

1 KNOWING CHINA

"China is a world unto itself, not a nation among nations."

— John K Fairbank

The Westerner who visits China for the first time will no doubt be overwhelmed by how different China is from his own world. China looks, sounds and even smells different. If your first port of call is Shanghai, you are likely to be pleasantly surprised by the sensation of difference. If, however, you have been sent to a nameless factory town in the Northeast, your feelings are likely to be less pleasant.

The "Explaining China" industry is large and rapidly growing. It already supports numerous Western authors and consultants. However, it should be borne in mind that the majority of such consultants have a vested interest in shrouding China with mystery. Many appear to suggest that the foolish foreigner who does not immerse himself fully in Chinese culture will court disaster. Pity the foolish foreigner who gives her Chinese partner a clock¹ as it will doom her chance of success not only in that particular project but possibly all of China. Other books seem to be all for foreigners spouting Confucius during meetings. In the main, the Chinese do not really care too much. They will be touched that you have read a book on their culture, but they are normally extremely forgiving for any unintentional faux pas which a foreigner may commit. You are a foreigner after all. Indeed, I conducted a survey of Chinese colleagues as to whether they would be offended if I give them a clock as a present. More than half had never heard that it was inauspicious to give clocks. Two still did not understand it was an unlucky present even after being given an explanation that this was a Chinese cultural no-no. However, all agreed that they would be happy to accept a clock if it was expensive.

1. Yes, a clock — the Chinese word "zhong" has the same pronunciation as the word "death".

Still, it should be noted that the Chinese themselves also believe that China is and should be a great mystery to foreigners. Once, a dinner companion was a Chinese woman who had been living in the US for five years and had married an American man. She asked me how long I had lived in Shanghai, and when I told her 12 years, her jaw dropped and she remarked that I must know Shanghai better than her. She herself had never lived in Shanghai and had only visited the city for three days some 20 years ago. Despite this, she was still not sure whether I knew Shanghai better or not.

“There is nothing mysterious about China once you understand her.”

— Zhou Enlai’s response to Kissinger

China is different and interesting. An investment in some books and a few courses is time well spent provided you do not take it all too seriously. Your Chinese colleagues and partners will in any event be supportive of such efforts. Knowing more about the country will also make it easier to be successful here.

This book will not presume to dwell on the cultural aspects of China, but I have, for ease of reference, prepared a short list of do’s and don’ts². This chapter will, however, presume to provide an overview of the legal system in China in respect of foreign investment, *guanxi* and related topics.

Brief Overview of the Chinese Legal System

Laws and Regulations

China has made great advances in establishing a legal system. The authorities have borrowed many principles and ideas from overseas and adapted them to the Chinese situation. From a virtual legal vacuum only a

2. Refer to pages 30-33.

few decades ago, we are now confronted with a quite comprehensive and increasingly sophisticated body of laws and regulations.

Most problems exist in relation to enforcement and not the written laws. For many foreign companies, the most serious legal problems are to enforce judgments or arbitration awards that have been made in their favour. However, it is also true to say that this aspect of legal life is also improving in China. In the battle of “rule of law” (*fazhi*)³ and “rule of man” (*renzhi*)⁴, it seems that the rule of law is winning.

After Chairman Mao’s death in 1976, Deng Xiaoping’s subsequent reforms have led to the rule of law replacing the rule by man. This has also been seen in the increasingly prominent role that the National People’s Congress has taken in issuing legislation and promoting an overall reform. The succeeding Chinese leaders have also shown their support for this change. By way of comparison, in 1976 there were only eight laws and regulations issued⁵; year 2005 saw 4,690 regulations and laws being issued⁶.

The political strategy “governing by law and building a market-based socialist country” was proposed in the 15th National People’s Congress and further rectified in the 2004 amended Constitution.

The legislative procedure is specified in the *PRC, Legislation Law* which was itself legislated in 2000. This law was the first time the Chinese government disclosed in detail the systematic procedure for legislating laws, administrative regulations, ministerial rules and judicial interpretations.

3. In Chinese: 法治。

4. In Chinese: 人治。

5. The regulations were two administrative regulations, four ministerial rules and two judicial interpretations.

6. Including 44 laws, 178 administrative regulations, 4,409 ministerial rules and 59 judicial interpretations.

Is Foreign Investment Subject to Restriction?

In China, the establishment of a FIE, including its specific business scope and scale, is subject to examination and approval of the competent authorities. Legally, investment projects are classified by the *Foreign Investment Industrial Guidance Catalogue (2004 Revision)*⁷ which provides for different categories:

- encouraged;
- permitted;
- restricted; and
- prohibited.

