supported their internal mobility) may result in additional future losses to your entire legal department. In short, to secure the medium-term loyalty to the corporation of key country-specific counsel, avoid having a "ballet" of new regional managers every two years.

- Just because a candidate is a well-educated local, does not mean that she is the right fit for your business. Having studied in one of the best schools in the United States or in Europe does not mean that your local employees will not be tempted or feel obliged to accept or recognize that the old-fashioned ways of doing business are unavoidable once back in their home country. Understanding how business is typically done in a particular country and culture is one thing; blessing unethical, if not illegal, business transactions on the ground is an entirely different matter. For example, doing business with a supplier who happens to be a relative or friend is not perceived negatively in many Asian nations for cultural reasons. It may well be reassuring for the individual you have tasked with procuring goods or services (such personal relationships may be a safeguard against unknown, and thus untrustworthy, counterparts). However, such business dealings may fall well short of meeting corporate standards and policies about avoidance, or at least clearance, of conflict of interests. It may well be reassuring for the individual you have tasked with procuring goods or services (such personal relationships may be a safeguard against unknown, and thus untrustworthy, counterparts). However, such business dealings may fall well short of meeting corporate standards and policies about avoidance, or at least clearance, of conflict of interests.

- Do not believe that "Asian experience" gained by remotely managing deals from London, New York, Los Angeles or Paris translates into someone who can live, thrive and be successful in any Asian nation. It is also astonishing to note how quite a few companies still remotely manage their operations in Asia, while assuming candidly that their internal controls are up and running smoothly without proper qualified and experienced corporate functions (legal and finance) located in the region itself, and without close watch on the business operations (sourcing, manufacturing, R&D, sales and marketing). By the same token, it is our strong opinion that any corporation is unlikely to generate profitable and long-term sustainable business results if the corporate counsel looking after Asia-Pacific sit comfortably at headquarters and travel to Asia, if and when required, even intensively. The wake-up call might be extremely difficult to digest.

- Long-term success in Asia is possible if you have the right senior staff who understand that maintenance of various relationships is just as important as your financial bottom line … they are connected.

- Always have in place a solid international corporate generalist who understands various countries and cultures. This goes beyond legal acumen into commercial and business areas. It is easy to hire a good transactional lawyer only to find that she is not adept at acting as a strategic sounding board for your senior management in the region.

In closing, remember, just because you can do something does not mean that you should. Hire wise senior staff who really understand this advice. **ACC**
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Clarity on Key China Issues All Foreign Companies Need to Understand

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I have lived and practiced law in Shanghai, China and throughout the world since 1997. I moved to China prior to its entry into the World Trade Organization (WTO) and prior to China’s full implementation of the Rule of Law. I was fortunate to have been in China to witness first-hand the birth and growth of the world’s most promising economic super power. I have seen phenomenal changes in the cultural, physical and legal landscapes of this country (and most specifically Shanghai where I have spent the bulk of my time) and greatly admire the tenacity, perseverance and cultural history of the Chinese people. Over the years I have been encouraged and optimistic at the reforms and progress that China has made in order to provide a safe investment environment for foreign companies wishing to access its markets and to do business in China.

That having been said, and even though I personally enjoy life in China, China is still fraught with significant risk. Risk of corruption, risk related to an inadequate legal system that is heavily permeated with barriers that heavily favor local citizens and local PRC entities, risks related to corporate fraud (which is endemic throughout Chinese business and political spheres), 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 (including blogs, especially Weibo\(^1\) which is in effect, the Chinese Twitter) manipulation of public opinion designed to interfere in judicial and arbitral decisions.

In today’s global business world, entering into China is no longer an option. If your company does not already have at least some business contact with China, it is most likely exploring the market for some future entry point in order to both increase its bottom line and to keep up with its competitors. It is for this reason that in house legal counsel need to understand and manage the practical risks confronting each and every deal or contact with China. All of these risks originate due to China’s unique historical, political, cultural and educational roots and this article is designed to briefly illuminate these roots, explain the risks and provide some guidance to better manage the same.

A Recent Event
A few days before I started drafting this article on July 23\(^{rd}\) 2011 (this article has taken quite a long time to complete, obviously), there was a horrible high speed train accident not far from Shanghai which took many lives and which succinctly provides a quick

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\(^1\) The rise of blogs, Weibo, is a new phenomenon where the Chinese public authorities, despite best efforts, are struggling 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](http://wallstreetrun.com/china-web-users-hit-485-million-reuters-2.htm)
snapshot of China today. On July 28, 2011, China’s Premier Wen Jiabao promised an
“open and transparent” investigation into the accident. However, this promise came after
a toddler was found alive in the wreckage following the Chinese rescue teams having
“called off the search” for survivors and just before workers mysteriously buried parts of
the wreckage without conducting any proper investigation. China Central Television
news host, Qiu Qiming, was then quoted as saying the following “Can you give us a glass
of milk that is safe?”, “Can you provide us a building that won’t fall?”, “Can you try not
to bury the carriages first when a major accident happens?”, “Can you give everyone a
basic sense of security?” and “China please slow down. If you go too fast, please do not
leave your soul behind.”

Comments posted after the rail crash on Weibo included “You
have to find out the real reasons for the crash, how can you stand back and watch
passengers die, where is justice, where is the rule of law?” It was also reported that in
the city of Wenzhou, where a large share of the victims reside, the Wenzhou Municipal
Bureau of Justice “asked” all local Attorneys not to represent any of the accident
victims.

Apparantly, China’s Rail Minister simply wanted to do everything in his power to get
trains back on the tracks and bury the problem (literally) without regard for the origins of
the accident as those origins are not relevant to his goal, get rid of the problem as fast as
possible. To people familiar with China, this is not surprising.

To put the Chinese railway system in context for those who are not familiar with China,
the following facts may be of interest; (i) The Chinese Ministry of Railways runs the
world’s second-largest rail network, employs more people than the U.S. government and
has debts larger than Denmark’s economy; (ii) The rail ministry has been run like an
independent kingdom for years and the concentration of power has caused inefficiency,
mismanagement and it’s a hotbed for corruption; (iii) Former rail minister Liu Zhijun was
removed for taking bribes after investigations found that 187 million yuan
(approximately USD $29 million) was embezzled from the construction project related to
the Beijing-Shanghai bullet-train line; and (iv) The ministry’s interests are closely tied up
with its suppliers and subsidiaries.

This sums up the current big picture in China as of today. There exists very real risk for
foreign investors, beyond bureaucratic complexity with no guarantee that in any of your
dealings with your partner or the government (including arbitral and legal bodies) that
you will have any level of transparency or predictability.

Application of the Rule of Law In China
If you look at the various laws and regulations in the PRC (no reference quoted herein
because I am speaking in general terms), it would appear that for just about any and all
legal matters, the laws are clear, transparent and that mechanisms are in place to protect
your legal rights. However, in reality the practice on the ground varies significantly from
the published laws and regulations.

In my experience, Chinese arbitrators, judges and other governmental people in positions
of power depart widely from the laws and regulations for historical, political and cultural
reasons. This leaves the distinct impression that China’s commitment to the rule of law

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fg-china-train-20110729,0,180599.story
3 Associated Press Television News, July 26, 2011:
4 The China Post, August 1, 2011:
ministry-kingdom-may-face-breakup-on-fatal-crash-corruption.html
remains incomplete and that various opaque factors are at play when trying to resolve any dispute in China.

Many people do not understand when entering into agreements or business relationships in China that regardless of the media effort to promote China as a safe investment destination, that the Preamble to the PRC Constitution continues to proclaim “the leadership of the Communist Party of China (CCP or Party) and the guidance of Marxism, Leninism, Mao Zedong Thought and Deng Xiaoping Theory.” I would like to point out that Mao Zedong’s ideology established CCP dominance over all aspects of Chinese society, education (compulsory education at all levels continues to require an education in communist politics and Marxist theories) and the courts and still remains a central principle of Chinese governance. The general label for this is called “socialism with Chinese characteristics.” Communist ideology and the Constitution continue to assert CCP primacy and supremacy of its policies over law, resulting in one leading scholar of Chinese law to explain, that these are instruments that “serve as a mechanism for the exercise of state power, which can still also be exercised by other available means, such as Party discipline or leadership fiat.”

In addition to the intertwining of politics and law as noted above, it should be understood that the Supreme People’s Court (SPC) acts like a legislative body, making laws by issuing interpretations of laws that are binding on the courts and that this judicial interpretation process is less transparent, with significantly less room for public participation, and is at odds with the proper role of courts in a civil law system.

One commentator, Mary Gallagher (studying the labor movement in China), summed up the rule of law in China very succinctly as “at best a long-off goal of an overstretched central leadership and at worst a cynical attempt by the party state to buttress its own monopoly on power with a patina of legitimacy.”

In my opinion, the Rule of Law may be rendered useless if you are involved in any dispute which involves any of the following risk factors: 1) involves a well-known PRC trademark; 2) involves any element that is of interest to the State; 3) involves a business which employs a significant amount of local people; 4) involves a sizable amount of money (this includes any business that pays a sizable amount of local taxes); 5) involves a previously State owned company that is currently partially publicly traded or owned partially by a local trade union or wherein your joint venture partner is well connected.

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6 I would like to note here that China has entered into more bilateral investment treaties than any other country, having signed approximately 127 (with 80% having come into force) and recently, a Malaysian construction company Ekran Berhad, became the first investor to bring a claim against China at ICSID (however, the proceedings have now been suspended pursuant to the parties’ agreement). This having been said, whether these bilateral treaties will have any true effectiveness or enforceability remains to be seen.

7 In 1999 an amendment to Art. 5 of the PRC Constitution inserted the statement that “The People’s Republic of China shall be governed according to law and shall be built into a socialist country based on the rule of law.”


9 I would like here to provide a credit to Prof. Stanley B. Lubman, a visiting scholar and lecturer at the School of Law of the University of California (Berkeley) for his contributions to this article in a general sense. While this article is primarily based upon my own experiences and practice, Prof Lubman (due to our prior working relationship on a case) must be credited with providing many historical references in this article.

10 Randall Peerenboom, Courts as Legislators: Supreme People’s Court Interpretations and Procedural Reforms (FLJS in collaboration with University of Oxford, 2002).


12 To be fair, the risk factors I list here are not necessarily exclusive to China.
and has been running or operating your joint venture or your joint venture partner is very wealthy; 6) involves a company doing business in multiple provinces or selling products throughout China to the local population; 7) a dispute in a court or before an arbitral body in any 2nd or 3rd tier city in China (i.e., outside of Shanghai, Beijing or Guangzhou); 8) any dispute that has been widely publicized by the media (includes internet reports or PRC internet chat rooms and Weibo). This listing is abbreviated. If you are successful in China, you will probably fall into a high risk category listed above or another risk category not listed above. In short, the only way you can avoid falling into a high risk category is to fly under the radar, which essentially means you are not successful in the market.

**Judicial Decisions are Frequently Not Impartial**

During a large PRC dispute in which I was involved, we had a court appearance in a not so small city in eastern China. Our external counsel left the court room and received a text message from the sitting Judge with the following message (something like the following), “I was very disappointed to see you representing [a company from Country X].” Clearly, at the outset of this particular case the Judge had made up her mind as to where she was going with the case based only upon the nationality of one of the litigants. We lost this case.

You need to understand that there is no judicial independence from the political dominance of the State or the Party and that Judges can be and are persuaded by factors such as nationalism. Courts are expected to apply the laws within the boundaries outlined by current CCP policy and frequently take instructions and directions from Party officials on certain decisions.

The basic principle of Party leadership can be summarized as follows:

“The installation of the courts organization, their organizational systems and various institutions and principles of adjudication were established under the leadership of the Party, and presently reflect the special historical conditions of our country and are the basic policies of adjudication...[T]he determination of basic institutions [and] principles are the results of the Party’s political leadership.”

All Judges in China are selected by the local government and in practice with the local Party committee. In fact, according to the Constitution and the Organic Law of the People’s Courts, the President of the Supreme People’s Court is elected and subject to recall by the National People’s Congress (NPC); the vice presidents, chief judges and associate chief judges of divisions as well as judges of the court are appointed or removed by the Standing Committee of NPC upon submission of the President of the Supreme People’s Court. The Presidents of a local court at various levels are also elected and subject to recall by the local people’s congress; and vice-presidents, chief judges of divisions, the other members of the adjudication committees as well as judges of the court are appointed or removed by the standing committee of the local people’s congress at the same level upon submission of the President of the said court and associate judges are appointed or removed by the court where they work.

