

**GHD WORKSHOP: INAUGURAL CHINESE CLIENT MANAGEMENT PROGRAM
30 YEARS OF NEGOTIATING IN CHINA
TEA HOUSE RESTAURANT
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During China's National People's Congress held in Beijing in March, the Chinese Minister of Commerce, Chen Deming announced China's intentions to utilise more of its massive 3 trillion dollars of foreign currency reserves to accelerate China's push for outbound investment, especially in the resources industry.

China has been investing more than 1.2 trillion dollars in US treasury bonds and the like. It was recently reported that China has suffered losses of around 250 billion dollars with the declining US dollar. This has prompted China to change its investment strategy. China has a balance of around 2 trillion dollars and it is actively going out to use these funds making investments and acquiring assets overseas.

China has already been making investments around the world to secure long term supplies of strategically important minerals, as well as oil and gas. For all of the projects where we are advising the Chinese side, the Chinese are agreeing to provide or assist with the financing. This gives them special leverage in their project negotiations and of course makes them especially attractive partners in addition to the offtake guarantees which they can offer.

Australia has long been regarded as the preferred destination for Chinese investment in resources.

The past decade has represented a period of great transformation in Australian economic history as a result. This also presents many challenges as we face managing the relationship.

It is always important to look at why things in China are done the way they are and how each side perceives each other's interests. I understand that this has been the special focus and purpose of your workshop today. In giving you some examples of our dealings with China, I would like to add to this with the benefit of our experience.

What is our relationship with China?

Two way trade with China now exceeds 100 billion dollars a year. There are 220 Chinese invested projects in Australia worth around 60 billion dollars.

China is Australia's biggest trading partner, accounting for one quarter of all of Australian exports. China is the world's biggest steel producer, and the biggest importer of iron ore which is Australia's biggest export earner.

All of this just highlights the great importance to Australia of this special relationship.

Bob Hawke made a speech at our law firm's 25th Anniversary that the most important decision of the 20th Century was the Chinese leader Deng Xiaoping's introduction of China's open door policy in December 1978.

It has been that one momentous decision which has changed the history of China and its evolving impact across the world, none more so than on Australia.

My time in China dates back to 1981 when I first went to China at the invitation of the Australian and Chinese governments. At that time, I was General Counsel of Rio Tinto in Australia. I was invited by the Chinese when I was in China to become an Adviser to the State Council's Economic Legislation Centre under Gu Ming to advise on the drafting of China's joint venture law.

In 1981, China's only economic law was a 5 page document called 'The Equity Joint Venture Law'. This was the start of China's codification of voluminous economic laws over the subsequent period.

In 1981, there were no lawyers in China and no law firms. There was only a small group called 'The Legal Counsel Office' in the China Council for the Promotion of International Trade, which was the body established to deal with foreigners. Few if any of the staff in the office had any legal degrees.

I travelled to China often after that giving lectures while I was still at Rio Tinto. We also provided volumes of papers on joint venture law and practice in Australia.

Several years later in 1983, at a top level meeting between Australia's Prime Minister Bob Hawke and China's Premier Zhou Ziyang the historic agreement was reached to do China's first overseas project in Australia. This was the Channar Iron Ore Joint Venture.

The Chinese negotiating team came to Australia in 1984 to appoint legal representation and to start the negotiations.

I had just left Rio Tinto and formed our law firm with other Rio colleagues. Our new law firm had to compete in the beauty parade, but fortunately all of the members of the negotiating team had been students in my lectures in China so I was appointed as the lawyer for the China side, which began my 26 years of advising Chinese enterprises on their Australian projects.

The negotiations extended for more than 2 years.

There was a lot of pressure coming from the Australian government in Canberra to fix the deal.

During the negotiations, I was invited at one time by the Australian Ambassador in Beijing to come to the Embassy to explain why the negotiations were not moving faster. He took me into the black box in the Embassy which was supposed to be bug proof. However, the next day I received a call from the Chinese Minister's office to meet the Minister for tea. He basically told me all of my discussion with the Australian Ambassador the day before. He did not tell me not to go back to the Embassy, but I never did.

