



Caroline Berube

Managing Partner, HJM Asia Law & Co LLC

Maximize Your Profits and Minimize Your Risks by Understanding Your Sourcing Agreements



Michelle J. Rozovics

Managing Attorney, Rozovics Law Firm, LLC

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Summary

- Background for Sourcing from China
- How to Engage in Sourcing in China
- Role of the Sourcing Contract
- Key Clauses / Issues Regarding the Sourcing Contract
- Quality Warranties in a Sourcing Contract
- Intellectual Property Provisions in a Sourcing Contract
- Enforcement of a Sourcing Contract

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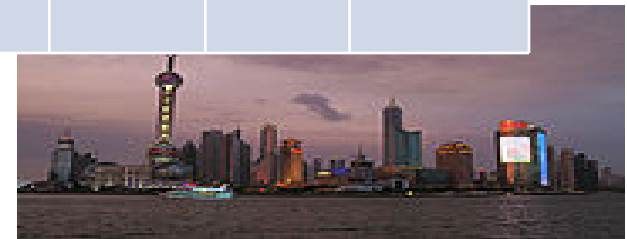
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Background - Sourcing from China

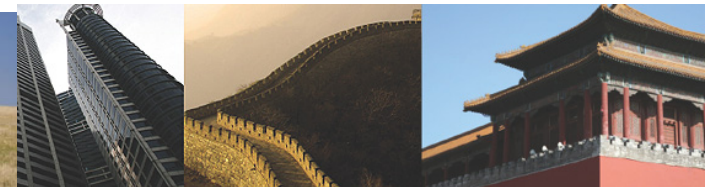
- The People's Republic of China (the "PRC" or "China") is now world's largest exporter

| Year | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|----------------------|-------|-------|-------|-------|-------|-------|------|-------|------|--------|
| Amount (Billion USD) | 194.9 | 249.2 | 266.2 | 325.6 | 438.4 | 593.4 | 762 | 969.1 | 1218 | 1428.5 |



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How to Engage in Sourcing in China (Contd.)

Methods (1/3)

(1) Working with a local Chinese agent

– Advantages:

- Usually the cheapest option
- Chinese agent can be well connected and find the most suitable products at the best price
- Can find agent with many years experience

– Disadvantages:

- Cultural differences – different focus on results (e.g. Chinese cost focus v. Western value/quality focus)
- Language difficulties - difficult to communicate wants and needs. Can be a huge issue in relation to product and technical specifications
- Thousands of persons/businesses offering these services – can be difficult to find honest and reliable agents
- Many domestic agents do not have import/export registration – another such agent will have to be used

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How to Engage in Sourcing in China (Contd.)

Methods (2/3)

(2) Working with a foreign-owned company based/operating in China

– Advantages:

- Qualified foreign staff work together with local Chinese staff – ‘best of both worlds’
- Foreign staff can better understand U.S. customer requirements
- Foreign-owned company can obtain import/export registration rights – third party agent not necessary

– Disadvantages

- Fees usually higher than using domestic Chinese agent
- U.S.-owned companies in China often subject to higher administrative duty/controls, meaning problems which arise may take more time/cost to be rectified

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How to Engage in Sourcing in China (Contd.)

Methods (3/3)

(3) Dispatching of Employee(s) to China for On-site Operations

– Advantages:

- Standard advantages of internal work vs. outsourcing - company staff already fully aware of products requirements, time frames, etc
- Can be very effective where relationships/contracts already formed with reliable Chinese suppliers and/or agents

– Disadvantages

- Very difficult for foreigner without China-based experience to find suppliers and deal with all issues/steps relating to production, purchase and exporting
- Again, best where suppliers and sourcing structure already set up, so only job of staff member is to oversee the process and report to head office

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Role of the Sourcing Contract

Overview

- Main form of agreement used when sourcing or buying from China is the sourcing contract
- Governed by the *Contract Law of the PRC* (“*中华人民共和国合同法*”, the “Contract Law”), which governs all contracts and contractual relationships in the PRC
- Even with the above law, a sourcing contract should clearly outline the terms and conditions of the arrangement. China adopts the ‘autonomy principle’, whereby parties to an agreement have a wide scope in drafting the terms and conditions as per their wishes, provided such do not conflict with laws and regulations (discussed further in ‘Avoiding Future Issues’ on slide 10 below)

