

**DOING BUSINESS IN THE USA
AND
DOING BUSINESS IN CHINA &
HONG KONG WITH AMERICANS**

**A “BULLET POINT” GUIDE
FOR CHINESE (PRC) AND HONG
KONG COMPANIES**

By

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- technology transfer and licensing;
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- computer law and contracts;
- customs law;
- insurance and insurance litigation;
- visas and immigration;
- tax law and tax planning;
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INTRODUCTION

THE PURPOSE AND ORGANIZATION OF THIS “BULLET POINT” GUIDE

The overall purpose of this guide is to provide valuable information and tips to Chinese business persons when:

- they contemplate doing business with Americans in the Chinese market;
- they intend to do business in the United States of America---in the U.S. market; and
- disputes arise, or may arise, between the Chinese and the American side (that is, litigation and arbitration, including how to deal with that possibility in contracts with Americans.

Part I of the present guide, consisting of Chapters 1, deals with what from the Chinese perspective are incoming transactions ----transactions with American parties aimed at the Chinese market. The particular focus is what the Chinese side should anticipate, and how, in our view, it should act and react when dealing with a potential American contract partner for a business operation aimed at the Chinese market (and possibly additional neighboring ones as well).The emphasis is providing practical information derived from the authors’ practice and experience.

Part II, by far the larger consisting of Chapters 2 – 11, , deals with outgoing business: Poles doing business in the U.S.A.---in the U.S. market. Many of the important aspects are dealt with in those Chapters from what we intend to be a concise, practical point of view.

PART I. DOING BUSINESS IN THE CHINESE MARKET WITH AMERICAN PARTIES

CHAPTER 1

CONTRACTING WITH AMERICANS FOR OPERATIONS IN CHINA: WHAT TO EXPECT AND HOW TO REACT

Suppose you, the Chinese entrepreneur, intend to acquire rights from a U.S. party for the Chinese market. I'll sometimes call it your **home market**". They might be (i) the right to sell and/or to promote the sale of the U.S. firm's products or services in the home market (a "**distribution agreement**" or "**sales agency agreement**"); (ii) the right to manufacture in China and/or elsewhere the U.S. company's products and to sell them in your home market (a "**license agreement**"); (iii) a joint venture with a U.S. company for your home market involving the sale and/or promotion of the U.S. company's products or services, or the manufacture and sale of those products (a "**JV**"). These are examples only.

In this Chapter, the intention is to offer some practical guidance for the Chinese business person as to what to expect and how he or she might wish to proceed.

- **THE PROSPECTIVE U.S. CONTRACTING PARTY**

Among the things you should verify, before concluding any agreements with a U.S. party are:

1. if the U.S. party is a company, its legal form and that it exists. If it claims to be a corporation, limited liability company, or a partnership, determine the State of its incorporation or formation and that it is in good standing there. If a company is not in "good standing" in its U.S. state of formation, it normally means that (i) it has been dissolved by action of the company itself; or (ii) it has not filed its state (or, where applicable, city) tax returns or annual or biennial reports and has not paid the corresponding taxes and fees due. In the second situation, what will normally happen if that situation is not straightened out, is that the U.S. state in which that entity is formed will suspend the company's charter, and eventually, after an additional time lapse without the situation being corrected, it will declare its charter to be void.
2. who its shareholders, owners, directors and officers (or partners, if it is a partnership) are (names, addresses) and who has power to sign for the company. Note that in general, there are no registers in the USA which will reveal who can sign for the U.S. entity. It may be desirable

to obtain a resolution of the U.S. corporation's shareholders and/or board of directors stating that the corporation is authorized to enter into the particular contract and that a particular officer is duly authorized to sign it.

3. the financial strength of the U.S. company. Audited financial statements, or at least unaudited ones, should be requested from the prospective U.S. partner. Also, the U.S. company should be asked permission to contact its banks, to obtain information regarding its balances and financial history.

4. whether there are any recorded "security interests" granted by the U.S. party as to its present and future assets (a security interest is like a mortgage on the U.S. party's present and/or future assets (but not including real estate); and whether any unsatisfied court judgments or federal or state tax liens are outstanding against the U.S. party.

5. whether the U.S. company is the subject of voluntary or involuntary bankruptcy proceedings in the USA.

6. whether the U.S. company holds registrations in its name or licenses from their owner to use the particular intellectual property rights that will be involved in the Chinese business transactions you will be entering into with that company (e.g., patent(s), trademark(s), copyright(s), trade secrets and know-how; domain names(s).

A U.S. lawyer can assist in obtaining, to the extent available, the above information. Of course, certain of the information and documents described above may be available only from or with the permission of the U.S. company, and whether they can be obtained will depend on whether the U.S. company is willing to supply them. If the U.S. company is unwilling to do so without very good reason, that is a negative sign.

Commercial credit reports on the U.S. company issued by service companies for a fee, are also valuable, however, sometimes they do not give a complete or totally accurate picture.

The Chinese party should be prepared to give similar information to the U.S. side.

In short, as a general rule, the Chinese side should not enter into any contract or transaction with an American company without first receiving information of the above types, evaluating it, and determining if the company is the right partner for it.

- **MORE ABOUT THE PROSPECTIVE U.S. CONTRACTING PARTY**

Your prospective U.S. contract partner will probably fall within one of the following categories:

1. a very large, well-known U.S. multinational company or a large, well-known U.S. company falling just short of a multinational;
2. a solid American company between small-medium to large (but not quite in category 1.), by American standards;
3. a small American company; or
4. one or more individual American entrepreneurs -- physical person(s).

While the Chinese side should be careful to check out all categories of persons and firms, it is particularly categories 3. and 4. that merit extremely close scrutiny and investigation. Many smaller American companies and individual entrepreneurs will not be appropriate contract partners for the Chinese side. Some will make promises and say this and that, but not be able or willing to do what they say. Some will be middlemen looking for a way to "broker" a deal to make fast money. Many deals with middlemen or "brokers" never become reality or if they do, they fail. Your American writer-lawyer has first hand experience with such situations. Often times, a U.S. lawyer can develop a feeling for when a potential deal involves honest, reliable persons or firms, has a solid contemplated structure, and stands a reasonable chance of success.

Also, the fact that you, the Chinese party, have been friends with some American or Americans for some time ----even business friends----does not mean they are the right persons or company to do business with. Business is business, and you should check out those parties in advance just as you might complete strangers.

- **USE BY U.S. CONTRACTING PARTY OF LOW CAPITALIZED AFFILIATES**

A common practice is for the U.S. side to utilize, as its contracting party, not its main U.S. operating company, but rather, a low capitalized company with little in the way of assets and resources. The thinking is obvious: (i) minimize risk; (ii) keep options open for the main operating company. When and as money, products, personnel, etc., are needed, the main U.S. operating company will funnel them into the low capitalized company, if it so chooses. If something goes wrong, it will be very difficult to attack, legally, the main U.S. operating company (since it did not sign the contract). Sometimes there will be clauses in the contract by which the Chinese party waives any claims it may ever have against the U.S. operating company and its other affiliates, their owners, directors, officers and employees. The Chinese party should proceed with care.

- **CONTRACT DRAFTS**

Where the U.S. party will be the supplier, licensor, or the one who will provide a major contribution (money, products, technology) to a JV, then in all likelihood the U.S. party will want to prepare and submit the first draft of the agreement(s).

The U.S. party's first draft will typically exhibit the following characteristics:

- it will be a U.S. style contract: long, detailed, and seeming to cover every eventuality;
- it will be slanted in the U.S. party's favor;
- it will impose many obligations on the Chinese party and relatively few on the U.S. party;
- it will either be of a short duration or will contain many clauses allowing the U.S. party to get out of the agreement;
- it will severely limit the potential liability and exposure of the U.S. party and will, whenever possible, maximize that of the Chinese party;
- it will often provide for the applicability of the laws of a particular U.S. State, typically the State where the U.S. party is located;
- it will often provide for arbitration of all disputes in the USA (typically, in a city convenient to the U.S. party); or that an American federal or state court located in the same U.S. state as the U.S. party's place of business will resolve all disputes and claims that may arise between the parties.

The foregoing is particularly true for sales agreements, distributorship contracts,

sales agency agreements, license agreements, technical assistance, services agreements, and cooperation agreements not involving the formation of a Chinese legal entity.

Even where what is involved is a joint venture calling for the formation of a new, jointly-owned Chinese company or the purchase by an American company of a certain percentage of the shares of stock or ownership interests in, or assets of, an existing Chinese entity, the American side is very likely to try to implement a similar pattern: (i) the U.S. side will submit the first contract draft which will usually be as above, with, perhaps, certain exceptions or nuances; (ii) typically, the U.S. side will have taken its very first draft, submitted it to a good Chinese law firm in; and that law firm will have suggested the necessary adaptations in order that it conform to mandatory Chinese law; (iii) the result will be essentially a long, detailed, U.S. style contract that is one-sided in favor of the U.S. party, but adapted to the extent necessary to take into account pertinent, mandatory Chinese law.

It is quite normal for the U.S. side to proceed as outlined above. If you were the U.S. side, so would you. American business people and their legal advisors (their in-house counsel, their outside law firm) appreciate the importance of strong contract protection and for seizing and maintaining the drafting initiative. That is so for both their domestic and international deals. For transactions with Chinese for the Chinese market, most American companies will probably try to adopt that procedure.

That being said,

- **WHAT THE CHINESE SIDE SHOULD DO**

The Chinese side would be well advised to consult, well in advance, an American international business lawyer with knowledge and experience in the type of transaction concerned, both American and Chinese law and practices applicable to it; and other potentially pertinent areas.

Consulting competent U.S. counsel in advance (i) might, in some circumstances, enable the Chinese party to grab and maintain the "drafting initiative"--typically a key element in the equation; or (ii) where that is not possible, to prepare a counter-draft that properly protects its, the Chinese side's interests or to outline by letter to the U.S. side those points that the Chinese side desires to modify, delete or add to the agreement.

It will often be less expensive or at least relatively equal in terms of legal fees for the Chinese party, to prepare the first contract draft(s), as compared with preparing counter-drafts or commenting on the U.S. side's drafts. Counter-drafts in particular can be expensive to prepare. And, as remarked above, the Chinese party is likely to obtain a more favorable contract if it is able to take and maintain the drafting initiative.

The Chinese party's Chinese business and the U.S. business lawyer would typically work in close coordination. Of course, the close participation, input and decision

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making of the Chinese client is vital.

However, before one even gets to the “contracting stage”, consider the remarks in the next section.

- **EVALUATING THE AMERICAN PARTY AND THE CONTEMPLATED DEAL BEFORE INCURRING MAJOR LEGAL EXPENSE; NB-SOTS**

Before preparing contract drafts, counter-drafts, or even commenting on any contract draft prepared by the American side, the Chinese side should strongly consider taking its American international business lawyer to a in-person meeting with the American side or have its American lawyer meet alone with the American side. Such an experienced lawyer will often be able to form an impression as to whether the American party will be a good, reliable contract partner, and whether the contemplated structure and terms of the business transaction or operation makes sense for his client, in this case, the Chinese party. He will typically know what to ask, what information to obtain, and what positive or negative signs to look for.

