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CHINA Legal Bulletin

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Executive Summary

New Anti-Monopoly Law Set to Change Business in China

After more than 13 years of arduous negotiations and endless rounds of revisions the PRC version of an anti-monopoly law was finally approved by the National Peoples Congress and will go into effect as of August 1st, 2008. The new law concerns many issues that will directly effect foreign busines owners and managers doing business in China. For example the new law will attempt to regulate agreements between market competitors, businesses in a dominant market position, and mergers and acquisitions. The Anti-Monopoly Law also sets forward a governing body to handle complaints and instigate investigations. While the first reaction to the new law is most probably going to be one of unease as it appears to target foreign companies first and make significant concessions to state owned companies, the Anti-Monopoly Law is a step in the right direction for China and one that we should all prepare for starting now.

By Maarten Roos

Legal Update; Toy and Food Recalls, Labor Law, and GUOFA and more

Newcomers Zhang Kehua and Alessio Longo have compiled updates on seven of the most important issues facing foreign businesses working in China. You will find a recent amendment to the Lawyer Law and the first case involving the new Property Law on page 2 followed by an update on contract law on page 3. Then on page 4 the most recent additions to the new labor law as well as information on toy and food recalls and other matters are laid out in a well organized table for your quick reference.

By Zhang Kehua and Alessio Longo

NEW DEVELOPMENTS

Civil Procedure Law amended

The China Civil Procedure Law was recently amended and will come in to force on April 1st, 2008. The background for such an amendment was the huge number of court rulings that remain unimplemented. In 2006 an unusal amount of case rulings were not implemented according to the appropriate timeline and that half of them were still to be implemented. In order to reduce this siutation, fines for those who fail to execute a civil court ruling will now be raised to 10.000 RMB (previously 1.000 RMB) for individuals and 300.000 RMB (previously 30.000 RMB) for companies. In addition those who do not cooperate in the execution of a court ruling could face detention.

New cases now have the right to apply for a review/appeal (including new evidence, lack of evidence essential for the decision, violation of law, deprivation of the right to a defense, etc.) and a new timetable (the applicant should receive a reply within 3 months, any deletion will have to be approved by the President of the Court and a reply from the Court is compulsory) assigned ot their case. Furthermore, application for a review of an already effective judgment can be made directly to the higher level tribunal, with no suspension of the effectiveness of the decision. In this way the first ruling tribunal will no longer be required to recognize its own mistakes.

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New Anti-Monopoly Law Set to Change Business in China



New Anti-Monopoly Law May Affect All Companies Engaging in China

In many jurisdictions, including the United States and the European Union, competition law (also referred to as anti-trust law) is an active area. In China, even though laws do contain some relevant provisions, competition law has been virtually non-existent in practice. As China continues its economic development, the pressure on legislators to come up with a law to deal with competition has grown. On the 30th of August, 2007, 13 years after the first draft was conceived, Chinas National Peoples Congress finally adopted the *Anti-Monopoly Law of the Peoples Republic of China* (AML), which as of the **1st of August, 2008** will regulate all kinds of anti-competitive behaviors (termed in the AML as Monopolistic Conduct).

The AML is modeled after European and German competition law, and is broadly in line with international practices, yet it contains some notable Chinese characteristics. Implementing rules will be issued within the coming year to clarify some of the details. Even after enforcement as of August next year, it remains to be seen how strict the new administrative authorities in charge will be when implementing the new law. In any case, companies should have a good understanding of the laws implications when doing business in China.

Horizontal and Vertical Agreements

Competitors are not permitted to enter into written or non-written agreements, decisions or concerted activities (so-called horizontal agreements) that restrict competition through price fixing, restricting of production or sales, dividing markets, limiting technology and equipment purchases, limiting new product or technological developments, or jointly boycotting transactions. Vertical agreements (i.e. between different levels of the supply chain) that fix resale prices or set minimum resale prices to third parties are also considered illegal, as are other agreements that the relevant enforcement agencies regard as anti-competitive.