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Role of the Sourcing Contract

Standard Type

Cooperation with Domestic Agent or Foreign-owned Company: Types of Agreement (Sourcing Contract)

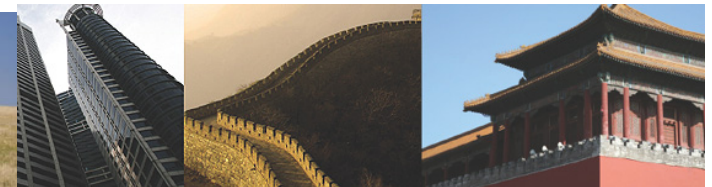
(1) Sales and Purchase Agreement (the “SPA”) between Foreign Purchaser and Chinese Supplier

- Agent or company assists purchaser in finding supplier, shipper
- Usually, agent obtains commission (“finder’s fee”)
- Agent not liable for the product (e.g. in relation to quality) **unless becomes party to the SPA**

•U.S. businesses “going global” rely extensively on this foreign business partner, and thus setting up the relationship properly is of the greatest importance.

- Use comprehensive agreements to protect your business, the quality of your items, your customers’ safety, your reputation, your intellectual property. A P.O. will not protect you.
- Take the time to understand your risks under the agreement, and whether you are willing to assume them
- Negotiate contract with the sourcing person, and with the manufacturer doing the final work

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Role of the Sourcing Contract

Standard Type

Cooperation with Domestic Agent or Foreign-owned Company: Types of Agreement (Sourcing Contract)

(2) SPA between U.S. Purchaser and Agent/Foreign-Owned Company

- More common option when China-based party is a foreign-owned company
- Agent is liable for the product and all other issues
- Problems can arise where agent is very small company and cannot afford to compensate foreign purchaser for product faults or delays, even where a court makes an order to do so

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Role of the Sourcing Contract

Avoiding Future Issues (1/4)

- All details of the deal, to the extent possible, should be agreed upon and included into the SPA
- Always important but especially so in China:
 - very difficult to enforce a judgment in China, partly due to a lack of proper bookkeeping by companies; many companies in trouble just close up and the owners disappear
 - some domestic agents/suppliers untrustworthy

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Role of the Sourcing Contract

Avoiding Future Issues (2/4)

- Best Practices – If it is not in the contract, it doesn't exist and can't be enforced
 - **Establish Clear Expectations** -- Have a prototype product completed before you go to China, along with detailed explanation of exactly how you want it manufactured (spec list) , including an exact list of the materials
 - **Control subcontracting by manufacturer** – if they get busy, are they going to send your job elsewhere? What will happen to quality, IP protections, timeline if this happens?
 - **Quality Control**
 - Who is to do it – you/your sourcing person/a third party?
 - Must be constant monitoring
 - Make payments in stages; receive one part with sufficient quality, send next payment
 - What Chinese law will imply to be a reasonable quality standard is not anything near that what a Western company will require – because the reasonable expectations of the two cultures are vastly different
 - Finding problems at time of final random inspection is too late – need them during production, at the factory
 - A 5% discount off your next offer will get you nowhere when you have paid for \$500,000 worth of goods that you do not wish (or are unable, as a matter of law) to sell

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Role of the Sourcing Contract

Avoiding Future Issues (3/4)

(1) Example 1:

- A Canadian company, distributor of parts for outdoor four wheel drive off-road vehicles, purchased plastic handles for their vehicles from a supplier located in Qingdao, Shandong Province
- The related sourcing contract did not stipulate the type nor the freezing temperature of the plastic to be supplied (important in Canada!)
- After the plastic handles were shipped to Canada, the plastic used in the handles would snap when exposed to temperatures below zero degrees Celsius (0°C).
- Since the Canadian purchaser did not specify the requirements for the plastic, will be difficult for them to claim against the Chinese supplier for their related losses (including the price of the plastic and replacement costs).

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Role of the Sourcing Contract

Avoiding Future Issues (4/4)

(2) Example 2:

- A Belgian company, provider of mobile telephone parts, ordered a shipment internal antennae from a supplier located in Dongguan, Guangdong Province
- The related sourcing contract did not include, in the breakdown of fees, include plastic slips in which the antennae were to be contained in (standard inclusion by factories due to the sensitivity of the product) – Belgian company assumed it was included automatically
- When questioned, Chinese manufacturer subsequently quoted a price for the slips; the amount quoted was over double the standard charged by other factories.
- Belgian company was faced with either accepting such amount, shifting supplier (and thus paying early termination fee) or outsourcing the adding of the slip packaging to another company (all expensive options).

