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## China

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# China

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## I. Property Law

One of the two basic laws enacted this year by the National People's Congress (NPC) was the Property Law.

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The sections drafted by the authors and editors express only the opinions of the authors and editors themselves and are not necessarily the opinions of any institution with which any individual author may be affiliated.

## A. THE DRAFTING PROCESS

The NPC passed the Property Law on March 16, 2007.<sup>1</sup> The law became effective on October 1, 2007.<sup>2</sup> The drafting process for the law began as early as 1998, in conjunction with an effort to create China's first comprehensive civil code.<sup>3</sup> In July 2005, the NPC released a draft of the law for public comments, which triggered heated debate and delayed the expected adoption of the law in both 2005 and 2006.<sup>4</sup> Only after eight rounds of deliberation did the NPC finally approve the draft.<sup>5</sup>

## B. THE REALM OF THE PROPERTY LAW

The legal rights recognized and protected by the Property Law are property rights in rem, known in civil law system as real rights.<sup>6</sup> Such real rights can only be defined by law and are enforceable against the world at large; moreover, private parties are not allowed to create new types of real rights.<sup>7</sup> By contrast, property rights in personam can be created at will by private parties but are enforceable only against the specific person. The Property Law regulates the legal relationships on the creation, change, transfer, and extinguishment of real rights as between private parties, including public entities in their private capacity.<sup>8</sup>

## C. THE GENERAL PROVISIONS

1. *No Real Rights are Protected Other than Those Prescribed by Law*

The Property Law codifies the prevailing theory that only those real rights stipulated by law are entitled to legal protection.<sup>9</sup> Three general categories of real rights are recog-

1. Wu quan fa [Property Law] (promulgated by the Nat'l People's Cong., Mar. 16, 2007, effective Oct. 1, 2007), [http://www.law-lib.com/law/law\\_view.asp?id=193400](http://www.law-lib.com/law/law_view.asp?id=193400) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "Property Law"].

2. *Id.* at art. 247.

3. The Property Law would have been a core component of the civil code, and work on its drafting continued after the civil code drafting process was suspended in 2004. Liang Huixing, *Zhong guo wu quan fa de zhi ding* [Drafting of the PRC Property Law], Sept 13, 2007, [http://article.chinalawinfo.com/article/user/article\\_display.asp?ArticleID=39823](http://article.chinalawinfo.com/article/user/article_display.asp?ArticleID=39823) (last visited Dec. 3, 2007) [hereinafter Liang].

4. Liang, *supra* note 3 (explaining that in the following months, the NPC Legal Affairs Office received 11,543 comments from the public); see Chinese Law Professor's Blog, [http://lawprofessors.typepad.com/china\\_law\\_prof\\_blog/2006/week10/index.html](http://lawprofessors.typepad.com/china_law_prof_blog/2006/week10/index.html) (last visited Dec. 3, 2007) (explaining that a Chinese law professor publicly questioned the constitutionality of certain aspects of the draft given that China is a socialist society, and this law embraces a private property rights regime).

5. Liang, *supra* note 3.

6. Chinese civil law theory categorizes private legal rights into property rights (*Caichan Quan* 财产权) and personal rights (*Renshen Quan*, 人身权); property rights further split into three subcategories: property rights in rem or real rights (*Wuquan* 物权), property rights in personam (*Zhaiquan* 债权) and intellectual property rights (*Zhishi Chanquan* 知识产权). The term personal rights as used here refers to rights that arise out of "a person's legal status or personal condition, as opposed to the person's estate". Black's Law Dictionary 1347 (8th ed. 2004).

7. Property Law, *supra* note 1, at art. 5.

8. Article 2 of the law states that the scope of the law only reaches legal relationships between private parties. *Id.* at art. 2.

9. *Id.* The principle that only legally defined real rights are entitled to legal protection was strengthened in the final text of the law. The previous drafts contained language that would have allowed legal protection by analogy for property rights that do not fall squarely under the legal definitions. The NPC decided to drop

nized by the Property Law: ownership rights, usufructuary rights, and security interests. The law does not explicitly adopt another prevalent theory in Chinese law that recognizes the superiority of real rights over property rights in personam.<sup>10</sup>

## 2. *Transfer of Property Rights*

The Property Law stipulates different formulas for the transfer of real rights in immovables as compared with rights in movables. With certain exceptions,<sup>11</sup> the transfer of immovables consummates on completion of the following two steps: execution of a lawful contract evidencing the underlying consensual agreement to transfer the rights and registration of the transaction with the designated registration office.<sup>12</sup> For movables, registration of the transaction is not required; instead, the transferee must take possession of the property for the real interests to vest in the transferee.<sup>13</sup> Ships, motor vehicles, and aircrafts are classified as movables, and registration is not required to transfer ownership in them, only to enforce those rights against a bona fide third party.<sup>14</sup>

## 3. *Registration of Interests in Immovables*

The Property Law requires registration of changes in real rights in immovables to consummate the transaction. The Property Law provides that "unless otherwise provided by law, the creation, change, transfer, or extinguishment of rights in immovables is effective only upon proper registration of the transaction,"<sup>15</sup> and mandates that the state establish a unified national immovable rights registration system.<sup>16</sup> Purchasers of real estate still under development may apply for "advanced registration," which will put the subsequent transferee on notice of the purchaser's interests in the estate; subsequent transfer is void

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this compromise in its final version of the Law. See JIANG PING, *ZHONG GUO WU QUAN FA JIAO CHENG* [A COURSE ON CHINA'S PROPERTY LAW] 180-181 (2007).

10. Some scholars believe that the two concepts, property rights in rem and property rights in personam, refer to different type of rights, and it is therefore inappropriate to say one is superior to another. Due to the objections by these scholars, the principle is not explicitly incorporated in the final version of the law. If, however, the provisions of the law are followed, as a practical matter, contractual rights alone are never sufficient to overcome the preexisting ownership rights.

11. For example, registration is not required for transfer of management rights in contracted rural land. Such a non-registered transaction is, however, ineffective against a bona fide third party. Property Law, *supra* note 1, at art. 129.

12. *Id.* at arts. 9, 14. The requirement for registration is not merely intended to give notice to the world, and failure to register cannot be cured by proof of actual knowledge. This provision indeed obliterates the need to deal with the issue of actual knowledge, a good demonstration of the drafters' inclination for predictability.

13. Taking possession need not be physical. It could be a transfer of a reverter's rights in the situation where the property is possessed by a third party and the transferor retains the title, or a transfer of the official document certifying the title to the movables. Property Law, *supra* note 1, at art. 26.

14. *Id.* at art. 24. The effective transfer and thus the vesting of real rights shall not be confused with the issue of when the contract becomes effective. In most cases, a contract becomes effective and enforceable upon meeting of the two minds. It may be the case that a contract is effective and enforceable but not the transfer of real rights because for transfer of real rights to become effective, the Law requires, in addition to an effective contract, either registration or taking possession of the property. In such a case, the non-breaching party is entitled to monetary damage but not the real rights, be it ownership or usufructuary rights.

