Daniel Roules *identifies the five key guidelines to getting your aerospace venture off the ground in China.*

How to succeed in China ...just follow the Roules

China is currently the world's second largest market for air travel – a market that is increasing at an astonishing rate.

In its recent report 'The China Challenge' ADS noted that air travel in China has grown 475% since 2000 and demand was expected to increase over the next 20 years. During that time, China is set to become the world's largest national aviation market, according to ADS Group chief executive Paul Everitt.

Other forecasts predict that, over the next five to ten years, China will increase the size of its general aviation fleet by as much as 30% annually, and the Chinese are projected to acquire more than 1,000 aircraft of at least 50 seats during each year of that period.

This ballooning of air travel in China has led to the construction of dozens of new airports and the renovation of many more. Together, these developments will vastly increase the demand for related services, such as those supplying pilots and controllers, flight training and maintenance, repair and operation services, state-of-the-art communications, and in-flight media and entertainment systems.

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Faced with such a fast-growing market, most US and European aerospace companies, as well as those providing related support services, are considering options to expand their operations in China – or, if they are not in China now, entering the market.

Many international companies came to the China market over the past decade to provide products, systems and expertise for the development of China's twin-engined regional jet, the ARJ21, or for the twin-engined narrow-body jumbo jet, the C919.

The development of both planes has been overseen by Commercial Aircraft Corporation of China (COMAC), a commanding state-owned enterprise (SOE) established in 2008 in Shanghai as part of China's 'national champions' programme, which invests heavily in SOEs that are considered crucial to the nation's economic development.

Recently COMAC has begun discussing plans to develop its first wide-body passenger jet, the C929.

To date, China's aerospace sector has been highly dependent on western technologies. For both the ARJ21 and the C919, COMAC has typically sought to include foreign companies that can provide technical expertise not available in China. With that goal in mind, COMAC has often required such suppliers to establish Sino-foreign joint ventures. Those agreements, however, are not without challenges.

So, while the boom in Chinese aviation may present business opportunities for international companies, understanding the important challenges of operating a joint venture in the China market are essential.

There are five key issues that our lawyers on the ground have identified in advising more than a dozen foreign aerospace companies in China in recent years.

International collaboration: Many companies came to the China market over the past decade to provide products, systems and expertise for the development of the ARJ21.

■ Joint venture or stand-alone?

A necessary first step when considering a bid to participate in any project with COMAC is to determine the form that the relationship must take.

Recognising China's need for technologies in the aerospace sector and the fact that a large component of many aircraft technologies is knowhow, COMAC has a preference for joint ventures that allow the Chinese partner to leverage the foreign partner's knowledge, while accumulating experience and internalising expertise.

COMAC has, however, sometimes been willing to accept a supply arrangement from the foreign or foreign-invested party in lieu of a joint venture.

Given the challenges of partnering with a People's Republic of China (PRC) company – particularly when that partner is state-owned – it may be prudent to explore entering into any business arrangement with COMAC as a stand-alone rather than as a joint venture, provided that your company has the necessary capital, expertise, relationships, and presence in China to do that.

■ Protecting intellectual property (IP)

Experience suggests that any company coming to China should presume that, at some point, its IP will be lost or misappropriated, so steps should be taken from the outset to maximise protection and minimise risk.

To start with, recognise that for patents and trademarks, China is a 'first-to-file' jurisdiction; so early registration is typically recommended.

Technology may be afforded protection under PRC law, but theft is

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difficult to prove. You, therefore, should consider the potential sources of 'leakage' – typically your partners, employees, suppliers or customers – and establish specific contractual terms that will afford your company maximum protection under PRC law.

Compliance

China's aerospace sector poses significant risks for compliance programmes, particularly with respect to anti-bribery.

During the past 18 months, China's strict anti-bribery laws have been widely applied and enforced against both Chinese and foreign companies across many business sectors. It is essential for any foreign company in the aerospace sector in China to ensure that it has a compliance programme tailored and made fit for purpose for the local laws and practices.

Operational control

Equity ownership alone in China does not convey operational control. In any joint venture it will be necessary for the foreign party to ensure it has sufficient experienced personnel in China to guarantee that the company cannot be taken in an undesirable direction.

This typically requires control over the power to appoint and remove key officers, including (wherever possible) the chairman, CEO, GM, CFO, compliance officer, and chief technology officer.

On a practical level, this also includes controlling the use of the company seal/chop and the power to establish and modify financial and compliance policies.

Competition issues

Due to the specialisation of their products and services, many aerospace companies enjoy relatively large shares of the relevant global and national markets in which they operate. This may trigger a need for competition approval in China when the company acquires another entity or establishes a joint venture. It might also present issues under the PRC rules prohibiting the abuse of a dominant market position. Overseas companies or foreign-invested companies in China should be mindful of these and related competition issues as they expand.

China's ambition to compete in the global aerospace market as a major player is a serious and credible one. As it gears up to meet its own domestic market needs and grow its aerospace capabilities, collaboration with international companies is both welcomed and required. However, for those collaborative opportunities to take off, planning and preparatory work of the kind outlined above will be essential.