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Role of the Sourcing Contract

The Contract Law: Example of Application (1/3)

Notice of Non-performance

- Where one party to a sourcing contract gives notice that it will not perform the contract, the other party may demand that the party giving notice bears liability for the losses sustained due to the non-performance.
- Notice can be given expressly or ‘indicated through action’, the latter term being open to interpretation but likely means implied notice such as via the abandonment of the agreement.

(Source: Article 108 of the Contract Law)

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Role of the Sourcing Contract

The Contract Law: Example of Application (2/3)

- **Example:**
- A US purchaser ordered microwave ovens from a Chinese supplier.
- Prior to the agreed delivery date, due to a dispute between the Chinese supplier and a third party, the main manufacturing equipment of the Chinese supplier are seized by the Chinese court.
- The US purchaser thinks that the Chinese supplier will subsequently deliver the product late (or not at all), thus makes an attempt to terminate the sourcing contract and claim compensation.
- The Chinese supplier applied to the Chinese court for the release of the manufacturing equipment by paying a deposit to the Chinese court equal to the value of the equipment (standard practice in China).
- Thus, as the risk of receiving the goods may be controlled, it cannot be regarded as an anticipatory breach unless (or until) the Chinese court refuses the release application. The Chinese supplier had not given express notice of, nor indicated through its acts, an intention to not perform the agreement.

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Role of the Sourcing Contract

The Contract Law: Example of Application (3/3)

- **US Comparison**
 - Compared to the U.S., Chinese courts tend to look more at the equities of a situation than the literal meaning of the contract or of the written laws.
 - Foreigners involved in a lawsuit in China against a Chinese company may already have difficulty in the “equities” balancing.
 - Nevertheless, a strong contract that favors you is better than a strong contract that does not favor you, a weak contract (regardless of who it favors), or, worst of all, no contract at all
- **CISG comparison**
 - Article 72 – anticipatory breach occurs when the breaching party intends to breach the contract before the contract’s performance date and such breach was fundamental to the contract.

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Key Clauses / Issues Regarding the Sourcing Contract

Choice of Governing Law (1/5)

KEY CONSIDERATIONS IN MAKING A CHOICE OF LAW

1. What are the potential areas of conflict which you might cause?
2. What are the potential areas of conflict which you fear the other party might cause?
3. Which laws are most favorable to you, in either preventing you from being found in breach (on #1) or finding a breach by the other party (on #2)?
4. What kind of remedies might you, as the buyer, need most in the event 1. or 2. occurs?
5. What does China, Illinois, the U.N. Convention on the International Sale of Goods, and any other potential governing laws say about these topics?
6. Which one is best for your purposes? Will it matter?

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Key Clauses / Issues Regarding the Sourcing Contract

Choice of Governing Law (2/5) -- CHINA

- The parties to an agreement involving foreign interests can usually choose the governing law which is applicable to their agreement, although certain contracts (such as those for the setup of Chinese-foreign joint ventures or the development and exploration of natural resources), must use PRC law as the governing law.
- If the parties to an agreement involving foreign interests have not made a choice of governing law, the law of the country to which the agreement is most closely connected shall be applied.
- However, for sales contracts, the domicile of the buyer applies where the agreement has been executed in the buyer's domicile or such domicile is the final destination of the buyer's goods.

(Article 126 of the Contract Law)

- For processing or assembly contracts, the governing law is the domicile of the party who provides the relevant processing or assembly services.

(Article 5 of the Judicial Interpretation on the Governing Law of the Civil and Commercial Disputes Involving Foreign Interests (“最高人民法院关于审理涉外民事或商事合同纠纷案件法律适用若干问题的规定”))

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Key Clauses / Issues Regarding the Sourcing Contract

Choice of Governing Law (3/5)

U.S. Choice of Law

- Complicated body of law, varies between jurisdictions (individual states and federal); however, you are free to choose own governing law. Suggest do so “without regard to conflict of laws principles.”
- Note that the Convention on the International Sale of Goods will preempt the UCC when it is applicable, because it is a self-executing treaty with the preemptive force of federal law.
- U.S. jurisprudence is clear that the only way to truly get around the CISG is to explicitly disclaim it in a contract
 - “PURSUANT TO ARTICLE 6 OF THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (UN CONVENTION), THE PARTIES AGREE THAT THE UN CONVENTION SHALL NOT APPLY TO THIS AGREEMENT.”