Co-author-attorney Aaron Wise has been involved in a number of international business transactions where his client, the foreign company, did not follow that procedure, even though Mr. Wise strongly suggested it several times. The foreign client did not understand that the role of the American business lawyer is a combination of lawyer, business and tax advisor. Rather, the client told Mr. Wise to prepare various contract drafts and do a great deal of other legal and tax work, which he did. The contract drafts were reviewed by his foreign client, and thereafter revised and modified, then sent to the American side. Ultimately, no deal was ever consummated. The reasons were either that the American side or the foreign company could not reach agreement on the structure and terms of the deal; and typically, that the American side was not the right contract partner for the foreign client. The foreign client meanwhile had incurred substantial legal fees and other costs and expenses, which it had to pay.

Mr. Wise has also been involved in numerous international business transactions where such an early meeting did take place in which he participated. On some occasions, he thereafter told his client that the American party and/or the contemplated deal did not seem right or seemed overly risky, and most often, he was accurate.

If the result of the in-person meeting and investigation of the American side point in the direction of a good contracting partner and a potentially sensible business operation, then, rather than commencing with contract drafts, the Chinese side might request its lawyer to prepare a “non-binding summary of key terms” (“NB-SOT”), reflecting the Chinese side’s desired key terms. Some call it a (non-binding) letter of intention, memorandum of understanding or term sheet. Once the NB-SOT text is approved by the Chinese side, it would be submitted to the U.S. side and its terms negotiated, until a final NB-SOT is signed. Although the NB-SOT is not legally binding, it normally makes it easier to prepare legally binding contract drafts and usually shorten the process of getting signed, legally binding agreements. If the parties

cannot get to the point of a signed NB-SOT, the chances are they will never conclude any binding written contracts.

- **SOME EXPERIENCES WITH JOINT VENTURES AND OTHER BUSINESS TRANSACTIONS FOR FOREIGN (NON-US) MARKETS**

Co-author-lawyer Aaron Wise has worked on many joint ventures, license, distribution and other agreements for foreign (non-U.S. markets) on behalf of American clients. He has also done so as in-house counsel for a large American multi-national company.

The company policy was, wherever possible (and in nearly every case it was possible), take the "drafting initiative". For JVs, that usually meant:

- (i) preparing a JV agreement draft in English, American style;
- (ii) submitting it to our local foreign counsel for review and modification, and sometimes, translation into the local language;
- (iii) local counsel would prepare other documents necessary to implement the JV (e.g., documents to form a local JV legal entity, etc.);
- (iv) once OK from our side, the document package would be submitted to the foreign side;
- (v) contract negotiations would ensue, but rarely did our side yield the "drafting initiative" to the other side.

That general modus operandi was followed no matter whether our (the U.S.) side was to be the majority or minority owner in the JV, or whether it was to be a 50%-50% deal.

U.S. companies, other than fairly small ones, will normally try to grab the "drafting initiative" and maintain it. That is so for just about any kind of contract. If, however, you, the Chinese party, are insistent on preparing the first contract draft(s) and maintaining the drafting initiative, you may succeed.

PART II. DOING BUSINESS IN THE USA

We not turn our attention to the doing business in the United States, from the standpoint of the Chinese business person. The remaining chapters of this Guide deal with various aspects of that broad theme.

CHAPTER 2

CONTRACTS WITH AMERICAN DISTRIBUTORS

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AND SALES AGENTS

- **Your Products and Services.** Make sure that your products and goods can be lawfully imported into the USA, that all legal requirements of U.S. customs and import laws are met, that you have all required licenses and permits to import and sell the products, and that your export and import documentation complies with U.S. law. Most of the points in the preceding sentence apply to services as well.
- **Trademarks; Other Intellectual Property.** If you intend to sell goods or services to the USA under a particular trademark, brand name, promotional slogan etc., have your U.S. lawyer check, before you start business, whether the use of the mark, name, slogan, etc. might infringe any existing trademark. If it does not, consider applying for U.S. trademark protection covering that mark, name, slogan, etc. That applies for the USA and any other Western Hemisphere countries in which you may wish to market your products or services. Essentially the same points apply to other types of intellectual property you may have and should protect (e.g., patents, copyrights and designs), though the application procedures for each type and the nature of the rights conferred are different.
- **What Are They and What Do I Want.** Be sure you understand the differences between a “distributor” or “dealer”, and a “sales agent” or “sales rep”. Decide carefully which you want for the U.S. market.
- **How Many?** Think through carefully whether you want to have one exclusive distributor, dealer, sales agent or rep for the U.S. market, or several of them. If several should be the answer, should each have exclusivity for a particular part of the USA or should they all be non-exclusive for the entire USA? There is no one pattern that will suit each and every company. A good market study may be a worthwhile expense.
- **“Due Diligence”.** Check out your prospective U.S. distributor(s), dealer(s), sales agent(s) and sales rep(s) in advance, before engaging them. There are several areas you should check. These include their legal status, financial situation and banking information/references. Your U.S. lawyer can obtain for you at a relatively low cost valuable information about your prospects. Too many non-U.S. companies rush into deals with U.S. parties without doing a proper “due diligence”, and the result is often a messy affair.
- **The Drafting Initiative: A Critical Point.** You, the Chinese party, should take and keep the initiative in drafting contracts and non-binding summaries of key terms (“NB- SOTs”). Try your level best not to let your eventual U.S. contracting party submit the first or any later contract draft, or any NB-SOT. Insist that the U.S. side comment on your NB-SOTs and contract drafts rather than submit its own drafts. The “drafting initiative” is a critical element in arriving at what, from your standpoint, is a “good contract”. Remember, the distributor, dealer, sales agent or rep will want a short contract that places on it few

obligations, with a long duration and severe restrictions on your right to terminate, no or low minimum targets to meet, excellent payment terms, no security for payment, and disputes resolved in the U.S. party's "back yard" under that U.S. state's laws. You, the supplier, will want essentially the opposite, and you should insist on it. After all, they are your products! See below regarding the NB-SOT.

- **Importance of First Class Contracts; Reducing Risks of Lawsuits.** The importance to you, the Chinese supplier, of properly drafted, first class contracts for the U.S. market, is paramount. They will help you to attain what you want, and to avoid pitfalls, potential claims and lawsuits. Also, if you do have an actual or potential lawsuit, a signed contract that has been properly drafted, protecting your interests, will give you certain key advantages. First class, U.S. style contracts are your first line of defense, and one of your primary assault weapons. Many lawsuits arise in the USA precisely because of poorly drafted contracts, oral contracts, contracts established by letters or memos, or "de facto" contracts, particularly where non-U.S. parties are involved. It is better to incur legal fees to prepare contracts and related documents properly, at the outset, than to pay the probably much higher litigation costs (plus, of course, the potential damages and losses).
- **"NB-SOT".** Very often, it makes good sense to begin formal negotiations not with a contract draft, but with a non-binding summary of key terms ("NB-SOT") prepared by your side (with the aid of competent counsel). Some call it "letter of intent". There are important strategic and tactical advantages of commencing with a NB-SOT.
- **Partial List of Important Points for Distributorship and Dealership Contract:** This list of important points is not meant to be complete nor are the points presented in any particular order.
 1. **Contract Products:** These should be clearly defined. If, during the course of the agreement, you develop other products, should they automatically fall under the contract?
 2. **Sales Territory; Exclusive or Non-Exclusive Rights:** These points must be clearly articulated in the contract. The contract should clearly define what is meant by a sale by the distributor or dealer within its specified territory. Where the territory is large (e.g., all of USA, Canada and Mexico, or even all of the Western Hemisphere), you may wish to grant exclusive rights for part of it and non-exclusive rights for other parts. You may wish to reserve certain customers in the agreed territory for direct sales by you, the Chinese supplier.
 3. **Sales To Only Specified Type of Customers:** You might wish to confine the distributor's or dealer's sale of your products to a particular type of customer (industry segment) or to customers who will use your products only in a particular way.
 4. **Can the Distributor or Dealer Appoint "Subs" and Sales Agents?** Should the distributor or dealer have the right to appoint sub-distributors or sub-dealers, and/or sales agents or sales reps? If yes, can that be done only with your (supplier's) prior written consent? Should you attach to the distributorship contract a model of such agreements that the distributor or dealer must use?

5. **Sales Outside of Territory or Outside of Permitted Scope:** Those points should normally be dealt with in the contract. There is, for example, American case law holding that if the contract does not clearly prohibit it, a distributor or dealer can lawfully sell outside of its assigned territory.

6. **Duration:** Will the contract be for a fixed term (with or without an option to renew) or of indefinite duration? Either way, there should be termination clauses. See point 19 below regarding “termination”.

7. **Delivery Terms:** These should be clearly set forth, and you should know exactly what the delivery terms mean and what rights/obligations flow from them. Specific delivery terms (e.g., FOB, CIF, C&F) carry with them certain consequences, unless the parties agree by contract to vary them. If there will be variations (e.g., when title or risk of loss passes to the buyer), they should be set forth in the contract.

8. **Payment Terms:** The method and time for payment, including provisions for interest on late payments, should be set forth. If payment (in whole or in part) will be by letter of credit, the l/c terms must be carefully drafted.

9. **Security for Payment:** If you will be selling on credit terms, what security for payment will you receive? One very frequently used U.S. mechanism is the “**security interest**” which operates basically the way a real estate mortgage does and can give you a “secured creditor” position in the agreed “collateral” of the distributor or dealer. The “collateral” under a “security interest” can be any present or future non-real property assets of your buyer. **For more about the “security interest” see the source cited at the end of this Part.**

10. **Minimums Quotas:** If you are granting the U.S. side exclusive or quasi-exclusive rights for all or part of the USA (or North America), you will normally want the U.S. distributor or dealer to agree to “minimum quotas” which, if not met, will entitle you to terminate the agreement. From your standpoint, minimum purchase quotas (the distributor’s or dealer’s purchases from you) are better than minimum sales quotas (the distributor’s or dealer’s sales to its customers). Sometimes, even when the distributor or dealer has only non-exclusive rights for its territory, minimums may be desired. **Minimum quotas are only effective if properly drafted, there being many points to cover to reach that goal.**

11. **Promotional Moneys:** Will there be an agreed minimum budget for promoting your products in the distributor’s territory? As between the distributor or dealer and you, the supplier, which will contribute what portion? Of course, the permitted types of promotion should usually also be specified in the contract.

12. **Sales/Promotion Under What Mark or Name?** As a **general rule**, the supplier’s trademark, brand and/or other distinguishing characteristics (for short, “trademark”), rather than the distributor’s or none, should appear prominently on the products and/or their packaging and be used to promote them in the contract territory. Otherwise, the supplier will not build up brand recognition in the marketplace and may lose the customers once the distributorship contract ends. When the supplier’s trademark(s) will be so used, the contract should so state and should contain special clauses designed to protect them.

13. **Adequate Stock:** Will the distributor or dealer be required to maintain a stock of the supplier’s goods, and if so, at what level?

14. **Sales on Consignment:** Yes, under U.S. law, you can sell on consignment, but experience has shown that it is a risky practice in terms of getting paid, recovering your goods and for tax reasons. You should consult competent U.S. counsel in advance if you are thinking about consignment sales.

15. **“Acceptance”:** Sometimes, distributorship arrangements involve machinery or equipment that the U.S. distributor will resell to customers, who will use them in their plants or factories. In arrangements of this type, the distributor’s customer will normally want to have a start up and initial trial test and then condition final acceptance of the goods on a final acceptance test. Provisions dealing with those points, including defining parameters for acceptance, should normally be built into the contract.