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13 The 1st tier cities (Shanghai, Beijing and Guangzhou) attract judges and arbitrators who are better trained in the law and have more experience on enforcement issues whereas courts in the 2nd and 3rd tier cities lack the necessary resources and are more susceptible to pernicious issues that I point out in other areas of this article.
15 Judicial Reform in China and Its Political Implications, Ji Weidong - Professor of the Graduate School of Law, Kobe University; http://www.reds.msh-paris.fr/communication/docs/weidong.pdf
Previously Chinese Judges were not selected because they have any legal training at all, in fact, did not even have a University education.\textsuperscript{16} In all fairness, I do need to point out that matters have improved in this area and that the quality of appointed Judges has increased and that there are more and more Judges being appointed that have legal training and which can be quite savvy. However, these Judges must still operate in an opaque system whereby they are not completely free to render final decisions in any manner they see fit.

But the fact still remains that Chinese judges are not necessarily appointed for their ability to be impartial. A majority of judges today are Party members and the local Party committee sometimes exerts pressure on the court to determine cases in certain directions because they are deemed to have either local or State importance. In numerous areas, a Party committee is embedded in the court specifically to intervene in specific cases. Professor He Weifang of the Law Faculty of Beijing University wrote the following on this topic:

“[The court] often reports...to the local Party committee and solicits opinions for solution...and if contradictions arise among different judicial organs, the Party’s political-legal committee often steps forward to coordinate.”\textsuperscript{17}

In fact, a Five-Year Reform Program for the People’s Courts issued by the Supreme People’s Court (SPC) in 2005 called for: “Perfecting methods and procedures by which the people’s courts consciously receive supervision from...[and accept]...criticism and recommendations of the people’s congresses and political consultative conferences.”\textsuperscript{18}

On March 25, 2009 the SPC released its Third Five-Year Reform Program for the People’s Courts which stresses the need for judicial transparency. It recommends posting judicial decisions on the internet and how to enforce them. Moreover, the SPC recognized that the people have the right to know about, take part in, comment upon and supervise court proceedings and that an appropriate structure must be established for their exercise of those rights.\textsuperscript{19} As with many things in China, as I point out in other areas of this article, what is written or legislated is not what you will experience in reality. As for these recent proclamations by the SPC, only time will tell if there is any real changes to be realized.

What you also need to understand is that in cases that are even potentially complicated or not routine in nature (ie, simple employment matters, breaches of contracts involving small amounts of money or cases not publicized in the press or apparently not involving a State interest) Judges routinely will, before rendering a decision, refer their findings to an Adjudication Committee of senior Judges who are all CCP members where difficult or complicated decisions will be made. This Adjudication Committee is basically deciding cases upon 2 key factors, reviewing a second hand report from the referring Judge and considering the interest of the CCP or the State in general. If a Judge does not follow this

\textsuperscript{16} Professor Benjamin Liebman, in a recent article, noted media reports in 2005 that state that for the first time, more than 50% of Chinese Judges had university degrees (but added that figure includes graduates of four year Universities and those from evening classes, junior colleges or “da zhuang” as well as correspondence courses and that these degrees are not necessarily in law. Benjamin L. Liebman, China’s Courts: Restricted Reform?, China Quarterly, No. 191, 620,625 n. 16 (September 2007)


\textsuperscript{19} Jerome A. Cohen, April 2, 2009: China’s New Court Reform Program: http://www.usasialaw.org/?p=809
procedure, and is overturned, he/she can be punished by, for example being subjected to the following liabilities; criminal liability, civil liability, administrative or Party disciplinary measures, fines or a reduction in salary, suspension of promotion or termination.\(^\text{20}\)

Basically, when judicial decisions are rendered which have been through the vetting process as I have described above, it is a type of collective decision making. It is extremely difficult, if not impossible, to pin point any particular Judge that rendered a decision. Therefore, your ability to properly appeal a court decision is quite problematic.

It is also possible that when you appeal an adverse decision to a higher court, that higher court has already “approved” or “validated” the decision of the lower court by way of a referral from the lower court prior to the lower verdict having been released. This basically blocks off your right to a fair appeal of an adverse decision and this occurs in cases which are of interest to the public, interest to the State and/or have some other element of importance.

I have had 2 experiences in this area that may be of interest:

1) I once had a case where a decision was not released as expected. I eventually learned that the lower court had referred its decision to a higher court for validation and that this validation process was underway. Even though we knew this procedure was underway, we did not have a right to intervene, have access to any information nor did we have a right to present our side of the case to the higher level court.

2) Previously we faced multiple lawsuits in different lower level courts in different geographical locations. The claims were basically identical, but the Plaintiffs and entities involved were different. When the lower level decisions were released, the text of all multiple decisions were identical even though they came from different courts and different Judges. When I say “identical” I am referring to literally identical. Upon appeal to the intermediate court, we were not surprised to learn that they were not very interested in the basis for appeal of decisions that were possibly previously validated by their court.

To put it bluntly, it is possible that your case may be subjected to a secret appellate process prior to having been decided by a lower court, which would make the lower courts’ decision even more solid upon release. Unfortunately, these types of internal procedures are not discussed in the Civil Procedure Law of China and are usually not apparent until you find yourself on the wrong end of a decision.

In my personal opinion, the risk of judicial non impartiality (I am not talking about corruption here) is not widely understood by the foreign legal practitioners and thus, not by foreign corporations seeking to do business in China. I have met senior people in large organizations that are overly optimistic in relation to litigating (or arbitrating) in China and their chances of receiving a fair and impartial decision, the source of their optimism is a mystery. I can only assume it comes from an over exuberance to conduct business in China coupled with surrounding themselves with the wrong advisors. In my opinion, spending too much time with corporate M&A counsel and no time with litigators who have an in-depth knowledge of what it takes to enforce your agreements is a long term strategy resulting in a misunderstanding of China and an inability to design a corporate management strategy to minimize litigation risks.

Civil Laws vs. Common Law

You can open up any newspaper, on any random day, and find a foreign company complaining that some Chinese company, partner or person has clearly violated their contractual obligations and that they are planning to “take action.” It sure would be nice if dispute resolution in China were this transparent and simple. Assume you are in a contract dispute in China and none of the risk factors are present (as I described them above) and that there are no Judicial politics or games being played. There is still no guarantee that your particular contract will be interpreted and enforced as negotiated or intended. The reason for this is the difference between a civil law jurisdiction and a common law jurisdiction.

When Chinese enter into a contract, their belief is that a contract is only a basic understanding as both parties agreed to on the particular day of the signing. The Chinese view a contractual relationship as one that will evolve over time and the contract itself does not have the importance it does to people in the USA or other common law jurisdictions. The key here is the growth of the business and personal relationship over a course of years and the concept that the original contract is a living document that evolves with that growth. This is not some hypothetical one off interpretation here, this is how contract disputes in China are actually analyzed and resolved by both Judges and Chinese trained arbitrators.

Disputes are always approached from a Chinese civil law perspective, which also differs slightly from other civil law jurisdictions (no attempt to explain the differences in this article). This perspective can be summarized as a focus on the big picture considering the justice of a situation with an eye toward balancing the interests of all parties in a relationship or a dispute. For example, if a company executes a contractual obligation poorly because of an incompetent or uncaring employee, a U.S. court is likely to hold the company liable for all damages arising from the breach if that employee was (in a general sense) acting within the scope of his/her employment. A Chinese court, on the other hand, might limit damages, because a Chinese judge might consider it unfair to penalize a company for the incompetence of one employee.

The problems here really arise when some of the interested parties in a dispute are determined to be the public at large or the State (possible political agenda). Even if there is no public or State interest in a dispute, a civil law perspective to resolving contractual disputes allows the judicial body to ignore the plain wording of a contract and “balance” the interests as they subjectively determine. In my experience, this balancing of the interests also allows a Judge or tribunal to ignore or marginalize proffered evidence that would directly contradict a decision that they desire to render.

It is always challenging to explain to people unfamiliar with the radically differing approaches of the Chinese civil law approach versus a more familiar common law approach why the contract they signed may be enforceable but uncertain as to interpretation of its terms (even if upon a plain reading of the contract the wording is crystal clear applying only common sense) as viewed today. In China, it is easy to spot a clear breach of contract, it is more difficult to come to the conclusion that litigating or arbitrating that breach will result in a favorable outcome. Always remember that Chinese judicial bodies (courts or arbitral bodies alike) may not analyze contracts from a textual perspective focusing on the words of a contract, as almost all foreign companies doing business in China assume.
Civil Procedure in China is Very Different from Common Law Courts

Whether you find yourself in front of a court of law or in front of an arbitral body seated in China, you will immediately face a huge hurdle in establishing the basics of your case (whether you are a Plaintiff, Defendant, Claimant or Respondent). That hurdle is related to severe difficulties in obtaining evidence under the Civil Procedure Law (CPL) which was most recently revised and effective on April 1, 2008. The CPL provides that the parties must provide evidence in support of their allegations and that the court shall collect necessary evidence if the parties are unable to do so for reasons beyond their control and it goes on to outline that people are obligated to cooperate with the court and testify in court or with court permission, submit written testimony. In addition, the CPL also provides that “with the permission of the Court (this is completely discretionary) the parties may question the witnesses, [court appointed] experts and inspectors.

If you read the CPL, frankly, it looks pretty comprehensive. It appears that options for gathering evidence and engaging in a discovery process is even balanced and even possibly fair. The reality is something quite different. What the CPL does not tell you is that most courts in China will give you approximately two weeks to gather and submit all of your evidence and some extra time is allowed to query the court for assistance in this regard. Following the expiration of this very short time frame, you are normally prevented from submitting additional evidence in support of your case. What is also not mentioned in the CPL is that the court system in China is quite backed up and that Judges will normally schedule cases (regardless of their complexity) for live hearings lasting from between only 2 to 4 hours (generally).

In short, there are really only three discovery (gaining access to information held by your opposing party) methods available in a PRC court, (i) gathering evidence yourself unilaterally; (ii) an order for evidence preservation; and (iii) Court-requested expert conclusions or opinions and both are in my opinion, woefully inadequate especially considering that you have an unreasonably short time in which to make your submissions and will likely face very little cooperation from the other side in this regard.

A few additional things are noteworthy; 1) that the Court may (or may not) undergo its own discovery process (you as a Party are not really in control of this process); 2) you do not have an automatic right to ask any questions of any witness or to control which witnesses will be allowed to provide evidence to the court; 3) you do not have an automatic right to introduce your own expert witnesses; and 4) from a plain reading of the CPL there appear to be no provisions for punishment of a witness for a refusal to testify in court.

It is also impossible (and possibly illegal) to take proper depositions in China (ie, American Attorneys simply cannot engage in this process) and there are “vast areas of official and unofficial information...[that] are considered off-limits to foreigners.” In summary, China in a general sense, does not allow for extensive discovery which puts a foreign investor (in the position of a Plaintiff or Claimant) at a significant disadvantage especially if part of the basis of the claims for relief are related to fraud, corporate wrongdoing, breach of noncompetition obligations, white collar theft or misappropriation of funds etc...

22 CPL, Art 64, 65, 70 and 71
23 CPL, Art 125
While China is a party to the Hague Evidence Convention, it has indicated that taking depositions, whether voluntary or compelled, and obtaining other evidence in China for use in foreign courts may, only be accomplished through requests to its Central Authority under the Convention. However, such requests have not been particularly successful in the past. Requests may take more than a year to execute. It is not unusual to receive no reply or after considerable time has elapsed for Chinese authorities to request clarification from the requesting court with no indication that the request will ever be considered.

At this juncture, I would like to let you know about one facet of China legal practice that has a direct bearing on the issue of discovery and which is something that both foreign companies and foreign legal practitioners should be aware. There are vastly differing ethical obligations on PRC licensed lawyers versus US licensed Attorneys or UK licensed Solicitors (for example only). As with many issues in China, what is written is not necessarily what is done in practice. While Chinese lawyers are forbidden to assist their clients in hiding evidence, forbidden to assist their clients in misleading a tribunal or court, forbidden in assisting their clients to commit fraud and must counsel their clients to comply with document production requests from a court or arbitral tribunal, there is virtually no teeth behind these requirements in practice. I have personally seen PRC lawyers proffer evidence and make statements to courts, opposing counsel and arbitral bodies that is factually incorrect, deliberately misleading and, at times, completely fraudulent. I have many Chinese lawyer friends that I respect very much. However, their view of their role in litigation is vastly different from the view of say a US Attorney engaged in the same process.