15. Property Law, *supra* note 1, at art. 9.

16. *Id.* at art. 10.

unless approved by the purchaser for development.<sup>17</sup> Any person who disputes the accuracy of the registration records may similarly request that his dispute be noted on the relevant records and is allowed fifteen days to petition the courts to resolve the dispute.<sup>18</sup>

#### D. OWNERSHIP RIGHTS

One issue that drew much attention in the drafting process was whether different types of ownership—ownership by the state, the collective communities, and private parties—would receive the same protection under the Property Law. Although the Property Law is not explicit on this point, nowhere does the text of the law differentiate between different types of ownership in protecting the rights of the owner. One member of the drafting team concluded that the Law seeks to provide equal protection for all types of ownership.<sup>19</sup> The Property Law does continue the state's monopoly ownership of certain types of property, such as mineral deposits, rivers, seas, and some other natural resources.<sup>20</sup> Individuals and other private parties receive protection for real rights in most other movables and immovables.<sup>21</sup>

Private ownership of land remains prohibited, but the Property Law allows *de facto* perpetual leasehold rights in residential land. The Property Law for the first time stipulates that a renewal of a long-term residential lease is to be granted automatically.<sup>22</sup> It does not, however, specify under what conditions the lease is to be automatically renewed. One member of the drafting team has explained that the lessee need not apply for a renewal; rather, the registration office shall amend the registration record accordingly, indicating that renewals will be granted unconditionally and at no additional cost to the homeowner.<sup>23</sup>

##### 1. *Condominium Rights*

The Property Law for the first time recognizes condominium rights.<sup>24</sup> Under the law, the private owner of a unit has ownership rights over his independent unit, concurrent ownership rights with other owners in the common areas, and, as part of such ownership rights, management rights for the common areas and the obligation to share the relevant maintenance costs.<sup>25</sup> The Property Law mandates a two-thirds majority vote by the own-

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17. *Id.* at art. 20.

18. *Id.* at art. 19.

19. See JIANG, *supra* note 9, at 198 n. 1.

20. Property Law, *supra* note 1, at art. 46.

21. As is generally the case in Chinese laws and regulations, a list is provided enumerating the rights that may be held by individuals, but that list is illustrative, meaning that other non-enumerated rights should be protected. Ownership rights of private parties to property such as income, buildings, household goods, production instruments, raw materials and other non-enumerated movables and immovables are protected. Individual rights to personal savings, investment returns, and other incomes are also protected, along with individual rights to inheritance. Property Law, *supra* note 1, at arts. 64, 65.

22. Property Law, *supra* note 1, at art. 149.

23. JIANG, *supra* note 9, at 346. Cases related to this issue are unlikely to arise for several decades until the first such leaseholds, which last seventy years, begin to expire.

24. Property Law, *supra* note 1, at ch. 6.

25. *Id.* at arts. 70-73.

ers,<sup>26</sup> representative of both the percentage of the living space and the number of owners, to conduct major maintenance or improvement projects for the building.<sup>27</sup>

## E. USUFRUCTUARY RIGHTS

Since private parties cannot own land in China, the real property regulatory system is built around usufructuary rights.<sup>28</sup> The Property Law reduced the number of recognized usufructuary rights to just four: management rights of rural contracted land,<sup>29</sup> rights to use in urban construction land,<sup>30</sup> rights to homesteads for members of the rural communities,<sup>31</sup> and easements.<sup>32</sup> The first three types of rights have been available to private parties since shortly after the start of "reform and opening up," and no significant change is made to these three types of rights. The Property Law recognizes the usufructuary right of easements for the first time and also introduces the concept of neighboring rights.

### 1. *Easements and Neighboring Rights*

The Property Law only recognizes appurtenant easements created by written contract.<sup>33</sup> Although an easement is a real right in an immovable, registration of the easement transaction is not necessary to enforce it against the other contractual party, but an unregistered easement is not effective against a bona fide third party.<sup>34</sup> A registered easement runs with the land and binds the subsequent owners of the servient estate.<sup>35</sup>

The Property Law recognizes six types of neighboring rights and sets forth principles to be followed in resolving disputes arising out of these rights.<sup>36</sup> The law also provides that use of real property may not violate the state regulation on waste disposal as well as other environmental and public nuisance regulations.<sup>37</sup>

## F. SECURITY INTERESTS

The Property Law recognizes security interests as a general category of in real rights and makes extensive changes to the current secured transaction system established by the 1995 Security Law.<sup>38</sup> The Property Law recognizes three types of security interests:

26. *Id.* at art. 76 (permitting the creation of a condominium board).

27. *Id.*

28. *Id.* at chs. 10-14.

29. *Id.* at ch. 11.

30. *Id.* at ch. 12.

31. *Id.* at ch. 13.

32. *Id.* at ch. 14.

33. *Id.* at art. 156-157.

34. *Id.* at art. 158. This departure from the general requirement of registration for transfer or creation of in rem rights in real property is due to the fact that the vast majority of the easement arrangements existing in rural areas are not registered and would have no place to be registered in the foreseeable future. See JIANG, *supra* note 9, at 374.

35. Property Law, *supra* note 1, at art. 167.

36. The six neighboring rights include rights to water; rights to air and light; rights of way; rights for utility services; rights to freedom from public nuisance; and rights to property safety. Property Law, *supra* note 1, at ch. 7.

37. *Id.* at art. 90.

38. *Id.* at chs. 15-18.

mortgage (*diya* 抵押),<sup>39</sup> pledge (*zhiya* 质押),<sup>40</sup> and possessory lien (*liuzhi* 留置).<sup>41</sup> Under the Property Law, the debtor retains its original rights in all the three types of security interests until foreclosure.<sup>42</sup>

Mortgages are security interests applicable to both movables and immovables<sup>43</sup> and can only be created by written contract.<sup>44</sup> Mortgages on real property must be registered before a security interest becomes effective between the contractual parties.<sup>45</sup> For registered mortgages, priority depends on the date of registration; all unregistered mortgages are equal in priority and proceeds from any foreclosure will be distributed in proportion to the amount of the secured debt<sup>46</sup> up to the maximum value of the unregistered mortgage.<sup>47</sup>

A pledge is a security interest created on movables and intangible rights. The holder of the pledge interest takes possession of the pledged property or, in the case of intangibles, a certificate. A pledge becomes effective when the recipient of the pledge takes possession of the pledged property.<sup>48</sup>

A possessory lien is created by the operation of law.<sup>49</sup> The Property Law recognizes that a creditor is entitled to a security interest in movables owned by the debtor but is lawfully in the creditor's possession, and the movable is related to the debt at issue.<sup>50</sup> The possessory lien enjoys priority over a pledge or mortgage attached to the same movable.<sup>51</sup>

#### G. INTERACTION BETWEEN PROPERTY AND BANKRUPTCY LAWS

Together, China's Bankruptcy Law,<sup>52</sup> which became effective June 1, 2007, and Property Law create the framework for China's first comprehensive commercial law. This framework allows each party to a commercial transaction to structure or restructure that transaction to minimize the risk of the other party's insolvency.

39. *Id.* at ch. 16.

40. *Id.* at ch. 17.

41. *Id.* at ch. 18.

42. *See id.* at arts. 186, 211, 240.

43. *Id.* at art. 180 (listing seven categories of moveable and immoveable mortgageable property: buildings and other fixtures on land; construction land use rights; land management rights whether acquired by tender, auction, public consultations, or other means for wasteland and other types of land; production equipment, raw materials, semi-finished products, and finished products; buildings, ships, and aircraft currently under construction; means of transportation; and other property not yet prohibited to be mortgaged by laws and administrative regulations).

44. *Id.* at art. 185.

45. *Id.* at arts. 187-190.

46. *Id.* at art. 199.

47. *See id.* at art. 198.

48. *Id.* at art. 212.

49. *Id.* at art. 230. The parties to a security agreement may, however, agree that a possessory lien will not arise. *See id.* at art. 232.

50. *Id.* at arts. 230, 231.

51. *Id.* at art. 239.

52. *Qi ye po chan fa* [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), <http://www.npc.gov.cn/cwh/common/zw.jsp?label=WXLK&id=351859&pdmc=fywj> (last visited Dec. 3, 2007) (P.R.C.) [hereinafter Bankruptcy Law].