16. **Clauses Designed to Reduce the Chinese Supplier’s Product Liability and Late Delivery Risks:** These types of clauses, including limitations on the supplier’s express warranty on the contract goods, require careful thought, negotiation and drafting. See the next Part regarding “product liability”.

17. **Competitive Restrictions on Distributor or Dealer:** Certain types of contractual restrictions on distributors or dealers may violate U.S. “antitrust” law. These can include price fixing, minimum price levels, territorial restrictions, non-compete clauses, “tying”, and other restraints. Avoiding antitrust violations or even allegations thereof is essential, because a party allegedly injured by competitive restrictions can sue for and, if successful, recover 3 times the damages sustained, plus attorneys’ fees and costs. With careful drafting, the Chinese supplier may be able to achieve its business goals while minimizing the risk of such claims.

18. **Avoid Having a “Franchise”:** Unless what you really want is a franchisor-franchisee relationship (or to grant a “master franchise”), avoid falling into the trap that your distribution, sales agency, license or other agreements can be characterized as “franchise” arrangements under U.S. law. Franchises are often subject to an entire level of regulation that you might wish to avoid. Competent U.S. counsel will provide guidance in this area.

19. **Termination Provisions; Improper Termination Claims: Related Points:** There should normally be a number of provisions allowing the supplier, or either party, to terminate the contract on several different grounds, including, in many instances, without cause. These must be carefully negotiated and drafted. **Not infrequently, terminated distributors, dealers, sales agents and reps attempt to claim damages for improper termination. With skillful drafting, that risk can usually be reduced, if not eliminated.** Similarly, the contract will usually state what happens upon or shortly after the contract’s termination or expiration. Among them, the supplier will often want either **the obligation or the right to repurchase the distributor’s or dealer’s remaining stock of goods. The supplier might also want the right to take over some or all of the sub-distributorships and sales agency/sales rep contracts that the distributor has entered into for the supplier’s products.**

20. **What Tribunal Decides Disputes/Claims and What Law Applies?** How you deal with these questions in your contract are **vital “business” points**, not just legal ones for the lawyers to work out. **That statement merits strong emphasis.** Consider this writer’s “general rule”: you, the supplier, should be able to attack (bring your claims against the U.S. side) in the USA via arbitration under particular American Arbitration Association (“AAA”)

rules in a U.S. city not too close to the U.S. party's place of business but reasonably convenient for you; and to defend (the U.S. side brings claims against you) via AAA arbitration in the same location as just mentioned or, alternatively, in a Chinese city under acceptable, specified arbitration rules. How these points are resolved will vary from case to case, according to the facts and circumstances and what can be negotiated.

21. **Tax Aspects:** When arranging your U.S. export sales and contracts, **be careful to avoid having a "permanent establishment" in the USA.** That is a tax concept defined in the US-Chinese income tax treaty.

- **Sales Agency and Sales Rep Contracts for the U.S. Market.** A number of the points made above will apply here, but with adaptations here and there. Unlike distributors and dealers that buy and resell goods, sales agents and reps do not buy and resell, but rather obtain customer orders for the supplier's goods (the sales being between the supplier and the customer). Here are a few other points applicable to sales agents and sales reps:

1. **Commission, Rate and Basis:** These terms must be carefully negotiated and drafted. On which sales does the agent or rep earn its commission and at what point in time? If you have more than one sales agent or rep for the USA, there is the potential for territorial customer overlaps. Who earns what commissions on which sales are questions that should be resolved in advance by contract.

2. **Agent or Rep Accepting Orders:** Avoid allowing your agents or reps having or exercising the power to accept orders for your goods, and deal with that point specifically by contract. Allowing any of your agents to accept orders can result in tax and legal problems for you. You, the supplier, should be the only one to accept (or decline) orders.

3. **Advances :** If you plan to allow your agent or rep to receive advances against future commissions, the contract should be very clear that these are advances to be repaid within a specified time--even if earned commissions do not equal the advances.

4. **Rep or Sales Agent as Your Employee:** If the sales rep or agent is an individual, take care that he/she is not characterized as your "employee". Simply writing in the contract that he/she is not your employee will probably not do the trick. A foreign company will not want to have any U.S. employees soliciting orders within the States. If one or more sales reps or agents are, in fact, likely to be viewed as your employees, and if you cannot alter that situation, you should consider forming a U.S. subsidiary and having those individuals be employees of the sub.

For more details on the above subjects, see Aaron N. Wise's "A Chinese Business Person's Guide to American Law - Business Practices - Taxation". Copies of the Guide are available at no cost from this author.

CHAPTER 3

PRODUCT LIABILITY IN THE USA

- **Proper Perspective of the Risk.** Do you have a realistic, informed view of the product liability risk in the USA as it applies to your particular goods? Or do you have an unrealistic, exaggerated, media-influenced viewpoint? While there is a product liability risk for many Chinese firms, it will normally be manageable if you adopt certain measures. In short, if you are concerned about product liability, educate yourself about the risk and what you can do to reduce and manage it. An unwarranted “knee-jerk” reaction shouldn’t frighten you away from the U.S. market.
- **Who Can Be Sued? Who Can Be Liable?** Stated in a general way, anyone who designs, manufactures, sells, distributes, or renders services in connection with a product, or component or part thereof, can incur product liability in the USA. That may include a licensor of technology used to produce the item or of a trademark or brand name (if the product is marketed with that mark or name). A plaintiff often tries to sue all parties in the distribution chain. That does not mean, however, that the plaintiff will succeed against all of them, or succeed at all.
- **Important Jurisdictional Point: Your Company May Not Be Subject to the Jurisdictional Reach of the Particular U.S. Court in Which a Product Liability Suit Is, or May Be, Brought.** You may at least have a good legal argument supporting that point and that in itself may deter the plaintiff from suing or continuing suit. That may apply even if you have a U.S. subsidiary or affiliate engaged in the sales or distribution process. We use the word “may” intentionally--the preceding three sentences will not necessarily apply to all Chinese parties in each and every instance. But they probably will apply to a considerable number. If you want more information about this very important point, you might consult the source cited at the end of this Part.
- **Passing and Reducing Risk by Contract.** A significant part of your product liability risk can, by contract, be passed on to your U.S. customer, distributor, dealer, licensee or joint venture partner, and be reduced in other ways by contract. Even properly drafted and implemented “General Terms of Sale” tailored to the U.S. market can reduce your risk.
- **Another Liability Area.** Liability can arise when your buyer, typically a legal entity, allegedly sustains losses and damages as a result of defects in or deficiencies of your products, equipment, etc. Damages due to your unexcused late delivery might also come into play. The alleged damages might include your customer’s plant down time, lost profits, other economic damages, penalties your buyer might incur to third parties, and other possible direct and consequential damages. The plaintiff might also attempt to claim punitive damages. The risks associated with this type of liability can be very substantially reduced by including or not including certain provisions in the contract with your buyer. The term “contract” can also include “General Terms of Sale”-see the preceding point.

- **Chinese Contract Documents Probably Won't Do The Trick.** You should not assume that contract documents prepared according to Chinese law or in any manner other than by competent U.S. counsel will accomplish the goal of reducing and helping manage the U.S. product liability risk. The likelihood is that they will not.
- **Product Liability Insurance.** You should seriously explore the possibility of purchasing product liability insurance and commercial risk insurance for the U.S. (and possibly Canadian) market in appropriate amounts. You should normally require your U.S. contract partner (e.g., distributor, licensee) to carry and maintain an acceptable level of product liability insurance covering the goods you sell to that partner. Sometimes, it makes sense to try to convince your U.S. contract partner (e.g., distributor, licensee, joint venture partner) to include you as a co-insured under its policy or policies, with you reimbursing the U.S. side for the additional premiums. Even with reasonably good insurance coverage, it will normally be prudent to consider implementing various other measures designed to reduce the risk.
- **If You Are Sued or Suit is Threatened.** If you are contacted by a plaintiff (actual or potential) or the plaintiff's lawyer regarding an actual or potential product liability suit against you, do not reply, orally or in writing. Rather, you should contact your U.S. lawyer, who will advise you what to do. Sometimes, your lawyer will prepare a reply for you to make. Not infrequently, the lawyer for the potential plaintiff will send you and request that you sign and return a document by which you waive service of process or allow service of process to be made upon you by a simplified route (e.g., mail). You should not comply, for normally, the plaintiff, in order to effect valid service of process against a Chinese company, might have to go through a tedious, formal procedure that can take several months. The fact that the plaintiff may have filed a Complaint with a particular American court does not mean the court has obtained jurisdiction over you---as one element, the plaintiff must effect a legally valid service of process against you and file proof of that with the court.

For more details on product liability, see Aaron N. Wise's "*A Chinese Business Person's Guide to American Law - Business Practices -Taxation*". Chapter 4 of that Guide deals specifically with product liability. Copies of the Guide are available at no cost from the author of this booklet and the above Guide, Aaron N. Wise.

CHAPTER 4

CREATING A U.S. SUBSIDIARY TO SELL OR MANUFACTURE IN THE USA

Here, we are dealing with **setting up a wholly-owned U.S. company**, not a U.S. entity with two or more shareholders which, broadly viewed, is a joint venture. Chapter 6 deals with joint ventures in the USA. There are many reasons to set up a wholly-owned U.S. company. You may want to have a presence in the market; to satisfy existing customers and prospects; to manufacture, process or assemble products in the States; to protect against liability claims; and to minimize certain tax or customs duty-related costs.

- **Legal Form.** What legal form should most Chinese parties use for their U.S. business? The answer for most Chinese parties is a **“corporation”**. There is no such thing as a U.S. corporation per se. Each of the fifty states has its own laws governing the creation of legal entities, corporations included. So, in the case of corporations, there are Delaware, New York, Florida, California, Illinois, etc. corporations. When this booklet refers to “U.S. corporation”, it means one formed under the laws of a U.S. state. A U.S. corporation offers the feature of limited liability to its shareholders (limited to their respective capital contribution).
- **LLC? Usually the wrong vehicle.** The limited liability company (“LLC”), while offering the limited liability feature, is for legal, tax and cost reasons, usually **not** the appropriate vehicle for non-U.S. parties.
- **Branch of Your Chinese Company? No.** With only rare exceptions, a Chinese company should not operate in the USA by way of a “branch”. That applies whether or not the branch is formally registered in the USA. A branch, or branch office, or other place of business in the USA, is nothing more than the extension of the Chinese company. It subjects the Chinese company to lawsuits in the USA, and to unfavorable tax consequences.
- **Which U.S. State?** Under which U.S. state’s laws shall I form my corporation? The answer will vary depending on the particular company’s needs. In most cases, though, the choice, in this writer’s view, will come down to: 1. a Delaware corporation; or 2. a corporation formed under the laws of the U.S. state in which the corporation will have its center of operations (e.g., main office).
- **Registering in Another State or States.** If I form my corporation in one U.S. state, then operate my business in one or more other U.S. states by accepting orders for goods and services within that or those other states, do I have to register my corporation to do business in that or those other states? The answer is generally, yes. Certain other activities that your corporation carries on or performs in U.S. states other than the one in which it is formed may require its registration to do business there. That registration process is not difficult, time consuming or expensive. Note, however, that the mere fact your corporation sells its

goods from one American state to a customer in another American state does not normally require the corporation to register to do business in the customer's state.