I will give you an example of this in the real world that is not necessarily uncommon. I was previously involved in a lawsuit filed in the USA against people and companies doing business in China. The Defendants retained a very large US firm as defense counsel. In response to interrogatories and discovery requests, US counsel for the Defendants (in a general sense) denied any documents requested existed and denied any involvement (or even knowledge) of their clients in the matters in which we claimed. Their responses were quite clear on these matters. Eventually, we were able to conduct depositions of certain Defendants (and their representatives). At the depositions, certain Defendants, under oath, continued to deny any knowledge of documents or involvement in anything related to our claims (they continued to claim lack of knowledge even when faced with numerous documents bearing their personal signatures and tried to excuse the oversights by claiming they routinely sign blank pieces of paper and other people print the text on after they signed) even when faced with literally boxes of documents from our own investigations directly contrary to previous responses to interrogatories and discovery requests. Eventually, US counsel for the Defendants took the extraordinary step of stopping the depositions due to serious ethical issues related to their clients’ depositions which prevented them from continuing with the deposition process. I later learned that the documents and answers to interrogatories we sought were in China and that PRC counsel assisted in the preparation of those documents and responses (basically, it was PRC counsel shielding their client from complying with discovery in the USA). Chinese lawyers simply do not have the same ethical obligations as do US Attorneys for

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26 US Department of State, China Judicial Assistance: http://travel.state.gov/law/judicial/judicial_694.html
27 An added complication here is that the Chinese legal profession is closed in that foreign lawyers are not able to qualify as Chinese lawyers. PRC nationals and Hong Kong permanent residents (that do not hold a foreign passport) are the only people able to obtain PRC practicing certificates. In addition, foreign law firms cannot advise on Chinese laws but must engage Chinese firms to advise on PRC law.
28 In England, Solicitors are officers of the court similar to American attorneys being considered officers of any court before which they are practicing. This is not so for PRC lawyers. This distinction is key to beginning to understand how each professional views his/her role in the legal process.
example. There is no downside for them in assisting their client to mislead or outright lie to a court or tribunal especially if that court or tribunal is not within the boundaries of the PRC.

In addition, Chinese people/companies are simply not familiar to the concept of discovery and that they have an obligation to disclose requested documents even if those documents may be damaging to their case or defense. It is clear to me that without having the opportunity to actually ask direct live questions to Defendants or witnesses (not shielded by responding only in writings drafted and reviewed by their lawyers) that fraud, deception and overall credibility can be tested and uncovered. Unfortunately, Chinese courts base their rulings almost exclusively on documentary evidence as opposed to live testimony, cross examination and correspondingly without any ability for either party to really test the credibility of any witnesses. In summary, litigate or arbitrate in China and you will not have the ability to test the credibility of witnesses and in many cases you will simply be arguing over documents prepared by legal counsel and signed off on by clients (sometimes who may care very little about the accuracy as the risk of detection of lies and deception is low and the upside [victory] high).

**Enforcement Difficulties in the PRC**

China is not a party to treaties or any other arrangements that provide for the enforcement of civil judgments given by the courts of its major trading partners such as the US, Japan, Hong Kong, Germany and the UK. It has treaties with a small but growing number of countries, including: Argentina, Belgium, Bulgaria, Cuba, Cyprus, Egypt, France, Greece, Hungary, Italy, Kazakhstan, Kyrgyzstan, Lithuania, Mongolia, Morocco, North Korea, Poland, Romania, Russia, Spain, Tajikistan, Tunisia, Turkey, Ukraine and Vietnam. In Asia as a whole, there are very few such treaties permitting the easy enforcement of civil judgments. Due to this, a fresh action must be commenced in the courts of the country where enforcement of the judgment is being sought. This may lead to a matter being re-litigated with little or no regard for the original decision of the foreign court. This inevitably leads to a duplication of costs and often puts the successful litigant in no better position than if it had started proceedings in that jurisdiction in the first place.

I would like to point out here that China in response to foreign parties experiencing significant local protectionism in the enforcement of any judgments in the PRC (ie, read, nearly impossible), did take various steps to alleviate the problem the most significant was to amend the PRC CPL in October of 2007 (CPL 2008) to give higher courts more supervisory powers over lower courts, set clearer procedures and timelines for enforcement decisions and to clarify that even though an enforcement notice has been challenged that the enforcement process is normally not suspended (among other adjustments). Although this is seemingly a step in the right direction, it is not yet fully understood whether in practice the courts in 2nd and 3rd tier cities are interpreting and or even applying these interpretations. The reason for the uncertainty at the time of this article is that securing any accurate statistics on enforcement rates in China is extremely problematic. In any event, in my experience, and as I have previously noted, practice usually differs greatly from codified laws or regulations throughout China.

For completeness on this topic, in respect to arbitration, China is a signatory to the New York Convention on the Recognition and Enforcement of Arbitral Awards of 1958 (New York Convention) so that enforcement of arbitral awards made in another convention country is made far easier and subject to only very limited grounds of challenge. Most importantly, the New York Convention does not permit any review of the merits of an

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award. Now, this having been said, try to enforce an offshore arbitral award in a 2\textsuperscript{nd} or 3\textsuperscript{rd} tier city in China. I do not think it will be as envisioned and agreed in the New York Convention.

If you are fortunate enough to have proper court support to enforce an award in China, be aware that in order to avoid paying judgments companies in China are notorious for shutting down their operations one day and then starting them again a few days later under a new name which effectively avoids paying a judgment and Chinese courts are seemingly powerless against this tactic. In contrast (and as most of you know) in the U.S, losers in litigation who seek to hide their assets from collection regularly face severe sanctions, ranging up to criminal liability and Courts can require judgment debtors to trace every single asset to ensure nothing is hidden which is a grueling and expensive process that can result in contempt of court proceedings if a defendant tries to cheat.\textsuperscript{30}

Therefore, without delving into this subject too deeply, I would just caution you to factor into any litigation (or arbitration) analysis the usefulness of a judgment or award and to be realistic in your assessment to ever recover any funds at all.

**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 of before a China based arbitral body. While, I generally believe that corruption does exist throughout China (more so in China’s 2\textsuperscript{nd} or 3\textsuperscript{rd} 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\textsuperscript{31} and that in the KPMG Global Anti-Bribery and Corruption Survey 2011 China had the 3\textsuperscript{rd} highest “corruption perception score.”\textsuperscript{32} It has also been noted that China’s judges are susceptible to corruption due to being “underpaid and generally treated like other officials rather than instilled with a distinctive professional and ethical spirit”\textsuperscript{33} and that “stories abound of various forms of judicial malpractice such as judges demanding bribes, meeting \textit{ex parte} with parties in restaurants or Karaoke bars, and demanding the parties to fund lavish “investigation trips.”\textsuperscript{34} 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 and that influence is known as, “guanxi.”

“Guanxi” is usually viewed by Europeans and Americans as corruption. However, viewing it in such terms misses the subtleties of the problem. Guanxi is a relationship. A direct personal relationship with a person or to 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

\textsuperscript{30} The Wall Street Journal, author Dan Harris, August 18, 2010: Chinese Companies Court Disaster:
http://online.wsj.com/article/SB10001424052748704554104575436523983011074.html#articleTabs%3DArticle

\textsuperscript{31} 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 Minxin Pei, Corruption Threatens China’s Future, Carnegie Policy Brief (October 2007).

\textsuperscript{32} http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Advisory/23816NSS_Global_ABC_Survey.PDF

\textsuperscript{33} US-China Economic and Security Review Commission, 106\textsuperscript{th} Cong. 126 (June 14, 2001) (statement by Jerome A. Cohen).

\textsuperscript{34} Randall Peerenboom, China’s Long March Toward Rule Of Law, 295 (Cambridge University Press, 2002).
that decisions are sometimes made (or heavily influenced) based upon personal networks rather than the facts or the law.\textsuperscript{35}

A close friend is a very successful Chinese lawyer. He is successful not because of his legal acumen (he is highly skilled actually) but for 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 very good friends with people in various locations and positions that 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 or 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\textsuperscript{36} ethical obligation to avoid even the “appearance of impropriety”\textsuperscript{37} 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.

Now, that having been said, this friend does spend a very 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 or high dollar gifts exchanged to sitting Judges. While it is easy to criticize China’s Judges\textsuperscript{38}, keep in mind that this problem is culturally and historically rooted based upon 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”)\textsuperscript{39} or the US’ Foreign Corrupt Practices Act (“FCPA”) is greatly increased if you approach a China dispute from the angle that increases your odds of success (ie, utilize guanxi). The key difference between the Act and the FCPA as that relates to “bribing” foreign public officials (PRC Judges for example) is that in the Act it is not necessary whether the offender\textsuperscript{40} sought to induce a public official to improperly perform his/her duties, it is only necessary that the offender sought to influence that official in the performance of his/her duties. In addition, the FCPA would allow reasonable and bona fide hospitality or business expenses (speaking loosely here) while under the Act such

\textsuperscript{35} See generally; Pittman B. Potter, \textit{The Chinese Legal System: Globalization and Local Legal Culture}, 30 (Routledge, 2001).

\textsuperscript{36} Referring to US licensed Attorneys and Judges here with the use of “our”.

\textsuperscript{37} 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.

\textsuperscript{38} 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 UK or which carries on any business in the UK. This new act (in some instances) removes the need for enforcement authorities to prove conduct was either corrupt or dishonest, there is no need for the offending activity to have any connection to the UK, subjects companies to an unlimited fine and individuals can be imprisoned for up to 10 years and/or an unlimited fine.

\textsuperscript{39} Offender in the Act includes liability for acting through a 3rd 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.
expenses may be viewed as intended to influence and are problematic (in March of 2011, 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 a company which carries on any business in the UK or has a close connection to the UK or to any individual holding a UK passport or ordinarily resident in the UK (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 fall out and criticism would be severe both at home and in China. There is a curious (maybe not so curious) aspect of the Chinese press of which you should be aware. The Chinese press are much more harsh and critical of foreign companies’ activities in China than they are local companies engaging in completely reprehensible behavior.

**Cultural/Generational Issues Effecting Contractual Performance In China**

Observers cannot be faulted for thinking that Chinese will enrich themselves by any means possible. It is however important to understand how this situation may have arose.

For a few generations, under communism, the Chinese population was not instilled with any real religious values (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 which left an entire generation of people devoid of any real value system based upon what is fundamentally right and wrong. Under the communist model of a planned economy, Chinese people were deprived of virtually all material wealth and the comfort. When Deng Xiao Ping (who was instrumental in reforming China into a socialist market economy) opened up China to this new system of a socialist market economy and encouraged people to go out and find their fortunes, it was as if 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. Many people in China were simply unprepared to navigate this new market economy and simply went forth with the goal to gain as much wealth as they can unburdened by the value system that people in the US (for example only) use to generally guide their actions.

It is not uncommon to meet people in China who admire wealth and admire the person that secures a fortune no matter how that fortune was gained. In general, a person is considered savvy at business if he/she broke agreements or cheated, without penalty, to become wealthy. At the end of the day, they have misinterpreted Deng Xiao Ping. But the real problem is that 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

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41 Please see a Legal Week article on the rise of Chinese law firms: http://www.legalweek.com/legal-week-analysis/1650466/china-years-dragon
42 Keep in mind that Confucianism is still quite prevalent in China
43 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.
44 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.
entrepreneurs which are, in a general sense, older than approximately 50 years old (Older Generation); and 3) Younger generation entrepreneurs which are, in a general sense, mid 40s or younger (Younger Generation). 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 the preferred route (and sometimes, the only route to market even today) was to create a joint venture with a SOE. Doing business with a SOE has a risk profile that is lower than other groups. The reason is simple. If your partner is a SOE, and your business interests are initially aligned, the growth of your business in terms of profitability or size does not result in an increased risk that the managers of your partner will necessarily desire to gain more financial benefit for the SOE. The individuals working for a SOE have no personal upside (in real terms) if a government owned company pulls in more cash into its coffers or breaches its agreement with its partner. The individuals working for a SOE (who may be possibly managing your joint venture) are usually not negotiating for the SOE or for the State and are simply public employees collecting a salary. This is not to say that these people will not manufacture ways to personally enrich themselves, but your business as a whole including your agreements with your partner are relatively secure in this instance.

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 due to educational and cultural issues, these people do not fully understand the true meaning of a contract and 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 nonstandard methods to achieve their goal and to be quite aggressive during any settlement or other negotiations over any contentious issues.

The Younger Generation: This group of people comprise the new generation. They all have primarily been the beneficiaries of a better educational system, possibly educated outside 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 are 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 in a dispute to negotiate a fair settlement that would be a true compromise.

Media Impact On China Disputes
Something not widely discussed in legal circles, is the impact of the media as that relates to your business and disputes in China. I would like to take a few minutes here to 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 reason the media reported so widely on the dispute was because the disputed China businesses were very successful, 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.\footnote{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, \textit{27th Statistical Report On Internet Development In China} 12 (2011), http://research.cnnic.cn/img/b000/b12/attach201101211728520.pdf (in Chinese).} What evolved was thousands news reports based upon false/questionable information, bogus facts, reports that sensationalized the fact that we were a foreign company and that characterized us as foreign invaders which resulted in literal country wide fever of nationalism (ie, prejudice against us because we were foreign), sparked live television shows analyzing our case from the perspective that we had zero prospects of recovery in any legal battle, at least two full books being written about the subject and damage to our good image in China. It was very common to have days (this was over a period exceeding 2+ years) when there would be literally 50 or 60+ separate news publications on the dispute throughout China, Asia and the world. Nothing was out of bounds and everything was reported in the press.