## H. TYPES OF PROPERTY AVAILABLE AS COLLATERAL

The types of property that can serve as collateral are listed in Articles 180 and 223 of the Property Law. That list includes “manufacturing equipment, raw materials, semi-finished products and products” as well as “accounts receivable.” Under Article 180, property eligible as collateral also includes “any other property” to the extent not prohibited by law.<sup>53</sup> With respect to equipment and inventory, detailed information regarding the collateral must be included in the mortgage,<sup>54</sup> which could present a challenge in taking a security interest in after-acquired equipment and inventory. That same level of detail must be included in the Chattel Mortgage Registration Certificate to be filed with the Administration of Industry and Commerce under Order No. 30 of the SAIC promulgated on October 17, 2007 (the “SAIC Registration Rules”).<sup>55</sup>

## I. SCOPE OF OBLIGATIONS SECURED

The parties to the mortgage are free to agree to the scope of the obligations secured<sup>56</sup> up to the maximum amount stated in the mortgage.<sup>57</sup> The parties are also free to define those events that constitute a default under the mortgage and give rise to the right to foreclosure.<sup>58</sup> These provisions afford ample flexibility to use collateral as credit support in a wide range of commercial transactions.

## J. TREATMENT OF COLLATERAL IN BANKRUPTCY

The fundamental questions for the secured party are whether the credit support will provide preferential rights in the debtor’s bankruptcy and whether a Chinese Bankruptcy Administrator will have the power to avoid that credit support. Under Article 109 of the Chinese Bankruptcy Law, the holder of a security interest in identified collateral is entitled to priority in the proceeds from that collateral. To the extent the secured obligation cannot be fully repaid from the collateral, the creditor will have an ordinary claim for the unpaid amount.<sup>59</sup>

During a reorganization, however, the Administrator may borrow money secured by the debtor’s property under Article 75 of the Bankruptcy Law. The Bankruptcy Law does not specify whether the Administrator may use as collateral property that is already subject

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53. Non-manufacturing and non-transportation equipment may fall within such “other property,” but, even if it does, it would not enjoy the benefit of the after-acquired property provisions of Article 181 or the registration provisions of Articles 188 or 189. Under Article 181 of the Property Law, a security interest may attach to after-acquired manufacturing equipment and inventory. Article 181 does not, however, include either transportation equipment or “other property” nor is there any provision enabling security interests to attach to after-acquired accounts receivable. A security interest attached only to current accounts receivable may have little value unless a new security interest is periodically granted and re-registered. *Id.* at arts. 180-181, 189.

54. Property Law, *supra* note 1, at art. 185.

55. *Id.*

56. *Id.* at art. 173.

57. *Id.* at art. 203.

58. *Id.* at art. 179.

59. This is analogous to the bifurcated secured and unsecured claims of an undersecured creditor under U.S. Bankruptcy Code. 11 U.S.C.A. § 506 (2004).

to another creditor's security interest or, if it can, whether the security interest granted by the Administrator takes priority over the creditor's existing lien. If the Administrator's general power to incur secured debt is permitted for previously collateralized property, such power will dramatically shift the bargaining position between a secured party and its debtor in the absence of detailed regulations to the contrary.<sup>60</sup>

#### K. ADMINISTRATOR'S AVOIDANCE POWERS

A question raised by gaps in the Chinese Bankruptcy Law is the extent to which the Administrator will possess three core powers to avoid credit support taken from a financially stressed debtor: 1) the strong-arm power to avoid unperfected security interests;<sup>61</sup> 2) the power to avoid preferential transfers;<sup>62</sup> and 3) the power to avoid fraudulent transfers.<sup>63</sup>

##### 1. *Strong-Arm Power*

The Bankruptcy Law does not expressly grant the Administrator the power to avoid unperfected security interests. That avoidance power can be reasonably inferred, however, from the Property Law. Under the Property Law, mortgages on real property interests are created at the time the mortgage is registered in the relevant real property records.<sup>64</sup> In other words, the creation and perfection of mortgage liens on real property occur simultaneously. Without registration, a real property mortgage is not enforceable either between the parties or against third parties. Consequently, an Administrator need not avoid an unregistered mortgage because it never became effective in the first place.<sup>65</sup>

Although not expressly stated in either the Bankruptcy Law or the Property Law, the Chinese Bankruptcy Administrator would likely be recognized as a bona fide third party for the purpose of avoiding unperfected security interests. As a result, an unperfected security interest should be ineffective against the Administrator even though it is effective against the debtor. If so, no separate act of avoidance would be needed. In this way, the strong-arm power may be implicit.

##### 2. *Avoidance of Preferential Transfers*

The Chinese Bankruptcy Law gives the Administrator the power to avoid transfers to creditors for antecedent debts made during a preference period, generally one year.<sup>66</sup> In particular, the Administrator has the power to avoid the transfer of a security interest in

60. The ability of a U.S. Bankruptcy Trustee to grant a "priming lien" can significantly shift the bargaining leverage of the secured party and debtor in a loan workout negotiation. *Id.* § 364(d).

61. *Id.* § 544.

62. *Id.* § 547.

63. *Id.* § 548.

64. Property Law, *supra* note 1, at art. 187.

65. Security interests in manufacturing equipment, inventory, transportation vehicles, and vessels or aircraft under construction become effective between the parties when the mortgage is signed. The same is true for after-acquired manufacturing equipment and inventory. In each case, however, until the mortgage is registered, it will not be effective against bona fide third parties. *Id.* at arts. 187, 188.

66. Bankruptcy Law, *supra* note 52, at arts. 31-32. A similar power exists in the U.S. Bankruptcy Code, 11 U.S.C.A. § 547(b) (providing for a 90 day "look back" period), although the one year "look back" period will

the debtor's property for an unsecured debt if made within one year prior to the court's acceptance of a bankruptcy application.<sup>67</sup> The Administrator's power to avoid security interests under this clause is similar to the preference avoidance power of a U.S. bankruptcy trustee.<sup>68</sup>

### 3. *Avoidance of Fraudulent Transfers*

Under the Chinese Bankruptcy Law, the Administrator has the power to avoid transactions entered into within one year prior to acceptance of the bankruptcy application if the transaction is conducted at "an obviously unreasonable price."<sup>69</sup> The risk of such avoidable debt may be especially acute when a Chinese subsidiary guarantees its foreign parent's debts to the detriment of other Chinese creditors. The parent's lender could strengthen its position by requiring that some of the loan proceeds be lent to the subsidiary guarantor or that other benefits be made available and clearly recited in the guaranty.

## II. Competition Law

### A. ANTI-MONOPOLY LAW

As a result of thirteen years of intensive debate,<sup>70</sup> the Anti-Monopoly Law of the People's Republic of China (AML) was passed on August 30, 2007, by the Standing Committee of the NPC (NPCSC).<sup>71</sup>

#### 1. *Summary of the Law*

The AML covers three types of monopolistic conduct by undertakings:<sup>72</sup> 1) monopoly agreements between undertakings; 2) abuse by an undertaking of its dominant market position; and 3) concentration of undertakings that has or is likely to have the effect of eliminating or restricting competition.<sup>73</sup> The law also bans abuse of administrative powers and regulatory powers by government agencies (*zheng fu ji guan* 政府机关), public

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likely cause problems for financially distressed companies because it greatly prolongs the secured party's uncertainty and may impede further dealings between the parties during that time.

67. Bankruptcy Law, *supra* note 52, at art. 31(3).

68. 11 U.S.C.A. § 547. The Administrator's security preference avoidance power under Article 31 does not include the detailed requirements like Section 547 of the U.S. Bankruptcy Code. Those details will be developed over time. But at least some of the requirements can be reasonably inferred from the general statement in Article 31.

69. Bankruptcy Law, *supra* note 52, at art. 31(2).

70. Shang Ming, *Foreword to THE ANTI-MONOPOLY LAW OF THE PEOPLE'S REPUBLIC OF CHINA: INTERPRETATIONS AND APPLICATIONS* (Shang Ming ed., 2007).