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Key Clauses / Issues Regarding the Sourcing Contract

Choice of Governing Law (4/5)

- **Compare application of CISG**

- Both U.S. and China are contracting states to CISG
- It applies where the parties have places of business in different contracting states, and where they did not opt out of the Convention application, as provided in Article 6.
- As self-executing treaty law, it takes preeminence over state laws and federal laws in U.S.
- Force in China if no exclusion
- Parties may exclude its application, or any particular parts thereof.

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Key Clauses / Issues Regarding the Sourcing Contract

Choice of Governing Law (5/5)

- **Example:**
- A US company incorporated in New York State purchased molds from a Chinese supplier incorporated in Shenzhen, Guangdong Province
- The molds were designed and will be used by a Korean company to manufacture finished products for the US company.
- The sourcing contract between the US company and its Chinese supplier was signed in New York and the molds were delivered to Korea
- **The governing law of the sourcing contract was not stipulated**
- The law of the country to which the sourcing contract is most closely connected shall be applied, although since the agreement was a purchase and manufacturing agreement, the buyer's domicile will be considered as well
- Since the buyer's domicile is not the final destination of the goods, and the place of execution (New York State) has no real connection with the agreement, the governing law will likely be that where the Chinese supplier is located

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Key Clauses / Issues Regarding the Sourcing Contract

Losses Caused by Breach (1/5)

- Usually, the amount of compensation for losses equal the losses caused by the breach, including interest receivable on the payment amount (if any)
- The amount cannot exceed the probable losses caused by the breach of contract which has been foreseen (or ought to have been foreseen) when the party in breach concludes the agreement

(Article 113 of the Contract Law)

- What is ‘foreseen’:
 - decided by the court and usually related to what is objectively foreseeable
 - reference is given to market prices and industry standards
- ‘Losses’ do not exclude indirect losses

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Key Clauses / Issues Regarding the Sourcing Contract

Losses Caused by Breach (2/5)

- **Compare to U.S. damages**
 - Commercial contracts for the sale of goods are controlled by the Uniform Commercial Code, which is implemented by the law of the individual states; in Illinois 810 ILCS 5/2-101, et seq
 - Most contracts contain clauses for **Limitation of Remedy & Limitation of Damages**
 - For the Buyer, when the UCC applies, remedies include
 - Buyer's rightful rejection of goods, section 2-711(1)
 - Specific performance/replevin, sec. 2-711(2)&(3)(if goods are unique or in other proper circumstances)
 - Money damages, section 2-703(d) and (e), 2-711(1)(a), and (b)
 - Remedies can be limited by contract, section 2-719
 - In practice, parties usually limit or exclude liquidated damages and consequential damages

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Key Clauses / Issues Regarding the Sourcing Contract

Losses Caused by Breach (3/5)

- Compare to CISG damages – far reaching consequences of contract avoidance makes it more difficult for seller to avoid a contract, compared to the UCC
 - Buyer's remedies - Articles 45 to 52 of CISG
 - Monetary damages
 - Specific performance (basically same as UCC or applicable state remedy)
 - Delivery of substitute goods
 - Repair
 - Fix additional time for the seller to perform
 - Declare the entire contract avoided
 - Reduce the price for non-conforming goods, or only partially conforming goods
 - Refuse to accept early delivery of goods
 - Seller's remedies – Articles 61 to 65 of CISG
 - Monetary damages
 - Specific performance (basically same as UCC or applicable state remedy)
 - Fix additional time for the buyer to perform
 - Declare the contract avoided (does not distinguish between rights before and after acceptance of the goods by the buyer)
 - Make necessary specifications as to form, measurement, or other features of the goods which the buyer failed to make

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Key Clauses / Issues Regarding the Sourcing Contract

Losses Caused by Breach (4/5)

