KEEPING PACE:

Fast-Moving Markets Bring New Challenges

By John M. Toth

The transformation of many economies from state-run to free-market status offers unexpected legal challenges to multinationals locating or investing in these countries. Corporate counsel must combine flexibility with extensive local due diligence to realize opportunities in select European, Asian and Latin American nations.

Flexibility Is Key

"The evolution of young judiciary systems is inseparable from each country's business, cultural and economic environment," declares Gordon Kaiser, corporate practice partner at Squire, Sanders & Dempsey L.L.P. Privatization and resulting rapid economic growth create change that outpaces traditional judicial and cultural frameworks in these countries. Under such circumstances, Kaiser observes, "Any assumptions that you make about conditions two years from now will likely be wrong. Flexibility is essential when the rules are constantly evolving.

"The key is an understanding of the cultural, business and legal realities," Kaiser says. This is particularly true when ostensible ethics concerns are actually conflicting cross-cultural business practices. Lawyers who understand local nuances are in the best position to culminate a deal in such circumstances.

China Watch

Dan Roules, partner in Squire Sanders' Shanghai office, believes that the most important legal and economic change in the Asia Pacific region in recent years was China's accession to the World Trade Organization. "Day by day we are dealing with the ramifications of that event as China implements its obligations to transform from a closed society to one that is governed by transparency and rule of law," he notes. Many multinational companies have acquired assets and interests in state-owned companies, but these are rarely considered privatizations and can entail complex disputes. In one instance, an appeal to central officials in Beijing was necessary when local officials tried to restrict a joint venture asset transfer by a joint venture between a U.S. and a state-owned company on the grounds that it was a transfer of state assets, even though the joint venture had purchased the assets with private cash.

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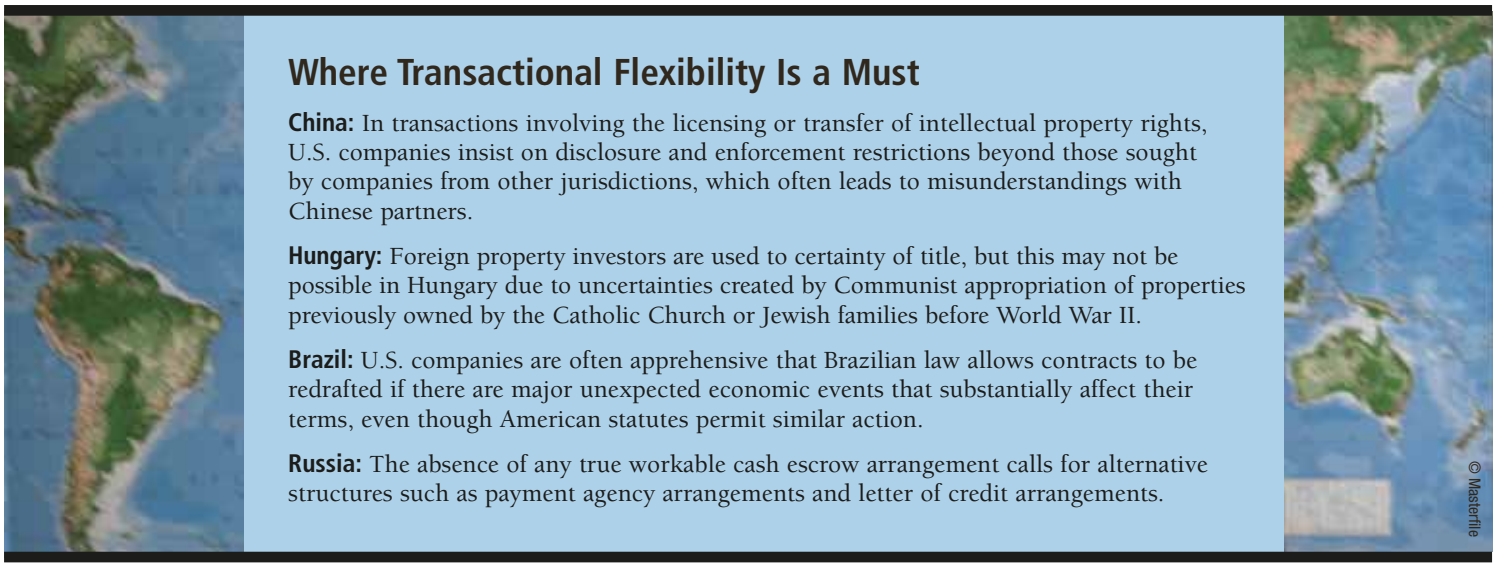
Roules recommends drafting contracts to specify that if there are material adverse changes in key laws shaping the transaction, the client can terminate the contract or alter the business relationship. Incorporating the far more restrictive American understanding of intellectual property rights is another major contractual challenge. "The challenges presented by perpetually evolving foreign ownership restrictions, asset- and equity-transfer rules, domestic distribution rights and intellectual property protections create the need for seasoned lawyers in China," Roules concludes.