71. Fan long duan fa [Anti-Monopoly Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), [http://www.law-lib.com/law/law\\_view1.asp?id=212679](http://www.law-lib.com/law/law_view1.asp?id=212679) (last visited on Dec. 3, 2007) (P.R.C.) [hereinafter AML].

72. Under EU antitrust law, an undertaking is "any entity engaged in an economic activity, that is an activity consisting in offering goods or services on a given market, regardless of its legal status and the way in which it is financed, is considered an undertaking." European Comm'n Directorate-General for Competition, Glossary: U, [http://ec.europa.eu/comm/competition/general\\_info/u\\_en.html](http://ec.europa.eu/comm/competition/general_info/u_en.html) (last visited Feb. 16, 2008). Because it is a broad term and a term of art in international competition discussions, it is the normal translation for the term *jing ying zhe*, used repeatedly in the AML.

73. AML, *supra* note 71, at art. 3.

organizations (shi ye dan wei 事业单位), and certain state-owned enterprises (guo qi 国企) (SOEs) to eliminate or restrict competition.<sup>74</sup>

A two-level anti-monopoly institutional structure is set up under the AML. First, an Anti-Monopoly Commission will organize, coordinate, and guide anti-monopoly work.<sup>75</sup> The State Council will also appoint an Anti-Monopoly Enforcement Authority to take charge of the enforcement of the AML.<sup>76</sup> The language of Article 9 suggests that the Anti-Monopoly Commission will be newly created<sup>77</sup> while it is not clear whether the functions of the Anti-Monopoly Enforcement Authority will be carried out by a new agency or allocated to one or more of the several existing agencies performing functions pursuant to various competition rules. Currently, the State Administration of Industry and Commerce (SAIC) enforces provisions prohibiting abuse of dominant market position under the Anti-Unfair Competition Law,<sup>78</sup> the National Development and Reform Commission (NDRC) enforces provisions on price-fixing and predatory pricing under the Price Law,<sup>79</sup> and the Ministry of Commerce (MOFCOM) and SAIC conduct merger control review in accordance with the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors.<sup>80</sup>

## 2. Monopoly Agreement

The chapter on monopoly agreements distinguishes horizontal agreements from vertical agreements<sup>81</sup> and has a set of exemptions that are applicable to both types of agreements.<sup>82</sup> The prohibitions listed in Article 13 include fixing prices, restricting output or sales, dividing up the markets, and boycotts. In addition, there is a prohibition against "restricting the purchase of new technology or new equipment, or restricting the development of new technology or new products."<sup>83</sup> Concerns about the relationship between

74. *Id.* at arts. 32-37.

75. *Id.* at art. 9. Specifically the Anti-Monopoly Commission is to perform the following functions: researching and formulating competition policies; organizing investigations and evaluations of overall conditions of market competition and issue evaluation reports; stipulating and publishing anti-monopoly guidelines; coordinating the administrative enforcement of anti-monopoly work; and other functions stipulated by the State Council.

76. *Id.* at art. 10.

77. *Id.* at arts. 9, 10. Article 9 states that the Anti-Monopoly Commission shall be "established" (*she li*) and its "composition" formulated by the State Council, as opposed to the more ambiguous word "appointed" (*gui ding*) used in Article 10 referring to the Anti-Monopoly Enforcement Authority.

78. Fan bu zheng dang jing zheng fa (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993) arts. 6, 11, 12, 15, [http://news.xinhuanet.com/newmedia/2003-05/31/content\\_897542.htm](http://news.xinhuanet.com/newmedia/2003-05/31/content_897542.htm) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "M&A Regulations"].

79. Jia ge fa (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29 1997, effective May 1, 1998) art. 14, [http://www.gov.cn/ziliao/flfg/2005-09/12/content\\_31188.htm](http://www.gov.cn/ziliao/flfg/2005-09/12/content_31188.htm) (last visited Dec. 3, 2007).

80. Guan yu wai guo tou zi zhe bing gou jing nei qi ye de gui ding (promulgated by MOFCOM, State-Owned Asset Supervision & Admin. Comm'n, State Admin. of Tax., SAIC, China Sec. Reg. Comm'n, State Admin. of Foreign Exch., Aug. 8, 2006, effective Sept. 8, 2006) at arts. 51-54, <http://www.mofcom.gov.cn/column/print.shtml?b/c/200608/20060802839585> (last visited on Dec. 3, 2007).

81. *Id.* at arts. 13-14.

82. *Id.* at art. 15. A horizontal agreement is an agreement between direct competitors while a vertical agreement is an agreement between undertakings at different levels of the supply chain. For example, a vertical agreement could entail a manufacturer restricting with which other manufacturers a particular distributor can work.

83. *Id.* at art.13(4).

intellectual property rights and competition policy have increased significantly over the last decade, and the AML reflects those concerns.<sup>84</sup>

The exemptions listed in Article 15 are also illustrative of general economic and consumer welfare principles. Two of the seven exemptions are based on the achievement of efficiencies in the economy or a sector.<sup>85</sup> One exemption advances “technology improvement or the research and development of new products,”<sup>86</sup> and three more exemptions are based on broader public interest justifications such as disaster relief, environmental protection and mitigating economic depression, and implementation of foreign trade agreements.<sup>87</sup>

### 3. *Abuse of Dominant Market Position*

The AML addresses abuse of dominant market position in just three articles.<sup>88</sup> One article sets out the prohibitions on unilateral conduct; the second sets out the basis for finding that an undertaking is in a dominant market position; and the third creates a rebuttable presumption of market dominance under specified circumstances.

Most of the prohibitions contained in Article 17 are common limitations on dominant undertakings found in national competition laws around the world: predation, refusal to deal, exclusive dealing, tied sales, and price discrimination.<sup>89</sup> Each of these prohibitions is qualified by a requirement that the conduct must be “without justification.”<sup>90</sup> One prohibition is not limited to unjustified conduct: dominant undertakings are prohibited from selling at “unfairly high prices” or buying at “unfairly low prices.”<sup>91</sup> Including this prohibition places China’s AML at the center of an ongoing global debate on the propriety of having administrative officials determine appropriate prices.<sup>92</sup>

### 4. *Merger Control and Pre-Merger Notification Review*

The AML substantially overhauls the pre-existing merger control system under the M&A Regulations.<sup>93</sup> The AML uses “concentration,” a concept that seems broader than the “mergers and acquisitions” it replaces in the M&A Regulations.<sup>94</sup> Unlike the current

84. See, e.g., FED. TRADE COMM’N, To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy (2003), available at <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>; U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition (2007), available at <http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf>.

85. AML, *supra* note 71, at art. 15(2)-(3).

86. *Id.* at art. 15(1).

87. *Id.* at art. 15(4)-(6).

88. *Id.* at arts. 17-19.

89. *Id.* at art. 17.

90. *Id.*

91. *Id.* at art. 17(1) (2007).

92. David S. Evans & A. Jorge Padilla, *Excessive Prices: Using Economics to Define Administrable Legal Rules* (Ctr. For Econ. Policy Research, Discussion Paper No. 4626, 2004), available at <http://ssrn.com/abstract=620402>.