Agreements will not be regarded as anti-competitive if (a) they are made for the purpose of protecting the legitimate interests of international trade and foreign economic cooperation, or if (b) they serve any of the following, *and* do not substantially restrict competition in their relevant markets, *and* enable the consumers to share the benefits.

- (1) improve techniques, research and new product development
- (2) upgrade product quality, reduce costs, improve efficiency, unify product models and

- standards, or carry our professional labor distribution
- (3) improve operational efficiency and enhance competitiveness of small- and medium-sized enterprises
- (4) maintain public welfare such as conserving energy, protecting the environment, providing disaster relief etc.
- (5) mitigate severe decreases of sales volume or excessive overstocking during economic recessions

Abuse of Dominant Market Position

Companies that have a dominant market position are prohibited from abusing it. To establish if a company is in a dominant market position, reference should be made to factors such as market share, and competitive status, the ability to control sales or raw materials purchasing, financial and technical status, and the level of market entry. Market dominance is presumed (subject to a lack of evidence to the contrary) if one company has a 50% share of the relevant market, two companies jointly have a 67% share, or three companies jointly have a 75% share.

In the above circumstances, any company with less than 10% of the market shall be excluded. A relevant market is defined as the commodity scope or regional area in which the companies compete against each other during a specific time, for specific commodities or services. The law does not define what constitutes such competition. Companies with a dominant market position in a relevant market are prohibited from activities such as predatory pricing, tying and other unreasonable trading terms, as well as dumping, refusing to trade, exclusive trading and discriminating treatment without justification. The competent enforcement authorities may also punish other activities that they recognize as an abuse of a dominant market position.

Restrictions for M&A Activities (Concentrations)

Under the *Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (2006), foreign companies are compelled to file domestic share and assets acquisitions for antitrust review if certain thresholds are met. The AML extends this obligation to all companies, albeit without defining the thresholds these will be established by Chinas State Council separately. Another difference is that under the AML companies are exempt from reporting intra-group transfers.

AMENDMENTS AND CASES Lawyer Law and Property Law

China Amends Lawyer Law

For the first time since its promulgation ten years ago, on October 28th the Law on Lawyers has been amended by the Standing Committee of the NPC. According to the new provisions, it will be possible to establish State owned law firms, associated law firms, and individual law firms. This will apply to lawyers who have practiced for a minimum of five years and have not had their license suspended during the last three years.

The most noteworthy amendment is the introduction of the right of defense lawyers to meet a criminal suspect and read the files and materials concerned without approval from a judicial department, and also to freely collect evidence for the defence. Such provisions are in contrast with the Procedure Law, which is supposed to be amended according to the new provisions of the Law on Lawyers.

Chinas New Property Law First Case is Heard in Beijing

The China new Property Law was put into effect on October 1st (see. Wang Jing China Legal Bulletin of May). The Law, which embodies the new concept of property which is stated by the amendments to the Constitution of the PRC in 2004, was written to protect public property as well as that of individuals.

The first case concerned with the Property Law was heard by the Beijing Changping Intermediate Peoples Court on October 10th and reads as follows; A man who went through all necessary procedures and bought 6 apartments has sued the auction company which subsequently auctioned off his property after a decision by Shijiazhuang court stated that the property belonged to the bribed official which sold it to the gentleman. The case is expected to reach a final verdict in the next 6 months.

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The competent authorities will have 30 days to handle a filing, though if further investigation is deemed necessary this time limit may be extended to a maximum of 180 days. Issues to be reviewed are the involved companies market share and control of the market, the degree of concentration and its influence over market to the market and advanced technology, the concentrations influence over consumers and national economic developments, and other factors that the competent authorities deem relevant. The competent authorities may then reject the concentration, or give the parties a chance to show that the concentration benefits will outweigh such shortcomings.

Enforcement Authorities and Legal Liabilities

Under the AML, an Anti-Monopoly Commission will be established under the State Council to make policies, issue guidelines, and coordinate enforcement efforts. The daily responsibilities of monitoring, review and enforcement will be in the hands of a new Anti-Monopoly Enforcement Authority, which may empower corresponding agencies at provincial and municipal level.