- **Corporate Name.** Is the name of my corporation formed in one state protected in all of the other U.S. states? The answer is no. But that usually does not present any serious problem. Even when it does present a problem, it can generally be satisfactorily resolved.
- **Corporate Name and Trademark.** A corporate name is not the same thing as a trademark. A registered U.S. federal trademark will provide protection throughout the entire USA for the particular goods or services for which it is registered. The corporate name of your U.S. corporation will give you (weak) protection within the state in which the corporation is formed, and in those other states in which the corporation is registered to do business. But the protection offered by a corporate name is far from, different, and much weaker than, the protection accorded by a U.S. federal trademark. Thus, a Chinese enterprise will normally want to obtain U.S. federal trademark protection for the name, brand, logo, or other designation used in connection with the products or services it will be marketing in the States.
- **Minimum Capital.** Is there any “minimum amount” of capital I have to put into a U.S. corporation? In most states, there is none; and the minimum is very low in those states that specify one. That means that you are essentially free to decide on the amount of capital you want to contribute. In some situations, it may make tax sense to split the total invested dollar amount into an equity piece and a debt piece. Property or services can usually be contributed as capital (but, under some states' laws, only past services rendered, not future services, can be contributed). However, if the Chinese party should wish to obtain an “E-2” type U.S. visa for one or more key Chinese nationals who will work for the U.S. corporation, the total amount of the corporation's paid-in capital must be of a sufficiently high level for the type of business operation concerned.
- **Nationality or Residence Requirements.** Non-U.S. nationals can own all of the shares of a U.S. corporation. There is no requirement that a U.S. citizen or permanent resident own shares. Nor must a member of the corporation's Board of Directors or corporate officers own any shares. Similarly, all of the members of the U.S. corporation's Board of Directors and all of its officers can, if so desired, be non-U.S. nationals and U.S. non-residents.
- **One Shareholder.** There is no problem with a U.S. corporation being owned by just one shareholder.
- **Par Value and No Par Value Shares.** It is common to issue “no par value” shares, rather than shares having a par value.
- **Board Members' Powers and Related Points.** Members of the Board of Directors (called “directors”) are not directors in the Chinese sense of the term. In the U.S. meaning, directors are simply members of the Board. The Board acts and decides as a body; individual directors have no power to act or to bind the corporation individually (unless, exceptionally, by resolution or power of attorney, the corporation grants a particular director certain powers). Under the laws of many U.S. states, a one person Board is possible. Some states

have a different rule when a corporation has two or more shareholders. Directors can be officers and officers can be directors.

- **Required and Optional Officers.** Many, if not most, U.S. state laws require a corporation to have a President, a Treasurer and a Secretary. Other officer posts are optional (examples: one or more Vice Presidents or an Assistant Treasurer). The officers' respective powers (and limitations thereon) will typically be contained in the corporation's bylaws and/or in a Board resolution.
- **Restricting Powers of Corporate Officers.** The powers of corporate officers can be restricted or expanded in the corporation's bylaws, by contract or special Board (or shareholder) resolution. However, a third party without knowledge of restrictions on the officer's powers may not be bound by them.
- **Is a Corporate Officer or Director of a U.S. Corporation Its Employee?** No, not merely from serving as such. If it is clearly agreed that the officer or director is an employee of the corporation and he/she is on the corporation's payroll, then yes. But, for example, it is not at all unusual to have a President, Vice President, Treasurer, Secretary or other corporate officer who is not an employee of your corporation. Often, your U.S. lawyer will serve as the corporation's Secretary, but he or she will normally not be its employee.
- **Tax Returns If Corporation Inactive.** Yes, the corporation must file tax returns even if it generates no income or is inactive.
- **Lawyer in One State Forming Corporation Outside That State.** An experienced corporate lawyer located in one U.S. state will have no difficulty in forming a corporation (or any other type of U.S. legal entity) in another U.S. state.
- **Time.** It takes only a short time to form a 1 shareholder U.S. corporation in any U.S. state from the time your lawyer has received all of the information required. But it does take time to do the preparatory paperwork properly.
- **Corporate Bank Account(s).** The setup of one or more bank accounts for the corporation is often done by your U.S. lawyer. That can often be a surprisingly lengthy, complicated procedure.
- **Manufacturing in the USA.** Here are a few things that will have to be done:
 1. Decide where in the USA to manufacture. Negotiate with the state and local authorities for incentives and benefits (e.g., tax breaks, reduced power costs).
 2. Decide whether to build a new or existing building for the plant or to lease it; decide whether to buy or lease the land; and how these operations will be financed.
 3. Decide what equipment will be needed for the plant, whether it should be purchased or leased, and how to finance the operations.
 4. Hire employees, deal and negotiate with a union, if any; and train employees.That short list is very far from being complete. One comment regarding point 1 is appropriate. **Legal and tax factors or incentives offered by particular U.S. states should not be your primary reasons for deciding where to locate your production facility.**

Other, more practical factors resolving themselves into one trite phrase should prevail: "Where does it make the most practical business sense to locate my production facility?"

- **Getting the Corporation Running: Legal Work.** Apart from forming the corporation, there is usually a litany of other legal and tax work involved in getting the corporation to the point of conducting business.

For more details on forming a U.S. company and manufacturing in the USA, see Chapter 7 of Aaron N. Wise's "A Chinese Business Person's Guide to American Law - Business Practices - Taxation". Copies of that Guide are available at no cost from the author of this booklet and the above Guide, Aaron N. Wise.

CHAPTER 5

DEALING WITH EMPLOYEES: OVERVIEW OF SOME MAJOR FEATURES OF U.S. LAW AND PRACTICE

This subject if treated in detail could occupy many pages. There are a great many aspects and each of them has many different features and ramifications. Only one of the reasons for that is that employment law is, in part, state law and thus will in some respects vary considerably from state to state.

Some aspects relating to employees and employment law has been treated in other Parts of this guide. By way of example, see Chapter 9 regarding U.S. visas for Chinese (and other foreign) employees of your U.S. operation. We will not reiterate those points here.

In this Chapter, we do not treat to any substantial extent the intricate subject of dealing with U.S. labor unions and U.S. federal law applicable thereto, which falls under the general rubric “labor law”. Rather, we focus primarily on a few key aspects of U.S. employment law and practice to keep in mind.

- **Employees of Your U.S. Legal Entity, Not of Chinese Company.** As stated in other Chapters, foreign (e.g., Chinese) companies should not normally have its employees working in the USA That may cause the Chinese company to have a “permanent establishment” in the USA for U.S. federal income tax purposes, cause it to be liable for U.S. state (and, where applicable, city) taxes, and will unnecessary subject the Chinese company to lawsuits and other potential problems in the USA. There may be exceptional situations where using Chinese company employees in the USA for limited purposes and for a short time period makes sense. However, the general rule applicable in most situations is as stated in the first sentence. The Chinese company’s U.S. subsidiary or joint venture company normally should be employer.

- **Employment Contracts; Employee Secrecy and Non-Competition Agreements.** It is normally advisable to conclude written employment contracts, American style, with key employees of your U.S. subsidiary or JV company, such as its executives, officers and key technical managers. One reason is obvious: to define the terms and conditions applicable to their employment; and often, to limit their capacity to act and bind the employer, e.g., without the prior written approval of the employer’s board of directors or owners. Another important reason is to protect the U.S. company and its Chinese parent company against claims by the employee, for example, claims of improper termination when the employment relationship ceases. Claims and lawsuits concerning “improper termination” of employees, based on one legal theory or another, are relatively common in the USA. With a good employment contract prepared by experienced U.S. counsel and proper conduct by the employer, it will usually be possible to avoid or at least substantially reduce the risks of such claims. From the company-employer’s standpoint, it is normally preferable that only the U.S. subsidiary or JV company (the employer) sign and be legally bound by thereby---not the parent company or JV company’s owners; and that the employment contract so state. Sometimes, however, the employee will insist on the written guaranty of the parent company or JV owners of the U.S. subsidiary’s or JV company’s obligations under the employment agreement. And sometimes the parent or JV owners will not

mind at all guaranteeing said obligations. In the employment contract, the law of the particular U.S. state where the employee will primarily perform his/her services should usually be specified as applicable, unless that law is particularly unfavorable to the employer, in which case, to the extent legally possible (and in many instances, it may not be possible for purposes of the desired effect), the law of another, more favorable U.S. state should be specified.

The employment contract should contain either an arbitration clause providing for arbitration in the USA (typically, under the American Arbitration Association's pertinent rules) or a clause specifying a particular U.S. court to resolve disputes and claims. Some U.S. states' laws will not permit arbitration of certain employment disputes, and a point to be checked before preparing the agreement.

All that being said, they must be considered in light of the remaining points of this Part that follow.

- **Termination Without Cause; Termination for Cause.** Some U.S. states, perhaps the majority, follow the common law "at will" rule that absent an agreement to the contrary, an employee can be terminated at will by the employer without cause without liability for improper termination. For example, New York State falls in that category. However, even U.S. states in the "at will" category have fairly recently developed exceptions to that norm. For example, if there is some company handbook stating or policy or practice to the effect, that employees will not be terminated without cause or only upon a certain minimum notice period, a court may apply that even if a written employment contract stating otherwise exists. Some U.S. states go to the extent of virtually prohibiting an employer from terminating an employee without cause except where parties reaching written agreement at the time of termination or thereafter on additional compensation to the employee.

The employment agreement should state the grounds for termination for cause, which can also include events like the closing of the U.S. company, its sale etc.

The main point is that prior to concluding any employment contract with a key employee, the employment law of the particular U.S. state(s) concerned must be taken into account for purposes of how the agreement should be drafted. Moreover, prior to the employer's termination contemplated termination of any employee, with or without cause, U.S. counsel should be consulted. The same applies where the employee quits of his/her volition or terminates.

- **Employee Confidentiality and Employee Invention Agreements.** The U.S. employer company should seriously consider having essentially all of its officers and employees, not only key ones, sign secrecy agreements. They would typically contain non-disclosure and non-use obligations on the employee with respect to the secret and otherwise proprietary data (technical, commercial, client lists etc.) of the U.S. company and its parent or JV owner(s), return or destruction of all company files and materials, etc. It might also contain provisions dealing with inventions, discoveries, improvements and the like developed by the employee while employed and possibly even a certain period thereafter (ownership thereof, patent and other rights, whether the employee is entitled to any additional compensation). If written employment contracts are concluded with particular employees can be built into them. If no employment contract will be concluded, then a secrecy/invention type agreement might well be in order.

- **Post-Employment Non-Compete Clauses.** Most employment contracts with employees will prohibit the employee from working for any other person or firm while in the employer's

employ (sometimes, there are exceptions made, e.g., where the employee is not full time in which case normally, the employee will be prohibited from working for a competitor of the employer). Normally, such clauses will pose no significant legal problem. Much more tricky, and problematic, are “post-employment non-compete clauses”----that is, a prohibition upon the employee, once his/her employment ends, from working in a particular field whether for a third party or for his/her own account. The enforceability of post-employment non-compete clauses will vary from U.S. state to state. In some U.S. states, it will be very difficult if not impossible to enforce them. In other states, they will have to be very carefully, precisely and narrowly drafted to stand a reasonable chance of being enforceable (e.g., by way of injunction, damages for breach): they will have to be reasonable in time, scope, geography and not unduly restrict the ex-employee’s ability to earn a living in his field.