93. M&A Regulations, *supra* note 78.

94. AML, *supra* note 71, at art. 20. In addition to mergers and acquisitions, a concentration also includes situations when an undertaking acquires a controlling right in another undertaking or it is able to exercise decisive influence over another undertaking by contract or other means.

system, rules for the control of concentrations apply to both foreign and domestic undertakings.<sup>95</sup> The AML, however, does not specify thresholds that trigger the obligation to notify but leaves the State Council to define such thresholds in implementing regulations.<sup>96</sup>

Within thirty days of the receipt of a completed notification, the Anti-Monopoly Enforcement Authority shall conduct a preliminary review.<sup>97</sup> If the authority considers an in-depth review necessary, it will initiate a second-phase investigation of ninety days, which can be renewed for a maximum of another sixty days.<sup>98</sup> Based on its assessment of the proposed concentration, taking into account a list of factors,<sup>99</sup> the Anti-Monopoly Enforcement Authority will make a decision to prohibit the concentration, to approve the concentration with conditions designed to reduce the negative impact of the concentration on competition, or to unconditionally authorize the concentration.<sup>100</sup> A decision can be challenged first through administrative review then subsequently by lodging an administrative suit in court.<sup>101</sup>

Notably, the AML contains the concept of “national security review;”<sup>102</sup> this is novel in Chinese practice. Strictly speaking, this does not fit in the control of the concentration system but apparently was added at the last stage of the drafting process to address concerns over foreign investors’ acquisition of Chinese companies.<sup>103</sup>

### 5. *Administrative Monopoly*

In China, there is comparatively widespread interest in the role of state-owned enterprises and government regulators in the economy. One of the concerns is that state-controlled industries such as oil, electricity, telecommunications, and tobacco can take advantage of their positions to enrich themselves using public assets.<sup>104</sup> The first article in chapter, Article 32, provides that administrative agencies shall not mandate the use of any one undertaking’s products. The article does not even contain the defense or limitation of the phrase “without justification.” Articles 33, 34, and 35 focus on prohibiting artificial regional trade barriers within China.

95. M&A Regulations, *supra* note 78, at arts. 2, 51, 53.

96. AML, *supra* note 71, at art. 21.

97. *Id.* at art. 25.

98. *Id.* at arts. 25-26.

99. *Id.* at art. 27. Such factors include the involved undertakings’ market shares and their ability to control the market; the degree of market concentration; the impact of the concentration of undertakings on market access and technical progress; the impact of the concentration on consumers and other related undertakings; the impact of the concentration on the development of the national economy; and other factors having an impact on market competition as determined by the Anti-Monopoly Enforcement Authority.

100. *Id.* at arts. 26, 28, 29.

101. *Id.* at art. 53.

102. *Id.* at art. 31.

103. See NPC Legal Committee, *Report on the Revision of AML Draft*, June 24, 2007, reprinted in *THE ANTI-MONOPOLY LAW OF THE PEOPLE’S REPUBLIC OF CHINA: INTERPRETATIONS AND APPLICATIONS*, at 412 (Shang Ming ed., 2007).

104. See, e.g., Shangguan Zhoudong, *China Considers Pay Caps in Monopoly Industries*, CHINA DAILY, July 18, 2007 available at [http://www.chinadaily.com.cn/bizchina/2007-07/18/content\\_6000875.htm](http://www.chinadaily.com.cn/bizchina/2007-07/18/content_6000875.htm); Liang Qiwen, *Monopolies’ Wages in the Cross Hairs*, CHINA DAILY, June 6, 2007, available at [http://www.chinadaily.com.cn/china/2007-06/06/content\\_887864.htm](http://www.chinadaily.com.cn/china/2007-06/06/content_887864.htm).

## B. SUPREME PEOPLE'S COURT INTERPRETATION ON UNFAIR COMPETITION

On January 12, 2007, the Supreme People's Court (SPC) promulgated a Judicial Interpretation on the Unfair Competition Law.<sup>105</sup> This is the first SPC Interpretation since the law became effective in 1993. The interpretation clarified certain issues on the protection of famous products and trade secrets, resolved standing and damages calculation for those actions, and addressed the regulation of false advertising.

### 1. Famous Products

Protection for famous brand names derives mostly from the 1993 Unfair Competition Law, which allows the owner of a famous product the exclusive rights in the use of its name, packaging, and trade dress.<sup>106</sup> The Unfair Competition Law, however, does not define famous products. The SPC Interpretation defines famous products as products that are well known in the Chinese market and among the relevant public.<sup>107</sup> The SPC directs the People's Courts to consider the following factors when determining whether a product is famous: sales of the product, including the geographic market, the volume of sales, and the targeted customer group; the advertising efforts, including the length of time, intensity, and geographic coverage; and whether the product is recognized as a famous product in another market.<sup>108</sup>

Once a product has qualified as a famous product, its owner is entitled to exclude others from using its distinctive name, packaging, and trade dress for commercial purposes, including using them in any commercial documents, in advertisements, at trade shows, and in other commercial activities.<sup>109</sup> The SPC Interpretation, however, specifies two limitations for this exclusive right. First, the exclusive right is subject to certain geographic limitations. A subsequent use of the same or identical name, packaging, and trade dress in a remote area is lawful if such use is in "good faith."<sup>110</sup> A famous product now facing geographic competition is, therefore, entitled to a court order requesting the junior user

105. See Guan yu shen li bu zheng dang jing zheng min shi an jian ying yong fa lu ruo gan wen ti de jie shi [The Supreme People's Court Interpretation on Certain Issues re the Application of Law in Adjudicating on Unfair Competition Actions] (promulgated by the Sup. People's Ct., Jan. 12, 2007, effective Feb. 2, 2007), [http://www.law-lib.com/law/law\\_view.asp?id=186198](http://www.law-lib.com/law/law_view.asp?id=186198) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "SPC Interpretation"].

106. See Fan bu zheng dang jing zheng fa, [the Unfair Competition Law], (promulgated by the Standing Committee Nat'l People's Cong., Sept. 2, 1993, effective Sept. 2, 1993) art. 5(2) (P.R.C.) [hereinafter "Unfair Competition Law"]. Instead of addressing the famous name directly, the Unfair Competition Law looks at the product. If the product is ruled to be famous either by an administrative agency or a court, then its name, packaging and trade dress are all covered by the Unfair Competition Law. The PRC Trademark Law (商标法) provides limited protection for unregistered trademarks. Shang biao fa (2001 nian xiu zheng) [Trademark Law (2001 amended version)], (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2001, effective Dec. 01, 2001), art. 4, [http://www.law-lib.com/law/law\\_view.asp?id=16432](http://www.law-lib.com/law/law_view.asp?id=16432) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "Trademark Law"].

107. SPC Interpretation, *supra* note 105, at art. 1, para. 1.

108. *Id.*

109. *Id.* at art. 3.

110. *Id.* at art. 1, para. 2. Hence, the exact geographical extension of the exclusive right hinges on whether a subsequent user can lawfully claim "good faith" (*shan yi*, 善意). "Good faith" is not defined either in the Unfair Competition Law or the SPC Interpretation. *Id.* In other contexts, the term generally means that the user does not have knowledge that his conduct breaches law or the legal rights of another person. See, e.g., Trademark Law, *supra* note 106, at art. 16.

to label its product with additional information sufficient to avoid consumer confusion. The owner cannot prohibit the junior user from using the name, packaging, and trade dress.<sup>111</sup>

Second, only a famous product's distinctive name, packaging, and trade dress qualify for legal protection.<sup>112</sup> Similar to the U.S. Lanham Act, the SPC Interpretation denies protection for descriptive names and functional designs, unless a descriptive name, packaging, or trade dress has acquired secondary meaning through actual use.<sup>113</sup> In addition, the owner of the famous product cannot prevent a junior user from using part of the name, packaging, or trade dress when such use is for the purpose of describing the quality, main raw material, function, use, weight, quantity, or other characteristics of the junior product.<sup>114</sup>

The SPC has gone beyond the language of the Unfair Competition Law to offer protection for famous products against false association.<sup>115</sup> Read literally, the Unfair Competition Law invalidates only conduct that leads to consumer confusion of the two products.<sup>116</sup> The SPC Interpretation now defines product confusion to include conduct that may cause the relevant public to falsely believe that the junior producer is somehow related to the famous product owner or has permission from it to use the famous product's name, packaging, or trade dress, whether or not the consumers confuse the two products.<sup>117</sup>

## 2. *Trade Secret*

The Unfair Competition Law defines "trade secret" as technological or commercial information not readily available to the public, of potential economic benefit or actual utility to the owner, and whose owner has taken appropriate protective measures to prevent public disclosure.<sup>118</sup> The SPC Interpretation further clarifies that potential economic benefit or actual utility includes potential or actual commercial value and competitive advantage.<sup>119</sup> To satisfy the protective measure requirement, the owner only needs to take reasonable measures under the circumstances, including taking into account the commercial value of the trade secret.<sup>120</sup>

In a clarification on standing, the SPC Interpretation allows an exclusive trade secret licensee to bring an action in court independent of the owner.<sup>121</sup> Damages should be

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111. *Id.*

112. *Id.* art. 2, para. 1.