If a project does not fall within one of the above specifications, it shall be dealt with as permitted and not subject to any particular preferential treatment or restrictions. Depending on the classification of a project under the Catalogue, either preferential treatments may be available or further preconditions or restrictions apply (eg project only allowed in form of JV, etc).

In practice, approvals are still to a large extent within the discretion of the relevant authorities (especially so in less developed area).

We will first take a look at the PRC regulations on contracts, an important element in any legal system.

7. Latest version issued by the National Development and Reform Commission and MOFCOM on 30 November 2004 and effective as of 1 January 2005.

I. Contracts

“Guest shall not engage in disturbances, gambling, drug taking, whoring, shooting. No guns, radioactive materials, fireworks, chemicals, poisons, explosives are allowed in room. The use of electric ovens, rice cookers, gas heaters is prohibited. Electric kettle not to be used to cook rice. Guests shall not connect copy machine, facsimile transmission machine without manager approval. Raising poultry and livestock forbidden in room.”

— Guest book in a three-star hotel in Dashiqiao, Liaoning

The PRC *Contract Law* of 1999⁸ has 428 articles and is a comprehensive law on contracts.

Despite the detailed provisions in the *Contract Law*, unlike continental Europe and North America, China still lacks sufficiently complete laws to dispense with long contracts.

As seen from the above hotel notice, the Chinese often feel the need to spell things out very clearly. Many a foreign hotel guest may feel that some items in the above notice are self-explanatory and he or she would have abstained from the specified activities in any event. Despite this, it does seem that the list was not based on theory but suited to the actual behaviour of guests.

It is a good practice to prepare relatively detailed contracts to stipulate matters specifically rather than rely upon assumptions. The contracts in China are generally longer than the usual ones, for example, as compared to Europe where contracts rely more heavily upon regulations.

Indeed, the more detailed the contract is, the more it protects both parties from suffering from a major misunderstanding.

8. Promulgated on 5 March 1999 and effective as of 1 October 1999.

The saying "One bed, two dreams"⁹ means that contractual partners separated by both language and culture can often have widely differing understandings of the stipulations in the contract. Detailed contracts are more likely to ensure that the parties do have the same idea.

Chinese Standard Contracts

Foreign companies should always try and prepare their own draft of contracts.

A variety of Chinese standard contracts exist. Normally they are clearly biased. In order to illustrate this point, one can compare the relevant standard clauses in supply and sales contracts listed below.

Item	MOFCOM Sales Contract*	MOFCOM Purchase Contract**
Shipment	CIF terms Transshipment allowed Chinese seller organises ship Advice of shipping on loading — notice by mail — no damages for delay	FOB terms No transshipment Ship nominated by buyer — little detail Advice of shipping by fax — seller liable for delays
Demurrage	No provision	Seller liable if product not ready
Payment	Confirmed, irrevocable, no-recourse Letter of Credit	Confirmed Letter of Credit of Chinese bank
Force majeure	Seller may delay or cancel shipment without penalty in the event of <i>force majeure</i>	Buyer may cancel shipment without penalty in the event of <i>force majeure</i>

9. Unfortunately, this saying will be used a number of times in this book. However, it is also used in every book about China. So I will try not to be too tough on myself.

Item	MOFCOM Sales Contract*	MOFCOM Purchase Contract**
Claims	Made within 15 days Inspection with Seller's involvement Seller not liable for normal variations Tolerance of non-confirm goods ie 10% Limit on Seller liability to value of the contract	Sometimes up to 90 days Inspection by Chinese inspectors No tolerance of non-confirm goods Broad potential Seller liability

* Chinese party is selling

** Chinese party is buying

In addition, the contracts will lack detail and will often be ambiguous. Ambiguity will normally not work to one's advantage when trying to enforce the contract.

Foreign Standard Contracts

As stated above, Chinese standard contracts can be unbalanced and unfair. Even worse, however, is to rely upon western standard contracts which can be extremely dangerous. Companies should be wary of blithely using a standard contract from the US or Europe. These standard contracts will often have jurisdiction specific clauses.

The Engineer Drafted Contract

As a lawyer, I would not recommend driving in a car that I would design. Similarly, using contracts in China that have been drafted by engineers can lead to unexpected (and unhappy) consequences.

