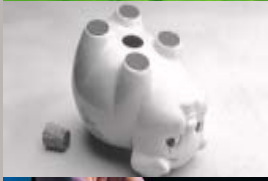




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CHINA Legal Bulletin

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Executive Summary

Historic New Property Law Set to Change China

Beginning on the 1st of October 2007, the PRC will have its first fully recognized Property Law and what it means to own property will be forever changed. Besides the legal conveyance of property to individuals and enterprises, the law also states that this can only happen after registration of any transferral. The next important provision is that upon the termination of the land use rights for residential property the renewal process is automatic. Finally, and most interesting for business interests, all property including movable interests can be used as mortgage collateral, therefore creating new financing opportunities.

By Zachary Wortham and Maarten Roos

Legal Concerns of Foreign Enterprises in China, Part I

Senior Client Service Manager Maarten Roos has amassed a wealth of experience in his more than four years of dedicated work at Wang Jing & Co. He now takes on the task of providing answers to the most frequently asked questions when businesses seek out advice on operating in the PRC. In Part I he makes the case for due diligence for commercial transactions, and how a little bit of elbow grease and time with qualified legal help can help avoid some very big headaches down the line.

By Maarten Roos

NEW DEVELOPMENTS

On April 27th, 2007, the annual ALB China Law Awards were held in the Westin Shanghai. Our partner, Mr. Wang Hongyu, attended the occasion on behalf of the Firm. Law firms and corporate counsel from all over China voted to nominate Wang Jing & Co. for several awards including Insurance Law Firm of the Year, Shipping Law Firm of the Year, and Guangdong Law Firm of the Year. At the end of the night Wang Jing & Co. walked away with the award for Insurance Law Firm of the Year. The Firm has also received recognition in previous years by winning the award for Insurance Law Firm of the Year in the first ALB China Law Awards in 2004 and the award of Guangzhou Law Firm of the Year in 2005.

Organised annually by Asia-Pacific's leading magazine for legal professionals, the ALB Law Awards recognises and promotes outstanding professional achievement and some of the best legal work of the year throughout China. Some of the other winners this year are; King and Wood for Banking Law Firm of the Year, Linklaters for International Law Firm of the Year, and Johnson Stokes and Master for Hong Kong Law Firm of the Year.

Congratulations to all the nominees and winners!

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Historic New Property Law Set to Change China



The Property Law of the Peoples Republic of China Promulgated on March 16th by the National Peoples Congress

The National Peoples Congress, China's highest law-making body, on the 16th of March, 2007 passed the *Property Law of the Peoples Republic of China*, which from the 1st of October, 2007 will form the basis for ownership and utilization of all **movable and immovable (real) property** by the **State, collectives, and private (legal) persons** in China. The law incorporates existing concepts of property ownership and introduces new concepts with a profound influence on businesses and individuals with ownership interests in China.

In the media, the laws recognition of private property becoming equal to State and collectively-owned property, has been heralded as the laws most significant feature:

- (1) *The individual shall enjoy ownership with respect to real and movable properties (Article 64);*
- (2) *The State shall protect the right of inheritance and other legal rights and interests of the individual (Article 65); and*
- (3) *The legitimate properties of individuals shall be protected by law and shall not be occupied or damaged by any institution or other individual (Article 66).*

However, many other provisions will have an even more direct impact on ownership in China. The remainder of this article focuses on the provisions relating to three key issues, namely the establishment and transfer of real property rights and land use rights, and the framework for security rights.

Real Property Rights Establishment and Transfer

The establishment, alteration, transfer, and termination of the right in real property shall take effect only on the registration in accordance with laws, unless otherwise provided for in law.

The Property Law announces the establishment of a uniform registration system, which will form the guidelines for all ownership of real property rights including buildings and fixtures. Only upon registration will any change of ownership take effect, which means that the registry will become a main source for prospective buyers to confirm ownership of real property, mortgages, or other liens. While a contract for transfer of real property will be valid whether it is registered or not, the buyer or seller must register the transaction to effect the ownership change. Thus it is important for buyers to ensure registration of a transaction as soon as possible!