113. *Id.* art. 2, para. 2.

114. *Id.* art. 2, para. 3.

115. *Id.* art. 4, first sentence.

116. Unfair Competition Law, *supra* note 106, at art. 5.2.

117. SPC Interpretation, *supra* note 105, at art. 4, para. 1.

118. Unfair Competition Law, *supra* note 106, at art. 10, para. 3.

119. SPC Interpretation, *supra* note 105, at art. 10.

120. SPC Interpretation, *supra* note 105, at art. 11, para. 1. The Interpretation lists the following as dispositive evidence of taking appropriate protective measures: limiting the access to the underlying information to those relevant person; locking up the media that stores the trade secret; marking the storage media as containing confidential information; using a secure code to safeguard the trade secret; requiring confidentiality obligations from any consignee of the secret; imposing restrictions on visitors to the equipment, factories and work shops, or requiring visitors to protect the secret. *Id.* at art. 11, para. 2.

121. *Id.* at art. 15, paras. 1, 2.



based on the illegal profit of the infringer or the lost profit by the owner, in a manner analogous to damage calculations under the Patent Law.<sup>122</sup> The party publishing a trade secret shall be liable for the value of the trade secret based on its development cost, potential benefit, and duration of the competitive advantage arising out of the application of the secret.<sup>123</sup>

### 3. *False Advertising*

The SPC Interpretation specifies three types of conduct that may constitute false advertising under the Unfair Competition Law if likely to mislead the relevant public: 1) purposeful omission in making presentation or comparison; 2) untruthful presentation of a scientific view or phenomena as a generally accepted fact; and 3) use of ambiguous language or otherwise misleading presentation.<sup>124</sup> Extravagant exaggeration, unlikely to mislead consumers, does not constitute false advertisement.<sup>125</sup>

## III. Enterprise Income Taxation Law

### A. PASSAGE OF THE EIT LAW

The new Enterprise Income Tax Law (EIT Law), adopted by the NPC in March 2007,<sup>126</sup> implements the long-planned policy goal of unifying the corporate income tax, so that the same tax rates and tax accounting methods apply to both foreign-invested and domestic enterprises. As of early December 2007, implementation regulations for the EIT Law have not yet been issued, even though income tax accounting changed for almost all firms at the end of 2007, with the first quarterly return in 2008 for estimated taxes quickly following. The summary below is based on multiple versions of the Draft Implementation Regulations (DIR) obtained by and circulated among multinational companies and international accounting and law firms.<sup>127</sup>

### B. INTERNATIONAL ASPECTS OF THE EIT LAW

The EIT Law reforms two overlapping areas of China's income taxation—taxation of international income and taxation of corporate income. In the international tax area, the EIT Law and the DIR introduce fundamental changes. Although the probability of a withholding tax (likely to be set at 10 percent) on dividends paid by Chinese companies to

122. *Id.* at art. 17, para. 1.

123. *Id.* at art. 17, para. 2.

124. *Id.* at art. 8.

125. *Id.* at art. 8, para. 2.

126. *Qi ye suo de shui fa* [Enterprise Income Tax Law] (promulgated by the Nat'l People's Cong., Mar. 16, 2007, effective Jan. 1, 2008), [http://www.law-lib.com/law/law\\_view1.asp?id=193287](http://www.law-lib.com/law/law_view1.asp?id=193287) (last visited Dec. 6, 2007) (P.R.C.).

127. Multiple versions of the DIR were prepared by the Ministry of Finance and State Administration of Taxation. After at least nine drafts, a version was circulated to local governments and ministries for review in August and subsequently submitted to the State Council Legislative Affairs Office. The Legislative Affairs Office made heavy revisions before submitting the DIR to the Standing Committee of the State Council, where they await approval at the moment of this writing.

(non-individual) non-residents has attracted the most attention,<sup>128</sup> other changes are just as significant.

For example, the rules for determining the source of income will likely be substantially revised in the DIR, affecting both how a non-resident's activities in China will be taxed and how a domestic operation will use foreign tax credits (FTC). With respect to non-residents, the DIR are expected to source gain from transfer of personal property in accordance with the residence of the transferor. Thus, if a U.S. company sells a piece of equipment located in China (other than in connection with an establishment), it would not be subject to Chinese income taxation on the gain because the gain would not constitute Chinese-source income. Exceptions include transfers of shares of a company (here source would depend on the location of the company) and transfers of inventory (source would depend on where the sale takes place). For domestic companies, source rules simply did not exist under prior law. Appreciation for their significance should improve as Chinese companies increasingly have to deal with FTCs.

A resident company of China is taxed on its worldwide income, and corporate residence is determined under the EIT Law by place of incorporation or the location of the company's "de facto management body."<sup>129</sup> Strict application of the latter criterion would result in some of the most successful foreign-listed "Chinese companies" (e.g., Sina.com, Alibaba.com, Suntech) being treated as Chinese resident companies for PRC tax purposes, despite their incorporation offshore.<sup>130</sup>

For the first time, the EIT Law provides the possibility for Chinese companies to obtain indirect FTCs for foreign income taxes paid by offshore companies they control.<sup>131</sup> A similar conceptual advance is the introduction of controlled foreign corporation (CFC) rules: if a CFC is formed in a low-tax jurisdiction and does not distribute its profits (and not because the business needs cash), the profits may be deemed distributed and will be included in the Chinese shareholders' income.<sup>132</sup>

### C. DOMESTIC ASPECTS OF THE EIT LAW

For purely domestic operations, the most important policy changes to prior law brought by the EIT Law include a unified 25 percent rate without special preferences for foreign-owned firms.<sup>133</sup> For Chinese-owned firms, not only is the nominal tax rate thus reduced from the former 33 percent, but the real tax burden is also further lowered by the general permission to deduct cost as actually incurred (deduction for wage payments, for

128. See EIT Law, *supra* note 126, at arts. 3-4, 27 (withholding tax at the maximum rate of 20% applicable to Chinese source income not connected with a Chinese establishment; rate may be reduced by State Council).

129. EIT Law, *supra* note 126, at art. 2.

130. See Wei Cui, *Jing wai ju min qi ye tou zi zhe suo de shui yu ti zhi du she li de kun hu* [Issues in Administering the Income Tax on Investors in Offshore Resident Companies], 2 ANHUI UNIVERSITY LEGAL COMMENTARY (2007), available at [www.cftl.cn/show.asp?c\\_id=4&a\\_id=7017](http://www.cftl.cn/show.asp?c_id=4&a_id=7017).

131. EIT Law, *supra* note 126, at art. 24.

132. EIT Law, *supra* note 126 at art. 45. Both the new indirect FTC and CFC regimes are in anticipation of greater foreign investments by Chinese companies, but the underlying rationale for the policies may also be subject to further debate in light of the U.S. Treasury Department's discussion in recent years of abandoning the CFC regimes established in the economic climate of the 1960s. See U.S. TREASURY DEP'T, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY (2000), available at <http://www.ustreas.gov/offices/tax-policy/library/subpartf.pdf>.

