

C A N A D I A N

INTERNATIONAL LAWYER

REVUE CANADIENNE DE DROIT INTERNATIONAL

Vol. 10, No. 1



2014

In This Issue

Editor's Note/ Mot de la rédactrice en chef

Noemi Gal-Or

Articles

Six Practical Considerations Before Self-Disclosing a CFPOA Foreign Bribery Offence (Sean Murphy)

Case Commentary/ Commentaire d'arrêt

The Ezokola Decision (David Matas)
The Modest Career of the *Justice for Victims of Terrorism Act* (Monique Pongracic-Speier)

Practice Notes / La pratique en bref

Asymmetric Clauses: A Risk worth Taking? (Christina Porretta & Vanja Ginic)
Pointers and Tips When Negotiating Contracts with Chinese Companies (Caroline Berube)

Dans ce numéro

Treaties / Traités

Canada Enters into Free Trade Agreement with South Korea (Paul M. Lalonde & Olivia Wright)

Legal Developments / Développements juridiques

First Jail Sentence in Canada for International Bribery (James Klotz)
Closing the Gap: China's Most Recent Efforts to Eliminate the Differential Treatment of Foreign-Invested Enterprises (Peter Corne & Ray Liu)
The LCIA Takes Control: Whether You Want it to or Not (Jane Wessel & Gordon McAllister)

Book Review / Critique de livre

Canada's Laws on Import and Export (Konrad von Finckenstein)



THE CANADIAN
BAR ASSOCIATION
L'ASSOCIATION DU
BARREAU CANADIEN

INFLUENCE. LEADERSHIP. PROTECTION.

Pointers And Tips When Negotiating Contracts With Chinese Companies

By *Caroline Berube**

China is a country with a rich culture dating back thousands of years. When negotiating contracts with Chinese companies, we should not only pay attention to Chinese laws, but also take note of Chinese culture, environment, and language barriers.

This article summarizes the pointers and tips to keep in mind when negotiating contracts with Chinese companies, namely: company searches and credit checks, undertaking other due diligence, use of contracts, and authorized signatories.

A. Company Searches and Credit Checks – Crucial!

Company searches and credit checks have become more and more common in recent times, not only for foreign companies wishing to conduct business with a Chinese company, but also for Chinese companies wishing to conduct business or establish connections with each other.

The basic information (e.g. the name, address, date of establishment, business scope, etc.) of a duly registered Chinese company is generally open for public search (but only available in Chinese characters) by the following means:

1. On-site search at the registry of the local Administration of Industry and Commerce (“AIC”); and
2. Online search via the official website of the local AIC. However, the AIC’s of certain minor cities do not provide online search facilities.

Detailed information (e.g. shareholder structure, history of company changes, financial information, etc.) of a duly registered Chinese company can be generally obtained by an on-site search at the local AIC, on condition that the individual requiring information provides certain documents required by the AIC. Note that such information is easily available because each company (locally or foreign owned) incorporated in China must comply with laws and regulations and submit on a monthly/quarterly basis financial statements to the authorities. Documents required by AIC vary in different cities, but usually include the following:

1. The ID card or business license of the individual requesting the information; and
2. A power of attorney authorizing the individual to proceed with the search.

Service companies/agents can also provide company searches in China, and thus can provide detailed information, including financial information, about any Chinese company without the individual requesting the information needing to provide the above-mentioned documents. However, note that the Chinese government takes a dim view of persons breaching data privacy these days and in recent times, has adopted new measures in this area.

For example, selling or illegally providing individual information or illegally obtaining information on an individual is a crime with a potential

Savoir négocier un contrat avec une entreprise chinoise

Caroline Bérubé*

Négocier un contrat avec une entreprise chinoise exige une attention particulière aux barrières culturelles et linguistiques. Il existe néanmoins des mesures que les entreprises canadiennes peuvent prendre pour s’assurer du bon déroulement de ces négociations. Les entreprises canadiennes devraient toujours effectuer des recherches et des vérifications de solvabilité sur les entreprises chinoises avec lesquelles elles font affaire. On peut généralement obtenir des informations détaillées auprès du bureau local de l’Administration de l’Industrie et du Commerce. Les entreprises effectuant une vérification préalable doivent cependant être sensibles au fait que certaines composantes courantes en Occident de la vérification préalable, comme l’examen des documents sur place, peuvent être perçues comme offensantes. Si possible, ces entreprises devraient utiliser d’autres méthodes. Par ailleurs, les contrats chinois sont en général beaucoup plus courts que les contrats occidentaux et misent davantage sur la bonne foi. Les entreprises devraient donc préparer des contrats courts et éviter les formules fortes susceptibles d’être considérées comme inéquitables.