As an intermediate solution, parties may also proceed with pre-notice registration of the sale of an apartment or other real property with the relevant registration department, such pre-notice registration will be valid for three months, during which the real property in question may be disposed of only with the consent of the prospective buyer.

If the registration of a real property ownership is incorrect, an interested party may file an application for amendment with the registration department. Parties that apply for registration with false documents will have liability for their actions, while registry officials will bear liability for compensation for any mistakes they make.

Usage Rights to Land

In China, all land is owned by either the State or collectives. However private individuals or legal persons may still own the rights to use land. These land-use (usufructuary) rights are given for a maximum period of 70 years if to be used for residential purposes, 50 years for industrial purposes and 40 years for commercial purposes. What happens after

CORPORATE LAW UPDATE

Revised Franchising Regulations

Ever since China issued the first franchise license to Kentucky Fried Chicken in Beijing 20 years ago, businesses have been waiting for a comprehensive set of regulations to answer specific questions related to being a franchisee or a franchisor. On May 1st, 2007 the State Council provided further clarifications.

The new franchise regulations detail 5 aspects, below we will list them and touch on the major points addressed in each.

1. Franchisor Requirements

Only corporations, not individuals, can be franchisors and they must adhere to the 2 + 1 requirement. (ie. own two direct-operation stores and be operating for at least one year); this does not apply to existing franchisors

2. Franchisor Disclosure Requirements

Franchisors are now required to provide detailed information to prospective franchisees 30 days before signing an agreement.

3. Filing Requirement with MOFCOM

A franchisor no longer has to receive approval from MOFCOM, filing for registration is sufficient.

4. Standard Franchise Agreement

The regulations detail what must be included in the agreement.

5. Relationship between Franchisee and Franchisor

The Franchisor is no longer equally liable for products and services provided by suppliers.

Historic New Property Law Set to Change China



expiration of such a term was uncertain until now.

The term of the right to the use of land for building residential property shall be automatically renewed upon expiration. (Article 149)

From the above we can conclude that whoever buys an apartment or house in China with associated land use rights, can rely on the Property Law to ensure that upon expiry their land-use rights will be renewed. Together with stipulations confirming inheritance principles (see above), this will go far to reassure residential property owners even though the law is silent on any fees to be paid. In contrast, the renewal of non-residential real property rights, as well as the ownership of buildings on such property, is yet to be decided. This will be dealt with in future laws and regulations.

The Property Law confirms that all land-use rights can be transferred, exchanged, used as capital contribution, donated, or mortgaged, even though such actions must be registered to take effect (see above). Property owners may also establish easements through contractual relationships, confirming a trend towards more flexibility for property owners to utilize their land.

Security Interests in Property Rights

China's existing framework for securities was established in the *Law of the Peoples Republic of China for Guarantees of 1995*, and subsequent regulations and rules. The provisions of Chapters 15 to 18 of the Property Law supplement these in some interesting, and extremely significant ways.

The Property Law explicitly provides for the possibility of mortgaging not only buildings and certain land use rights, but also existing and future production of equipment, raw materials, and (semi-)finished products; buildings, ships and aircraft under construction; and other means of transportation. Furthermore, certain movable property may also be pledged, including:

- (i) Bills of exchange, cheques, promissory notes;
- (ii) Bonds, certificates of deposit;
- (iii) Warehouse receipts, bills of lading;
- (iv) Transferable shares or stock certificates;
- (v) Transferable intellectual property rights including trademarks, patents and copyrights
- (vi) Proceeds from toll roads and power grids and;
- (vii) Other rights as per laws and regulations.

Since the specifications in a pledge contract are general rather than specific, this gives companies various new financing opportunities!

Conclusions

The new Property Law has been announced as one of the fundamental laws for China's future development towards a market economy. The New Property Law has been announced as one of the fundamental laws for China's future development towards a market economy. In fact, its adoption was extremely controversial, as it includes many provisions that strengthen the role of individuals in China's economy.