- **Discrimination and other Unlawful Acts by Employer.** U.S. state and federal law prohibit essentially any form of discrimination by the employer against the employee. Also prohibited more or less throughout the USA are sexual harassment in the workplace; and retaliatory firing or demotion by the employer where, for example, the employee blows the whistle or threatens to do so regarding some illegal action by the employer. There is American legislation requiring the employer to retain a woman’s job while she is on maternity leave, and while a person is serving in the military. There are many different types of employer acts which U.S. law will regard as unlawful or which an employer must comply with which cannot be mentioned in this Guide.

- **Retaliation against employee(s) desiring to start a labor union.** Any form of employer retaliation against an employee that desires to form a labor union within an enterprise is quite likely illegal----it may constitute an unfair labor practice under U.S. federal labor law.

- **Employer Handbook or Similar Document.** It is generally a good procedure for the U.S. subsidiary or JV corporation to have an employee handbook or similar document stating its policies and procedures applicable to employees and employment; and to update it regularly. Competent U.S. counsel can assist in preparing it.

- **Proper Payment of U.S. Taxes and Other Withholdings.** The employer should be sure that all amounts required to be paid to the U.S. tax authorities by the employer (e.g., by way of withholding) are paid in on time. In a small U.S. operation one should not leave it to the employee to see that that is done; rather, a bookkeeper for the U.S. company or a commercial payroll company should take care of that.

- **Employee Pensions and Profit Sharing Plans; Certain Other Employee Incentives.** U.S. law does not require enterprises to offer pension or profit sharing plans to employees. Careful planning is required where such benefits are contemplated. On occasion, the employer offers a particular employee the opportunity to acquire or purchase shares of stock or ownership interest in the U.S. company. In such case, written agreements are necessary regarding such acquisition or purchase, including provisions on restriction on the employee’s transfer of shares, cash-out or buyout provisions and a plethora of others.

- **Agent, Consultant or Independent Contractor: Is He or She Really an Employee?** It frequently occurs that a particular enterprise will engage an individual as its sales (or other

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agent, a consultant or as an independent service-rendering contractor. At least that is the intention. However, it can easily occur that such person, from a tax and/or legal perspective, really meets the requirements of an “employee” and will be so treated. Most commonly, that occurs once the relationship is cut with that person. He/she will claim to be an employee for federal and/or state unemployment compensation, social security, workers compensation or other purposes, and claim that the employer, e.g., did not make the required payments and owes the employee money. Or, the federal or state authority will make such claim. Prior to engaging such person, competent advice should be sought.

• **Smaller U.S. Operations of Foreign Companies: Proper Controls and Monitoring.** It occurs not too infrequently that a foreign company places one, perhaps two persons, in charge of running its U.S. subsidiary. But, it does not maintain proper control over or monitor those persons’ acts. Such persons might be American, or might be brought in from abroad. There are either no proper contracts with such persons or poor and incomplete ones. The persons are not required to report and account on a regular basis to the company’s Board or owners, financially or otherwise; and may not do so. Sometimes, they are ----wrongly---permitted to hire U.S. company’s legal counsel, accountants and other experts, or the foreign parent accedes to those persons’ recommended experts being hired. Whereas, the foreign parent should select them, and they should be totally independent and loyal to the foreign parent, not to the U.S. company or any of its employees. Those experts should be eyes and ears of majority owner. Runaway employees can wreck a small U.S. operation. Your American lawyer-author has seen it happen more than once. Once such a problem presents itself, the foreign owner is typically in a bind: it is reluctant to dismiss the runaway employee because it has no one else to run the U.S. operation and finding someone is difficult and will take time. It will try to bring the runaway into line, but not infrequently, it does not succeed but allows the situation to continue until it is forced to shut down the U.S. company. The risks of this occurring are reduced by proper planning and action from the start.

CHAPTER 6

JOINT VENTURES IN THE USA

- **The Right Partner.** JV's for the U.S. market will work only if you have the right partner(s). Check out each JV candidate carefully in advance of any deal. Your U.S. lawyer can obtain valuable data for you about the candidates that you probably cannot obtain elsewhere.
- **Most U.S. JVs Not Permanent.** Nor should you view them as permanent -- or even, in many instances, as long term arrangements. Circumstances, people and mentalities change. Try to arrange your U.S. JV and your planning so that if the JV breaks up at some point, you can continue the U.S. operation.
- **U.S. Corporation as JV Vehicle.** Rarely should a foreign party participate directly in a U.S. JV or "cooperation agreement". Direct participation in an "unincorporated JV" or "cooperation arrangement" will expose the foreign party to potential liability for the venture's debts and liabilities, to lawsuits in the States, and to negative tax consequences. **As a rule, from the Chinese partner's standpoint, a new U.S. "corporation" should be the JV vehicle.** There may, of course, be instances in which another form of U.S. legal entity, like the limited liability company ("LLC") would suit the purpose.
- **Three Typical Types of U.S. JV:** 1. Distribution JV: Chinese and U.S. parties form a corporation under the laws of a U.S. state (very often, Delaware), each owning an agreed percentage (the "JV Corp"). Typically, it will be the Chinese side's products that the JV will sell, and a distributorship contract will be among the JV documents to negotiate/sign. If the U.S. side will also be selling goods or products to the JV Corp, the terms will normally be embodied in a separate agreement. Typically, the U.S. side will contribute U.S. marketing knowledge, a sales force (its own or independent agents/ reps), technical knowledge about the JV products, and possibly things like administrative assistance and the use of its physical facilities. The JV Corp will sell the products to customers in its agreed territory (e.g., the entire USA, and possibly elsewhere in the Western Hemisphere). 2. Production JV: It is similar to the distribution JV except that the JV Corp will manufacture (in whole or part) and/or assemble the products emanating from the Chinese side (and, where applicable, those coming from the U.S. side), and resell them. The U.S. side may have a production facility which will be used to make the JV Corp's products, or the JV Corp may buy or lease an existing one or build a new one. Manufacture may take place in the USA, or even in Canada, Mexico or elsewhere in the Western Hemisphere. Among the contract documents to conclude is a "license agreement" from the appropriate JV partner to the JV Corp allowing it to manufacture its products with the partner's technology or other intellectual property. 3. R&D JV: A Chinese and a U.S. party form a U.S. entity to engage in research and development or similar activities.
- **Importance of First Class JV Contract Documents.** This is a must, especially for the foreign (e.g., Chinese) side. To the extent possible, all the transaction documents should be signed at essentially the same time.
- **"NB-SOT".** Rather than proceeding directly to contract drafts, it is usually advantageous to commence negotiations by preparing, honing to your and your U.S. counsel's satisfaction,

submitting to the U.S. side, and working to the signature of, “a non-binding summary of key terms” (“NB-SOT”) of the deal. That technique has many benefits for both sides.

- **Drafting Initiative.** Repeating the same thought made several times in this booklet, you, the Chinese side, should do your utmost to seize and retain the drafting initiative throughout, regarding both NB-SOTs and contract drafts. Let the U.S. side comment on your documents. The importance to you of the “drafting initiative” should not be underestimated.
- **Tax Planning.** Proper tax planning for a U.S. JV, with the assistance of experts, is important. It may affect the JV structure negotiated and implemented.
- **Some Key JV Points to be Negotiated (Non-Exhaustive List):**

This listing of only a few examples presumes that the JV vehicle is a U.S. “corporation”.

 1. Under which U.S. state’s laws will the U.S. JV corporation be formed?
 2. What type(s) of shares the JV vehicle will issue and what percentages will each side have therein?
 3. Capital contributions to JV vehicle of each partner; capitalization of the JV corporation generally. How will future capital increases or loans be handled if the corporation needs additional funding?
 4. How will members of JV vehicle’s governing management body (“Board of Directors”) and its officers be selected and who will they be?
 5. What are the functions and powers (and restrictions thereon) of each of the JV corporation’s officers?
 6. What acts, binding documents, etc. of the JV corporation require the prior approval of the JV’s shareholders and/or Board of Directors? Will there be a special majority or unanimity required for certain acts and activities of the JV corporation?
 7. Deadlock situations and how to deal with them contractually.
 8. What will be the restrictions on transferring shares of the U.S. JV corporation? Buyout obligations? Options to purchase or sell? First refusal provisions?
 9. Provisions for terminating the JV and dissolving the JV corporation.
 10. All of the key provisions in any distributorship, license, employment, loan, service, employment, or other agreements between or among the JV partners and the JV.
 11. Provisions dealing with how and where disputes and claims will be resolved, and what laws will apply to the JV contracts.
- **Input of Chinese Client.** The Chinese partner will have to work closely with its U.S. lawyers to put together and close a U.S. JV. That input and cooperation is vital.
- **U.S. Corporation with More Than 1 Shareholder.** Whether or not called a JV, if there will be more than 1 shareholder in a U.S. corporation, what will be needed (at a minimum) is (i) a shareholders’ agreement between the parties; and (ii) special Bylaws of the U.S. corporation tailored to the shareholders’ agreement’s provisions. As one example: a Chinese company forms a U.S. corporation. Either at the time of formation or later, it decides that a particular employee or group of employees of the U.S. corporation can buy or otherwise obtain shares in it. When that happens, it will be necessary to prepare, negotiate and sign, at the very least, a shareholders’ agreement, plus special bylaws.

- **Costs.** It will normally cost considerably more in legal fees to create a JV than to form a wholly owned U.S. subsidiary.

For more details on U.S. joint ventures, see Aaron N. Wise's *"A Chinese Business Person's Guide to American Law - Business Practices - Taxation"*. Chapter 8 of that Guide deals specifically with that subject, however, other Chapters will also be relevant to joint ventures. Copies of the Guide are available at no cost from the author of this booklet and the above Guide, Aaron N. Wise.

CHAPTER 7

LICENSING, TECHNOLOGY TRANSFER AND INTELLECTUAL PROPERTY IN THE USA

- **The Meaning/Pros and Cons of Licensing.** In practical, non-legal terms, licensing means granting to someone the right to use, normally for commercial purposes, certain intellectual property. A non-exhaustive list of the types of intellectual property that can be licensed are: patents, trademarks, internet domain names, copyrights (including computer software), trade secrets and know-how. Except for computer software, the license will normally permit the licensee to produce or manufacture or have produced or manufactured, in whole or in part, particular products or components, to assemble them (where applicable), and to sell them in an agreed territory. In most instances, the licensee is granted the agreed rights for a specified time period; or, alternatively, the agreement will have no fixed term but can be terminated by the licensor (or both parties) for specified causes or without cause. Typically, the licensee will agree to make certain payments for the rights granted (and possibly for services the licensor will render). The term “technology transfer”, in the American context, has no specific meaning. It is mentioned only because in some circles the term is loosely used. There are positive and negative features of selecting licensing as a way of doing business in the USA. You should be well aware of them before deciding to embark on the licensing path.
- **Protecting Your Intellectual Property.** The Chinese party’s intellectual property to be licensed should, to the extent possible, be registered (or filed, as appropriate) or at least applied for, in the USA (and where applicable, in other Western Hemisphere countries). That should, whenever possible, be done prior to negotiating the license agreement. You, the licensor, are likely to negotiate a better deal in that posture. Trade secrets and know-how are not filed or registered with any governmental agency.
- **“Due Diligence” Review of Licensee Candidates.** You should do a careful due diligence review of each licensee candidate. That will include reviewing the prospect’s financial and legal condition, its capability to produce the licensed products, and its ability to market them expeditiously in the contractual territory. Your U.S. lawyer can assist you in obtaining certain important information regarding licensee candidates and evaluating them.
- **License Agreements for the U.S. Market.** For the licensor’s protection and benefit, there is no substitute for a carefully drafted license agreement prepared by a American lawyer experienced in that field. Without that, the results can be a failed deal; placing your intellectual property rights at risk; a legal dispute or an actual lawsuit; and unnecessary expense. Most properly prepared license agreements for the U.S. market will be rather detailed, complicated and fairly lengthy, and not easy to negotiate. The reason is that there are a considerable number of points to be covered, negotiated and drafted.
- **The “NB-SOT”.** As with any other contract, it is often useful not start with a draft license agreement, but rather, with a non-binding summary of key terms (“NB-SOT”) as the first

negotiation document. Your U.S. lawyer, with your input, will bring an NB-SOT to the point where both of you are satisfied with it and are ready to submit it to the licensee.