Certains problèmes de langue peuvent également survenir. Il faut toujours faire appel à des traducteurs indépendants spécialisés en droit. En outre, les entreprises devraient exiger la primauté de la version en langue anglaise du contrat et de la loi canadienne. D’autres considérations incluent le



sentence of imprisonment of up to three (3) years plus a fine.

B. Due Diligence

Although due diligence has been seen as being more important in the last decade, due diligence on target companies is still less common in China than in the Western world.

HJM conducted due diligence on a Beijing company in early 2013. Our investigation showed that this company was well organized; the officers of the company were cooperating during the due diligence exercise and the company records were easily available. However, the officers mentioned that it was the first time they heard about and experienced a due diligence process.

For a majority of Chinese companies, cultural sensitivities play a part. Company personnel feel offended if a team of lawyers or other professionals come to their office, scrutinize their documentation and interview their staff with dozens of questions, despite the due diligence team acting professionally and cordially.

Therefore, when conducting due diligence in China, certain aspects which may be perceived to be “offensive” by the target company may be best eliminated from the process (depending on the circumstances). For example, reviewing documentation, such as certificates on-site and interviewing the employees of the target company could be substituted by doing a neutral credit check, interviewing long-standing counter-parties of the target company (should they be willing to co-operate), and other means that would not directly cause conflict.

C. Contract

Practical pointers regarding the contract with Chinese counterparts are listed below. They focus on the importance of brevity and simplicity, avoidance of “strong” wording, use of competent translators, tips for choices in governing language and governing law, and avoidance of other common pitfalls.

1. Keep it short and simple

Western standard contracts are usually quite lengthy and thorough. They are drafted from a highly risk averse standpoint, with the aim that no ‘loophole’ is left open which may expose the contracting party to risk. However, Chinese businesses rely on good faith and value relationship with each other, commonly called “guangxi” in China, much more than the preciseness of contracts.

HJM has experienced many negotiations with Chinese companies in different fields and industries. Chinese companies prefer entertainment with their counter-party in order to obtain more knowledge about the counter-party and pay less attention to contract clauses. If the parties have established trust, the contract may only be one (1) to two (2) pages long. It is worth noting that some Chinese companies may not even review the contract before signing it.

HJM once negotiated a contract more than thirty (30) page long for a Beijing company, which was drafted for our client. We spent two full days in a meeting in Beijing, where we explained the clauses of the contract providing further clarification about the contract to the Chinese counterparty. Explanations, differences of opinion and revisions went back

fait que seul le représentant légal de l'entreprise chinoise peut engager celle-ci et que le sceau officiel de l'entreprise doit être utilisé.

** Caroline Bérubé, B.C.L. et LL.B. (Université McGill), est associée directrice chez HJM Asia Law & Co. Basée en Asie depuis 15 ans, elle a représenté des sociétés et des banques internationales dans des opérations transfrontalières de financement garanti par des actifs et de fusions-acquisitions dans la région Asie-Pacifique. Elle est également une arbitre agréée par le Centre d'arbitrage sino-européen (CEAC). Courriel : cberube@hjmiasialaw.com.*

and forth between our client and the Chinese company for more than a year - and the contract has not been finalized to date. All parties were exhausted by the length of the negotiation. A long and ‘thorough’ contract therefore may have a detrimental effect on a Chinese company’s interest in conducting business with a foreign company as it may impact the development of their “friendship”.

Therefore, we suggest providing Chinese companies with contracts between five (5) and ten (10) pages which only state the necessary clauses, i.e. the terms and conditions of the transaction, the rights and obligations of each party, how the contract can be terminated, the consequences of a breach, payment terms, and dispute resolution and language conflict.

2. Be fair and avoid “strong” wording

Chinese companies are sensitive and frustrated by some unconditional wordings such as “any”, “all” and

“in no event”, even though the actual meaning of the whole sentence in context is fair. Chinese companies consider such wordings to be “against” them, particularly if the contract has been drafted in a ‘one sided’ manner.

A disproportionate balance of rights and obligations was an issue when we negotiated with the above-mentioned Beijing company. Explaining that the true meaning of these phrases was not as ominous as they perceived was a time consuming exercise.

Therefore, simple statements should be used in place of wording which may be viewed as being too strong. This does not mean that we recommend a party to agree to a contract template in obvious favor of the contract provider; merely that a simple balanced contract would save time spent on negotiations as well as costs.