The problem we faced here was multifaceted. 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 as that relates to influencing Judges and judicial bodies throughout China as well as the impact upon certain PRC government officials tasked with assisting us to find a resolution to our underlying dispute. Third, we were under very strict confidentiality orders with regard to certain facts and issues in various arbitrations and lawsuits throughout the globe which prevented us from revealing facts which would undermine a lot of the inaccurate negative press reports and help to restore our public image. Fourth, the negative media reports impacted us throughout numerous countries in the Asia Pacific region and caused other partners, and potential partners, to be wary of us as a business partner. 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 in order 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 wide spread public protests in at least 10 cities throughout China\footnote{For more information on this, please see theAFP article located at: http://afp.google.com/article/ALeqM5j-_RMPi3PaeMDXIMoTj7UzdIfBA-Gg} and it was widely rumored on the internet that the retailer supported the Dalai Lama.\footnote{“Carrefour faces China boycott bid”, BBC News. 15/04/2008. http://news.bbc.co.uk/1/hi/world/asia-pacific/7347918.stm. Retrieved 11/05/2009}

What I am getting at here is that 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 have as their goal to stir up feelings of nationalism as a base to tout the superiority of China, its policies and its laws. 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, on-line chat rooms and other internet based communication tools) it is now not uncommon for your competitors (or anyone with the proper funding and motivation) to organize, artificially influence and artificially manipulate on-line dialogue with the goal to disparage and inflame passions against your products or company and instantly reach an on-line population of at least 457 million 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 on-line monitors and firewalls which have as their goal to remove or censure on-line 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 (including the nationality of your company) and products to be the subject of wide on-line criticism organized by your competitors (or your opponent in litigation) usually on the basis of patently false and misleading gossip which has a negative impact throughout all geographic regions of China. In short, the impact is real and does result in an immediate reduction in sales and significant financial loss.

The problem with all of this is that when you have a lawsuit before a court or tribunal in 2nd or 3rd 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) when that foreign party is generally thought of by everyone in that particular location as an [fill in the blank here with anything that pops into your mind].

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) begins to report on your losses in various locations (regardless of the reasons for such losses), it makes it even more difficult to receive a favorable verdict in subsequent cases. In addition, when the Chinese media begins to publicize your losses, the reputational damage to your company may also increase especially if media reports are skewed in such a way as to question your original decision to participate in those cases in the first instance (among other things).

While my experience here in this area may be viewed by some as unique, I would like to point to at least one recent case wherein the media did in fact influence the outcome in order to illustrate that this issue may not, in fact, be so uncommon. In 2007, a man in China was sentenced to life imprisonment by the Guangzhou Intermediate People’s Court, due to the theft of (the equivalent of) approximately $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 where by common people are punished much more harshly while more powerful Defendants are either not prosecuted or treated more leniently. In 2008, the life sentence was reduced to 20 years.

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50 Article 264 of China’s Criminal Code states that anyone who steals and 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.

51 No quotation intended here as this is just a summation of the feeling as espoused generally in the media reports.
to 5 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.\(^{52}\)

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

**How To Manage A Dispute With A Chinese Component**

Managing a dispute in China begins long before a dispute erupts. The following are some practical tips which will assist you in tackling a China based dispute or simply avoid one all together.

I. **Seek Balanced Legal Advice When Entering into Any Deal**

When entering into any contract involving China, especially one involving a joint venture or intellectual property, seek out balanced legal advice. Breaches of contract in China are inevitable. Therefore, when you enter into a deal using only the services of a corporate Attorney, you may not be getting needed advice on whether the legal structure you have set up is the best to minimize the pain if you end up in litigation. There are two distinct Attorney skill sets available, corporate and litigation. When doing a China deal, you must always view every provision from the aspect of litigation risk (while a key component is negotiating an offshore [non China] dispute resolution mechanism, ie arbitration in Singapore, Hong Kong, Sweden etc, I will not analyze that here). Corporate M&A counsel may not always view your contract from this perspective. Therefore, if you do not have an extensive litigation background yourself, I always advise that you run any contract (in the process of negotiation) by litigation counsel for a quick opinion.

A quick example will illuminate part of the issue. A few years ago, I was negotiating a joint venture in Asia (not China) and I faced an issue over what should have been a routine provision. I was negotiating a deal where we would have an evenly split board and a 50/50 shareholding structure. I drafted a quorum provision such that if a quorum was not reached after three validly called meetings were attempted, that at the fourth validly called meeting a quorum would be achieved if 3 out of the 6 total directors were present. The opposing Attorney explained that never under any circumstances could a quorum be achieved if one of their Directors did not appear. I explained that in China protracted litigation ensued because one shareholder’s appointed board members refused to attend validly called board meetings effectively preventing a quorum from being achieved indefinitely (which nullified the Board from ever passing resolutions) and that the issue which was litigated, at great expense, was quorum. I was told that we should “trust” each other and that quorum is never the subject of litigation and that in that particular country a quorum mechanism as I proposed was never part of any deal etc. My own local corporate counsel did not fully understand my litigation risk concerns. It was eventually agreed that we would use my proposed quorum provision (after I let them know that if they wanted to kill this deal based upon a quorum provision to “go right ahead”). I was the only person on both sides of the negotiating table with any litigation insight into the subject matter.

\(^{52}\) Fiona Tam & Tze-wei Ng, *Life Sentence for ATM Withdrawal Cut to Five Years*, South China Morning Post, Apr. 1, 2008, at 7.
II. Minimizing the Risk of a Dispute

It is always wise to take steps to deal with a dispute before a dispute arises. Here are a few practical tips:

Ensure All Contracts Accurately Reflect Negotiations

- When dealing with a Chinese party, make sure there is a clear understanding of the agreement, including any “off contract” understandings. Usually, legal counsel is not present at initial negotiations or commercial discussions leading to the creation of a business case upon which a legal deal is based. The problem is that, at times, there are unofficial promises and incentives discussed which are not included in either a joint venture agreement or for example a distribution agreement.
- Legal counsel will routinely insert an “entire agreement no representations” clause and make the assumption that this will exclude any prior discussions not specifically outlined in the agreement. This may work in countries applying common law principles but is not entirely effective in China, a civil law jurisdiction. As explained above, Chinese view a contract as an evolving document and the way they behave post execution will highly likely reflect what they view as “the deal” and not what was signed.
- You need to set clear limits on the transaction team which are usually under great pressure to close a deal at all costs. You need to work with them earlier in the process in order to ensure that the resulting contract genuinely reflects what has been agreed and that the transaction team has not promised more than they can deliver.

Proper Internal Corporate Governance Of Your Partnerships

- To minimize disputes, establish a system of checks and balances to enable an effective separation of power between the Board of Directors and general management of your business. In China (as well as in other Asian countries) it is not uncommon to entrust your partner to run and operate your business. If (for example) your joint venture partner has appointed your General Manager (GM) (regardless of your involvement in the initial choice) and that GM is tasked with reporting financial data and performance results to the Board, and this GM is a “bad actor”, the Board cannot effectively review and challenge management decisions. In short, always ensure that you have trusted employees in your business that are actively involved in the day to day operation and that those employees regularly report back on the happenings on the ground.
- Constantly monitor and update all intellectual property rights to ensure that all registrations and assignments are legally completed and approved at all PRC governmental departments. Do not completely entrust your Chinese partner to ensure that all of these matters are completed.
- If R&D is a key component of your business growth, work with an R&D facility separate from your joint venture. In other words, do not include R&D inside of a joint venture in China even if it would first appear to be more efficient.
- Follow through on all contractual obligations. You would be surprised how many operational people don’t really understand what is contained within the key contracts or the key obligations of all players until a dispute arises. It is always wise to create summaries of negotiated deals and conduct
periodic training courses for key operational people to educate them on what to monitor and manage on the ground.

- Conduct on-going investigative due diligence (DD) on your Chinese partners. Investigative DD is different from standard legal or operational DD. When in China you need to regularly conduct searches at the various AIC (Administration for Industry & Commerce) offices to discover entities that are competing with your company by using your trade name as part of their own name.

- Another goal of investigative DD is to check the ownership structures of competing companies to see if there are any connections with people running or operating your own businesses. Unfortunately, it is not uncommon in China to be competing against your business partner and have no idea you are not dealing with legitimate third party competition. In my experience, even conducting regular AIC checks is not in itself enough to minimize the risk in this area as Chinese are quite sophisticated at using offshore holding companies and straw men to obfuscate their ownership of various entities for both legitimate and non legitimate reasons.

- Be sensitive to the local corporate culture, but ensure that your expectations regarding how a business operates is aligned with the actual practice on the ground. It is always risky to allow your joint venture employees (or wholly foreign owned entity employees for that matter) to do things the “Chinese” way (ie, emphasis on guanxi, gentlemen’s agreements and to enter into business decisions on an informal basis without proper documentation).

- Keep in mind that it is common for employees of your joint venture, which were previously employed by your partner, to be previously unexposed to western style management, processes and procedures. Anti foreigner sentiments can easily be created among your joint venture’s employees to the benefit of your partner. Therefore, implement training seminars and conduct internal PR for your company in relation to Chinese employees.

- Create a small team to fully discuss brewing problems with your Board members so that you can develop strategies early to approach and discuss concerns with your joint venture partner.

- In house Attorneys need to act as consultants to Board Members on not just legal issues but to act as a sounding board for strategy and guidance on relationship management.

- Do not rely too heavily on financial or management data specifically prepared for the Board by your joint venture partner.

- Ensure that you are properly documenting and recording any and all variances from contractual and legal obligations.

III. Managing China Disputes Should One Arise

I would like to provide some insight into how to manage a China dispute should one arise. While there is certainly no one size fits all panacea, if you at least consider the issues I point out below (which are primarily based upon facing large scale, high dollar, complex disputes), you may find yourself better positioned going forward.

The Golden Rule is: Settle. Trust me when I say, that you have very little to gain in seeing Chinese litigation through to a decision and into the process of possible enforcement activities. Don’t be emotional just find a mechanism to settle. If you ever find yourself questioning the Golden Rule, re-read this article.
The following tips are designed to facilitate settlement discussions and to motivate a Chinese party to actually desire to sit down at a settlement table.

- If a dispute arises, try to get a good feel of your counterparty as soon as possible. Don’t assume they will approach the issue from the same perspective. Ask yourself (and your business team) what is their motivation is it money is it personal? Is there any underlying concern that can be addressed? Is there a genuine desire to settle from the other side? Is there any scope to salvage the relationship?

- Take active steps to manage the dispute immediately to avoid letting it get out of control. Conventional wisdom is to slowly escalate the dispute (eg, the transactional team will try to deal with the problem, failing which it is escalated to senior management, and then to in house counsel then to external counsel etc…). However, take control (from a legal perspective) earlier to obtain an accurate assessment of the merits and the scope of the problem such that by the time external counsel are involved relationships would not have been strained to the extent that it is all but impossible to bridge the gap between the parties due to cultural and other factors.

- Problems in China are larger and more complex than they first appear. It is nearly impossible to negotiate a real resolution until you understand the scope of the problem. It is quite common for sophisticated Chinese parties to use offshore entities, friends and associates to compete against your venture or to take actions that they themselves may not be contractually able to undertake. For example, you believe your partner is in violation of a non-compete obligation and you identify one or two companies associated with your partner to establish this fact. If you negotiate on the basis that there are only 2 competing entities when in fact there may be 20 scattered throughout China (that are managed or controlled by your joint venture partner) you have no effective way to negotiate. If you end up in litigation (which happens) and your goal is to eventually enjoin the infringing activities of all entities illegally competing (exploiting your TMs, violating your IP or which are operated by your JV partner) at best you will only achieve part of your goal if numerous entities are not covered by a judicial decree or judgment.

- To grasp the scope of an issue (and to determine if you are eventually dealing with the right people which can resolve your issue, which is not easy in China) you must conduct an in-depth investigation prior to alerting the other party that a lawsuit or arbitration is pending (remember, preparation is absolutely key as once proceedings are commenced in the PRC there will be no discovery, a tight timetable, limited/no access to witness’ evidence and no/limited cross examination). It is highly likely that your only chance to go through a discovery process is to conduct an initial investigation prior to those avenues of investigation being “closed”.
China

- You will need to immediately hire and retain both an investigator and an accounting firm (sometimes they can be one in the same depending on your scope of investigation). The goal is the following (nonexclusive listing which is highly dependent upon your particular circumstances):
  1. search all AIC records in a large selection of provinces in China (where you believe infringing products or activities are taking place) to uncover competing entities and their shareholding structures (For accuracy, recent policy changes have closed the door to easy access to AIC records. While these records are now challenging to obtain, accessing them should be currently approached with caution to ensure that you are not inadvertently violating any PRC laws, the FCPA or the UK Bribery Act. In the near future, I may do a separate analysis of this evolving issue.);
  2. to do a market analysis of products on the shelves in various locations and the source of those products;
  3. to investigate internally and externally the financial data surrounding your business and to re-analyze production data (raw material purchases, utilities etc…) versus sales and market penetration;
  4. to fully investigate your potential adversary;
  5. to begin to create a relationship chart to show connections both familial and business between your joint venture partner and all related persons and entities that appear as shareholders on the various AIC records you have previously recovered (it is not uncommon to uncover raw material suppliers to your venture which are connected to your Chinese partner or his/her family);
  6. if necessary (usually is) to take your investigations offshore to follow the ownership chain of discovered offshore entities and the physical location/nationality of people associated with those offshore entities;
  7. analyze the financial data disclosed on the AIC corporate records (usually this indicates gross sales reported for tax reasons and usually this is unreliable as Chinese will sometimes run two sets of books) and this financial analysis, if compared to your known cost of goods sold, can give you a rough idea of the scope of infringing sales of competing entities.