Certainly, the implementation of various provisions will take time and efforts from all parties involved. The adoption of a new land registry, for example, will be a difficult and complicated process, especially in smaller counties. On the other hand, the clauses relating to the automatic extension of land-use rights for residential property give owners immediate cause for celebration, while many businesses will no doubt soon move to take advantage of the rules on mortgages and pledges to create new financing opportunities.

by Zachary Wortham and Maarten Roos

Legal Concerns of Foreign Enterprises in China, Part I

In my more than four years working for Wang Jing & Co., assisting foreign companies in their business activities in China, I have been frequently asked about the major legal concerns that foreign companies in or entering in the Chinese market must deal with. In surveys, foreign businesses operating in China often identify legal issues as among their biggest challenges; while many are idiosyncratic, what concerns are most frequently encountered? Below, I will identify and share my perspective on

the key legal issues that many companies face when operating in China, in the fields of commercial transactions (in Part I), as well as corporate activities and intellectual property rights protection (in Part II).

Commercial Transactions: the Need for Due Diligence

The first step in China for many foreign companies is commercial in nature. China has become the workshop of the world for numerous products, and is at the same

time an attractive albeit daunting market. However, legal issues frequently arise from such transactions.

Many of the problems that foreign companies encounter when dealing with Chinese counterparts directly result from a failure to conduct due diligence. China's business environment is often thought of as one where the usual rules of business do not apply. Differences in language and culture are taken as an excuse to do away with the checks and

Legal Concerns of Foreign Enterprises in China, Part I



balances that are usually applied in business dealings. And Chinese counterparts take maximum advantage of this, by reinforcing the conception that China is different, and things are done the Chinese Way. But while differences in languages and culture undoubtedly form an obstacle that foreign businessmen must seek to overcome, this is all the *more* reason to be cautious.

Confirming that the Chinese counterpart and his representative are legitimate, concluding a proper contract, ensuring the Chinese contents and identifying the parties of such a contract, clarifying products, payment and delivery clauses and deciding on inspection processes, and agreeing on dispute resolution mechanisms in the event that something goes wrong, are the most basic steps that are too frequently ignored. Chinese business partners may try to avoid these issues, emphasizing the friendly nature of your relationship and becoming seemingly offended when you insist. Following blindly may be done in good faith, but in the end, it is the foreign company which will bear the risk of unforeseen conflicts.

One counterargument to due diligence often heard, is that even with a contract and proper due diligence, that if something goes wrong it is impossible to have your rights enforced. A contract is not worth the paper it is written on, goes the saying. However this sentiment is simply not true. While China's legal system is still

developing, and the enforcement of rights can in some cases be complex, difficult and expensive, this is in fact the most fundamental reason to perform proper due diligence. Dealing with a legitimate counterpart with an interest in completing the transaction as anticipated, becomes all the more important. Contract negotiations are an opportunity to understand your opponent and his priorities, and to educate him on what yours are. And with a proper arbitration clause, for example, the long and difficult road that is Chinese litigation can be avoided.

Many disputes in China arise because the parties to a transaction never fully understood their priorities. Therefore, one of the best ways to avoid future problems is to come to a comprehensive understanding of the transaction and its mutual benefits. The contract is an ideal forum for this, serving as a way to educate as well as potentially enforce.

In the end, whether the costs of a proper due diligence weigh against the risks of the deal going wrong is a decision that every company must make for itself. For many small businesses, such costs can be proportionally high compared to potential profits. But the fact remains that without proper due diligence, the chances of enforcement, should future conflicts arise, are minimal.

by Maarten Roos

In the second part of this article, to be published in the next China Legal Bulletin, Maarten Roos will discuss common problems with investments, and ways to protect intellectual property in China.

CONTRACT LAW UPDATE Quotas for Hiring Handicapped Workers

A new regulation concerning the mandatory hiring of disabled workers was recently issued by the State Council. Many larger cities such as Beijing, Shanghai, and Guangzhou have already issued local regulations, after the 1991 Law on the Employment of Disabled People stated that businesses should hire disabled people, but did not provide any implementation details. The new Regulations for the Employment of Disabled People requires that disabled persons comprise at least 1.5% of an enterprise's workforce

Those businesses that do not meet the new mandate may be penalized by being required to make a contribution to a fund for vocational training and employment services for disabled people.

Employers that exceed the requirement can be rewarded with tax incentives and preferential policies. However, the regulations do not detail what those incentives may be.

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