133. EIT Law, *supra* note 126, at art. 4.

example, had been severely and irrationally restricted). An issue much debated in 2007, but not reflected in the EIT and DIR drafting process, was whether corporate groups may pay income taxes on a consolidated basis.

At least in the United States, the core legal issues for corporate income tax are usually thought to surround corporate finance transactions including asset contributions to the corporation, distributions, and asset and stock sales.<sup>134</sup> Existing Chinese tax rules addressing these issues have evolved mostly in the domestic enterprise area, outside of the purview of multinationals and their tax advisors.<sup>135</sup> Thus, development in China has proceeded differently, and both the EIT and the DIR present further advances. For example, with respect to the tax exemption for inter-corporate dividends, the previous system of attempting to apply the highest corporate tax rate applicable in the chain of distribution is abandoned. The DIR excludes dividends paid on publicly traded stock from the dividend exemption system, thus obviating the need for dealing with tax arbitrage through "dividend capture."<sup>136</sup> The different versions of the DIR also took different approaches to taxation of reorganizations and liquidations.<sup>137</sup>

Finally, one version of the DIR valiantly attempted to make general use of the concept of tax basis. The tax basis of assets is a much more general concept than the concepts of cost and book value and is crucial to sophisticated income tax accounting. While China's new corporate accounting rules have adopted the tax basis concept,<sup>138</sup> the writers of tax regulations are still not all familiar with it. The final implementation regulations may revert, however, to a mixed use of tax basis and the more traditional concepts of cost and book value.

#### IV. Labor Law

2007 saw major developments in the area of labor law, particularly the passage of two pieces of landmark legislation. The Labor Contract Law and the Employment Promotion Law, both effective on January 1, 2008, are poised to cause sweeping changes in China's labor system.

##### A. LABOR CONTRACT LAW

The Labor Contract Law<sup>139</sup> was enacted on June 29, 2007, and drastically changes

134. See, e.g., David Weisbach, *The Irreducible Complexity of Firm-Level Income Taxes: Theory and Doctrine in Corporate Tax*, (Univ. of Chi. L. & Econ., Olin Working Paper No. 327, 2007), available at <http://ssrn.com/abstract=957358>.

135. See Wei Cui, *Zi chan chu zi de shui wu chu li* [Asset Contributions], 9 YUEDAN FIN. & ECON. L. REV. (2007), available at [http://www.cftl.cn/show.asp?c\\_id=24&a\\_id=6983](http://www.cftl.cn/show.asp?c_id=24&a_id=6983).

136. But a subsequent version of the DIR allows exemption of dividends received by a corporation on publicly traded stock if such stock is held for more than a year. This would require tax authorities to determine actual holding periods for particular shares.

137. See Sussman et al, *Tax Structuring of M&A in China: Acquisitive Tax-free Reorganizations*, 3 CHINA TAX INTELLIGENCE 4 (2007).

138. See Ministry of Finance, Enterprise Accounting Standards No. 18 (Income Tax) ch. 2 (Feb. 15, 2006), available at <http://iasplus.com/country/china.htm#0602>.

139. Lao dong he tong fa [Labor Contract Law] (promulgated by the Standing Comm. Nat'l People's Cong, June 29, 2007, effective Jan. 1, 2008), [http://www.molss.gov.cn/gb/news/2007-06/30/content\\_184630.htm](http://www.molss.gov.cn/gb/news/2007-06/30/content_184630.htm) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "Labor Contr. Law"].

several aspects of labor relations. Compared with the Labor Law,<sup>140</sup> the scope of the Labor Contract Law has been expanded to apply to all aspects of labor contracts between workers and enterprises, all types of economic entities, and private non-profit entities.<sup>141</sup>

To form a legal employment relationship, a labor contract must be in writing.<sup>142</sup> If no written labor contract was executed at the formation of an employment relationship, a written labor contract should be signed within one month of hire.<sup>143</sup> If an employer does not sign a written contract with a worker after one year of employment, a contract of no fixed term will be deemed to exist between the parties.<sup>144</sup> According to the preexisting system under the Labor Law, a contract without a fixed term can only be obtained subject to the agreement of an employer.<sup>145</sup> By contrast, the Labor Contract Law enables an employee to secure a contract without a fixed term by making a request under prescribed circumstances.<sup>146</sup>

The Labor Contract Law also imposes detailed restrictions on the length of any probation period. The probation period may not exceed one month for labor contracts with terms between three months and less than one year of length. The probation period may not exceed two months for labor contracts with terms of exceeding one year but less than three years. In the case of a contract with a term of more than three years or a contract with no fixed term, the probation period may not exceed six months. Only one probation period is allowed between an employer and a worker. The probation period forms part of the labor contract term.<sup>147</sup>

Changes are made with respect to the termination of a labor contract. Both employers and employees are given more specific grounds for terminating a labor contract. For example, an employee may terminate a contract because of the employer's failure to pay the social insurance premium for the employee,<sup>148</sup> whereas an employer may terminate a contract if the employee is found to have formed another employment relationship with a different employer that materially affects his work performance and refuses to rectify the situation after being requested to do so by the employer.<sup>149</sup>

Further, the law makes it clear that an employee is entitled to severance pay under certain circumstances when the labor contract has been terminated or has expired in accordance with the Labor Contract Law.<sup>150</sup> The total sum of severance pay is based on the number of years of employment at the rate of one month's salary for each full year worked. Any period of more than six months but less than one year shall be counted as

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140. Lao dong fa [Labor Law] (promulgated by the Standing Comm. Nat'l People's Cong., July 5, 1994, effective Jan. 1, 1995), [http://www.molss.gov.cn/gb/ywzn/2006-03/02/content\\_108641.htm](http://www.molss.gov.cn/gb/ywzn/2006-03/02/content_108641.htm) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "Labor Law"].

141. Labor Contract Law, *supra* note 139, at art. 2.

142. *Id.* at art. 10.

143. *Id.*

144. *Id.* at art. 14.

145. Labor Law, *supra* note 140, at art. 20.

146. *Id.* at art. 14.

147. *Id.* at art. 19.

148. *Id.* at art. 38.

149. *Id.* at art. 39(4).

150. *Id.* at art. 46.

one year, and the severance pay payable to an employee for a period of less than six months shall be one-half of the worker's monthly salary.<sup>151</sup>

## B. EMPLOYMENT PROMOTION LAW

The Employment Promotion Law (EPL) was adopted by the NPCSC on August 30, 2007.<sup>152</sup> The law has two distinctive features: strengthening government's role in employment promotion and prohibiting job discrimination.

The Chinese government began to embrace an "active employment policy" in 2003,<sup>153</sup> but the EPL is the first law that explicitly recognizes employment promotion as a government responsibility.<sup>154</sup> Governments above the county level are required to make employment expansion an important long-term goal and coordinate industry policy with employment policy.<sup>155</sup> Various measures set out by the EPL include: the creation of a coordinating mechanism under the State Council to advance employment promotion work;<sup>156</sup> the establishment of an exclusive fund for employment promotion by governments above the county level;<sup>157</sup> preferential tax treatment for companies that hire laid-off or disabled workers;<sup>158</sup> and increased provision of loans to small- and medium-sized enterprises.<sup>159</sup>

Employment discrimination has been previously proscribed;<sup>160</sup> however, the EPL provides much greater specificity regarding what conduct constitutes employment discrimination and creates a right of action. The EPL contains the most complete list of proscribed discriminatory practices of any Chinese legal measure, being, for example, the first regulation to ban discrimination against rural migrant workers.<sup>161</sup> In addition, the law grants victims of job discrimination a specific right to lodge a suit in court for the first time;<sup>162</sup> an employee may recover if the employer infringes his lawful employment rights.<sup>163</sup>

151. *Id.* at art. 47.