The Anti-Monopoly Enforcement Authority is given broad powers to receive complaints, initiate investigations into suspicious activities, receive complaints, stop concentrations, confiscate illegal gains and impose penalties. Of the latter, the most important are:

- (1) For horizontal or vertical agreements, or abuse of a dominant market position, confiscation of illegal gains and imposing of fines of more than 1% of total yearly sales volume in the relevant market (or if the agreement was not implemented, a fine of less than RMB 500,000);
- (2) In case illegal concentration, or in case a company fails to file for approval while meeting relevant thresholds, a fine of up to RMB 500,000.

Decisions by the Anti-Monopoly Enforcement Authority can be appealed in an application for reconsideration or administrative suit, which may again be appealed in court. Individuals and companies that fail to cooperate with the Anti-Monopoly Enforcement Authority may be fined, or in some cases may bear criminal liability. On the other hand, if parties to a Monopoly Agreement cooperate and provide evidence, they may be treated more leniently.

Finally, parties that by violating the AMLs provisions cause damages to others, shall bear civil liability as well. This provides, in theory at least, a legal basis for one company

to sue another for damages resulting from anti-competitive behavior.

Competition Law with Chinese Characteristics

While the law generally follows competition law in other jurisdictions, some of the more provisions reflect the specific economic, political and administrative conditions of China at present. One example is the including, in the chapter on concentrations, a provision that states that acquisitions with foreign capital should be reviewed not only for competition issues, but also for national security issues. This creates a legal basis for the Anti-Monopoly Enforcement Authority to prohibit acquisitions in sensitive industries. Another provision (Article 7) refers to Chinas protection of the interests of industries dominated by the state-owned enterprises and particularly important to the national economy and national security.

Chapter V prohibits administrative agencies and organizations with administrative powers to abuse such powers by requiring organizations or individuals to deal with, purchase from or use commodities provided by designated companies, or by engaging in other discriminatory activity. Among others, they may not use discriminatory practices to restrict investment in their region, or to restrict the establishment of local branches by companies from other regions. Due to the controversial role that industrial and trade associations have played in encouraging or facilitating the formation of cartels, the AML contains a provision threatening a fine of up to RMB 500,000 and in serious cases the revoking of their license, if such an association assists in organizing or facilitates monopolistic conduct among its members.

Conclusion

Chinas plans to introduce its first comprehensive competition law have taken years to take shape, but the result is a first, and relatively clear framework on how relevant authorities are to deal with anti-competitive conduct. As with all laws of this scale, it will take time, and further legislative efforts, to implement the AML, and meanwhile companies will have plenty of time to consider and adjust their policies. One main critique is that the law is biased in favor of Chinas state-owned companies not only through the national security article and the provision on the protection of the legitimate interests of the state-owned economy, but also in its implementation, as foreign companies may be the easiest targets. Nonetheless, competition law is in China to stay, and companies are advised to take note.

By Maarten Roos

CONTRACT LAW UPDATE Rules issued on Jurisdiction of Foreign Related Contracts

New Interpretation Rules on Foreign Related Contract Disputes

On July 23rd of this year, Chinas Supreme Court issued new interpretation rules when hearing foreign-related contract dispute cases related to civil and commercial matters. Of particular interest is that article 8 clarifies that the following contracts must always be interpreted according to Chinese law;

- contracts regarding Chinese-foreign joint ventures;
- contracts concerning Chinese-foreign cooperation in the exploration or exploitation of natural resources;
- contracts on the transfer of shares in a wholly foreign-funded enterprise;
- contracts on the purchase by a foreign operator of share equity held by a shareholder in a non-foreign-funded enterprise
- contract on the subscription by a foreign operator to the increased registered capital of a non-foreign-funded limited liability or company limited by shares
- contract on the purchase by a foreign operator of assets of a non-foreign-funded enterprise