Although it is probably unnecessary to have a lawyer look at every contract, it is wise to have a lawyer experienced in China at least review the first contract you prepare or draft a standard template for future use.

hiring suitable personnel. After the initial stage, it will be crucial to ensure that the termination of unsuitable employees is handled in a proper way — this is an art, not a science.

This section of the book hopes to provide some background and tips in respect of these issues of project implementation.

The chapters discuss the common issues in the management of FIEs in China including the role of the head office, finding the right General Manager, descriptions of common types of General Managers (the good, the bad and the ugly), human resources issues and an overview of intellectual property concerns and possible actions to take.

This section can be summarised in the following five rules:

- Find a good General Manager.
- Ensure that the head office is closely intertwined in its FIEs operations.
- Running a China operation successfully is not and should not be a one-man job. Make sure that the General Manager is given adequate support to ensure that the FIE runs properly. This will include having good access to useful external consultants.
- Every company active or planning to be active in China should have a comprehensive intellectual property strategy in place.
- Human resources are a cornerstone of any enterprise, including those in China. For this reason, it is important for both the General Manager and the head office to have a basic understanding of human resources issues in China.

5 PRE-PROJECT

5.1 CHOOSING A CONSULTANT

“Hi, we are here to help you!”

A single conversation with a wise man is better than ten years of study.

— Chinese Proverb

听君一席话，胜读十年书。

—— 谚语

The unsuspecting foreign investor will be surprised to find how helpful everyone is in China. Indeed, it often seems that China's biggest sector after manufacturing is consulting service in relation to China. A Google search of “China consultants” resulted in over 20 million results¹.

In this chapter, I will share some experiences, both good and bad, with consultants².

Most companies entering China will likely to benefit from the support of external consultants. Only the largest multinationals with plenty of experience in China can easily dispense with external support. Even such multinationals often need external consultants. However, as so much is the case — who do you need? How do you find a good one? And what role should they play?

1. Googling “ethical consultants in China” resulted in two million results — more than expected!
2. Admittedly more good than bad, but there is more coverage on bad experiences in this chapter because they are more entertaining.

Why Does a Company Need External Support?

Clearly, not all companies have experience in managing overseas operations. One of the reasons that multinationals do relatively well in China is the depth of their management. Medium-sized companies will often need external support for their China projects, and there are so many consultants to choose from in a myriad variety of types and sizes. The usual suspects (ie types of consultants) are listed below.

The China Consultant — Jack of all Trades

“Russia is a riddle wrapped in a mystery inside an enigma.”

— Winston Churchill

“China is much more complicated than that!”

— China consultant

The China Consultant can be a blessing to an inexperienced China investor. However, it is extremely important to choose one that understands you and what you wish to do.

Further, it is important to ensure that the investor remains deeply involved in the project — responsibility cannot be outsourced. If it is your investment project and it fails, it will not help to blame the hired hands, ie the consultants.

Depending on the complexity and nature of projects as well as the level of experience of the client, consultants typically focus on one or more specific aspects of a project. Some consultants are specialised in specific areas such as marketing, human resources, environmental or construction. Typically, these consultants have their own area of expertise and are not generalists.

However, in this chapter we will concentrate on the generalist China consultant — the “zhongguo tong”, or the old China hand.

In many cases, these consultants have little knowledge³ (far less than the client) of the industry in which the client is operating. They rely to a great degree on their “China knowledge” and “guanxi”.

China is clearly different in many ways from Europe or the US. However, it is not the unfathomable enigma made out by many China consultants. Naturally unscrupulous consultants wish to make China more mysterious than it actually is in order to maintain their role in a project. If a consultant states to you that he is a crucial part of the project (as opposed to becoming crucial by doing a good job), well then, it is probably time to find a different consultant.

However, it would be unfair to dismiss the China consultants out of hand. Consultants can and do play important roles. It is important for foreign investors to select a consultant with whom they feel comfortable and who can cover manpower shortage or expertise within their own organisation.

Below are a few crucial criteria for selecting a consultant.

Criteria 1: The consultant has your interests at heart

For many consultants, it is not the success or failure of the project that matters. Rather, it is whether the project proceeds that is important. In many cases, unscrupulous consultants prepare feasibility studies which have best case scenarios based on the assumption that “if every Chinese added one inch to his shirt tail”, and worst case scenarios which are only slightly less pessimistic, such as “if every Chinese added two-thirds of one inch to his shirt tail”.

This is well illustrated by the case of “The World Is Not Enough” in the “Know Yourself” chapter.