- **The Drafting Initiative.** You should do your utmost to seize and retain the drafting initiative both for NB-SOTs and contract drafts. To the extent avoidable, you should insist on the U.S. side only commenting on yours. Losing the drafting initiative can make it difficult to conclude a binding license agreement on terms that are advantageous to you. Also, once the potential licensee has submitted its draft, it is difficult, and often more expensive, to reformulate it to satisfy your concerns.
- **Competitive Restrictions on Licensee: Potential Illegal or Dangerous Terms.** Certain competitive restrictions imposed on a licensee and certain other contractual terms may 1. violate the U.S. federal or state antitrust or analogous laws; and/or 2. where you are licensing U.S. patent rights, be a patent misuse and put your patent at risk. Moreover, whether or not there is an actual violation or misuse, a poorly drafted or inappropriate restriction can lead a licensee to bring or threaten to bring a legal claim or counterclaim against you, typically to retaliate when you sue or try to terminate the license. A party who successfully pursues an antitrust claim can collect treble damages, actual damages times three. Also, the court can award the winner its legal fees and costs. Experienced U.S. counsel will know how to draft the agreement to minimize this type of risk.
- **Exclusive Licenses; Non-Exclusive Licenses.** As a general rule, nothing prohibits an exclusive license covering all of the USA. Like all general statements, there are a few exceptions. But the general rule will apply to most Chinese companies. Sales by a licensee outside of its territory can lead to problems that – while thorny – can be solved. The granting of one or more non-exclusive licenses will not normally pose any problem under U.S. law.
- **Clauses Protecting Licensed Trademarks.** Under U.S. law, an agreement licensing or permitting a third party to use a trademark should contain certain clauses designed (among other things) to protect the licensor's rights in the mark. Without such clauses, the licensor's trademark may be jeopardized.
- **Royalties; Up-Front Payments, etc.** With few exceptions, the licensor and licensee can freely agree on the royalties, including, where applicable, an up-front payment (payment upon the license agreement being signed or very shortly thereafter). The same applies for minimum royalties, which the licensor will often want. The “few exceptions” just mentioned are points about which you may wish to question your U.S. lawyer.
- **Trade Secret and Know-how Licensing and Protection.** These can be licensed, and in general, clauses prohibiting the licensee's unauthorized use and disclosure during the contract's term and after the contract ends are enforceable, at least if the technology is not in the public domain. With a clear contract, even technology or knowledge that is not secret at the time of contracting, or ceases to be, can be the subject to royalty or similar payments. That is, with concise drafting, the licensee will not usually be able to convince a court that it can stop paying because the licensed technology or data is in the public domain or is known to all competitors. U.S. law offers strong protection to trade secrets and proprietary data. In

appropriate circumstances, U.S. courts will issue injunctions to protect trade secrets and other proprietary information. Under the arbitration rules of the American Arbitration Association, arbitrators too can issue preliminary and final injunctive-type orders.

- **Sale of Intellectual Property.** Instead of licensing the right to use for a limited time period, it is possible to sell outright intellectual property. In the case of trade secrets and know-how, the sale can be confined to the rights for a particular country or territory (e.g., the entire USA, or the USA and Canada). The tax aspects of intellectual property sales should be examined carefully.
- **Choice of Tribunal and Choice of Law.** These points are **not** just “legal points for the lawyers and of secondary importance to the economics of the license deal. They are very often critical business-legal points. What the agreement states on these points can be crucial for the licensor if it wishes to consider attacking, for example, if the licensee does not pay the agreed royalties, abuses or steals the licensor’s intellectual property or engages in some other wrongdoing. When the licensor may be defending a claim by the licensee (for example, for the licensor’s alleged breach of contract or a product liability or similar claim), what tribunal located where will decide the claim under which law is of paramount importance. Review these issues in detail with experienced U.S. counsel, arrive at the best solution and fall back position, and attempt to negotiate the most favorable provisions on these points.
- **Tax Aspects.** The Chinese licensor should, with the aid of experts, examine in advance the tax ramifications of the particular license or other intellectual property deal. Among other sources, the U.S.-Chinese income tax convention should be consulted. As a general rule, a Chinese party should do everything possible to avoid having what that tax convention defines as a “permanent establishment” in the USA. U.S. state and local taxes, such as sales and use taxes, may also be relevant.
- **Clauses Often Difficult to Negotiate and/or Draft in License Agreements.** Here are a few examples (without much explanation given here):
 1. When exclusivity will be granted for only a part of the USA and that will be the licensee’s entire contractual territory, the issue of under what conditions the licensee can sell the licensed products in other parts of the USA.
 2. Royalty clauses, particularly: A. Up-front payment; B. minimum royalties; C. running royalties: the percentage, the base on which they are calculated, when they accrue and when they are payable.
 3. Improvements or modifications of the licensed technology or licensed products made: A. by the licensee: To whom do they belong? What rights therein should the each party receive? B. by the licensor: Are they part of the licensee’s rights? What if the licensor’s improvement is a “major development”?
 4. Infringements of the licensed intellectual property rights by third parties: which party has which obligations, if any, to prosecute infringers and under what terms and conditions?
 5. If the licensed products infringe the intellectual property rights of a third party, how will the license agreement deal with that?

6. The duration of the license agreement, and in particular, the termination clauses. One especially tricky issue relates to the licensor's right to terminate should the licensee enter into bankruptcy proceedings.
7. Others mentioned above.

For more details on licensing, technology transfer and intellectual property, see Aaron N. Wise's *"A Chinese Business Person's Guide to American Law - Business Practices - Taxation"*. Chapter 9 of that Guide deals specifically with that subject, however, other Chapters will also be relevant. Copies of the Guide are available at no cost from the author of this booklet and the above Guide, Aaron N. Wise.

CHAPTER 8

BUYING AN EXISTING U.S. COMPANY OR A PART OWNERSHIP THEREOF

“Bullet points” are really not appropriate for this complicated subject. There are many types and varieties of acquisitions and acquisition structures, and for each, there are many facets and key points. Mentioning all or even many of them is impossible in this short publication. Nevertheless, here are a few short and rather general observations about acquiring a U.S. company.

- **“Due diligence” is a must.** For any acquisition of a U.S. company, a considerable amount of preliminary homework will be required. All aspects of the acquisition target company will have to be carefully examined and evaluated, from top to bottom. This process is called “due diligence”. A due diligence review by your U.S. lawyers (a thorough review of the legal, tax and other aspects of the target company) which data will be supplied mainly, but not exclusively, by the target/its owners, is standard practice in the USA. Other types of experts will often be involved in the due diligence process, such as an accounting firm, an environmental study firm, or a construction engineer. Consummating an acquisition without proper “due diligence” is like “buying a pig in a poke”. If your experts’ due diligence reports reflect a company that is not to your liking, you might decide not to consummate the deal, or might bargain for better terms.
- **Stock Purchase; Assets Purchase.** Most acquisitions of privately owned companies will be by way of either a stock purchase or an assets purchase. Potentially, each has its particular upside and downside features for the buyer and the seller. You should be aware of them.
- **Drafting Initiative.** Through your U.S. counsel, you should do your best to prepare the first draft of the acquisition agreement (and any non-binding summary of terms or letter of intent that might precede it), and thereafter, to maintain the “drafting initiative”.
- **Do Your Own Homework and Be Patient.** Do not underestimate how long it will take to finalize an acquisition. Although the parties may have reached agreement in principle, it takes time to complete the “due diligence”, obtain the financing (where applicable), negotiate, prepare and revise the necessary contractual and other documents and get them signed, and do all of the other legal and non-legal tasks. You should not become exasperated because the acquisition agreement and other contractual documents are long and complicated. To get the best possible results, you should work very closely with your U.S. counsel, review and comment on contract drafts and other documents, and generally, be part of a team.
- **The “Antitrust” Law Aspects.** Where the acquisition is fairly sizeable, the U.S. antitrust aspects should be evaluated before proceeding too far with the negotiations. Also, for fairly sizeable acquisitions, a pre-notification filing with a U.S. government antitrust watchdog agency will be required.

- **The Tax Aspects.** Before proceeding too far with negotiations, the buyer's experts should study the tax aspects of the proposed target company. They may affect the manner and structure of the deal the buyer wishes to negotiate.

For more details on this subject, see Chapter 11 of “*A Chinese Business Person’s Guide to American Law - Business Practices - Taxation*”, copies of which are available at no cost from your author.

CHAPTER 9

U.S. BUSINESS RELATED VISAS FOR CHINESE NATIONALS

- **Your U.S. Visa Requirements Should be Part of the Planning Process in Structuring Your U.S. Operation.** U.S. visas needed by your key employees to be paid by your U.S. operation can affect the structure of the U.S. operation you are planning or already have in place (e.g., its ownership structure and capital). **A non-U.S. national cannot be paid from a U.S. source for services rendered unless he/she has a U.S. visa so permitting.**
- **Temporary U.S. Visas; Permanent Residence Visa (“Green Card):** There are several different types of “temporary” visas available to Chinese nationals meeting the corresponding requirements, among them (examples only):
 - B-1 Visitors Visa (and the somewhat similar B-2 Tourist Visa);
 - L-1 Intra-Company Transferee Visa;
 - H-1, H-2 or H-3 Visa;
 - E-2 Treaty Investor Visa;
 - O-1 and O-1(a) Visas for athletes and entertainers;
 - “A” Visa for diplomats.

The permanent residence visa or “green card” is a permanent or “immigrant” visa, whereas the above listed ones are temporary.
- **The B-1.** With a B-1, a non-U.S. national cannot work for and be paid by any U.S. source. However, he/she can negotiate contracts, consult with business associates, litigate or arbitrate, participate in conventions and seminars, do research, and engage in certain other permitted activities in the States. With a B-1, each U.S. stay will be limited to a short period (6 months is the maximum but the maximum will often not be granted for a particular stay)
..
- **L-1.** This visa is for a foreign (e.g., Chinese national) “executive”, “manager” or “person of specialized knowledge” (all defined terms in the U.S. immigration law) who has worked for an enterprise outside the U.S.A. for at least 1 year within the past 3 years in one of those capacities and is being transferred to that enterprise’s U.S. subsidiary, branch office or affiliate temporarily in a comparable capacity. With an L-1, the holder can be paid for his/her services by the U.S. sub, branch or affiliate. Extensive documentation is usually required for L-1 applications.