- Following your investigation, consult with Chinese and foreign litigation counsel with regard to all litigation options. If you have uncovered a “network” of infringing activity, your litigation options may be much more extensive than just launching a suit under one joint venture agreement. You need to develop a global “potential” litigation chart that brings everyone possibly involved in the wrongdoing into the matter.

- As I have noted above, guanxi is a key tool for Chinese to obfuscate, diffuse and deflect (as that relates to business associates and partners as the notion of guanxi extends much deeper than I have explained above relating to the judiciary etc…). As guanxi is based upon relationships, one of your litigation strategies is to upset this personal network of acquaintances such that everyone scrambles at the same time. If for example, you uncover a network (which is in effect a relationship network) of individuals or companies owned/controlled by identified individuals, and you launch lawsuits against everyone in the network on the same day, the pressure on
the key player to negotiate a settlement will be much greater than if you simply launch one lawsuit under a single breach of say a joint venture agreement. In order to get someone in China to seriously sit down and settle, you need to be prepared to completely upset the guanxi network which will result in the application of a great amount of pressure.

- If during and after your investigations, you have not been able to facilitate genuine settlement discussions, you need to be prepared to launch all possible lawsuits in order to facilitate the desire to settle. However, a word of caution, only launch those lawsuits that are supported by the law, the facts and which you believe you have a real chance of victory.

- Use caution when you negotiate. The concept of “face” is still important to Chinese parties and foreigners who fail to appreciate this find it impossible to reach an agreement. You must also be aware of negotiations turning sour and the Chinese party taking it personally.

- Instead of using the original business team, consider using a new team to try to negotiate a settlement. There may be historical animosity between the original team and the counterparty that may prevent a productive settlement discussion.

- Do not be overly fixated on your point of view or approach (do not focus only upon the written contract) but look at matters from the other side and see if any compromise is possible. Sometimes (I know this sounds simplistic, but it is true) all the counterparty requires is an acknowledgement that its position is legitimate, which may pave the way to a settlement.

- Do put in place a proper media management team to deal with potential media leaks which will include understanding and communicating internally your internal corporate guidelines for media communications.

- Lastly, use caution when developing your overall negotiating strategy and analyzing the data from your investigations, and consider, am I negotiating with the right person to resolve my problem? Sometimes, this may be the toughest issue you face.

Similar to many countries in Asia, China is fraught with risks. It is my belief that if you fully understand and attempt to manage/minimize these risks before a China centered dispute emerges, you will be better positioned to minimize the disruptions to your business, management and bottom line.

Always keep in mind that one of the greatest risks to your business and contractual enforcement effectiveness in China, is the level of your financial success.

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ConAgra Foods is one of North America’s largest food companies, but we’re more than that. We’re more than 36,000 individuals, each with a story to tell. And we’re a family — from the son who followed in his dad’s footsteps with a career at ConAgra Foods to the employee who took a temporary job and — eight years later — still loves what he does.
Breaking up is hard to do!
Lessons Learned from Separating Contracts in the Largest Tech Split in History

In recent years, a number of large companies have undertaken corporate separations as a way to unlock shareholder value, increase focus, accelerate growth, and reduce operational complexity. On October 16, 2014, Hewlett-Packard Company announced its plans to do just that - separate into two new publicly traded companies: Hewlett Packard Enterprise, which would comprise HP’s enterprise technology infrastructure, software and services businesses, and HP Inc., which would comprise HP’s personal systems and printing businesses. This transaction remains the largest technology company separation in history and was completed in 391 days, no small accomplishment for a US-based company with subsidiaries in over 110 countries!

While there were many complicated aspects to this separation, one particularly challenging issue was separating the company’s 150,000+ customer, partner, and vendor contracts, as well as millions of associated orders, and simultaneously ensuring that customers, partners, and vendors will be able to continue to do business with both companies effectively and seamlessly after separation. This is a common issue faced by in-house counsel in the context of a corporate separation; yet, there is little guidance available beyond the traditional approach of reading each and every contract to determine the assignment requirements thereunder. This article provides an inside look at how the lead commercial attorneys at Hewlett-Packard Company approached the contract separation task, along with lessons learned and best practices to consider should your company be facing a separation.

1. Understanding the Scope

Before doing anything else, we determined we needed two things: (i) a clear view of the contracts in scope – what they are, where they are, and what lines of business are affected across the company; and (ii) a basic understanding of how the separation is being structured from a corporate perspective. Contract separation for a company in a single country, with a single database of contracts, with easily-defined business lines is hard enough. But the task is amplified significantly for a global company with numerous contract repositories, and lines of businesses that overlap.

As senior and long-tenured commercial lawyers we thought we knew our own company. But it turned out our contract bureaucracy was even more bureaucratic than we realized. Because contracts had been negotiated by hundreds of lawyers around the world over several decades with many contract repositories that were not consistently used, we did not have any one place to turn when we were asked, “Where are all the contracts?” In fact, the Hewlett-Packard Company contract ecosystem consisted of customer, partner, and vendor contracts held in multiple databases, in multiple languages with multiple subsidiaries acting as the contracting party. While most contracts were primarily in electronic format, some existed in paper in the farthest flung regions around the world. To complicate matters further, while some contracts could easily be assigned to one company or the other based on the business units using the agreement, a good portion of the contracts would be needed by both companies following separation. Many contracts were global in nature, with local agreements executed in several countries. In addition, traditional purchase and sale contracts were only the beginning. Lurking behind many of them were millions of order level documents that needed to be allocated to each of the companies as well. To the extent orders needed to be moved between legal entities, a plan would be needed to ensure that payments were made from and to the right legal entities after separation.
[Submission for the International In-House Counsel Journal]

Under our separation structure, in most countries where both Hewlett Packard Enterprise and HP Inc. would have a legal presence post-separation, a new legal entity was created to facilitate the split. It would have been simpler if all existing HP subsidiaries were allocated to one of the companies and the newly created entities allocated to the other. But not surprisingly, simplicity for the sake of the commercial lawyers was not the driving force. Rather, the allocation was based on a complex mix of tax and litigation considerations which offered no logic or consistency to our efforts. To add to the confusion, the separation did not take effect on the same date across all countries where HP conducted business either; separation happened at the country level in waves to help ensure there was time to work out the operational nuances before HP separated legally. In short, any hope that this would be a straightforward contract assignment exercise flew out the window in our first meeting with the corporate lawyers running the deal.

We did find some silver linings. For example, the decision to divide countries into four waves and test each country’s capabilities for effectively operating as separate legal entities before the official separation date of November 1, 2015 actually helped our contract process. The first wave countries consisted of the larger countries, with the second and third waves comprising smaller countries or countries that needed more time to start transition work (such as countries where works council approval was needed before separation work could begin). A fourth wave consisted of countries where HP decided to change its business model, requiring customized approaches to handling contracts. This multi-phased wave approach initially seemed complicated but ultimately helped to simplify separation activities in two key ways. Contract assignments taking place before separation were essentially transfers between affiliates that eliminated the need for third party consent in many cases. Also, the wave approach provided us with the ability to change course in later waves based on experience from the first wave.

2. Formulating the Strategy

Once we had some idea of the contract population and a basic understanding of the corporate transaction, we needed to formulate a strategy for separating contracts that would (1) meet the goals of the separation; and (2) meet the needs of customers, partners, and vendors critical to both companies’ success. To put it as our clients put it to us, we needed to enable revenue generation and business operations to continue uninterrupted during and after separation; and we had to make sure the whole thing would be legally effective under scores of different legal systems!

Companies usually separate because they recognize the difficulty of managing businesses that target different customer segments and different markets, with different competitors and competing priorities. From a contracts perspective, the goal is to make sure each company has the contracts it needs to conduct business today and after separation. One area of complexity came from the “mixed contracts,” that is, contracts that contain scope from both parts of the company that will be separated.

For Hewlett-Packard Company, examples of mixed contracts included outsourcing deals that pull through printer, PC, and related services, or multivendor equipment maintenance services that leverage resources from services organizations across the company. As a first guiding principle to determine whether a contract should be allocated or split, we looked to customer expectations. In the case of outsourcing deals, for example, the guiding principle was to allocate those contracts to Hewlett Packard Enterprise because customers expect to work with one company who manages other suppliers and subcontractors in outsourcing deals. In the case of maintenance services, a key decision point was if the customer was already separately billed for services performed by the businesses going to HP Inc. and
those going to Hewlett Packard Enterprise. If the answer was yes or if the customer had no concern
with separating the contracts, the approach was to separate the contract and notify customers of the
need for the vendor setup changes described below. If the answer was no or the customer wanted only
to deal with one company, the contract was allocated to one company (based most often on the
company with the higher deal revenue). The lesson here: whatever methodology is chosen, it is
important to establish the guiding principles upfront and apply them consistently through the
separation.

Turning to the needs of third parties, one step we found to be very helpful was to meet early on with a
representative cross section of customers and partners to get their feedback on the separation. Those
meetings highlighted the fact that, in the end, the vast majority of our customers, partners, and
suppliers really cared only about their own business – they didn’t care about HP’s plans to separate into
Hewlett Packard Enterprise and HP Inc. except to the extent it might impact them. This news was
extremely helpful as it meant the likelihood of third parties objecting to contract assignments was low.
Most third parties thought the separation made sense and wanted to continue a strong business
relationship with both companies after the separation. They did express concern, however, in two key
areas: (1) the time it would likely take to set up new legal entities in their systems, some indicating that
this process may take as long as six months; and (2) whether both new companies would honor existing
commitments such as pricing and discounts so future business could be done under existing terms
without lengthy renegotiation.

What we learned from these meetings led to another guiding principle that was widely shared internally
and with third parties on the contract separation: no attempt to renegotiate existing agreements and
commitments would be made. Rather, both new entities would honor existing HP commitments,
including pricing and discounts, for their respective scope after the separation. The goal was simply to
allocate contracts to the right legal entity to effect a separation. While these principles and
communications helped to alleviate third party concerns, they served a more important function, which
was to help to focus attention within HP and third parties on how to make the contract separation
process as quick and painless as possible for all parties involved.

Of course, just because our partners and customers were comfortable with the concept of separation
didn’t mean we would be in the clear on every contract. We were well aware that there could be a host
of reasons why different contracts might be problematic and one of our key tasks was separating the
contract population into buckets for purposes of deciding whether to pursue active consent from
customers, partners, and vendors or to merely send notifications.

We started by identifying those contract populations where consent or some action other than
notification would likely be required to assign contracts to a different legal entity. From a legal
perspective, public sector contracts are an obvious category of contracts that would likely require
consent, particularly as public sector procurement rules in most countries require a formal assignment
or novation of contracts before they can be transferred from one legal entity to another. The public
sector also has unique risks to consider when deciding whether to split or assign contracts. In many
countries, changes in the contracting entity, scope of agreement, and the like could give competitors the
right to challenge a public sector contract award or the right to rescind the award. From a practical
perspective, contracts already in dispute is another category that will require some consideration, since
the third parties involved are more likely to look at the separation as a potential opportunity to improve
their negotiation leverage. Contracts in this population will take longer to analyze and resolve, and they
require input and leadership from resources in the countries who are experts in handling third parties
[Submission for the International In-House Counsel Journal]

within the applicable business and legal environment. Moreover, in some countries, regardless of contract language, the legal and business practice is to obtain consent for all contract assignments. It is critical that the appropriate country counsel, business leadership teams, and relationship leads own and drive the analysis and communications with third parties who have contracts in this category. A process should also be established to quickly escalate and resolve issues that cannot be resolved or addressed locally.

3. Assessing the Contracts and Simplifying the Separation Process

After identifying contracts that will likely require detailed analysis and in-country action, the next step is to assess the remaining contract types to determine whether there are ways to simplify the contract separation process. Does there need to be a review of every contract that will be allocated to the new company and an effort launched to pursue required consents?