The key issues for the Chinese side in the negotiations were not focussed on how to structure joint ventures. The Chinese Minister of Metallurgical Industry was the party to the joint venture, and it controlled all of China's iron and steel industry. The Chinese team knew nothing about Australian joint venture law or how to do business in Australia. They had never been to Australia or indeed anywhere outside China.

They were principally concerned with only 3 key issues:

- what law should govern the voluminous contracts – all the documents were agreed to be governed by Australian law except for the Sales Contracts which the Chinese wanted covered by Chinese law, but as a compromise no governing law was specified;
- the place for arbitration – they decided on Stockholm; and
- the language – all documents had to be equally binding in both English and Chinese.

All the rest of the negotiations were left to me to manage and to advise them on what to do.

I once made a speech at an international conference that Stockholm was chosen by the Chinese as the venue for arbitration as it was so far away that no one would travel to Stockholm to arbitrate, so there would never be any arbitrations. However, someone at the conference protested that he was from the Stockholm Arbitration Institute and that they did many arbitrations for China.

The Channar Joint Venture became the model joint venture for all future Chinese investment in Australia, linking as it did the requirement to have Chinese equity investment in the project together with guaranteed offtake to underpin the project financing and development.

There were many cultural and economic issues to be resolved. However, the joint venture documentation was signed with great fanfare in 1987 and production commenced in 2000. I sit on the Board of the holding company and represented the Chinese side, which is now Sinosteel, in the Management Committee.

The profits from the joint venture last year were twice the original capex of the project.

Agreement was reached last December to extend the joint venture for a further 5 years.

Dealing with the Chinese on the joint venture was obviously a new experience for me as well.

In my early days in China, I had often received valuable advice from Professor Jerome Cohen from Harvard University. There were very few of us in China at that time and we often met up together. One advice was that if you were having difficulties in negotiations with the Chinese, go back to your hotel room and go through all of your negotiating points again. Your room would be bugged so you had two chances to get your points understood. I didn't have to resort to that on the Channar project, but I never forgot it.

In the resources industry, China has not been very welcoming for foreign investment. Neither BHP nor Rio has any significant investment in Chinese resources.

While I have done various construction projects and manufacturing, technology and agricultural deals, our biggest inbound project into China was acting for a big US group to tranship its chemical plant from Michigan in the United States to China. This was a three year negotiation. When we were first appointed, the American client had never been to China. We had a practice of taking all of our new clients coming to China for the first time to the Great Wall before any negotiations commenced. I always wanted to impress on them that China was very different and that in dealing with the Chinese you needed to understand and recognise the cultural and historical differences.

The negotiations for that project were long and protracted, but I worked very well with the Chinese law firm which acted for the Chinese chemical company. All of the joint venture documentation had to be reviewed and approved by the Provincial Office of the Ministry of Commerce. We also had to deal with a number of other Chinese regulators, including the Commodities Inspection Bureau. They insisted on visiting the US plant in Michigan before it was to be transhipped, and managed to demand side trips to New York, Las Vegas and Hawaii.

At the first meeting of the joint venture Board of Directors after everything had been signed up with the required chops, the President of the Chinese side began the meeting by announcing that he wanted to renegotiate some important points in the joint venture even after 3 years of negotiation.

From my experience, this was not an exceptional case. However, the US President exploded. He regarded that as completely dishonest and unethical. He walked out of that meeting and returned to the US. The chemical plant never made it to China.

Our role for numerous Chinese clients has been to act on their inbound investments into Australia. We have been the lawyers on 8 of the iron ore projects, including 2 out of the only 3 major Chinese operating iron ore joint ventures in Australia, including one with BHP and one with Rio Tinto.

We have also been involved across the whole range covering other resources includes coal, tin, lead, nickel, copper, gold and silver. More recently, as projects have matured, we have become involved on infrastructure for railway and ports, as well as power plants and mine development.

China is also more recently moving into the area of mergers and acquisitions to acquire direct interests in projects rather than just through joint ventures.

What have we learned from our experience with China?

One of the most significant issues which stands out for our Chinese clients is their failure too often to obtain professional and financial advice before they do these deals. They obviously have to get legal advice to do the legal documentation, although even then we often find that Heads of Agreement or Framework Agreements which are legally binding have already been signed and which have serious legal issues. We have to try and re-negotiate them once we get involved and have to put together the numerous legal documents for our Chinese clients.