- **The “H” Category Visas. 1. The H-1:** Among the requirements, the applicant must have professional level qualifications for a professional level position in the USA. Usually, this means that the position typically requires a baccalaureate (university) degree or an equivalent combination of education and experience. Applying for and receiving labor certification from the U.S. Department of Labor is also required for the H-1. That means convincing the Department that the U.S. employer will be paying the applicant a fair wage, that his/her employment will not displace other U.S. workers, and that there is no strike, lockout or work stoppage in that occupation. **The H-2:** Generally, the H-2 is for non-U.S. national workers or technicians needed to perform specific tasks in the States. One example might be to install and teach other workers of a U.S. company how to operate certain machinery. That U.S. company may pay the H-2 holder for his/her services. As with the H-1, labor certification is required. **The H-3:** The H-3 is for an alien coming to the USA to receiving training from a U.S. employer. Stringent requirements must be met.
- **E-1 (“Treaty Trader”). NOTE: At this writing Chinese nationals cannot obtain E-1 visas. The E-1 is mentioned only for information purposes.** The E-1 is predicated on a company (from a country whose nationals qualify for the E-1 visa = “Treaty Country”) having a U.S. subsidiary, affiliate or branch (“US Operation”). The foreign national seeking an E-1 must show that he/she will hold an executive or supervisory position in the US Operation and has the requisite skill for the post. At least 50% of the US Operation’s total volume of trade, which must be “substantial”, must be with the Treaty Country. Nationals of the Treaty Country must own at least a majority of the non-U.S. parent company. Generally, the US Operation will have to have been in actual operation for about a year. The E-1 holder can be paid for his/her services from the US Operation’s payroll.
- **E-2 (“Treaty Investor”). NOTE: At this writing, Chinese nationals cannot obtain E-2 visas. The E-2 is mentioned only for informational purposes.** Nationals from certain countries (with which the US has concluded a certain type of treaty) can obtain an E-2 visa if the corresponding requirements are met. The key for the E-2 is the amount of “capital” the foreign company or individual has invested in its US Operation. It must be sufficient for the type of business concerned (no precise amount is specified in the regulations). The applicant can be, but need not be, an owner of the foreign company, but he/she must be employed by it. He/she must be a manager or highly trained or specially qualified employee who is needed to develop and direct the US Operation.
- **“Green Card”.** The requirements for a “green card” will not be discussed here for lack of sufficient space (the source cited below discusses the “green card” in some detail). The following points are noteworthy: 1. A foreign (e.g., Chinese) national may not be able to obtain a green card straight away. He/she may have to apply for and obtain, as a first step, one of the types of temporary visas described above. Later (but before the temporary visa expires), it may be possible to apply for and obtain a green card. 2. Once a person has a green card, that is not the end of the story: the holder must meet certain criteria (e.g., presence in the USA for minimum periods), failing which it can be revoked. 3. A green card

holder becomes a permanent U.S. resident for American income tax purposes. That causes the holder to be taxable on his/her worldwide income.

For more details on U.S. visas, see Aaron N. Wise's "*A Chinese Business Person's Guide to American Law - Business Practices - Taxation*", Chapter 10. Copies are available at no cost from your author, Mr. Wise.

CHAPTER 10

LITIGATION AND ARBITRATION IN THE USA IN U.S. BUSINESS TRANSACTIONS BETWEEN CHINESE AND AMERICAN PARTIES

- **Americans inclined to start lawsuits or threaten to do so.** Americans are, in general, inclined to start litigation or to threaten it - considerably more so than Chinese people.. It is not just American lawyers that exhibit this tendency, but also (and particularly) American business people. The common expression “sue the bastards” quite probably originated with an American business person, not a US lawyer.

Americans often sue or threaten suit as a strategic device to obtain some sort of amicable settlement: a money payment, a new contract, an agreement by the other side to abandon its claims, or the like. The great majority of commercial litigations started are never decided by the court or arbitration panel. They are settled by the parties after the legal proceeding has begun. Sometimes, the threat of legal action is sufficient to bring about a settlement.

An example: a foreign firm sells goods to a US buyer or grants a technology license to a US party. The US side does not pay for the goods or the royalties. The Chinese firm sues the US party in an American court. In such a case, the US side’s lawyer will often respond by making strong counterclaims, possibly claiming high damages. Often such counterclaims are quite exaggerated and not at all justified. That is a strategy to frighten the foreign party into abandoning the lawsuit or concluding a settlement favorable to the US side but not the foreign side. We would emphasize that in a US litigation, the plaintiff or counterclaimant does not have to deposit any money with the court (e.g., in proportion to the damage amount claimed). Rather, in the USA claims for very high amounts are commonly made in lawsuits, often for psychological reasons even though the party making them knows its chances of recovering them are small.

In our experience foreigners are particularly good targets for lawsuits and serious threats of litigation. They frequently do not understand the US milieu, mentality and underestimate the chances and danger of a lawsuit. They often do not really fully appreciate the value in the US climate of carefully drafted, American style contracts aimed at protecting them. They typically do not bring an American lawyer into the picture early enough to reduce significantly the risk of lawsuits and claims against the foreign party.

- **Litigation in US Courts: As a rule expensive and time consuming.** Commercial lawsuits in the US courts are typically expensive and time consuming. In most cases, it is not a swift method for resolving disputes.

Unless there is a contract between the disputing parties stating that you, the foreign party,

are entitled to recover in litigation your legal fees connected with the litigation, US law generally does not permit that. There are only a few exceptions to that rule.

The lawyers for both sides can use various procedures to delay the day of final decision of the case by the US court. A good example are “pre-trial discovery mechanisms”. In a great many countries, it is primarily the judge who controls and directs the production of evidence. The lawyer presents his proof to the judge and from there, finds out what counterarguments his opponent has. In US civil law suits, it is the lawyers for each party that obtain from the other, normally without court intervention and well in advance of the actual trial, all of the evidence the other side. This is done via pre-trial discovery mechanisms such as:

- depositions (oral testimony under oath given by a witnesses, often in the office of the lawyer of the party requesting the particular deposition;
- document inspection requests (the party receiving this request must provide opposing counsel with copies of all requested documents having some relevancy to the case. Locating, reviewing and assembling the documents can often be time consuming;
- interrogatories (written questions, which are often quite voluminous, complicated and take time to answer properly;
- notices to admit or deny (statements are made which the other party is asked to admit or deny).

This “discovery” can produce high legal fees for both sides, and, as mentioned, can be used as a delaying tactic. Of course, that does not always occur. Sometimes the lawyers will use no or relatively little “pre-trial discovery”. However, one should normally presume that in most cases there will be a fair amount of pre-trial discovery.

It is often difficult to initiate commercial lawsuits in the USA where the plaintiff is claiming less than around \$100,000 in damages. The reason is that the costs, particularly legal fees, will normally be too high in comparison with the relatively small amount of damages. If, however, the parties have agreed to arbitrate their disputes and claims and the arbitration clause is properly drafted, then it might be cost effective to sue in arbitration for the small (or larger) claims.

- **General Suggestions.** At the time of contracting with a US party, you, the foreign party, side have in mind:
- to the extent possible, stay out of the US courts;
- provide for arbitration of all claims and disputes in its contracts with US parties (including in your General Terms of Sale), typically in the USA;
- be sure that its contracts with US parties is drafted, or at the least carefully reviewed by US legal counsel with experience in the area.

- **Exceptions.** There are situation in which serious consideration should be given to providing in a contract that a particular US court will have jurisdiction for disputes and claims, or certain of them. One such situation might, for example be where the foreign party has licensed the US side to use its “trade secrets” or confidential information. That might occur within the framework of a license agreement, a joint venture or a cooperation agreement. One of the main concerns of a licensor or JV partner is to be able to prevent the US side from making authorized use or disclosure of the secret or confidential information. In such a situation, a US court can react quickly by issuing first, a temporary restraining order and then, a “preliminary injunction” ordering the US side not to take such action. While arbitrators might have the power to issue similar orders, often they will not be in the position to react quickly enough.

It is usually possible to state in the parties’ contract that disputes and claims will be resolved by arbitration, but that one or both parties reserves the right to seek “interlocutory relief” (of the type mentioned above) from a court.

- **The Arbitration Clause; Applicable Law**
- **General Considerations.** Although arbitration has its pros and cons, it is usually the best solution for transactions with the USA and with US parties. In the States, the most well known and used arbitral institution is the American Arbitration Association (“AAA”) with its headquarters in New York City. It is capable of handling an arbitration anywhere within the USA and, additionally, anywhere in the world. The AAA’s International Arbitration Rules and its Commercial Arbitration Rules are frequently used in commercial and international commercial disputes.

To repeat, a properly drafted arbitration clause will usually be the best solution for a foreign party. From the offensive viewpoint (claims of the Chinese side against the US party) a US arbitration will normally be quicker and less costly than a lawsuit in a US court. That also applies for smaller claim amounts. In a US arbitration, the permissible scope of “discovery” (compared with pre-trial discovery in a US court) is reduced. From a defensive standpoint (the US side has claims/counterclaims against the foreign party), arbitrators are often inclined to award lesser amounts of monetary damages than a US court, particularly if a jury is deciding.

Most US parties will not agree to arbitrate disputes and claims in a foreign country or anywhere other than the USA; and will not agree to some “foreign” law or any law other than the law of some US state being applicable to disputes and claims. They will as a rule agree to arbitrate disputes in some US city according to the AAA’s International or Commercial Arbitration Rules. Moreover, clauses stipulating arbitration in a foreign country (not the USA) but stating that the law of some US state will apply to the parties’ relationship will usually not be good for the foreign party. It will usually be expensive, difficult and problematic to plead and

prove American law before arbitrator(s) outside of the USA. Although an arbitral award can normally be enforced in the USA through the New York Convention, experience has shown that the enforcement procedure is complicated and costly as compared to the enforcement in the USA of arbitral awards rendered within the USA.

The US city in which the arbitration proceedings will occur, does not have to be the city where the US side has its headquarters or a place of business. In fact, from the foreign party's standpoint, that should be avoided. Where possible, the arbitration clause should provide for arbitration in a US city not too close to the US side's location, and but one that is reasonable convenient for the foreign side. Quite often, the parties in their contract stipulate New York City as the place of arbitration and provide for the application of New York State law to their contract (even though New York State may not have a material connection with the transactions).

- **Variations and special points regarding arbitration.**

The parties may provide in their contract:

- that if the foreign side (as supplier, licensor etc.) is the one initiating arbitration, it will be under the AAA's International Arbitration Rules in a particular, named US city, but if the US side initiates arbitration, it must be take place in a named city in the foreign party's country under, the same AAA International Arbitration Rules or some other agreed arbitration rules. This variation permits the foreign party to attack in the USA where the American party is located---a distinct advantage; but allows it to defend in its home country---another important advantage. The US party, of course, more often than not will not accept this formula, but it might well be worth a try.
- that only the foreign party has the right, at its sole election, either to arbitrate disputes and claims pursuant to the arbitration provisions in the contract, or to sue the US side in a US court. Under the laws of many US states, such a provision is legally enforceable. It provides flexibility to the foreign party.

Obviously, there are many other possible variations too numerous to mention here.

Typically, US parties will, in contract negotiations, initially refuse to have any court or arbitral tribunal other than one located very close to the US side's place of business decide disputes and claims, and will insist that the laws of that jurisdiction (US State) apply to the contract and all disputes/claims. If, however, the foreign party is firm in negotiations, insisting on arbitration and applicable law clauses of the types noted above, it might end up with them.

- **Other important considerations regarding arbitration clauses**

- How many arbitrators should decide the disputes/claims, one or three? How should the arbitrators' fees and other costs of arbitration be divided by the parties

- Who should the arbitrator(s) be and how should they be chosen?