- Compare to U.S. damages
 - However, “where circumstances cause an exclusive or limited remedy to fail of its essential purpose”, the limitation of the remedy in the contract shall have no effect. Section 2-719(2), *Razor v. Hyundai Motor America*, 222 Ill.2d 75, 854 N.E.2d 607 (2006) (holding that if a contract limits a remedy to, eg repair or replacement, but then fails to comply with that limited remedy, then the attempted contractual limitation, eg the exclusion of incidental and consequential damages will have no effect).
 - Contracting parties from China may not realize this implication due to non-understanding of U.S. case law (as opposed to Code-based Chinese law)
 - Voiding written language in the contract is likely to be confusing to a Chinese court, or arbitrator. Where Illinois law applies, but case is to be heard in a Chinese court or CIETAC, beware of application of damages issues

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Key Clauses / Issues Regarding the Sourcing Contract

Losses Caused by Breach (5/5)

- **Example:**
- A Canadian company purchased toys from a Chinese supplier located in Guangzhou, Guangdong Province, but executed the agreement with an agent (the “Toy Purchasing Agreement”)
- The Chinese supplier delivered the toys a month late; as a result, the Canadian company’s client terminated a purchase agreement signed with the Canadian company and claimed RMB 50,000.00 from the agent as compensation
- Had the Toy Purchasing Agreement been properly executed, the Canadian company would have made a profit of RMB 100,000.00
- The RMB 50,000.00 paid to their client as compensation will be regarded as a direct loss (as is usually decided by Chinese courts)
- The RMB 100,000.00 profit will be regarded as an indirect loss
- The Canadian company can claim compensation totaling RMB 150,000.00 against the agent

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Key Clauses / Issues Regarding the Sourcing Contract

Quantification of Losses (1/2)

- The parties to an agreement can stipulate a certain amount as compensation or the calculation method for quantification of losses when one party violates the agreement.

(Article 114 (1) of the Contract Law)

- Fixed amount compensation must be paid even where no loss is incurred; such compensation considered punitive damages
- Where the compensation amount given in the agreement is lower than the actual losses caused by the breach, the aggrieved party can request an increase; if *significantly* higher, the breaching party can request an appropriate reduction
- It is unclear whether the ‘stipulated compensation’ includes references to stipulated calculation of compensation or not; however, it is likely that it does.

(Article 114 (2) of the Contract Law)

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Key Clauses / Issues Regarding the Sourcing Contract

Quantification of Losses (2/2)

- **Example 1:**
- An Australian company purchased elevator pulleys from a Chinese supplier located in Zhuhai, Guangdong Province
- The sourcing contract between the parties stipulated that a penalty of RMB 500.00 applies for each day of late payment
- The Chinese supplier delivered the pulleys thirty (30) days late
- Even where the Australian company suffers no loss, they are still entitled to claim a total of RMB 15,000.00 (RMB 500.00 x 30 days) as compensation
- If actual losses of RMB 100,000.00 are also suffered, the Australian company can increase the claim to 115,000.00 (RMB 100,000.00 + 15,000.00)
- **Example 2:**
- The above agreement may require the Chinese supplier, in the event of late delivery, to compensate the Australian company double the amount of losses incurred by the latter due to the late delivery
- Losses of RMB 100,000.00 are again suffered; Australian company claims 200,000.00
- The Chinese supplier can argue that the claim of RMB 100,000.00 is significantly higher (i.e. double) the actual losses incurred due to late delivery

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Quality Warranties (1/3)

- U.S. parties may have certain warranties (implied, express or limited) which relate to goods they are selling in the U.S. customers
 - Warranties of title and noninfringement (810 ILCS 5/2-312)
 - Express warranties (810 ILCS 5/2-313)
 - Implied warranties of merchantability (810 ILCS 5/2-315)
 - Implied warranties of fitness for a particular purpose (810 ILCS 5/2-315)
 - Magnuson-Moss Warranty – federal consumer protection
 - Illinois Consumer Fraud and Deceptive Business Practices Act
 - Common Law implied warranties
- Your U.S. counsel helps you understand these and how they relate to your business. But, when you manufacture in China, how does that impact your ability to comply with the warranties you owe under the law or contract?