The new Chinese Ambassador to Australia, Chen Yuming, who came to Australia at the end of last year, at a private lunch in Melbourne shortly after his arrival told me that the Chinese government was very concerned about the 'mistakes' that the Chinese had been making their investments in Australia. And there have been a number of significant examples.

Many of those mistakes arose from the Chinese paying excessive prices. We have our own list of examples where ridiculous prices have been paid for projects.

The problem is that when these state owned enterprises, including even the biggest, enter into negotiations most of the Chinese officials who are involved in the negotiations have never been to Australia or even worked on anything else outside China. This puts a lot of extra pressure on us as we are required to take a lot more responsibility for all of the negotiations. To do this properly, we always work as a team with the PRC lawyers in our firm, using them especially for all interpreting and for all written communications, which we send out in Chinese as well as English to make sure they are fully understood by our Chinese clients.

Another issue is how the Chinese find these projects

I am often surprised at how new introductions are made when even major Chinese SOEs get involved on projects. Often they seem to be done through low level personal contacts or simply chance meetings at conferences or in some other random fashion. Rarely are they done through properly organised investigations and contacts to double check on the suitability of the Australian parties. They don't always end up doing projects which are really the most suitable and best for them.

When we acted for one of China's biggest steel mills, the signing ceremony in China was attended by 600 officials and guests. The celebration dinner was attended by the Party Secretary of the Province, the Chairman and the President of the steel mill. When the Chinese came to Australia to set up their office to start work, they were shocked to find out only 3 people sitting in a very down market office and could not understand how they had been able to secure this investment by a major Chinese enterprise.

Another Issue - Face

This brings me to another very important factor in all our dealings – face. After having just done six months of intense negotiations to put together all of the legal documentation for that project, I was approached by middle management to ask me to break the contracts because they did not like the project. But with top level representation at the signing ceremony and in choosing this project, the loss of face for the senior officials would never have allowed this to happen.

The issue of face comes up all the time, and I mean all the time, in our dealings with our Chinese clients. It is a subtle requirement, but one which demands full recognition of its importance.

Next - Access to real Chinese Skills

Even after a long time of working with China, I regularly defer to my Chinese colleagues in our law firm who are PRC nationals to get their input and counsel on how best to deal with difficult situations which arise from time to time. Their knowledge and instincts and how best to deal with all kind of situations is something which is invaluable.

For myself, I have developed excellent long term relationships with many of our Chinese state owned enterprises who are our clients.

I have been appointed to the Boards of Australian Subsidiaries and even represent them on the Management Committees of the joint ventures.

In that capacity, I play a very hands on role for them and they rely on me very much. I have built excellent trust and I get consulted on many of their decisions about their business in Australia.

Their projects are usually complex and represent big investments. The Chinese are smart enough to recognise that they need a lot of help to be successful here.

One of the biggest negotiations I have conducted for China were acting for four of China's biggest steel mills who combined together on an iron ore joint venture with BHP. I had a team of 15 Chinese representatives acting for the steel mills over the 9 months of the negotiations in China and Australia.

They had appointed one leader who was the agreed conduit for our instructions. They organised themselves as a team and that certainly made the negotiations more effective and efficient.

However, it is not always possible to dictate who should be participating from the Chinese side. You have to work with what they give you. But it is vital that you can communicate properly with them and also know how they are thinking and what they are looking for. This is one of the most important of all of the requirements in acting for the Chinese.

Conclusion

Overall, working in China and with the Chinese here in Australia, success is most heavily dependent upon established networks and relationships. This is well known to most people doing business with China.

It is usually at the top of any consultants list on how to do business in China. The Chinese word for this is 'Guanxi'. This is a reference to mutually dependent relations. It is easy to say, but its importance in being successful in China cannot be overestimated. We continually invest heavily in building on those networks and relationships across everything we are doing in China.

I have been in China for 30 years. I have travelled to China 200 times and spent long periods of time there. Our success has been wholly dependent on the special, valuable networks and relationships and indeed real friendships which we have built up in China over that period.