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Challenges And Opportunities As Beijing Office Expands Global Firm Capabilities In Trade, M&A, Corporate And Private Equity

The Editor interviews ***Spencer S. Griffith****, Partner in the International Trade practice and former Partner-in-Charge of Akin Gump's Beijing office, and* ***William L. Rosoff****, current Partner-in-Charge of Akin Gump's Beijing office, whose practice focuses on M&A, general corporate and China-related matters.*

Spencer S. Griffith

William L. Rosoff

Editor: Please tell us about your background and current practice.

Griffith: I was managing partner in Akin Gump's Beijing office from summer 2009 until early fall of this year. I am a trade lawyer by background, and I represent foreign governments and foreign companies as well as U.S. companies in various trade cases, including WTO matters, subsidy and dumping cases, and trade policy matters that arise when dealing with the U.S. government on trade issues. Right now I am based in Washington, DC, and I travel back and forth between Beijing and Washington. Prior to moving to Beijing, much of my career had been spent going back and forth between Washington and Beijing as well as other Asian countries, including Japan, Taiwan and Korea. I also do a lot of work with Canadian clients.

Rosoff: I am now the managing partner of the Beijing office. I joined Akin Gump in September and moved to Beijing almost immediately. My background is in corporate M&A law. I've also served as general counsel of a couple of Fortune 100 companies, so I've had experience in a broad range of issues beyond M&A. It puts me in good stead in a place like our relatively small Beijing office, where you have to know a little bit about everything and whom to call to get the answer.

Editor: **Spencer, during your tenure as managing partner of the Beijing office, what was the environment for foreign law firms doing business in China? What obstacles and opportunities remain?**

Griffith: I took over the office in the summer of '09. That was a relatively tense time in China and in U.S–Chinese relations generally because we were still in the midst of the financial crisis, during which all law firms in China were experiencing slower business. Also, there was a tightening of security in China due to riots that took place in Xinjiang province. This tense atmosphere gradually eased over time, and law firm business soon picked up.

The obstacles that all foreign firms face include restrictions on their ability to practice law in China: for example, when a Chinese national with a Chinese law degree is hired by an American law firm in China, that Chinese lawyer loses the ability to practice Chinese law. Foreign law firms and all their employees are prohibited from practicing Chinese law.

Also, foreign law firms in China are prohibited from appearing before Chinese courts and before various agencies, and there is a different tax treatment of foreign law firms relative to domestic law firms in China. Another important factor is the strong competition that U.S. law firms face from Chinese law firms, not only those operating in China but also internationally. Based on my experience working in many Asian countries, the Chinese law firm community is the strongest competitive threat to the big, Western, multinational law firms, despite the legal industry in China being

Akin Gump
Strauss Hauer & Feld LLP

Please email the interviewees at sgriffith@akingump.com or wrosoff@akingump.com with questions about this interview.

relatively new.

Chinese firms are aggressive and very competent. They have a strong business sense, and Chinese clients, particularly government clients, often have an interest in working with Chinese counsel. So we face much stronger competition from Chinese law firms in China than we do from Japanese, Korean or Taiwanese law firms when operating in those other countries.

Rosoff: Because the Chinese firms have become much more competitive and capable, they seem to feel less threatened by foreign firms like ours. While there's still sensitivity – and we have to be careful that we don't technically practice Chinese law – the sophisticated Chinese firms understand the potential for our presence to be helpful rather than threatening.

Editor: What is the level of government scrutiny on foreign law firms?

Rosoff: One never really knows, although the view on foreign firms seems fairly relaxed at the moment. A few years ago the Shanghai bar filed complaints about some U.S. firms, but a couple of months ago they actually invited foreign firms to join the Shanghai Lawyers Association. That's clearly an indication of a very different view. The government could decide that foreign firms are too active, but I don't see any outward manifestation of that.

Griffith: There have been some policy changes that affect foreign law firms and other businesses operating in China. For example, there's a new value-added tax being implemented in China, and all foreign enterprises are looking at how that affects their business. Overall, I have not seen an increase in visible scrutiny of foreign law firms in the last couple of years, and I also agree with Bill's point about the more cooperative atmosphere between the Chinese and foreign legal communities.

Editor: What is the current environment for China-related investments, both incoming and outgoing?

Rosoff: That is a complicated question, so I'll make some general points. For a variety of reasons, the Chinese government, at the national and provincial levels, continues to encourage what they call "going out," meaning outbound investments by Chinese firms. One hears and reads a lot about this in China. Although the level of outbound investment has not been as great as some of us had hoped, it's still been quite large. This year has seen the largest outbound Chinese investments ever – in the U.S. – over $8 billion. The Chinese government at both the national and provincial levels is clearly supporting this activity.

Conversely, there's a range of regulation for foreign companies investing in China. In broad terms, this regulation applies along different categories. For instance, there are some industries in which investment is not allowed and others in which it is actually encouraged. Overall, today's foreign investment environment in some areas is as good as it's ever been, but in other areas, the government appears less open to foreign investment than in the past.