The following contractual provisions may, in a particular case, be beneficial of the Chinese party:

- a clause to the effect that claims based on the violation of the US antitrust laws are not within the competence of the arbitrator(s) under the arbitration clause. The advantage is that the US party, who would normally be the one making an antitrust law-based damage claim, would have to start a separate lawsuit against the Chinese party in a US court. Often, such claims are not strong ones (and are raised primarily to “frighten” or “intimidate” the foreign party), so that the US side might well be reluctant to spend the time and money to initiate a separate lawsuit.
- a clause stating that each party can, despite the arbitration clause, apply to a court for interlocutory relief (e.g., a temporary restraining order and/or preliminary injunction).
- a clause stating that the arbitrator(s) can, upon application of either party, require the other party to deposit security (e.g., a bond, bank guarantee) to satisfy any eventual monetary award in favor of the other party.
- a clause stating that the prevailing party in the arbitration will be entitled to recover from the other party its own legal fees and costs connected with the matter.
- a clause providing that if the US side wishes to raise a product liability claim against the foreign party, it must do so in the arbitration. For example, a person in the USA is injured or dies allegedly through the use of a product or component produced or sold by the foreign party, sues the, the foreign party’s U.S. distributor, agent, licensee or the like (the “US contract partner”)----- but not the foreign party itself. The US contract partner would like to bring the foreign party into the case, claiming indemnification of any damages awarded against it and its costs. If the arbitration clauses if properly drafted, it will usually be possible to avoid that---in other words, US side would normally have to initiate arbitration under the arbitration clause to make its product liability claims against the foreign party.

Last word on this subject: first class, US style contracts are your best weapon and best protection. It cannot be emphasized enough that in connection with US transactions and business relationships, first class US style contracts, prepared by competent US legal counsel, are the best insurance policy for any company. That applies in particular for foreign companies. If the foreign party is an exporter, it should have first class General Terms of Sale prepared by an experienced lawyer, and use them correctly.

CHAPTER 11

ERRORS FREQUENTLY MADE BY NON-U.S. PARTIES

Non-U.S. parties have often made and still make many errors in their U.S. business endeavors. Some are commercial, some legal, but the majority of them have both commercial and legal components. The reason is that commercial is legal and legal is commercial---they are usually inextricably bound together. It is not possible in the space of this short booklet to list all the errors non-U.S. parties tend to make. But a few notable ones are listed here.

- **U.S. Product Approvals.** Some products cannot be brought into the USA and sold without the approval of a particular U.S. federal or state government agency. For some products, there is a registration process (and thereafter, possibly, periodic report filings) rather than prior approval applies. Be sure you check out if any such requirement applies to your product. Be sure also that the data you receive is current study. In one instance, a European company (“ECo”) wanted to export into and sell in the USA non-prescription sunglasses. ECo received information from the commercial section of its country’s trade office, both in its home country and in the USA, that prior U.S. Food and Drug Administration (“FDA”) approval of the sunglasses was required, which could take months of effort to obtain. ECo engaged your author’s firm to review the situation. It turned out that the information ECo had received was no longer correct---the FDA had changed its policy and rules a few months before. No prior approval was required. Instead, ECo and its U.S. sales subsidiary only had to register with the FDA. That process involved completing several forms, mailing them in to the FDA, and receiving back registration numbers. Thereafter, annual reports would have to be filed with that agency. The registration process was completed in a couple of weeks. The hard part was locating and contacting the specific FDA offices dealing with the process (there are many FDA offices in several different locations). **The point: If there is any reasonable doubt whether a prior U.S. government approval, registration or similar process may apply to your product, or what that process is, you should engage competent U.S. counsel to deal with those issues.**
- **“Due Diligence” on Your Prospective U.S. Business Partner.** A fair number of non-U.S. business people meet someone at a trade fair or similar event, on the plane, through a friend, or in some other way. That someone says he/she (or his/her company) just loves the foreign party’s products or services and is ready to be its distributor, agent, licensee, partner etc. Without checking out very carefully, the foreign party agrees, either orally or in writing. That is a bad error. It could lead to business problems, legal problems or even a lawsuit. You need to investigate your potential business partners thoroughly (“due diligence”) before agreeing to or starting any business relationship. Your U.S. lawyer will usually be able to obtain valuable information about a prospective candidate. **The point: Don’t get into bed with anyone without first carefully checking them out.**

- **Letting Someone Other Your Most Trusted Employee Handle Intellectual Property Filings.** Some foreign companies permit their U.S. distributor, agent, joint venture partner, a friend, or someone other than one of the company's most trusted employees handle the filing of the company's intellectual property (patents, trademarks, copyrights, etc.). The result can range from an error to an outright fraud. On occasion, the person entrusted will file the application showing himself or his company as the owner-applicant, rather than the foreign company. **The point: These items are at the heart of your business. Only a very trustworthy representative of your firm should handle these matters, working with competent U.S. counsel.**
- **Intellectual Property Filings in the USA (or in the Western Hemisphere) a Priority Item.** One of the very first things a foreign company should do---and many are remiss--- is to file applications in the USA and, where applicable, in other Western Hemisphere markets, for patent, trademark, copyright and other intellectual property protection. You should have these applications in process *before* you start doing business in those territories. Certainly that is so for the trademarks, brand and trade names, slogans, logos and symbols that you plan to use there. That process will involve first checking whether some third party has already registered or applied for, or is using, that mark, name, etc. or one confusingly similar hereto. You should not use and might be sued for using a mark, name, slogan, logo or symbol that infringes a third party's rights. Plus, if you have already started using such a mark, name etc., and have to stop, you will incur expense and possible difficulty in getting potential customers to recognize your new marks, brands, etc. **The point: Putting your intellectual property situation in order should be a priority item.**
- **Don't Let Anyone But Your Trusted Employee Handle Setting Up Your U.S. Company, Working With Your U.S. Lawyer (and Other Experts).** A true story will illustrate this point. A European company ("ECo") engaged what its owner ("ECo Owner" or "Owner") believed to be an old friend to work for the U.S. subsidiary corporation ECo intended to form ("USCorp"). The "friend" told the ECo Owner that under the applicable U.S. law, at least one shareholder of USCorp must be a U.S. permanent resident, which the friend was. In point of fact, no shareholders have to be U.S. permanent residents---the statement was false. ECo and its Owner intended that 1 share of USCorp's stock be issued to ECo Owner, 1 share to the "friend" as a nominee share to satisfy the supposed "legal requirement", and the balance of the 98 authorized shares to either ECo or a trust beneficially owned by ECo (whichever ECo should decide later). ECo Owner believed he had conveyed that information to the "friend" and that he understood and was in agreement. **No written contract between ECo, ECo Owner and the "friend" was ever prepared or signed.** The "friend" proceeded to form USCorp using a U.S. lawyer of his choice. They purported to issue 20 shares of its stock: 10 to the "friend" and 10 to ECo Owner. The "friend", from then on, claimed that he was the 50% owner of USCorp. The "friend" also claimed that he was the President and CEO of USCorp and, along with ECo Owner, one of its two Board of Directors' members. The substantial moneys (capital) invested in USCorp came from ECo. USCorp meanwhile signed a lucrative, fairly long term contract with a major U.S. customer to purchase ECo's products from USCorp. ECo and its Owner tried to settle the matter amicably with "friend", but to no avail. An expensive lawsuit in the USA and associated "pain" was the result for ECo and its Owner. **The lessons: 1. Be sure you**

control the entire process of forming the U.S. entity; and 2. Make sure your agreements and “ground rules” are in writing, prepared by your U.S. counsel.

- **Using Service Companies To Form Your Own U.S. Company.** Ads circulate in many countries offering to form a U.S. company for a very low price. You should not hire any such company. In your author’s experience, these service company do not do the complete job required to form and (in U.S. lawyer’s parlance) **“organize”** the company. That is particularly so when the company is a “corporation” formed under the laws of a particular U.S. state. Services companies typically do not attend to matters like the documentation to elect directors and officers, adopt bylaws, set forth and approve capital contributions, issue the shares, and certain other measures. The result is a defective organization. Your author has been engaged many times to complete and bring up to date the organizational and other documentation of U.S. corporations that clients have formed using “service companies”. Generally, it will be more costly and complicated to fix up the deficiencies and defects after the fact than if the job had been done thoroughly and correctly in the first instance.

The same basic principals apply regarding such service companies’ advertisements to form an LLC under a particular U.S. state’s law (e.g., Delaware).

- **First Class Contracts for the U.S. Market Are a Must.** If you want to optimize your chances of getting paid, succeeding commercially, protecting your intellectual property, and staying out of legal, tax and other trouble, you will need well-drafted contracts for the U.S. market prepared by competent U.S. experts. A literally limitless number of cases can be cited where foreign parties have not adopted that course, and have paid the price later. Here is one example. A European company (“ECo”), without using any lawyer (let alone a qualified American one) signed a “cooperation agreement” with a U.S. manufacturer-seller of similar industrial equipment. The agreement contained a clause prohibiting ECo from selling its own or similar products anywhere in North America for 5 years after the agreement ended. The agreement ended with the U.S. party owing money to ECo. Per the agreement, all disputes were to be resolved by 3 arbitrators in the U.S. party’s “home town” (in Indiana), and under Indiana law. The U.S. party started arbitration claiming ECo owed it money, and more importantly, to enforce the non-compete clause. The result was a lengthy and expensive arbitration with the U.S. side having the “home court” advantage. **The point: Had ECo engaged competent U.S. counsel to draft and help negotiate the agreement, this misfortune would, in all likelihood, never have occurred.**
- **Using Properly Drafted General Terms of Sale (“GTS”) Tailored to the U.S. Market.** They offer very clear and important advantages to foreign exporters, including for their U.S. subsidiaries and affiliates. The benefits are too numerous to mention here. **A Reference: A list of the benefits of properly drafted GTS tailored to the U.S. market can be found Chapter 14 of “A Chinese Business Person’s Guide to American Law - Business Practices -Taxation”. See below.**
- **Be Careful when Terminating U.S. Distributors, Franchisees, Sales Agents and Licensees.** Proceed carefully, with competent advice, before you attempt to terminate. Terminated distributors, franchisees, sales agents and licensees frequently sue based on alleged improper termination or raise improper termination counterclaims when suppliers,

franchisors, principals, or licensors sue them (e.g., to recover moneys due). **The two lessons: 1. Make sure any steps you take to terminate (or not renew) are done properly; and 2. If the distributorship, franchise, agency or license agreement is properly drafted by experienced counsel, the risk of successful improper termination claims or that they will be made at all, will be substantially diminished.**

- **Your U.S. Business Lawyer Should Be Part of Your Negotiating Team.** Experienced U.S. business lawyers absorb quickly the key features of your business and that of your potential contract partner, the respective mind sets, what you want to achieve in your deal, and other practical and commercial information. They will be able to guide and advise you regarding your contemplated business transaction. They are accustomed to negotiating a variety of business arrangements. Since, in the final analysis, they will be the ones preparing the contract documents, their participation in the negotiations will facilitate their task and typically result in the best work product.

For more information and other examples of errors frequently committed by non-U.S. parties, see Chapter 14 of Aaron N. Wise's "A Chinese Business Person's Guide to American Law - Business Practices -Taxation". Copies are available at no cost from the author of this booklet and the above Guide, Aaron N. Wise.