3. Many people believe the sentence could end at this point.

The Intermediary

In the *Harvard Business Review on Doing Business with China*⁴, an article entitled “Chinese Negotiation” by John L. Graham and N. Mark Lam lays great importance on the role of the “intermediary” (*zhongjian ren*)⁵. Basically the intermediary is a person who can bridge the two sides and intercede when there is conflict. The authors advise that the intermediary plays an “indispensable” role in such discussions:

*“Only a native Chinese speaker can read and explain the moods, intonations, facial expressions, and body language Chinese negotiators exhibit during a formal negotiation session. Frequently only the zhongjian ren can determine what’s going on. ... the zhongjian ren can step in because he is an interpreter not so much of words as of cultures.”*⁶

Experience, at least mine, has shown that if in order to communicate with the Chinese partner on the other side you need someone to analyse his “moods, intonations, facial expressions, and body language”, well, it is probably time to look for another Chinese partner who is less difficult to deal with. One should also bear in mind that the mission is not accomplished with the signing of a contract — it is the establishment of a successful project. At the time of project implementation, the *zhongjian ren* will no doubt be off brokering deals elsewhere while you will be sitting with Chairman Liu, trying to work out what he means when he crosses his arms and speaks with a slightly higher than normal lilt.

4. Graham, John L. and Lam, N. Mark, “The Chinese Negotiation”, in *Harvard Business Review on Doing Business in China* (Boston MA: Harvard Business School Press, 2004).

5. In Chinese: 中间人。

6. Graham, John L. and Lam, N. Mark, “The Chinese Negotiation”, in *Harvard Business Review on Doing Business in China*, p 41.

However, I may be wrong as John L. Graham and N. Mark Lam even helpfully provide an example of intermediary “magic”:

“Indeed, we have seen more than one zhongjian ren successfully deal with divisive disagreements. The following is one such case.

*A vice president of a New York-based software company went to Beijing to negotiate a distribution contract with a Chinese research institute. Having attended meetings arranged by the intermediary — a former senior executive with the institute — the VP was pleased with the progress during the first two days. But on the third day, the two sides became embroiled in a fruitless debate over intellectual property rights. Feeling they were losing face, the Chinese ended the meeting. That night, the VP and the China country manager met with the intermediary. The following day, the intermediary called the head of the institute and worked his magic. In the end, both sides agreed that the intellectual property rights were to be jointly owned, and the contract was signed.”*⁷

And that indeed sums up the problems with using intermediaries in China.

Intermediaries normally convince the unsuspecting foreigner to agree to what the Chinese counterpart wants. The above passage even admits that the intermediary was “a former senior executive with the institute”. It is unlikely that he would switch allegiance to the US company based on some nice dinners⁸. In my experience, the intermediary (especially one with links to the Chinese partner) grants the Chinese partner an enormous advantage in negotiations. The intermediary will allow the Chinese side to know what the foreign side is thinking and will normally push for the

7. *Ibid.*, p 42.

8. According to the authors, “Expensive meals in nice places are key.”

easiest way to an agreement. This is normally to convince the foreign partner that “this is China” and to agree to the proposal on the table.

The “magic” solution outlined above was that the New York software company agreed to joint ownership of the intellectual property rights of its software with a Chinese distributor. Leaving aside the fact that it would seem strange to grant a distributor intellectual property rights, the even greater question is: what was the “magic”? Did the Chinese distributor want sole ownership of the software? I do not think I would grant a distributor ownership of software.

Criteria 2: The consultant is realistic about China and himself

Many China consultants have a vested interest in making China a mysterious, unfathomable, and almost dangerous place. Only with their guidance and even more importantly, their highly placed contacts, could your medium-sized company hope to navigate the behemoth which is China.

This is obviously over the top. Some things are different in China, but most things that make sense overseas also make sense here. Contacts do help as is the case everywhere, but they are not the only factor.

In addition, one should be wary of consultants who claim that “I have unrivalled contacts in China”⁹, “my father was a foreign minister in post-liberation China”¹⁰ or “I am close friends with the party secretary who is in charge of your project”.

Criteria 3: The consultant should not care too much

Naturally it is important for your consultant to care but it is also important that he does not care too much.

9. This is a claim by a German consultancy that has two employees.
10. Three consultants have made this claim — they may all well share the same father as they all proved to be crooked.

This can be best illustrated by a case study:

There Is No Place Like Home

A company from Austria was interested in manufacturing cane chairs in China. Basically, the design was made in Austria. Cane would need to be sourced in China and some assembly work was required. The production would then be exported. All in all, a small project.

