

# Navigating China and U.S. Law

## A GROWING PRACTICE AREA

By Dennis M. Horn

China's economy expanded at a blistering 11.4 percent pace in 2007 according to the National Bureau of Statistics. Why is China of interest to American lawyers? In a global economy, the grasp of international "best practices" is an exportable commodity. American lawyers with international practice experience have opportunities to export their knowledge so long as they understand the rules of the road for doing business in China. Some of the challenges these lawyers will face when they do business in China include competition from Chinese and British-trained lawyers and a legal system that is far less developed than the legal systems in the United States and Europe.

The Chinese economy is based largely on trade with the rest of the world. This trade raises myriad legal and regulatory issues. For example, U.S. manufacturers who produce goods in China must be licensed in China. When the manufacturers export goods to other countries, they must comply with the laws of those countries, including import-export laws and consumer protection laws. U.S. manufacturers must protect their trademarks and patents and be properly advised on tax and finance issues. China itself is also becoming a significant market,

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raising even more legal issues for both foreign and domestic companies who seek to penetrate that market.

There are hundreds of lawyers practicing with U.S. law firms, both in the United States and in Asia, who represent Chinese clients in navigating U.S. law with respect to investments in China, exports to China, and imports from China. For example, the Department of Commerce's Bureau of Industry and Security recently expanded the types of commercial products requiring a license for export to China, including, in particular, exports that could have military applications. U.S. lawyers need to advise their clients on complying with these regulations. Chinese exports to the United States are regulated by U.S. Customs regulations and health and safety laws. When a toy made in China injures a U.S. consumer or a U.S. consumer is harmed by an adulterated food product produced in China, U.S. lawyers will typically handle the lawsuit and the regulatory review.

Similarly, U.S. companies that invest in China must comply with U.S. law, Chinese law, and to the extent they set up investment vehicles in other countries, the laws of those countries. As an example of the U.S. laws that apply, the Foreign Corrupt Practices Act regulates how U.S. companies are permitted to do business worldwide, including a prohibition on bribing local officials. Making "gifts," which may

be common practice in many developing countries, is not permitted under this U.S. law. Similarly, China has a myriad of laws and regulations regulating foreign investment in China. For example, under current Chinese law, foreign investors can invest in Chinese real estate only by establishing an onshore "foreign-owned enterprise" or by investing through a joint venture in a Chinese company with the appropriate real estate business license. Chinese regulations also restrict the amount of cash that can be remitted out of China from an onshore property-holding structure, requiring sophisticated tax and financial planning.

All of these regulations on entry are in addition to the "normal" licensing and land use planning permissions that would be required to set up a factory or a retail operation in most countries, including China. And "normal" may have a different meaning in China than it does in the United States. Deloitte's *China Real Estate Investment Handbook* (June 2007, available at [www.deloitte.com](http://www.deloitte.com)) diplomatically observes, "Although China's history is long, its transition to a country with 'rule of law' that is respected by its people and administrators alike, is still in process." The authors of the handbook also note that "[t]ransaction processes are often not done in an open and prompt manner. Generally speaking, there are no clear and consistent taxation and registration processes applicable across

the country.” All of this uncertainty increases the importance for U.S. companies to have advisors who are both sophisticated in general legal principles and conversant in Chinese laws and customs.

However, Chinese-educated lawyers may not have the experience or the perspective to provide this advice. In recent years, China has not produced enough trained lawyers to handle China’s emergence as a nation operating under the rule of law. According to a recent *Wall Street Journal* article, China has 122,000 full-time lawyers today, up from 48,000 in 1997. This is less than one lawyer for every 10,650 people in China, compared to one lawyer for every 270 people in the United States. These Chinese lawyers also have an increasing workload. Chinese citizens in increasing numbers are using the courts to protest discrimination, poor labor conditions, and in the case of the earthquake in Sichuan province, the allegedly substandard construction of school buildings. The number of civil cases filed by Chinese lawyers in 2006 was up 54 percent from 2001. (“Chinese Seek a Day in Court,” *WALL ST. J.*, July 1, 2008, at A12.)

The gap in mainland Chinese legal expertise has been filled by lawyers from the United States and, to a lesser extent, from the United Kingdom. While China continues to train more lawyers, at least for the immediate future, it is likely that U.S. and U.K. lawyers will enjoy a competitive advantage in some legal specialties—such as business law, finance, and intellectual property—because of their more sophisticated legal training and international experience. For a while, U.K. law firms had a competitive advantage because Hong Kong was a British colony for so long, and Hong Kong is an engine for Chinese economic growth. But Hong Kong has also been open to U.S. law firms for many years. In addition, other areas in China, such as Shanghai and Beijing, are becoming economically more important. For these reasons, U.S. law firms are able to compete on a more even playing field.