3. Use a good translator with a legal background (as opposed to a young grad with only a technical/commercial background)

Recently, HJM reviewed the Chinese translation of a contract between our U.S. client and a Shenzhen company, which was translated by the Shenzhen company. In the contract, the translation of some of the clauses in Chinese was completely different to the English meaning, which may have exposed our client to risk. These translation issues were particularly relevant, given that the contract provided that the Chinese version of the contract prevailed. Our client had to be informed about the discrepancy in the meaning as they had to agree and fully understand their rights and obligations before committing to the Chinese party.

Hence, we strongly suggest that you that do not request the Chinese counter-party to translate the contracts. A reliable neutral translator or an international law firm providing Chinese translation service is a better option.

4. Does the English version or the Chinese version prevail?

Some contracts such as a joint venture contract/employment agreement must by Chinese law be in Chinese though an English version exists. In such cases, only the Chinese version prevails.

HJM usually recommends our clients to have their contracts translated into Chinese and English to make sure the parties fully understand their rights and obligations. Furthermore, we advise our clients to explicitly state in the contract that the English version prevails in case of dispute.

However, again, the decision depends on the bargaining power each party has – most Chinese counterparts do not feel comfortable having the English version prevailing even if they are the one who appointed the translator for the English version and such version has been notarized by a Chinese notary.

5. Can Canadian laws be the governing law of your contracts?

Most contracts (saved for example for employment agreement, joint venture agreement, etc.) can be governed by foreign laws according to Chinese laws and regulations. However, parties may still opt for Chinese law as governing law in their contract as Chinese parties are usually very reluctant to have foreign law as the governing law. This discussion will be driven by the bargaining power

of each party. One advantage to have Chinese laws as governing law is that in case of dispute, Chinese judges and arbitrators will be able to handle the case more efficiently than if the contract was governed by foreign law. Risks are reduced.

Hence, HJM usually suggest that Chinese law governs the contract as it is more efficient in the event of dispute, especially if the dispute is handled by Chinese courts or arbitration commissions.

D. Other Pitfalls

Pitfalls that lawyers and companies from common law jurisdictions often fail to consider have to do with which person at the Chinese company the contract should be negotiated with, and who should sign it in order for it to be an enforceable contract.

1. With whom should you negotiate your contract?

When negotiating a contract in China, you should be sure you discuss with a representative of the Chinese company that he/she is authorized in writing with the company seal affixed on the authorization/power of attorney to bargain and make decisions on behalf of the company. Otherwise, in the event that the person does not have the proper authorization, the company may deny the contract and/or any terms the “representative” has offered and/or accepted.

Only the *legal representative* of a Chinese company can legally bind a Chinese company.

Please note it may be offensive if you directly ask the representative about his/her authorization at the first meeting. You could obtain



some information by asking for his/her name card and through general conversation. After the meeting you could investigate the information provided further.

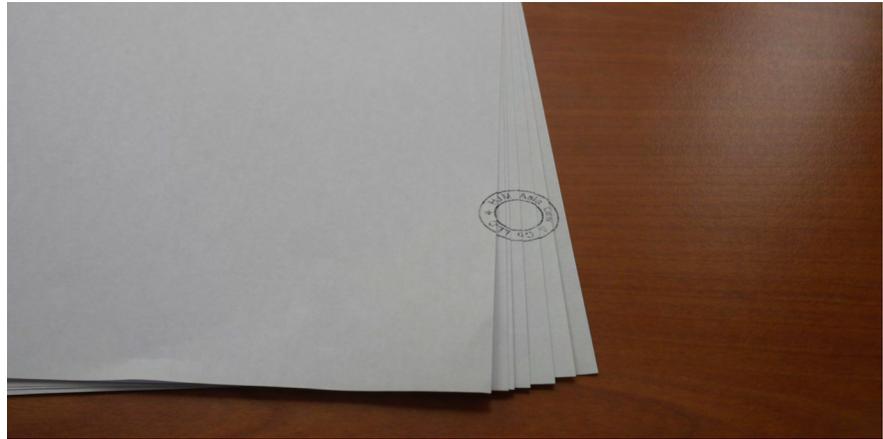
A few options are:

- A. Asking your Chinese counterparty for a copy of the business licence of the company (the Chinese characters for business licence are “营业执照”) and the business licence should state the registered capital of the company, the shareholder, the duration of their business licence and the name of their legal representative;
- B. Requesting a review of the authorization is considered fair and reasonable when the negotiation is near conclusion; and
- C. Starting a company/credit search on the company which will state the name of the shareholders, directors, legal representative and capital/business scope/financial statements, etc.