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Quality Warranties (2/3)

- Guaranteeing quality is one of the most crucial issues in a sourcing contract
- If such standards are not made clear (or not mentioned) in the sourcing contract, a Chinese court will adopt national or industry standards

(Article 62 (1) of the Contract Law)

- Contrast this with interpreting other unclear or missing clauses, which are to be decided in light of the purposes of the sourcing contract. However, courts may apply both tests if need be

(Article 61 of the Contract Law)

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Quality Warranties (3/3)

- The ‘national standards’ or ‘industry standards’ refer to the relevant *Chinese* standard
- A Chinese court will *not* apply foreign standards unless specifically mentioned in the sourcing contract
- **Practice Tip:** In any event, it is always wise to:
 - clearly specify product standards, whether in detail or by reference to a foreign standard
 - withhold a portion of payment until delivery to avoid issues/disputes over quality

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Intellectual Property Provisions

Patents and Trade Marks (1/5)

- Generally, only trademarks and patents *registered in China* can be protected
 - **U.S. Practical Tip:** Keep in mind that if you do not create and properly register your IP in the U.S., you will have nothing to protect in China. Take the time here first to properly register TM, Copyrights and Patents. Understand how to protect trade secrets, and have processes in place to guard them.
 - If your local agent needs to promote, advertise or manufacture your products, they are going to need a Trademark and Patent License from you.
 - You can't grant them a license in China if you don't have registration in the U.S.
 - You can't grant them a license in China if you don't have registration in China.
 - You need to do your registrations properly in China – and don't wait or a Chinese agent or competitor may register them for themselves.
 - You should have provisions in your sourcing contract that makes the sourcing agent responsible for policing your rights
 - At a minimum, to alert you if they become aware of any incidents of infringement

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Intellectual Property Provisions

Patents and Trade Marks (2/5)

- Even though a sourcing contract may state patents and trademarks are the property of the U.S. purchaser, this may not be an enforceable argument
- In an attempt to convert from a manufacturing hub to a global design center, China is attempting to pay more attention to IP protection.

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Intellectual Property Provisions

Trade Secrets (3/5)

- Trade secrets refer to the technical information and business information which should include four (4) aspects:
 - the trade secrets are not known to the public
 - the owner has an interest in keeping them secret
 - the trade secrets have practical applicability
 - the owner of the trade secrets takes measures to protect them

(Article 10 (3) of the Law of the PRC against Unfair Competition (“ 中华人民共和国反不正当竞争法”))
- In a sourcing contract, such trade secrets should be listed clearly; or, an agreement can state that trade secrets must be kept secret, and subsequent correspondence containing such secrets can be marked as ‘confidential’.
- **U.S. Practical Tip** – for small and mid-size companies, know-how and trade secrets can be their most valuable assets. These can and should be protected.

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Intellectual Property Provisions

Patents and Trade Marks (4/5)

So What Can You Do To Protect Your Intellectual Property in China?

Always Remember -- NNN

Non Disclosure Agreements – in addition to normal NDA terms, you also need to prevent internal disclosure within the contracting party’s network of subsidiaries and subcontractors (disclosures to entirely unrelated third parties is much less of a risk)

Non-use Agreements need to prevent “copycat” manufacturing, eg the Chinese party uses the U.S. company’s product design to create a same/similar product which directly competes with the U.S. company (produced under a Chinese trademark)

This is especially important for products that are not covered by patent or other IP registrations.

Non Circumvention Agreements -- prevents the Chinese party from approaching the U.S. company’s current or future clients, saying they are the company making the product and soliciting them directly, eventually cutting out the U.S. business



Intellectual Property Provisions

Patents and Trade Marks (5/5)

Other Key Terms in NNN Agreements

- **Choice of Law**
 - not U.S. courts (Enforceability, enforceability, enforceability)
 - not arbitration outside of China (Expensive, slow, denies access to injunctions)
 - **Chinese language of agreement controls**
 - (English is for client use only)
- **Enforcement through Chinese court or CIETAC**
 - **Set floor for Liquidated Damages**

Contrast with U.S. - injunction sole remedy b/c economic damages not quantifiable – in China amount is determined under Chinese law, sets a floor on liquidated damages PLUS

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Enforcement of a Sourcing Agreement