U.S. law firms have followed several models in serving the China trade. For example, Sughrue Mion PLLC is solely an intellectual property firm that joined the newly formed China Trademark Association last year. Sughrue lawyers visit China periodically to lecture on U.S. trademark law and advise Chinese clients who want to export goods to the United States. Other firms provide a wide array of services with registered representative offices in China. As of the end of 2006, there were 93

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such firms in Beijing and more in other Chinese cities. These firms are not permitted to give opinions on Chinese law or to litigate in China. They are permitted to have registered representative offices in China and to provide an array of other services. For example, both Holland & Knight LLP and White & Case LLP have registered representative offices in China. Both represent clients from around the world in mergers and acquisitions, project financing, establishment of investment vehicles, tax planning, and intellectual property counseling in China. Both firms employ young U.S.- and Chinese-educated bilingual Chinese nationals as lawyers and experienced U.S.-educated U.S. nationals as lawyers, based both in China and in the United States. Each firm also works closely with Chinese law firms to provide the opinions, litigation expertise, and other specialized advice that foreign law firms are not permitted to provide.

Not all clients are satisfied with their U.S. firm representation. One large U.S.-based retailer that entered

the China market around 2000 began using a large U.S. firm to prepare store lease and contract forms and advise it on structural issues. When the company ran into problems in establishing foreign-owned subsidiaries and with licensing, it engaged Chinese law firms. As one senior executive with the retailer put it, “In the Chinese legal system where relationships are often more important in problem solving than understanding the letter of the law, a Chinese lawyer who went to school with the minister can be more helpful than a U.S.-trained lawyer who understands the letter of the law.” Another China lawyer noted that reliance on connections can be overstated since very few Chinese lawyers have the best connections. This is probably because there are more lucrative and prestigious careers than law available to well-connected native-born Chinese.

The Chinese judicial system also operates in a manner that many U.S.-trained lawyers who are not steeped in Chinese culture may find difficult to fathom. Rather than administering “blind justice,” Chinese courts can administer government policy at the expense of the equities of the individuals before the court. In China, the courts are a branch of government without independent administrative power. Judges may be agents of government policy rather than neutral arbiters. The *Washington Post* recently reported on the case of Zhang Chunjiang, who was awarded almost half a million dollars by the Shanxi Provincial High Court. The High Court ruled in his favor after the local authorities auctioned off Zhang’s company and kept the proceeds, even though the company was privately owned. According to the article, “The last attempt [at a compromise] came September 29 [2007], Zhang said, in a telephone call from a provincial High Court judge trying to broker a deal on behalf of the government. ‘If you continue to make trouble, you will not even get one cent, and maybe you will end up in jail,’ Zhang quoted him as saying.” (See “Businessman’s Defeat

Illustrates Party's Rule in China, Local Officials Can Ignore Law," Edward Cody, WASH. POST, Oct. 12, 2007, at 1-12, available at Washingtonpost.com/wp-dyn/content/article/2007/10/11/AR2007101102135).

Despite the hype about China's emergence as a world power, China is still a developing country in many respects. Its legal system is not yet mature, and the rule of law has not been established as a core principle for dispute resolution. In addition, although laws come from Beijing, local officials in the provinces who administer the laws may be influenced much more by increasing local taxes or doing a favor for a relative than by Beijing policy. That leaves plenty of latitude for getting an administrative approval, the right to develop land, or a favorable court ruling by bribing local officials or appealing to priorities other than the equities of the parties involved. One *Financial Times* columnist notes that the "lofty-sounding" laws may not be "an effective instrument

to protect property rights." He quotes a farmer in Jiangsu province north of Shanghai who believes that the Chinese Real Property Law, which was being debated when the article was written and went into effect in October 2007, "holds little promise of salvation." The columnist further notes, "His objections are to the practical application of any rules by local officials, who control all arms of government, including the courts. Such officials can profit personally by seizing farm land and rezoning it for commercial use. They can rely on real estate sales to raise taxes. Without the administrative and legal system that can act independently of officials and the Communist party, laws can be next to useless." ("Farmers Are the Last to Benefit from Chinese Property Reform," Richard McGregor, FIN. TIMES, Mar. 9, 2007, at 4.)

Corrupt officials aside, in Chinese culture, family and social connections are extremely important. There is therefore plenty of room for the Chinese equivalent of Tammany Hall "fixers"

who have strong contacts with local officials and business leaders. As is the case throughout the world, deals are often made through local connections. However, since businesses also need more sophisticated assistance, there is plenty of room for both foreign-trained and Chinese-trained lawyers who know the laws and regulations and international best practices.

Not surprisingly, clients want it both ways. They want lawyers with broad international experience who are bilingual, steeped in Chinese culture and customs, and enjoy the connections required to operate in China. While China offers significant opportunity to U.S. lawyers, it enjoys a unique culture that requires particular skills to navigate. For those lawyers and law firms with the intestinal fortitude to navigate that culture, China offers significant opportunity. For the rest of the U.S. legal community, we will continue to have to experience the benefits of the China trade by buying less expensive toys at Wal-Mart.