Progress in Eastern Europe

Eastern European companies have largely made the transition from complete state ownership to nearly full privatization, according to Kevin Connor, partner in Squire Sanders' Budapest and Bratislava offices. With the exception of a few countries such as Belarus, multinational companies will find an acceptable business environment. In countries that have joined the European Union (EU), such as Hungary, EU regulations



Where Transactional Flexibility Is a Must

China: In transactions involving the licensing or transfer of intellectual property rights, U.S. companies insist on disclosure and enforcement restrictions beyond those sought by companies from other jurisdictions, which often leads to misunderstandings with Chinese partners.

Hungary: Foreign property investors are used to certainty of title, but this may not be possible in Hungary due to uncertainties created by Communist appropriation of properties previously owned by the Catholic Church or Jewish families before World War II.

Brazil: U.S. companies are often apprehensive that Brazilian law allows contracts to be redrafted if there are major unexpected economic events that substantially affect their terms, even though American statutes permit similar action.

Russia: The absence of any true workable cash escrow arrangement calls for alternative structures such as payment agency arrangements and letter of credit arrangements.

form the fabric of commercial law. These countries have solid economic infrastructures, educated workers and great market potential, making them extremely attractive for startups, acquisitions and investments by companies such as global auto manufacturers.

"The top consideration for corporate counsel in Eastern European transactions is that knowledge of the market is power. Corporate counsel really need to emphasize due diligence," says Connor. "Many companies are so anxious to enter these markets that they don't thoroughly investigate the strength of local partners or the application of local law in areas such as labor," he adds. Even though EU regulations apply to Hungary, enforcement through the courts can be spotty. Issues like real estate titles are hard to resolve after decades of Communist rule. Connor believes that, while privatization is about 90 percent complete, economic infrastructure is perhaps 10 years behind American and European standards, and the national business consciousness is nearly a generation behind. There are cross-cultural complexities, such as local perceptions that American straightforwardness is too aggressive. "It's the lawyer's job to understand the total environment to reduce risk," Connor says.

Adjusting to Brazilian Reality

Privatization is largely completed in Brazil, but Tim Smith, partner in Squire Sanders' Rio de Janeiro office, still sees substantial fluidity in the legal considerations involving equity investments, acquisitions and energy projects. Even if American companies want U.S. law to apply in such transactions, labor, real estate and environmental concerns necessarily come under Brazilian law. Private entities have more contract flexibility, but so-called public contracts that involve public entities or "mixed companies" with majority state ownership must adhere to Brazilian requirements.

Smith warns that corporations must adjust to other transactional realities they don't expect. Under Brazilian law, contracts can be redrafted if there are major unexpected economic events that substantially affect their terms. Significant tax issues have an impact on materials sourcing for greenfield construction projects involving local companies, often requiring establishment of an offshore entity. Currency risk and capital repatriation are major concerns. However, Smith emphasizes, "No issue is so complicated that it doesn't have a solution. Corporate counsel should avoid overemphasis on unique aspects of Brazilian or other national law. Proactively dealing with key issues up front in contract negotiations is essential under any governing law."

Slow Change in Russia

As a partner in Squire Sanders' Moscow office, David Wack faces a different kind of challenge from that of lawyers in China, Hungary or Brazil. The legal/business environment in those countries is changing swiftly; in Russia the concern for foreign companies is the absence of certain significant changes. This lack of change impacts three important areas. First is the absence of any true workable cash escrow arrangement, which often requires formulating alternative structures including payment agency arrangements and letter of credit arrangements. Second is the lack of mechanisms for the enforcement of security interests and the absence of self-help alternatives. Third is the lack of recognition for enforceable shareholder agreements and equity adjustments such as ratchets. "Because institutional solutions have been slow to emerge for each of these concerns," Wack declares, "counsel in Russia regularly must develop certain workarounds that allow for successful completion of a transaction."

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