Now, the corresponding environment in the U.S.is a bit of a mixed bag when you consider both acquisitions and greenfield projects. On the one hand, U.S. states are competing madly to attract Chinese and other investors to come in, build plants and employ people. For example, Chinese companies have built steel factories in Mississippi and Texas.

On the other hand, Chinese companies may encounter difficulties when trying to acquire existing business. There are certain areas – such as telecommunications and anything to do with the power grid – where it's clear that a Chinese company cannot make a U.S. acquisition. Anything that is near a military base also appears to be off limits. Still, there is far more openness than you would think by reading the newspaper.

The election season has slowed recent activity, but I expect that over the course of the next year, increasing amounts of Chinese investment will clear U.S. regulations without a problem, as long as they avoid a few very sensitive areas.

Griffith: As an example, one recent small but high-profile deal involved a Chinese investor trying to purchase an existing wind turbine facility that was near a U.S. military installation. The U.S. objected on national security grounds, which caught a lot of press attention and raised overblown concerns that the U.S. is not welcoming to Chinese investment. If Chinese investors are careful about which deals they pursue, they will find the U.S. quite welcoming.

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Rosoff: One of our jobs as lawyers working in China is to help Chinese companies get comfortable with the process. We have to be persuasive in explaining, first, why we think that, with the proper planning, a particular transaction can get done and, second, how to do it.

Further, as Chinese growth rates and returns start to come down from the high rates of 12 percent to 7 percent or so, other opportunities in other locations may become attractive. When you're earning 12 percent at home, there's less incentive to invest anywhere else.

Editor: What are some of the specific challenges in handling complex deals with Chinese parties? Please talk about activity in Russia, Canada and Africa.

Griffith: One challenge is to convince Chinese investor clients to be patient and to learn about international regulatory processes. We have seen Chinese investors trying to rush into a new market or sector that was sensitive for national security or other reasons without having a plan for how to handle that development.

Also, Chinese parties are comfortable with a relatively low level of detail in terms of the documentation, often preferring to create a one-page term sheet without having lawyers hammering out all the details. Obviously, Western investors want detailed term sheets, so this is another challenge we face.

In Russia, Canada and Africa, Chinese outbound investment traditionally involved the natural resource sector. Our Moscow office has represented a number of Chinese clients with such investments in Russia, and there is similar activity in Canada's oil sands and Africa's oil.

Rosoff: The cliché is true: Chinese business people are much more driven by relationships than by legal documents, and I have found that it can take a long time for them to develop sufficient trust to go forward with a deal. Once they have that trust, they want to do the deal based on a handshake – and do it overnight. They can get very impatient when the lawyers hold up the process for the sake of contracts and the Western way of doing deals.

Again, it's a challenge to educate our Chinese clients as to why we need to follow our process and why doing so is ultimately to their benefit. In the U.S., transactions are not based on trust and relationships; they're based on what's in the written document.

Editor: Where does the U.S. fit into that picture of Chinese investment in other countries?

Griffith: In terms of natural resources, the U.S. fits into the technology area, namely access to U.S. fracking technology to access Chinese shale gas and oil reserves. But we'll also see more investment geared toward accessing the U.S. market. By contrast, much of Chinese investments in Russia, Canada and Africa were made to obtain natural resources to send back to China, so the U.S. plays will be very different.

Rosoff: I agree that we're going to see more market-access and technology-related investments in the U.S., but we'll also see investments seeking access to global brands. With a few exceptions, Chinese brands don't do very well in the U.S. and other Western countries, and we're going to see acquisitions that will enable them to acquire global brands to match their manufacturing capabilities.

Editor: Please expand on the discussion of fracking technology. What is the current status of China's efforts toward environmental reform?

Griffith: China has massive shale gas reserves, currently estimated to be second only to U.S. reserves. The big difference is that the U.S. has the technology to exploit those reserves; thus, as just noted, China will be interested to acquire U.S. fracking technology.

This is a big play. Much of China's outbound investment over the last decade has been in the natural resources sector, and China's gaining access to fracking technology would go a long way toward enabling them to meet their own energy demands. It's unclear to date as to the exact scope of those reserves and whether they are accessible.

Rosoff: As for environmental reforms, I would make a general point that, although the pollution in China over the last decades has been atrocious, they are far ahead of us in trying to remedy the situation. They are taking alternative energy much more seriously than we are and will be well ahead of us in terms of its use over the next decade.

Editor: We've been talking about Chinese investment outbound. What about critical concerns for U.S. businesses in establishing or expanding connections in China?

Rosoff: For some American companies, China will become a bigger market than the U.S. itself. China is *the* big play, and I don't think that's going to change for the next five to ten years.

Two big issues for many companies are intellectual property and technology, specifically the protection of IP and the sharing of U.S. technology. The Chinese government has basically insisted that if U.S. or foreign companies want to enter into China to build/acquire a business or do a joint venture, they have to share their technology with the Chinese company. That's the price of entry, and it's a sensitive issue for U.S. companies.