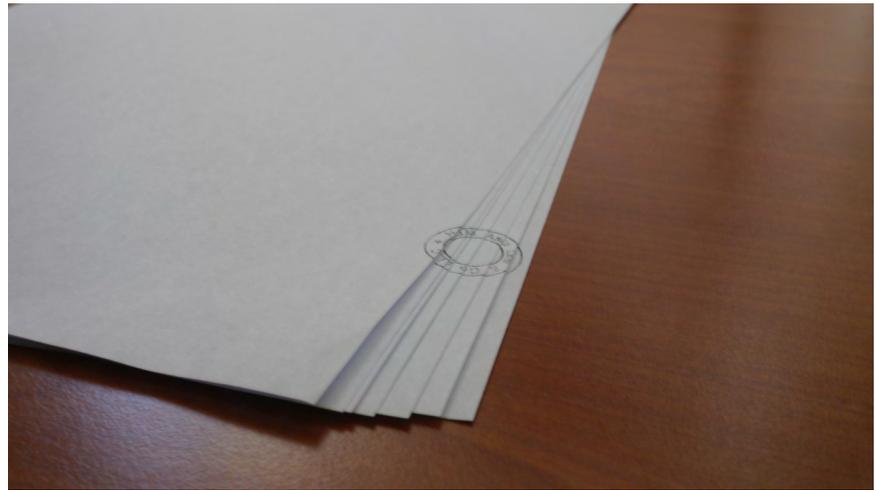
The legal representative is key in China and should be the one you are dealing with.

2. Who should sign the contract and which forms should your contract have?

- a. *Blanks*: make sure you do not leave blanks when you sign or affix a seal on the contract. Anyone could add information, which may expose you to substantial risks. The trend in China is to affix the company seal on the edge of each page, so when all the pages are put together, the full seal can be viewed. The following photos demonstrate how this is done.



Samples of a company seal on the edge of each page



- b. *Signature and seal*: all Chinese companies have five (5) seals: an official company seal, a contract seal, a legal representative seal, a financial seal and a fapiao seal.

The seals are registered with the relevant authorities. Either the official seal or company seal of the Chinese company must be affixed in order to legally and contractually bind the company. Alternatively, signatures of the legal representative or the authorized person are also sufficient to make a contract legally binding without the above seals being affixed.

However, as best practice, we suggest that contracts be affixed with

company/contract seals or affixed with both seals and an authorized signature, rather than only signed.

- c. *Electronic contracts*: contracts duly agreed via emails, fax and other electronic methods are valid according to Chinese laws. However, there needs to be sufficient evidence to demonstrate that the sender/recipient of such an electronic contract is the contracting Chinese company or the authorized person (in case the Chinese company contests the existence and validity of the contract).

The name card, company website, promotional material and any other written materials that assist

to demonstrate that the company's or the authorized person's email address or fax number is identical to that of the sender/recipient of the electronic contract are useful in such circumstances.

Nevertheless, HJM still suggests that a printed original contract executed by both parties should be exchanged after the contract is agreed via electronic method to avoid any issues.

3. Validity of emails?

Although this consideration is not as much related to the negotiation of contracts, we mention it as we experienced it recently.

In 2013, a client relied on emails alleged to be from his Chinese counter-party requesting payment to a certain bank account for goods purchased. The client made the payment without contacting the Chinese party (by other means) for confirmation. It transpired that the email address of the Chinese party was hacked and the bank account belonged to the hacker. This resulted in substantial loss for the client in terms of goods never delivered, since the payment was not made to the right account, and loss of substantial sum of money.

HJM strongly suggests that whenever dealing with payments, you confirm with your Chinese partner the details of the bank account in at least two (2) different ways, e.g. by email, phone call, fax, face-to-face meeting, etc.

Conclusion

China is a country that values efficiency, good faith and personal relationships. There is a popular saying in China to this effect: "the

friendship shall remain even though the deal is not made."

In light of the pitfalls and pointers mentioned above, those who seek to enter negotiations with Chinese companies should take all reasonable steps to protect their own interests whilst having regard to cultural sensitivities.

** Caroline Berube, BCL and LL.B (McGill University), is the Managing Partner of HJM Asia Law & Co. LLC. Based in Asia for 15 years she has represented international corporate clients and banks in asset financing and M&A cross-border transactions in the Asia-Pacific Region. Caroline is an arbitrator approved by the Chinese European Arbitration Center (CEAC).*

Email: cberube@hjmasialaw.com