Legal Update; Toy and Food Recalls, Accounts Receivable, and GUOFA



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| <p>Cancellation of Examination and Approval Requirements After a rigorous review and an analysis lasting several months, the State Council decided to cancel the examination and approval requirements for 128 items and adjust such requirements for another 58 items, thereby making these items more conducive for foreign direct investment.</p> | <p><i>Decision of State Council on Canceling and Adjusting the Fourth Group of Administrative Examination and Approval Items (GUOFA 2007 No.33)</i></p> | <ul style="list-style-type: none"> ➢ Approval for preferential treatment of exemption from or reduction of income tax relating to foreign-invested companies, to be cancelled as of 31 December 2007; ➢ Approval of refunding income tax for re-investment by foreign investors of foreign-invested companies, to be cancelled as of 31 December 2007; ➢ Approval for establishing and altering foreign-invested commercial companies, to be delegated to the competent commerce authority at the level of province, autonomous region and municipality; ➢ Approval for establishment and alteration of foreign-invested printing companies, to be delegated to the competent commerce authority at the level of province, autonomous region and municipality. |
| <p>Regulations on Food and Toy Recalls On 27 August 2007, the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China released the first regulations on food and toy recalls in response to a recent spate of unsafe product scandals; the regulations are in line with international practice but are still to be completed.</p> | <p><i>Toy and Food Recall System in place</i></p> | <p>Regulations on Food Recalls</p> <ul style="list-style-type: none"> ➢ Food recalls may be carried out by the producer itself or at the request of a governmental order; ➢ There will be a three-level food recall system according to the extent of detriment; ➢ Producers must inform the public and retailers if it is revealed that their products are unsafe within one day in the event of the first level, two days for the second level and three days for the third level. <p>Regulations on Toy Recalls</p> <ul style="list-style-type: none"> ➢ Toy manufacturers should stop production and sales and recall products when defects are found in their toys and publish the information concerning the defect to the public; inform retailers to stop selling the defective toys and consumers to stop purchasing them; ➢ In the case that toy manufacturers do not recall defective toys, the General Administration of Quality Supervision, Inspection and Quarantine can release a governmental notice to the toy manufacturers to recall all defective products; ➢ In the event that toy manufacturers do not stop production and sales when defects are found, they will be given a fine not exceeding RMB 30, 000. |
| <p>Accounts Receivable as a Kind of Right In accordance with Article 223 of the Property Law, accounts receivable as a kind of right can be pledged by the debtor or a third party. To define the details for this matter, the People's Bank of China recently issued Measures on Pledge Registration of Accounts Receivable.</p> | <p><i>Measures on the Pledge Registration of Accounts Receivable</i></p> | <ul style="list-style-type: none"> ➢ The Credit Center of the People's Bank of China is the competent authority responsible for registration of the pledge of accounts receivable; ➢ Any individual or enterprise can search for information concerning the pledge of accounts receivable after registering as a user of the public registration system; ➢ The accounts receivable pledge registration shall be conducted by the pledgee, and the pledgor and the pledgee shall enter into a contract before registration to define it; ➢ Registration term shall be within five years, but the pledgee can apply for a five-year renewal period prior to the expiration of the previous registration term. |

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LABOR LAW UPDATE Employment Promotion Law and Arbitration Rules

Labor Law Update

Starting from January 1st the Employment Promotion Law (EPL) will come in force, the same day as the new Contract Labor Law. The law aims at providing guidelines for central and local administration, in order to prevent unemployment and job discrimination. Labour intensive jobs will be highlighted and local governments will be required to establish a special fund to provide vocational training loans. There will also be a preferential tax system for the enterprises which are going to employ disabled workers. Worker who are discriminated against will be entitled to sue the offender directly in court. The law also clearly states that migrant workers must enjoy the same working conditions as all other workers, thus underlining increasing attention by the Chinese government on workers conditions.

In a similar vein, draft legislation concerning the labor arbitration system has been submitted to the Standing Committee of the NPC. According to the draft, public funds would now cover the arbitration committees expenses for those workers that are involved in:

- disputes over labor payments, workplace injuries, compensation and pensions;
- disputes over holidays and social security;
- disputes over collective contracts.

While workers that are not able to display relevant evidence will face a punishment. Labor disputes have been growing steadily in recent years and recent legislative initiatives show that the attention of the government on the issue is bound to become ever more incisive.