We will see continued investment, but we'll also see growing competition and sophistication on the part of the Chinese. So it may be that for a foreign company, whatever the regulatory environment, from a competitive perspective, China might not be as open as before.

Griffith: Expanding on Bill's point, IP remains the number-one issue for many of our clients. It's a particularly difficult issue in China for two reasons. First, the Chinese government has focused on encouraging investments in areas that give Chinese companies access to foreign technologies. In some cases that's a transparent factor in the investment; in other cases, you never really know how much behind-the-scenes emphasis is placed on access to foreign technology. Second, newspapers are full of reports about actual IP losses in connection with Chinese investments, so increased sensitivity is a reality of this game.

Editor: What are the key global trade issues with respect to China? Please include specific discussion of U.S.-China relations and the current status of efforts to force China to "play by the rules."

Griffith: Having practiced in DC and Beijing, I've seen these issues from both sides. I've represented Chinese companies in trade cases that the U.S. has brought against China, and I've represented U.S. companies in trade cases that China has filed against the U.S.

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While there certainly is heavy pressure on U.S.-China trade relations, this is not a trade war, which occurs when trade disputes are turned into political fights. Both sides have an incentive to continue trade expansion, and both correctly are keeping these disputes within the boundaries of the international disciplines on hashing out trade disagreements – that is, through use of dumping and subsidy laws as well as use of WTO sanctions and dispute resolution.

That said, China is by far the number-one target of dumping and subsidy cases filed by the U.S. and by the rest of the world; however, people forget there is a historical dimension to this. Trade case dynamics are cyclical: 30 years ago, Japan was the number-one target; 15 to 20 years ago, it was Korea; now it's China, and in 5 or 10 years – who knows? – it may be Vietnam or India.

Further, China itself is now a more active user of trade law. In the past, China was reticent to file its own subsidy and dumping cases against imports from other countries, but that has largely disappeared. As a WTO member, China has every right to file cases, and other countries have the right to challenge those cases, so I don't see China's greater use of this action as signs of a trade war.

I also think it's important to remember in terms of U.S.-China trade relations that China has proven itself to be a responsible member of the WTO. When China first joined the WTO, there was concern by some that China might politicize the WTO by becoming the leading advocate for developing countries in Geneva rather than participating substantively in the WTO processes. But that didn't happen, and most WTO disputes involving China have been resolved under the WTO dispute resolution system.

For the next few years, we will continue to see heavy pressure on China in terms of dumping and subsidy cases, and two other trade issues will get even more attention. One is the role of state-owned enterprises, or SOEs. How do foreign countries deal with SOEs? Should they be treated as an arm of the government or as an independent commercial actor, and what's the test for distinguishing between the two? The second issue will be government procurement. For some years the U.S. has been pushing China to liberalize its government procurement policies and regimes, and the U.S. has been unhappy with the pace of reform in that area in China.

The final issue I want to focus on is currency manipulation. That has been a topic of tremendous debate and has been politicized in Washington. Going forward, it is not clear that China's alleged currency manipulation will ever be resolved within the context of the WTO. Many people feel that the WTO is not appropriately structured to address currency manipulation issues and that these issues may be better addressed by the IMF or in government-to-government talks.

Editor: Bill, as the current partner-in-charge of the Beijing office, what are your priorities for the firm's continued development in China? Feel free to mention some of the things you're doing beyond the professional context, such as teaching at the Temple University Rule of Law Program at Tsinghua University next spring and studying Mandarin.

Rosoff: Before I joined the firm and moved to Beijing, we opened the Hong Kong office, about six months ago, with a focus on corporate and private equity work. Now we're looking at Beijing to work closely with Hong Kong with a renewed focus on doing more corporate and fund work. We're going to continue to do the trade and regulatory work that Spencer had done, but we want to try and build a real corporate practice based in Beijing working with Hong Kong, so one of the things I'm spending a lot of time on right now is trying to find the right people to help us do that, which is not easy.

As a practicing lawyer prior to my work as general counsel, I represented foreign companies in acquisitions, sales and joint ventures in the U.S. I want to continue that with Chinese companies, so we will focus on the outbound work, which many people see increasing.

As to my other activities, I thought teaching would be an interesting thing to do at this stage in my career, and I've been lucky enough to have the opportunity to do it at one of the top universities in China. It's actually a great program and something I am very much looking forward to. I'm not doing it for business connections, although as it turns out there is a great alumni network of graduates of this program, many of whom are in very senior legal positions at big companies. So it may turn out that teaching will help the firm in getting to know some of these people.

Griffith: I'd like to make one last comment about our interest in continuing to expand our outbound investment work out of China. As I mentioned, we have a large office in Moscow, and there has been significant growth in Chinese investment in Russia, primarily to date in the natural resources sector. Our Moscow office has already worked with our Beijing office on prior Chinese-Russian deals, so we're confident that we can continue to represent Chinese clients investing in Russia given the comparative advantage we have of a large Moscow office.