As the company was small and had little overseas experience, it came across an Austrian entrepreneur living in China. This Austrian entrepreneur had a factory located in Xiaoshi, a small village in Liaoning province in the Northeast of China. The Austrian entrepreneur had convinced the Austrian company that he was an extremely successful businessman in China and was running a number of factories very successfully. That this successful businessman was willing to take time out of his hectic schedule to assist in locating an ideal place to assemble some cane chairs did not seem to raise any alarm bells.

In any event, consult he did. The conservative Austrian company requested a feasibility study on the location of the facility. The Austrian consultant went off and conducted his investigation. Now, a layman may think that the obvious location for a small assembly plant for export would be near a port, a railway connection or some other form of transport. Alternatively, it would make sense to have the facility located near the raw materials.

You would be wrong. The feasibility report concluded that the perfect location for the assembly would be Xiaoshi — despite being located far from rail, sea or port; despite being four hours from the nearest airport; despite being possibly one of the only places in China where bamboo refuses to grow.

7 CORPORATE FRAUD AND NON-COMPLIANCE WITHIN FIES

"As we know, there are known knowns. There are things we know we know. We also know there are known unknowns. That is to say we know there are some things we do not know. But there are also unknown unknowns, the ones we don't know we don't know."

— Donald Rumsfeld at a Department of Defense news briefing
on 12 February 2002

I. Introduction

"We have met the enemy, and they are ours."

— Oliver H. Perry

Recently, the writer read a survey in which foreign investors were asked what they considered to be the major risks to the development of their businesses in China. The foreign investors taking part in the survey were concerned about the changes in regulations, worried about the protection of intellectual property rights, nervous about the rule of law, etc.

However, based on the survey it appeared that few foreign investors were aware of a much greater problem — fraud and poor corporate governance within enterprises. Problems in foreign-invested enterprises ("FIEs") vary from outright criminal activity to serious non-compliance issues arising from poor management. Many of the problems are foreseeable and their prevalence in China may be due to a number of factors such as:

(1) Poor Oversight/Lack of Communication

In many cases the headquarters rarely visits or conducts spot checks. Management in China often feels remote from the headquarters and over time there is a blurring of the “employer-employee” relationship into one of “partnership” where the management in China feels that it is also an “owner” of the business.¹

(2) Wilful Ignorance

Many foreign companies fail to make an investigation as to what Chinese legal requirements are or how to implement some form of corporate governance in their subsidiaries.

(3) Ethical Blind Spots

There are foreign companies who feel it appropriate to condone business activities in China which they would not countenance in their home jurisdictions.²

(4) Inexperienced Managers

Foreign investors tend to spend much time negotiating contracts, but little time in deciding upon the person who will actually manage the company. Often general managers are appointed not on the basis of capability or experience, but rather availability.³

1. It is a very typical situation for the rogue general manager or chief representative to describe himself as a “partner” in the company — this blurring of relationships makes termination more complicated and emotional.
2. It can be difficult for a FIE to be run ethically when all the staff know the GM’s salary is split between a Chinese bank account and a Hong Kong bank account, prices on imports are artificially low to avoid tax, etc.
3. Indeed in some cases, one has the suspicion that the GM’s main qualification was that China was far away from the headquarters.

(5) Failure to Build in Checks and Balances

Few companies bother to even give the appearance of trying to establish a system of corporate governance. In our experience, it is important to clearly define different roles within management and also to reserve certain powers to the board. Check and balance within the management is also important. While it is nice for the general manager and financial controller to have a good relationship, it should not be too good.⁴

This chapter, which deals with fraud and poor corporate governance within foreign-invested enterprises in China, seeks to give an overview of the legal framework in China in respect of fraud as well as providing some common examples of fraud experienced in FIEs.

1. Legal Framework

Although constantly evolving, the Chinese laws that regulate corporate governance of FIEs (which are normally in the form of a limited liability company) are still in many ways unsatisfactory. Foreign investors faced with rogue or incompetent elements within their FIEs are often confronted with limited legal avenues to seek suitable resolution.

Criminal Code

Criminal law in the PRC has not, by and large, experienced the same level of revision in the last years as the laws which regulate economic activity. Accordingly, dichotomies still exist in that some “crimes” do not depend on the actions of the perpetrator, but rather the nature of the victim. Certain actions are deemed to be criminal if the victim is a state-owned enterprise but not if the employer is a privately owned company.