Thankfully, for the HP separation, the answer was no in most cases. As mentioned earlier, HP chose to separate contracts in each country well in advance of the legal separation date to allow time to ensure operational readiness, and this decision meant that contract assignments would take place between affiliates. HP’s contracts with suppliers and channel partners were mostly on HP standard terms with no consent requirements for contract assignment to an affiliate or to third parties. That said, suppliers and channel partners still required notification that they would be doing business with a different entity following separation. They would also need key information about the new entity (including entity name, address, tax ID, and bank account information) in order to complete “vendor setup” – the process to set up a new legal entity in their order processing systems to facilitate future business. Accordingly, for those contracts, HP sent each partner a simple notification to introduce the separation, outline the contract separation approach, inform them that their contracts were being assigned, and provide them with an individual or an e-mail box to contact with questions. The notification included a link to a website that contained the most current information available for each entity by country. A sample notice is included at the end of this article.

This notification approach was also employed for the large population of master agreements that HP used to facilitate future business. HP already knew that its customers, partners, and suppliers wanted the right to use existing agreements after the separation with both of the new companies. When HP initially approached outside counsel regarding contract separation, we were advised that consent should be obtained from each customer to essentially replicate or “clone” those agreements. Because HP had well over 100,000 contracts in this category across customers, partners, and suppliers, this seemingly simple task would have been impossible to complete before the target separation date. So, we immediately started to brainstorm alternative approaches, keeping in mind that third parties were overwhelmingly supportive of the separation and wanted to continue to use existing agreements to do business with both parties after separation. Country counsels were consulted in all affected countries to understand whether a simpler, less labor intensive approach like notification was a legally viable option.

Ultimately, we developed a two pronged approach that leveraged “course of dealing” with third parties to effect assignment. As described above, third parties were first provided with notification of HP’s contract allocation and associated contract assignment approach for suppliers and partners. The notification confirmed that third parties would have the right to use any of their existing HP master agreements with both new companies for their respective scope, and that the new companies would honor those terms. Working with the sales operations team, HP ensured that all order level documents for deals submitted after separation would be quoted and invoiced by the right legal entity within HP
Inc. or Hewlett Packard Enterprise based on the scope of the order. As future orders were consistently placed with and payments made to the appropriate legal entities, a course of dealing between the parties developed to support the parties’ agreement to the contract allocation and assignment described in the notifications.

This approach was not only more manageable for HP as we moved quickly toward separation but also proved satisfactory outside of the public sector for the vast majority of third parties in most countries. Only a very small percentage of third parties requested alternative documentation (such as an amendment, assignment agreement, or written consent) to assign their contracts, which were easily accommodated within the timeframe of the HP separation.

4. Implementing the Strategy

Once the contract separation strategy is developed, it is critical to communicate the strategy across the organization consistently and clearly. For the HP separation, developing our communication approach was a challenge given the time zones and the large number of interested groups, such as legal leads in all impacted countries and the procurement, supply chain, sales/go-to-market, sales operations, customer/partner readiness, and regional team leads. A variety of communication vehicles were utilized to ensure communications and updates continued to flow, starting first with written responses to frequently asked questions, followed by e-mail updates, periodic telephone meetings, one-on-one calls, and weekly optional office hours where business clients and country attorneys were invited to dial in to ask questions or raise concerns.

Often, the first question asked after describing the strategy is how the strategy will be implemented and who owns each step in the implementation process. Ideally, people who currently handle contracting in the countries and regions should be the ones that implement the contracting strategy. However, in some cases, allowing each country to drive the contract separation process can be inefficient and confusing.

Consider the following scenario. Your company has several existing agreements in place with a global customer, and there are active orders being delivered in 45 countries. Having 45 potentially different approaches to communicating with this customer about contract separation would likely cause confusion and result in more work for your company and the customer than is necessary. Also, in many cases, particularly in countries where there may be few resources, it is not possible for them to handle the work needed to implement the contract separation in country, even if they wanted to do so.

For the HP separation, an order level separation strategy as well as a contract level separation strategy was developed. At the order level, the IT, sales, and business operations teams took the lead on mapping out the operational and systems changes required to separate orders, such as changes in systems to accommodate new legal entities and pursuing or issuing new purchase orders as appropriate. Sales and business operations also took the lead in working with customers, partners, and suppliers to complete vendor setup activities. One key challenge worth noting is the impact to revenue flow when orders are placed before separation and delivery continues after separation. Most companies have order processing rules that require the quotation to match the purchase order and the invoice for each order. Where orders are placed before separation and delivered and/or invoiced after separation, the legal entity name on the quote and purchase order may not match the invoice. For the HP separation, sales operations and legal worked proactively to identify problematic scenarios and draft language to be included in invoices to bridge the legal entity gap and help expedite processing of affected orders.
At the contract level, because third parties were unlikely to push back on contract separation, the default strategy ultimately selected for the HP separation, as discussed above, was to provide notification of contract separation to most third parties, with order level documentation referencing the appropriate parties and contract terms. Public sector contracts and contracts currently in dispute, on the other hand, were handled in-country. However, getting into the details of implementing the notification approach, which seemed simple on the surface, came with its share of complexities and required a good deal of pre-work to ensure successful implementation.

A significant amount of time was spent working with country counsels as a group and individually to create the appropriate notification template for each country. A sample template was first drafted at the worldwide level and provided to the country counsels for review and feedback. Careful consideration was paid to the specific legal requirements and business practices within each country to make sure that the notification strategy was adopted or adapted to ensure the greatest chance of successful delivery and acceptance for each country. In some countries, for example, notices could not be sent by e-mail but were required to be sent by post. Where e-mail was acceptable, some countries required that a specific e-mail notification system be utilized for the notice to be binding. A close partnership with country counsels was therefore critical to the successful implementation of the strategy.

A close partnership with other groups, such as external consultants, was also important to the successful implementation of the contract separation strategy at HP. One of the first challenges for the HP separation was to locate all relevant contracts and load them into a centralized database. For this work, contracts operations led this effort with some assistance, since contracts outside of the larger countries (particularly in Latin America, Asia Pacific, and in some of the newly acquired companies) were often kept in local databases and offices. A multinational consulting firm who had worked with HP before and was familiar with the company’s structure, people, and databases was retained to collect and centralize contracts into one database. In some cases, this involved physically going to office sites around the world to scan and upload hardcopy contracts into the database.

An external vendor was also retained to send and track notification letters. Because notifications were sent both via e-mail and post, it was important to find a vendor who could manage the entire end-to-end process. The vendor needed to be able to provide the services worldwide and handle multiple languages. The vendor was also required to create and maintain a searchable database to store copies of all notices sent and to give HP the right to duplicate the database for use by both of the new companies following the separation. The procurement team at HP was instrumental in finding the right vendor to assist with this effort and helping to manage the vendor throughout the project.

In addition to finding a vendor to send notifications, HP faced the additional challenge of determining where to send the notices and to whom. HP databases had multiple contacts and addresses for each third party, and some of the information was not current. After expending a significant amount of effort in an attempt to gather this feedback from internal clients, a decision was made to send notifications to customers, partners, and suppliers at their headquarters with attention to their legal department where reliable contact information did not exist. Those supporting the vendor setup process then followed up with their contacts to ensure that the notifications were received to facilitate the vendor setup process. Again, the fact that third parties were not concerned about the HP separation led to adoption of a practical approach to address this challenge.
Ultimately, because the HP separation moved so quickly, and there was no clear roadmap to follow, the scope and magnitude of the project was not fully appreciated until it was over. In retrospect, a strong program manager (whether internal or external) would have been extremely helpful to keep all work organized and on-track. The necessity of an end-to-end project plan with definitive deadlines is critical to the success of a project of this scale and complexity. That said, despite the “learn as we go” approach, the HP separation was hugely successful. The contract separation project allowed both companies to continue revenue generation and business operations on Day 1 with minimal disruption for our customers, partners, and suppliers.

5. Lessons Learned and Best Practices

Completing a corporate separation is a trying experience, particularly at the size and scale of Hewlett-Packard Company. Some things that seem so obvious to us now were only learned through hard trial and error. While each transaction will have its own nuances and particularities, here are ten principles garnered from the lessons we learned that we hope will provide a good starting point to undertake the separation of contracts in a corporate separation of any size.

1. **Focus on the big picture.** Get a holistic perspective before developing the contract separation strategy. Understand your contract ecosystem and the end-goals you want to achieve. Don’t forget to view the transaction from the perspective of your key customers, partners, and suppliers. They can help you eliminate low risk areas and understand where you should focus our attention.

2. **Engage the right people.** Key contracting risks are usually in areas where tax, finance, sales ops and legal are most knowledgeable, so engage these groups early. For the legal function, M&A and leads for the regions, business units, and global functions should be engaged.

3. **Plan ahead.** Invest in a project manager with contracts knowledge. Develop a detailed project plan with clear, defined roles and timelines.

4. **Be flexible.** Adjust the plan as the project progresses. It is important to align on the plan upfront, manage the plan, and hold people accountable for delivering on their commitments but also be flexible enough to handle any unforeseen obstacles you may encounter.

5. **Keep current.** Changes to the overall company separation plan will occur, whether those changes are the result of internal or external decisions or events, which can impact your contract separation strategy.

6. **Bring in the experts.** Don’t try to recreate the wheel. Consultants, outside law firms, specialty vendors, and internal subject matter experts can all add to the success of your project. Identify and engage the team in your organization that is in the best position to compile a list of customers, partners, and vendors and determine how best to get contact info. Your procurement organization will likely be in the best position to help select and manage the vendor needed for notice delivery.

7. **Be inquisitive.** Ask questions and raise concerns early and proactively. With time, you can usually solve any problem.

8. **Over communicate.** Be prepared to communicate information multiple times in different ways. People absorb information differently.

9. **Be considerate.** People work nights and weekends for extended periods of time on these projects and have many urgent requests. Before asking for help, consider whether you’ve done what you need to do to clearly identify the question and the best person to help. Also give people the benefit of the doubt. Be constructive in raising concerns. Assume intent of feedback you receive is constructive.

10. **Celebrate!** Celebrate successes, large and small, as they happen. Thank those who help you accomplish those successes and remember to prioritize what’s important, including making time to
wind down, de-stress, and stay healthy. Mistakes are most often made when people are rushing or are overly tired, stressed, or hungry.

Even if you’re not currently facing a contract separation exercise, there are steps you can take now that would be very helpful in the event such a need ever arises. Simple steps such as maintaining current customer, partner and supplier lists, making sure addresses and contacts are updated regularly, and maintaining a database of agreements that is easily searchable would all go a long way in making a contract separation exercise run more smoothly. Ideally, if you have the capability, electronic tracking of relevant contract data fields, such as the legal entities that signed the agreement for your company and consent requirements for assignment and change of control would be even more helpful to your efforts. The only certainty in any corporate separation is that you will wish you had more time to prepare for it, so anything you can do proactively will reap dividends if or when that day ever comes!

Author Biographies and Company Information

Peggy Chang Barber is Vice President and Associate General Counsel for Global and North America Commercial Sales at Hewlett Packard Enterprise (HPE). In this role, she and her team provide legal support for a wide range of sales and go-to-market clients and transactions involving the Enterprise Group, HPE’s largest business unit. Peggy joined HPE in 1999 through its predecessor, Hewlett-Packard Company, and has held leadership roles supporting all business groups and regions, including a rotation as Asia Pacific Region Counsel for the services businesses. She has also served as the lead commercial attorney in a number of corporate transactions, including the split of Hewlett-Packard Company in 2015 where she served as lead commercial attorney for HPE. Peggy is currently the lead integration attorney for HPE’s acquisition of Aruba Networks, in addition to co-leading contract separation for the spin-merger of HPE’s Enterprise Services group with CSC. Before joining HPE, Peggy was a commercial real estate attorney at Rudnick & Wolfe (now part of DLA Piper) in Washington, D.C. She holds a J.D., MBA, BBA in Finance, and BA in Mathematics from The University of Texas at Austin.

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HP Inc. creates technology that makes life better for everyone, everywhere. Through our portfolio of printers, PCs, mobile devices, solutions, and services, we engineer experiences that amaze.
Hewlett-Packard Company Contract Assignment Notice - Sample

[Insert Date]

[Insert Entity Name of Third Party]

ATTN: Legal Department

Re: Assignment of [Customer/Partner/Supplier] Agreements relating to Hewlett-Packard Company and its subsidiaries (collectively, “HP”)

Dear [Customer/Partner/Supplier]:

Background

On October 6, 2014, Hewlett-Packard Company announced plans to separate into two publicly traded Fortune 50 companies (“Separation”): one comprising HP’s market-leading enterprise technology infrastructure, software and services businesses, doing business as Hewlett Packard Enterprise Company (“HPE”), and one comprising HP’s market-leading printing and personal systems businesses, doing business as HP Inc. (“HPI”).

