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Paul Hastings Point of View: Why are Chinese companies running afoul of U.S. Laws?

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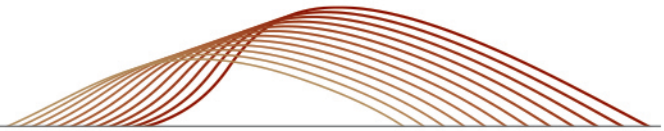
Litigation is a Standard Part of Business – But There's No Reason to Fear it If Your Company is Prepared

Authorities in the United States, increasingly in cooperation with their Chinese counterparts, are cracking down on fraud, corruption and intellectual property (IP) violations committed by some Chinese companies. Fearful of litigation, many Chinese companies are withdrawing altogether from the lucrative and influential U.S. market. Companies that operate in the U.S., but lack the knowledge to properly mitigate litigation risks, are risking millions of U.S. dollars in legal fees and damage to their brand and reputation to fight allegations in court.

It is apparent when speaking to companies which of the two camps they fall into: grossly underprepared or cautious to a fault. Cautious companies view the threat of lawsuits as a far greater risk than the revenue (or potential future revenue) they derive from the U.S. market. Acting on their anxiety, they choose to abandon the market, either by ending exports to the U.S. or by choosing to relist their IPO in China instead of the U.S. This phenomenon, which may be developing into a trend, is demonstrated by the recent privatization decisions by E-House, 21Vianet Group, and Renren, among others.

Unprepared companies pay dearly when litigation comes their way. The cost of litigation varies, but it can run into millions of U.S. dollars and take years to resolve. These companies undervalue the benefit of competent, in-house counsel, appointing a chief financial officer and arguing that the cost of hiring general counsel is too high to merit investment. This is a disaster waiting to happen. Setting up a legal department lowers the cost of future litigation. For example, creating a robust compliance program often only cost about 10% of what it would cost to fight lawsuits initiated in the U.S.

Litigation is now a standard and inevitable cost of doing business globally and in the U.S. In the past, U.S. authorities were reluctant to bring cases against Chinese companies given the politically sensitive climate. The climate has changed, as Chinese authorities now assist the U.S. in their investigations. As a result, a growing number of cases feature Chinese companies. Take, for example, the cooperation displayed in November last year. President Obama, President Xi Jinping and the APAC leaders announced an agreement to elevate their efforts in combatting corruption and bribery across the Asia-Pacific region. The fruit of their proposed efforts is ACT-NET. Once established, ACT-NET may provide a platform through which law enforcement agencies of the member countries can share information regarding their cases.

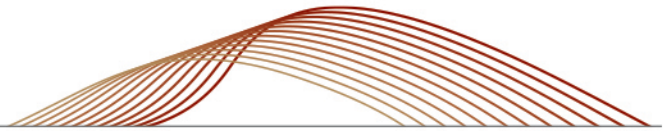


For Chinese companies operating in the U.S., education is key as mistakes are costly. Bankers, lawyers and advisors have a role to play in educating their growing Chinese client base with global ambitions. Technology is the lifeblood of many Chinese companies, yet companies forgo hiring good intellectual property lawyers to create high-quality patents. Companies fail to confirm which technologies have been patented, especially when hiring and building on technology that has been used at other companies. Many companies also fail to recognize the significance of domain names. It is a relatively quick and inexpensive process to trademark aspects of their business this way, yet many companies do not realize that failing to do so can have large, costly consequences.

Cultural differences also play a role in mitigating risk, because companies' lack of experience often leads to unease. Often, companies need reassurance that the courts in the U.S. will treat them fairly. Many worry that without proper "connections" they will be at an insurmountable disadvantage. All that's required to increase the chance of winning, however, is an experienced legal team and thorough preparation. Additionally, measures common in the U.S., such as class action suits and document preservation, are not standard in China. Companies may panic, ignoring the laws and destroying documents. In their haste, they create a more challenging, damaging legal position.

Of course, not all companies are underprepared. Many forward-thinking, emerging companies invest the time and resources needed to put proper procedures in place. As Americans say, "An ounce of prevention is worth a pound of a cure." But we have also seen that it is never too late to introduce these measures. The recent antitrust ruling against banks involved in the LIBOR scandal illustrates how authorities show leniency in sentencing if companies recognize the need for and implement compliance programs after a breach occurs. Encouraging Chinese firms to invest in lawyers who can help them establish tailor-made, global compliance programs is vital in establishing a prevention tool to reduce risk for a company. The cost-saving potential is likely to be enormous, as compliance programs can help the company avoid the risks and detect wrongdoing long before its implications kick in.

U.S. litigation will continue, buoyed by economic globalization, measures like ACT-NET, and increased cooperation between Chinese and American authorities. Litigation, however troublesome, is an established aspect of the business landscape. If companies are underprepared, they will face unpleasant and potentially disastrous consequences. Proactive companies that take steps to prepare, however, have no need to fear. Bankers, lawyers and advisors should take steps now to educate their Chinese clients. Chinese companies must not allow anxiety about litigation to prevent them from taking advantage of opportunities in the U.S. market.



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