



Commercial contracting with a Chinese counterpart

Many say that China is a relationship-based economy, with contracts not being worth the time it takes to create them. *Exporter* asked Nestor Gounaris of Shanghai-based advisory firm China Solutions, for his view on if, and how, contracts matter.

EXP: *If an exporter knows his supplier and doesn't see a need to create a contract, or risk offending him, are contracts worth it?*

NG: Yes, contracts are worth it. We have heard the same arguments before, often from companies that were not aware of the value of a good contract in China. However, in more

than 13 years in China we have seen many cases in which a well-planned contract protected the savvy (and many in which the lack thereof filled others with regret).

In a wide variety of commercial relationships (employment, sale & purchase, rental, investment, trademark licensing, etc) robust

contracts can and do protect parties.

On the other hand, a poorly prepared contract can leave parties vulnerable. For example, one of our clients entered into a lease

agreement for an office of a soon-to-be established company, paying two months deposit and two months advance rent on a one-year contract.

Unfortunately, the office address could not be used as the company's registered address. Furthermore, the lease did not allow for early termination if the office address failed to meet this requirement. Ultimately, the tenant was forced to pay rent for the remainder of the year, in addition to renting a second, qualifying, office.

“A somewhat common scheme is for a seller to request payment to a specific bank account from an offshore buyer by email. Once made, the seller asserts that their email account was hacked, and denies having issued payment instructions. A well-written contract effectively blocks such a tactic.”

EXP: *What about emails, faxes, pro forma invoices, and a handshake? If a firm has lots of emails and other supporting documents that prove what's agreed, and has even paid the up-front deposit – do these various documents together demonstrate a binding contract?*

NG: Yes, but.... no, not really. If the documents and materials can establish proof of an offer and acceptance, then a contract may have very well been formed under contract law of many countries, including China and New Zealand.

But, the reality is that these documents and materials are often quickly drafted, use acronyms, industry terminology, shorthand – and are devoid of critical details and hastily translated into Chinese, if at all. Such language offers woefully inadequate protection in the event of a dispute.

To illustrate this point, a somewhat common scheme is for a seller to request payment to a specific bank account from an offshore buyer by

Five golden rules for China-based contracting

- Enter a contract, if the contract matter is worth protecting.
- Think through commercial, legal, regulatory issues.
- Confirm critical corporate details through a corporate due diligence.
- Anticipate strategic concerns.
- Notarise the contract, if the subject value is considerable.

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China's legal culture is document-intensive; courts have an almost singular preference for an original, bilingual contract with the original binding signature and company seal.

Moreover, if the subject matter is of sufficient value, consider preparing the contract for submission as evidence by having the contract notarised by the relevant notary.

EXP: *How can a contract protect someone in China? Doesn't everyone just do what they want anyway?*

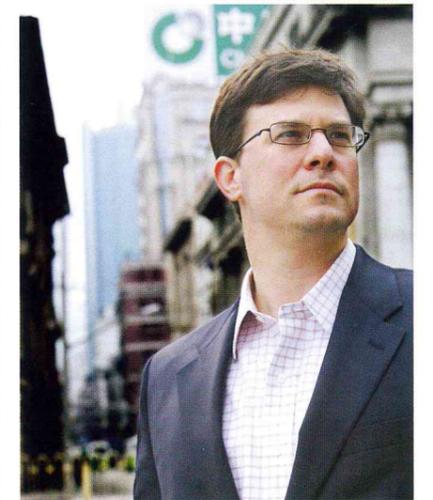
NG: It is easy to assume that a contract has little or no value, but that simply is not true.

All things being equal, if the contracting parties have relative power parity then a well-planned and well-drafted contract can offer tremendous value.

Preparing a contract will protect you in the following ways:

- (a) Triggers you to think through the legal and regulatory issues that will impact your transaction (e.g. withholding tax on payment from a Chinese client to your offshore company, landlord's obligation to register your Shanghai-based lease);
- (b) Demonstrates to your counterpart your comprehension of legal, regulatory and business norms in China (and, thus, your

- reduced susceptibility to bad faith or fraudulent behavior);
- (c) Creates an opportunity to study your commercial counterpart's business and legal attitude and values as they negotiate the contract;
- (d) Creates an opportunity to execute a binding and enforceable contract by conducting corporate due diligence to confirm critical corporate details (e.g. signatures, company seals, registered name, registered address, business scope); and
- (e) Enables you to plan strategic issues, such as ongoing evidence creation throughout the commercial relationship (e.g. written confirmations, inspections), ideal selection of governing law/dispute resolution body/language, consider enforcement of the agreement and power parity.



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This article is intended to provide a general guide to the subject matter and should not be treated as a substitute for specific advice concerning individual situations. Readers should seek formal advice before taking any action with respect to the matters discussed herein.