Until the Separation is completed, HP will remain a single organization and continue to operate under our agreements with you and your affiliates in the manner you have come to expect from us. Starting in August 2015, HP will reorganize its business by delegating and assigning its assets and liabilities to HPE (and its subsidiaries) or HPI (and its subsidiaries). This letter contains confidential information about HP’s reorganization plans which we are sharing with you under the confidentiality provisions of our existing agreements with you.

Country Separation

HP’s reorganization is anticipated to happen by country according to the schedule found here [insert website] (“Country Implementation Date”). For the United States, the Country Implementation Date is August 1, 2015. On this date, a newly created Hewlett Packard Enterprise Company will begin to transact HPE-related business with you, while Hewlett-Packard Company will continue to transact HPI-related business with you.

Your Agreements with HP

This letter is one step in the Separation process, and we would like to notify you that, effective as of August 1, 2015 (“Effective Date”), each of your agreements with HP in the United States (including all associated agreements such as non-disclosure agreements and equipment loan agreements is being delegated and assigned (“Assignment”) as follows:

1) Your agreements that relate solely to HP’s enterprise technology infrastructure, software and services businesses, including agreements with HP Financial Services, will be delegated and assigned in full to HPE and its subsidiaries.
2) Your agreements that relate solely to HP’s printing and personal systems businesses will remain in full with HPI and its subsidiaries. Please note that for agreements you and your affiliates may have with HP outside of the United States, such agreements will be delegated and assigned in full to HPI and its subsidiaries where the newly created entity will transact HPI-related business.

3) Your agreements that relate to both HP’s enterprise technology infrastructure, software and services businesses and HP’s printing and personal systems businesses will be divided, delegated and assigned so that in effect, each agreement operates as a separate agreement with HPE and HPI, allowing you to transact business with each company for their respective offerings, without interruption. For clarification, outsourcing services agreements under which printing and personal systems products and services are delivered by HP will be delegated and assigned in full to HPE and its subsidiaries.

For agreements between HP and your affiliates outside of United States, the effective date for the allocation above will be the applicable Country Implementation Date provided in the Country Separation section above.

HP’s rights, duties and obligations under all of the agreements described above will be divided, delegated and assigned to HPE, HPI and/or their subsidiaries accordingly.

Additional Information

We understand that you and your affiliates will need some information about HPE and/or HPI entities for the Separation. Updated information for HPE and HPI (including legal entity name, address, and operational information) is provided and will be regularly updated at: [insert website]

All open orders with your current HP contracting party will be transferred together with their related agreements on the applicable effective date. Further communications will be provided to you with all required information for those open orders.

Please contact us at [Name/email address] by or before July 15, 2015 if you have any questions or concerns about the Separation, the Assignment or this letter.

Sincerely,

Hewlett-Packard Company

[Insert signature block(s) and works council disclaimer]
RK Associates GbR
Cecilienallee 33,
40474 Düsseldorf, Germany

Mr. Raj Kaul
Managing Partner
Email: raj.kaul@rka-advisors.com

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THE M&A PROCESS & ENVIRONMENT

“In a world of abundant capital, low interest rates and high investor expectations, M&A is one of the best options available to companies to help hit growth targets“

Source: Bain & Company 2014
Why M&A (Divestments)

- Companies choose acquisitions, carve outs, JVs, IPOs (company, product, technology) over internal opportunities to help create winning strategies.

  - leverage own R&D
  - production resources / supply chain assets
  - geographical presence
  - competition pressure (industry consolidation)
  - brand leverage / expand or rationalise product portfolio / new customers
  - growth prospects, attain / maintain leadership
  - post patent strategy
World Class Transaction Process

Corporate Strategy - Corporate Strategy and Business Model - Board Leadership
- Target selection
- Pre bid valuation
- SWOT Analysis (Risk)

Transaction Strategy - Appoint advisors
- Synergy identification and valuation
- Due diligence
- Deal structure and financing

Realisation - Review risks and issues
- Planning post acquisition implementation
- Negotiations

Completion - Integration team
- Deliver INTEGRATION plan and synergies

Implementation

August 2016
Ensuring Success

Pitfall 1: Faulty Strategic Reasoning

This is a pre-acquisition phase activity.

A well thought out strategy is key to success.
## Ensuring Success

### Pitfall 2: Valuation

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Some Challenges:
1) Value of R&D / new technologies
2) Synergy assessment
3) Asset / Share deal
4) Analysis of competing bidders
5) Cash generated

Source: Deutsche Bank
Pitfall 3: Synergy Mirage

- Synergy math: 1 + 1 > 2

“Synergy has been defined as increase in competitiveness and resulting cash flows beyond what the two companies are expected to accomplish independently“ – Mark L. Sirower.

Possibly the most risky element as you “pay up-front“ and then recover in future dependent on speed and efficiency.

Synergy is expected Benefit minus Premium paid.
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Integration problems could be categorized as “hard” and “soft” areas.

- **Hard Areas** - Production technology, IT, Regions, Distribution, R&D assets etc. Integration easier but cost sensitive especially over time.

- **Soft Areas** - Culture issues
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- Clarity, guidance and communication are vital for ”soft” issues.
What Selection Criteria do Corporations most often use to select their M&A Advisor(s)?

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The top reasons given for deciding to do a deal without an advisor were:

a) the corporation already had the appropriate expertise in-house;

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Criteria for selecting M&A Advisors

- Understanding of company's needs
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Often small boutique advisors are preferred because of expertise of industry and reliability.

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There is growing evidence of a resurgence of M&A in the Agchem and seed business. Some recent examples that underscore this:

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Pitfall 1: Faulty Strategic Reasoning

- This is a pre acquisition phase activity.

- A well thought out strategy is key to success.

- SWOT analysis as key tool to develop business strategies:

  Analysis of strengths, weaknesses, opportunities, threats aiming at e.g. identifying:

  - capabilities and areas of improvement;
  - weaknesses and needs to strengthen or to abandon;
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August 2016
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“I would like to acknowledge the contribution of my RK Associates partners in **Europe** (Joerg Kempken), **India** (Chander Sabharwal, Pavan Kumar) and the **USA** (Cora Steginsky, John Finney).”
In March 2016, the Brazilian Ibovespa stock market index had its best monthly performance since October 2002 and posted a 17 percent increase. During the same month, the Brazilian real appreciated by 10 percent against the U.S. dollar. Fueled by the impending impeachment of President Dilma Rousseff, Brazilians are cautiously optimistic that they may be freed of what her critics have termed disastrous economic and legal policies. Should this sudden euphoria be a signal to international companies to buy businesses in Brazil, especially as asset values have fallen with the recent economic downturn, and the real has devalued by more than 100 percent relative to the U.S. dollar in the last five years?

Impeachment by itself will not improve Brazil’s “ease of doing business” ranking of 120 out of 189 countries by the World Bank and the International Finance Corporation—a ranking that can make the M&A process particularly challenging. Getting rid of the added cost of doing business in Brazil, or the “Custo Brasil,” will require more than a change in the Brazilian president. Foreigners looking to invest in Brazil need to take into account a number of economic and other factors, including the peculiarities of Brazilian law, custom, and culture.

Corruption is an important element of the Custo Brasil that can make the M&A process formidable. The due diligence process, especially involving privately held companies, may uncover inappropriate payments made by the target to governmental authorities, frequently in connection with tax, labor, governmental permitting, or customs matters. In light of the mandates of the U.S. Foreign Corrupt Practices Act and other similar relevant laws, before entering into any transaction, an investor needs to identify such practices and implement the necessary controls and training systems to ensure that these practices do not continue post-acquisition. In addition to hiring an auditing firm to examine accounting records, retaining a private investigator to do background checks on the target company and its executives and shareholders is common.

The Brazilian Clean Companies Act, which went into force in January 2014, imposes requirements comparable to those of the U.S. Foreign Corrupt Practices Act and the UK Bribery Act. In the case of an entity acquired through merger, the law makes the successor entity liable for restitution and fines of up to the...
value of the assets transferred in the transaction. In addition to the decrease in illicit practices as a result of the new law, investors can take some comfort that Brazilian executives, unlike many of their counterparts in other parts of the world (and unlike some Brazilian politicians!), when queried often will come clean and admit to their past questionable practices.

The lack of transparency also affects trust in judicial authorities. Because of concerns about transparency (whether perceived or actual) and inordinate delays in Brazilian courts, arbitration is the preferred dispute resolution mechanism in M&A agreements. If arbitration decisions will have to be enforced in Brazil (because a party’s principal assets are in Brazil), the arbitration should be conducted on Brazilian soil; those rendered outside of Brazil must be “homologated” before Brazilian courts will enforce them. Arbitration in Brazil can be in the English language using international rules.

**Labor Laws**

Another key part of the Custo Brasil is Brazil’s complicated labor laws. They dictate the provision of various fringe benefits and terms of employment, including severance obligations upon termination. At-will employment is a concept that does not exist in Brazil.

Most employees in Brazilian companies are automatically members of the union that represents their industry or profession; the employer must comply with the requirements of the relevant collective bargaining agreements. Most companies have a large number of pending labor lawsuits (for example, a well-known international company with 18,000 employees in Brazil has 2,000 pending labor litigation matters).

Salaries for qualified executives can often be higher in Brazil than those for comparably situated executives in the United States, given the high cost of living and relative scarcity of educated professionals. If key executives are to be retained in management roles (particularly in the administrator role of a limitada, or limited liability company), some Brazilian lawyers suggest that “pro-labore agreements” might provide more flexibility than what would otherwise be required by employment agreements under Brazilian labor laws. Post-employment noncompetition obligations, however, are difficult to enforce and require payment of compensation during the noncompete period (noncompetition obligations imposed upon sellers of a business, in contrast, do not require payment of separate consideration).

Many companies seek to avoid labor law mandates by using independent contractors and sales representatives, who may later challenge their status in employee-friendly labor courts. Moreover, the Brazilian sales agency law requires payments upon termination equal to one-twelfth of all consideration paid to the sales representative during the lifetime of the relationship.

**Taxation**

A third contributor to the Custo Brasil is the convoluted tax regime, with myriad taxes imposed at the national, state, and local levels. The difficulty in complying with the complicated tax system is compounded by aggressive tax planning. Many of these tax positions may be challenged years later, and they can be subject to high interest and penalty charges. Even if the likelihood of discovery and challenge of the tax position is remote, FIN 48 of the U.S. GAAP accounting standards requires U.S. companies to prepare financial statements where tax contingencies are accrued based on the assumption that all tax positions will in fact be examined by the appropriate taxing authority.

Tax planning is an important part of the Brazilian M&A process. To obtain partnership (“check the box”) tax treatment for U.S. income tax purposes, the Brazilian entity acquired should be a limitada and not a sociedade anônima (corporation). Brazilian tax lawyers often recommend that acquisitions be structured by creating a Brazilian entity that acquires the shares of a target company, which merges into the target company at some point after the acquisition to secure certain tax advantages as part of the transaction.

**Civil Law Mandates**

The civil law tradition of Brazil may also limit flexibility in structuring transactions. Buying the assets of a business as opposed to the equity interest of the company does not avoid successor liability for labor, tax, and other contingent liabilities. In fact, the acquiring company can be ensnared with group-wide liability for tax, labor, and environmental matters. As such, there is a heightened focus on applicable statutes of
limitations. For tax contingencies, there is generally a statute of limitations that covers tax liabilities for five full tax years, and for labor contingencies, the statute of limitations is generally five years for a current employee and two years from the date of termination for a former employee.

To guarantee repatriation of the original investment and dividends, an investment should be made with funds that are brought into Brazil and duly registered with the Brazilian Central Bank. Licensing transactions that result in payment of royalties on trademarks, patents, and know-how outside of Brazil must be registered with the INPI, the Brazilian patent and trademark office. Royalties between related parties on trademarks and other rights are often limited by the INPI. Under Brazilian law, know-how is not licensed, but rather deemed to be transferred by the party possessing the know-how.

Antitrust Considerations

Brazil now requires prior approval by CADe, the Brazilian antitrust authority, of acquisitions surpassing certain statutory thresholds. Transactions in which the combined operations will result in a market share of more than 20 percent in the relevant market require the filing of a laborious “long form statement” that allows the authority more time to review the filing. From an operational and due diligence perspective, buyers need to take into account that there is greater scrutiny of anticompetitive behavior, including price fixing.

Public Company Issues

Investment in publicly traded companies is affected by the rules of the CVM, the Brazilian securities and exchange commission, and the listing rules of the BM&F Bovespa. Acquisition of a controlling interest can trigger a mandatory tender offer for the free float of the publicly traded company. The bylaws of publicly traded companies can contain what is termed by Brazilian lawyers as “poison pill” provisions that extend such tender offer requirements to where only a 10 or 20 percent interest is acquired. In acquisitions where the target will remain publicly traded, the transfer agent of a publicly traded company may require certain information or other actions in order to register the shares in the name of the purchasing entity. Transfer agents sometimes also impose limitations and restrictions upon future transfers of shares.