- Parties should contemplate the best, most efficient and most applicable method of enforcement, **based on their situation**
- Choice of venue is different than choice of governing law
- Enforcement of an agreement (even a judgment issued by a Chinese court in relation to an agreement) can be difficult
- Key questions:
 - Which system can provide the most efficient and cost-effective resolution (or vice-versa, if that is your goal)
 - Court matters, arbitration matters often ‘move’ faster than in many Western jurisdictions
 - **U.S. style discovery practices** are very expensive and time consuming
 - Which method is most likely to be cooperated with (voluntarily or involuntarily) by parties
 - Where are the parties?
 - Where are the parties’ assets?
 - What is the mechanism for enforcement of judicial v. arbitration awards?
 - New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958)

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Enforcement of a Sourcing Agreement

- **When is it a good time to voluntarily choose application of Chinese law and courts?**
 - When Chinese company provides poor quality product, but there is enough of a dispute to make it worth suing over
 - They are solvent enough to get some recovery with a judgment in China
 - Court costs are lower in China and/or through arbitration
 - You usually find out on the first shipment how bad the goods are (you forgot to do Quality Control earlier, didn't you?)
 - Outside China – higher costs, no foreign judgment enforcement
 - Chinese company manufactures product without your permission and in violation of your agreement
 - You need injunctive relief, and the only and fastest way to get it is a Chinese court
 - Arbitration will not give you that relief
 - Precious time lost while try to figure out where to go, arbitrators, etc.

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Enforcement of a Sourcing Agreement

- When is it a good time to voluntarily choose application of Chinese law and courts?
 - Chinese manufacturer refuses to return your molds
 - You don't want damages – you want your molds, because without them you can't manufacture anywhere else.
 - Need that injunction!!

If you are going to be enforcing an agreement in the Chinese courts, make sure the official language of the agreement is in Mandarin. English can be non-official. Otherwise, you are going to have difficulties when enforcing.

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Enforcement of a Sourcing Agreement

- An aggrieved party to a sourcing contract can enforce performance of the contract by the other party by making an application to a Chinese court
(Article 110 of the Contract Law)
- Such claim is refused (although damages/compensation can still be successfully claimed) where:
 - the obligations are unable to be performed due to application of law or factual scenario
 - the object of the debt is unfit for compulsory performance or the performance expenses are excessively high
 - the creditor fails to request performance within a reasonable time period

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Key Clauses / Issues Regarding the Sourcing Contract

Dispute Resolution (1/2)

- Parties to an agreement can only resolve a dispute by arbitration if they have agreed to do so in writing, whether separately or as part of a wider agreement.

(Article 4 of the Arbitration Law of the PRC (“中华人民共和国仲裁法”))

- If there is no clear stipulation in relation to what is to be arbitrated on (e.g. any dispute under the agreement or only in relation to matters of quality), or specific arbitration court or the stipulation is ambiguous, the arbitration clause or agreement will be regarded as invalid.

Interpretation by the Supreme People’s Court in relation to the Application of the Arbitration Law of the PRC (“最高人民法院关于适用《中华人民共和国仲裁法》若干问题的解释”))

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Key Clauses / Issues Regarding the Sourcing Contract

Dispute Resolution (2/2)

- **Example:**
- A sourcing contract between a French purchaser and a Chinese supplier and a foreign purchaser contains an arbitration clause stating that any dispute arising out of or in connection with the agreement shall be settled by final and binding arbitration conducted in the English language in Singapore
- As there is more than one arbitration commission in Singapore dealing with foreign matters, this clause will be regarded as ambiguous and therefore invalid
- Accordingly, the Chinese court will retain jurisdiction to hear the matter

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Caroline Berube
cberube@hjmasialaw.com
Direct Line: +8620 8121 6418
Cell: +86 135 000 278 60

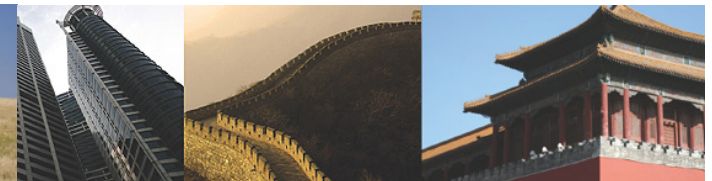
Question & Answer Session



Thank you for your attention



Michelle Rozovics
mrozovics@rozovicslaw.com
Phone: 815-479-9733 or 312-474-6439
Cell: 708-476-0575



Guangzhou Shanghai Singapore

www.hjmasialaw.com