4. We have had multiple cases in which the GM appointed a blood relation as financial controller. In one case the GM appointed a person whose primary qualification was that he was never there. When we wished to interview the financial controller, the GM was very surprised and asked why, since the financial controller “does not even know 1% of what is happening”. The company was subsequently restructured.

Certain actions by employees are crimes regardless of the nature of the employer:

- Conversion of corporate funds or property (Criminal Law, Article 271);
- Misappropriation of corporate funds (Criminal Law, Article 272);
- Demanding or accepting bribes as a corporate employee (Criminal Law, Article 163); and
- Offering bribes to corporate employees (Criminal Law, Article 164).

In addition, the below listed actions are considered criminal if committed by managers of a state-run enterprise:

- Illegal competition with the business of the manager's own state-owned enterprise (Criminal Law, Article 165);
- Diversion of corporate opportunities for the benefit of friends or relatives (Criminal Law, Article 166);
- Culpable neglect of official duties leading to losses to the enterprise or its bankruptcy (Criminal Law, Articles 167 and 168); and
- Sale of corporate assets at unjustifiably low prices in exchange for personal benefits (Criminal Law, Article 169).

Company Law

Overview

The PRC, *Company Law* ("Company Law")⁵ also directly touches upon management fraud within companies. The Company Law seeks to regulate, at least to some degree, the accountability of managers towards their company as well as attempting to stymie the ability of certain individuals to hold positions of trust.

The Company Law allows companies to take civil action against directors or managers who breach the law or their obligations towards the company. Under certain circumstances the errant director or manager may even face criminal sanctions, although this is rare in practice.

Fiduciary Duty

Article 148 of the Company Law provides that directors, supervisors and managers shall abide by their company's articles of association and have a fiduciary obligation and obligation of diligence to the company. In particular, directors, supervisors and managers are prohibited from exploiting their position to accept bribes or other illegal income, or wrongfully convert company assets (Company Law, Articles 148 and 149).

Misappropriation

It is a common problem in China that managers are unable to distinguish between company and personal assets. The Company Law prohibits directors and managers from misappropriating company funds or loaning company funds to third parties. Further, directors and managers are not

5. First promulgated at the 5th Session of the Standing Committee of the 8th National People's Congress ("NPC") on 29 December 1993; first amendment made on 25 December 1999; second amendment made on 28 August 2004; third amendment adopted at the 18th Session of the Standing Committee of the 10th NPC and promulgated on 27 October 2005, and effective as of 1 January 2006.

permitted to open accounts in their own names or in the names of other individuals for the deposit of company assets.⁶

Prohibition on Certain Persons Acting in Positions of Trust

A company's corporate culture is often only as good as the character of the person that manages the company. By virtue of Article 147 of the Company Law, the Chinese authorities seek to bar certain persons from serving as a director, supervisor or manager of a company. Prohibited persons include those who have been convicted of corruption, bribery, infringement of property rights, misappropriation of property or sabotaging the socio-economic order.

Non-competition

Although important to regulate in their employment contracts in detail, the law does prohibit directors and managers from engaging for their own behalves or on behalf of others in any business similar to the business of the company in which they hold office or being involved in activities harmful to their company's interests. The proceeds from such business or activities shall belong to the company.

III. Common Types of Fraud/Non-compliance in FIEs

Non-compliance or poor corporate governance is not always part of a grand scheme to defraud a manager's employer (although it may be or may later evolve into this), but very often it starts when there is little transfer of corporate culture, little internal regulation and little follow-up by the parent company.

6. Company Law, Article 149.

1. Confirming the "Known Knowns" — Trust but Verify the Basics

In most FDI projects, foreign investors commit most of their efforts and resources prior to the signing of the joint venture contract. Normally less effort (and money) is spent in actual implementation or indeed in checking implementation. Often, the same foreign partners who spend days negotiating in painstaking detail the terms of an acquisition never bother to check whether such acquisition actually occur subsequently, or if it does, on what terms.

An internal legal audit of the FIE's records with the State Administration for Industry and Commerce ("SAIC") can confirm the following:

- if the company is approved to be established and registered;
- which joint venture contract was actually approved; and
- the current composition of the board and management.

An internal legal audit of a company's records can normally confirm:

- if the company is the legal owner of the land and buildings; and
- if the company is the proper or registered owner/user of the trademarks.

Case Studies

We have been involved in numerous cases where it was discovered that the "known knowns" should have been confirmed at an earlier date:

Which Joint Venture Contract Has Been Approved?

As mentioned above, investors often involve lawyers to a great extent in relation to the signing of joint venture contracts. However, the same