M&A Customs and Practices

The customs and practices surrounding Brazilian M&A agreements can be helpful to buyers. For example, asset or stock purchase agreements, unlike in the United States, often contain pro-buyer provisions indemnifying for all preclosing liabilities, with no cap or one equal to the purchase price, with baskets of less than one percent of the purchase price, and with indemnification time periods that typically range from three to five years. Escrows of between 15 and 30 percent of the purchase price for the indemnification term are not uncommon. The limited caps and time periods for indemnification and baskets that one sees in U.S. acquisition agreements, however, are gaining favor in Brazil. In addition, in cross-border M&A transactions where the target is Brazilian, New York, Delaware, or other U.S. state law may be used as the governing law of the transaction documents (as is often the case in other Latin American countries).

Brazilian law generally requires that contracts governed by Brazilian law specify payments in Brazilian reais. In cross-border transactions governed by laws other than those of Brazil, to avoid some of the complications that might result from fluctuating exchange rates, it may still be advisable to fix the purchase price in the Brazilian currency. Fixing the price in local currency is consistent with a valuation that is based on revenues and costs in local currency and simplifies the process of introducing the correct amount of funds for Central Bank registration purposes.

A final important matter that cannot be ignored is that negotiating transactions in Brazil often becomes a process where the counterparties get to know each other. As such, the process generally is longer than one would see in the United States or Europe. Getting down to business immediately or aggressive negotiating tactics with “take it or leave it” stances are usually counterproductive and do not facilitate getting the deal done.

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Lawyer Contacts

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30-SECOND SUMMARY Western companies entering Asia for business should consider the following. Always try to privately negotiate a settlement. There is nothing to be gained by following arbitration or litigation through to a decision or judgment with the intention of enforcing that award. The mediation route is the most recommended course of action because it preserves long-term business relationships. Personal relationships are more important to your business success than any written agreement and should not be underestimated. Because relationships can take time to foster, recognize that deals in Asia take longer than in many Western countries. Never force a deadline if things are generally progressing forward.

WHAT YOU NEED TO KNOW ABOUT Doing Business In Asia

By Iohann Le Frapper and Randall Lewis

Between the two us, we have over 25 years of legal experience in Asia, specifically China. Over the years, we have both witnessed avoidable and costly mistakes made by very savvy Western business leaders in regard to their businesses throughout Asia. The missteps and errors are continuing to this day, and it seems as though several Western companies are still entering into Asia with their eyes wide shut due to either over-exuberance or simply poor advice. Whatever the cause, we both felt the legal community would benefit from a simple checklist of considerations and concerns (and of course, our pointed and wise advice) that your company (and its operations) will face in any Asian nation. While this listing does contain some generalizations, the benefit of this listing is to save you the trouble of ferreting out the same takeaways gleaned from 20+ lengthy articles.

What you need to know

• Avoid signing any agreement, whenever possible, that provides for local litigation or arbitration (e.g., CIETAC) in mainland China (with some minor exceptions not discussed herein). While we will admit that the implementation of the rule of law and the judiciary in China is improving, the system is still fraught with non-standard behavior that results in arbitral and judicial decisions based upon factors not associated with your written agreement. In our experience, for low-dollar disputes, disputes that do not implicate any State interest and disputes that have very low public interest, fair impartial decisions can be rendered in a Chinese court or through CIETAC arbitration. When entering into a contract, the basic assumption is that you will be a success and your venture will be wildly profitable. Therefore, there is no reason to contractually subject yourself to a dispute resolution mechanism that could destroy the basis of your bargain. Arbitrating in Singapore (SIAC) or in Hong Kong (HKIAC) is always our preferred dispute resolution mechanism and the enforceability of such arbitral awards in China is well established.

• Don’t assume that the agreement you have signed will be interpreted or enforced as written. In many Asian countries (China in particular), contracts are interpreted based upon course of dealing, taking into account the evolution of various external factors. Remember that your contract is only your understanding on the day of signing, and not on the day you sit down to resolve a dispute. Any informal waiver or deviation in practice from the initial terms of the agreement, which is not rare, is likely to have very significant weight on the future interpretation of the deal terms. Betting that you are better off not to memorialize such variation may cost your company greatly the day you opt to revert back to the initial terms of the agreement.

• Always try to privately negotiate a settlement. There is nothing to be gained (in most cases) by following arbitration or litigation through to a decision or judgment with the intention of enforcing that award. The mediation route is the most recommended course of action, particularly for preserving a long-term business relationship and everyone’s corporate reputation, although outside counsel may have a different position (often driven by self-interest). In other words, the litigation route implies that the company (and not a manager for a matter of principle) has come to the conclusion that there will be no further business dealings with that partner, vendor or customer.

• If you negotiate contracts and agreements as you would back home (i.e., creating lengthy documents that cover any and all contingencies), you may unintentionally alienate your new business partner and start your commercial relationship off on the path to failure. Further, a few months after a strategic deal has been signed off, taking the stance that your Asian partner can only blame itself for having accepted unfavorable terms and conditions (e.g., arguing that they should have read carefully all exhibits to the main body of the agreements prior to signing off on the deal) can be tempting but may not pave the way to a successful and sustainable relationship. This might sound odd, but it is true: You cannot assume that people in Asia (China in particular) have read and understood all the terms and conditions contained within a contract. It is possible, even today, that key people sign contracts in China based upon mutual trust rather than a careful reading of an agreement.

• In most developing nations, personal relationships are more important to your business success than any written agreement. That having been said, great agreements are always doomed to fail if you do not take the time to build real and long-term relationships with your local partners. For example, if you believe that it does not matter that a deal is mutually beneficial to both parties as long as you manage to impose your terms and conditions even to the detriment of your Asian counterpart’s interests (e.g., “We won and they lost”), your company may encounter some serious difficulties at a later stage. Your short-term business win or your one-off successful M&A deal may not compliment the strategic goals of your company in a specific market, especially if it

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transactions be accelerated.

- It is usually a good long-term strategy to make concessions in the interest of preserving a commercial or business relationship, even if such an accommodation would not be proper in your home country. Aggressiveness and strict adherence to contractual compliance in Asia can sometimes alienate your business partners and result in bad publicity that harms your ability to secure future relationships. However, each side should make concessions to reach a win/win trade-off outcome. But keep in mind that making any unilateral concessions may not lead to gaining any respect or future return from your business partner who might believe that you are just a fool.

- Deals in Asia often take much longer than you will expect. Never allow your internal financial or strategic goals to drive artificial deadlines to secure agreements or close deals. Cool down the expectations from senior management about the realistic timeline of deals in Asia. Long-term costs may greatly outweigh short-term gains. In our experience, quite a few Western companies have paid a high price in making hasty, last-round concessions that significantly reduced the profitability of the business or the protection of their technology crown jewels, simply because the time pressure was too high to close negotiations in line with senior management’s expectations. For in-house counsel, the challenge will be to manage commercial expectations and offer clear explanations of risks should a transaction be accelerated.

- Companies in Asia who face less short-term pressure from their shareholders, and often focus more on their long-term strategic plans, can be extremely skillful in their negotiations. This is very pronounced when those same Asian companies are negotiating with listed entities in the United States or Europe that must deal with financial disclosure and market expectations every three months, and may be under pressure to close deals or agreements on set timelines.

- In a nutshell, everything in Asia takes longer than at home. Use caution when setting deadlines and expect unforeseeable delays. Never force a deadline if things are generally progressing forward.

- If your business becomes profitable, use caution to ensure that your local partner is not privately manufacturing ways to rebalance the financial landscape in a manner that fits their idea of fairness (i.e., look at your suppliers, raw material purchases and competitors to ensure they are not connected to your partner or his family/friends). In short, do not assume that because you are profitable that your local partner is necessarily satisfied with his revenue stream.

- Business success in Asia is measured by your public image, and not only by your gross revenue or sales.

- Financial projections in China and some other Asian geographies (excluding possibly Hong Kong or Singapore) are just projections. Take them with a grain of salt. If you want profitability, create a good market-entry strategy that focuses on gaining brand recognition and good support from your strategic partners. Instead of focusing on a financial target, set market and soft factors as measures of success. If you are entering into any new foreign market, you need to think long term, rather than only two or three years out.

- Train, monitor and guide local agents closely, and do not assume that their motivations are aligned with your obligations in your home country and your internal policies. Sometimes, people who promise success due to their local connections will expose you to US Foreign Corrupt Practices Act and UK Bribery Act violations, and possibly violations of local laws as well. Use caution when dealing with local agents and employees.

- Training of local employees with regard to your preferred business practices is important. Local employees who are aware of your internal policies may not always understand how to implement them or understand why they exist. This is especially true in China (for example only), where it is possible that some of your employees may never have been exposed to foreign management or foreign companies. They may continue to do business on the basis of gentlemen’s agreements and in a non-standard manner that exposes you to risk.

- Do not assume that local employees understand your employment manuals or other policies, which should also be available in key languages where your company operates. Always conduct training...
Don’t assume that because local government officials, officers or people are friendly that they will support you or your business.

programs for all levels of staff, including local general managers, business partners and senior executives. Deliver your trainings (face-to-face or online) using the audience language as much as possible. For example, a training in English for the benefit of your Chinese staff will not be as effective as a training in Mandarin (the same is true for back-up slides).

- When creating important policies — the violation of which can have a huge financial pain (FCPA, UK Bribery Act, competition law, antitrust issues) — circulating these policies and conducting training programs is not enough to ensure people really understand. Create mini quizzes that are sent to all staff, along with a confirmation upon completion. This is the only way to really ensure that people have not only read the policy but have also been forced to actively think about and consider real-life scenarios in practice. Last but not least, face-to-face trainings are by far more effective than online trainings, as they enable people to speak up and share their experiences and specific dilemmas.
- Don’t assume that because local government officials, officers or people are friendly that they will support you or your business. Being friendly is far from being supportive. Local protectionism is also alive and well in Asia (but, of course, not specific to Asia). Do not be lulled into thinking your business or staff is somehow immune from this reality.
- Always ensure you have in-house regional counsel with experience in dispute resolution. This does not mean litigation experience. The keyword here is “resolution” and not litigation.
- Always have a good corporate social policy and programs to help disadvantaged people in your key countries of operations. In many Asian nations, the concept of charity or social activities by local companies may be lacking (although one could list quite a few companies in each country that are well-known for their CSR activities). If you are seen by the local public to genuinely care about your host nation and its people, you will be rewarded with increased sales and a good public image.
- Corruption is widespread throughout Asia. However, there are gray areas that you need to understand with regard to each location. For example, while it is widely thought that corruption is rampant in China, this is not your sole concern. Your larger concern is with the “guanxi” system. Guanxi is a direct personal relationship with a person or a friend of that person. Guanxi, both historically and today, does play a part in influencing governmental officials, judges and most of society to either act or refrain from acting (as the case may be) based upon that personal relationship. The label “corruption” is not entirely accurate in this context. For the sake of clarity, guanxi may have positive or negative bearings depending on the circumstances in which one person is leveraging his network, what is the goal (legitimate or not), which favours are sought, etc. Please see the article in ACC’s March 2013 Asian Briefings titled, “Clarity on Guanxi, Cultural and Media Issues in China.”
- Creative structuring of a business or acquisition may look great on paper. However, no matter how beautifully structured your deal is, it is doomed to fail if you do not have trusted employees and management in your business with the right to influence and control decisions on the ground. We would rather have an inefficient corporate structure but great board and management control of operations.
- Competition is fierce in Asia. Do not underestimate the power of existing players to take unexpected action in order to force you out of the market or to make your business more challenging (e.g., artificial manipulation of the media and online discussion forums,

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Top Ten

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customs inspections, regulatory inspections, visits from tax officials, compromising your employees, industrial espionage, etc.). Also, don’t assume that your competition is legitimate. It is also possible that some of your employees or their friends/relatives may be invested in, control or manage your competition.

- Always have in place a good government relationship team that is regularly reaching out to key government players in your industry. However, do not assume that government lobbying alone will result in the alleviation of any of your legal troubles in any Asian country.
- Always have in place a good media management team that is well versed and prepared to assist in the event your company finds itself in the press or the subject of local social media criticism.
- When in China, if a local government offers your business tax or other incentives, never assume that these are ironclad. Frequently, in second-, third- and fourth-tier cities, local officials will grant promises and incentives that are not supported by PRC laws or regulations at central level. If the local officials are shuffled or certain inspections take place, you will not be able to rely upon concessions granted which were not supported by national policies at the time granted.

While our listing of advice and considerations may appear daunting, do not fret. Asia is an amazingly exciting place to do business, and even though fraught with hidden risks, those risks are relatively containable with a little forethought, planning and management. Please do not hesitate to contact either of us if you have any further thoughts on this article. ACC

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