152. *Jiu ye zu jin fa* [Employment Promotion Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Jan. 1, 2008), [http://www.law-lib.com/law/law\\_view.asp?id=212683](http://www.law-lib.com/law/law_view.asp?id=212683) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "EPL"].

153. *Zhong gong zhong yang guan yu wan shan she hui zhu yi shi chang jing ji ti zhi ruo gan wen ti de jue ding* [Decision on Issues Concerning the Improvement of the Socialist Market Economy Institutions] (issued by the Third Plenary Meeting of 16th Central Comm. of the Chinese Communist Party, Oct. 14, 2003) § 9, para. 28, available at [http://www.law-lib.com/law/law\\_view.asp?id=81335](http://www.law-lib.com/law/law_view.asp?id=81335) (last visited Dec. 3, 2007).

154. EPL, *supra* note 152, at arts. 2, 4-6, 11.

155. *Id.* at arts. 4, 11.

156. *Id.* at art. 6.

157. *Id.* at art. 15.

158. *Id.* at art. 17.

159. *Id.* at art. 19.

160. The Labor Law states that workers should not be discriminated against in employment based on nationality, ethnicity, gender, religious beliefs, etc. See Labor Law, *supra* note 140, at art. 12.

161. EPL, *supra* note 152, at art. 31.

162. *Id.* at art. 62.

163. *Id.* at art. 68.

## V. Partnership Law

China's new Partnership Law came into force on June 1, 2007.<sup>164</sup> The general legal framework under this new law is by and large similar to the ones under U.S. state law. A partnership is not recognized as an independent legal person.<sup>165</sup> Hence, its general partners are personally liable for the partnership obligations. On the benefit side, the partnership enjoys pass-through tax treatment; income is directly attributed to each partner and taxed accordingly.<sup>166</sup>

The most significant changes from the 1997 Partnership Law<sup>167</sup> are the introduction of two new categories of partnerships: Limited Partnerships (LP) and Special General Partnerships (SGP).<sup>168</sup> The law likewise expands the scope of eligible partners. In addition to individuals, an entity can now become a general partner except where explicitly banned by the Partnership Law—wholly state-owned companies, state-owned enterprises,<sup>169</sup> publicly listed companies, and public-service institutions.<sup>170</sup> Contribution to a partnership can take the form of personal service by a general partner.<sup>171</sup> Admission of a new partner should be approved by unanimous vote of the existing general partners, unless the partnership agreement stipulates otherwise. A newly admitted partner will be personally responsible for the entire partnership liabilities, including the liabilities incurred before his admission.<sup>172</sup>

The Partnership Law introduces an LP for the first time in Chinese law. An LP is a partnership with a two-tier partner structure: general partners and limited liability partners. Limited liability partners do not have partnership authority.<sup>173</sup> As investors, they are exposed to partnership obligations only to the extent of their respective capital contributions.<sup>174</sup> An SGP is a distinct type of general partnership designed for professional service providers. The partners of an SGP are not personally liable for obligations arising out of a willful or gross negligent conduct by their co-partners in providing professional

164. He huo qi ye fa [Partnership Law] (promulgated by the Standing Committee Nat'l People's Cong., Aug. 27, 2006, effective Jun. 1, 2007) [http://www.law-lib.com/law/law\\_view1.asp?id=171393](http://www.law-lib.com/law/law_view1.asp?id=171393) (last visited Dec. 13, 2007) (P.R.C.) [hereinafter "Partnership Law"].

165. *Id.* at art. 2.

166. *Id.*

167. He huo qi ye fa [Partnership Law] (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 23, 1997, effective Aug. 1, 1997), [http://www.law-lib.com/law/law\\_view1.asp?id=343](http://www.law-lib.com/law/law_view1.asp?id=343) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "1997 Partnership Law"].

168. See Partnership Law, *supra* note 164, at arts. 2, 55.

169. State-owned enterprises refer to those enterprises having not been incorporated under P.R.C. Company Law.

170. Partnership Law, *supra* note 164, at art. 2. The Company Law generally prohibits a limited liability company from investment in enterprises that may result in the company assuming unlimited liability, unless such an investment is specially allowed by law. Since a limited liability company is not listed among the four types of banned entities, it is believed that limited liability companies can now invest in the partnership and become general partners.

171. Partnership Law, *supra* note 164, at art. 16.

172. *Id.* at art. 44, para. 2.

173. *Id.* at art. 68.

174. *Id.* at art. 2, para. 3.

services.<sup>175</sup> For an SGP, the law requires the partnership name to include the words “special general partnership.”<sup>176</sup>

## VI. Regulatory Developments

### A. CHANGES IN DEATH PENALTY REVIEW BY THE SUPREME PEOPLE’S COURT

China’s Supreme People’s Court (SPC) holds final authority to review all death penalty decisions handed down in China.<sup>177</sup> Since 1980, however, it has delegated that authority to the provincial-level High People’s Courts,<sup>178</sup> sometimes with disastrous results. In 2005, two cases exposed in the Chinese press demonstrated that the Chinese death penalty system resulted in the execution of innocent persons.<sup>179</sup> Following the publicity resulting from two cases—one wrongful conviction and one wrongful execution—in 2005, the SPC made reducing the use of death penalty a policy priority.<sup>180</sup> It has followed up the policy statement with some real changes in the way death penalty cases are handled in China.<sup>181</sup>

175. *Id.* at art. 57, para. 1. It should be noted that other general partners are still liable to the partnership obligations in such an instance, but such liabilities are limited to the extent of their capital contribution to the partnership. *Id.*

176. *See id.* at art 56.

177. Xing fa [Criminal Law] (promulgated by the Standing Comm. Nat’l People’s Cong., July 1, 1979, amended March 14 1997, effective as amended Oct. 1, 1997, further amended with immediate effect Dec. 25, 1999, Aug. 31, 2001, Dec. 29, 2001, Dec. 28, 2002, Feb. 28, 2005), art. 48, <http://www.cecc.gov/pages/newLaws/criminalLawENG.php> (last visited Nov. 29, 2007 (P.R.C.) [hereinafter “Criminal Law”]); Xing shi su song xu fa [Criminal Procedure Law] (promulgated by the Standing Comm. Nat’l People’s Cong., July 1, 1979, amended March 17, 1996, effective Jan. 1, 1997), art. 199, <http://www.cecc.gov/pages/selectLaws/laws/criminalProcedure.php> (last visited Feb. 17, 2008) (P.R.C.) [hereinafter “Criminal Procedure Law”].

178. Guan yu tong yi xing shi si xing an jian he zhun quan you guan wen ti de jue ding [Decision on Issues Relating to Consolidated Review of Death Penalty Cases] (promulgated by the Sup. People’s Ct., Dec. 28, 2006) [http://www.law-lib.com/law/law\\_view.asp?id=184198](http://www.law-lib.com/law/law_view.asp?id=184198) (last visited on Nov. 29, 2007) (P.R.C.) [hereinafter “Consolidated Review Decision”] (listing the measures, revoked in this Decision, that had delegated final authority over death penalty adjudication to the High People’s Courts).

179. For an in depth discussion of Nie Shubin (who was wrongfully executed) and She Xianglin (who was jailed for fifteen years after his death sentence was commuted before his wife, the supposed victim in the case, reappeared in mid-2005), see Congressional Executive Commission on China Virtual Academy, *Wrongful Execution Sparks Controversy in China*, Apr. 8, 2005 available at <http://www.cecc.gov/pages/virtualAcad/index.phpd?showsingle=961>; Congressional Executive Commission on China Virtual Academy, *Hubei Man Convicted of Wife’s Murder Ten Years Ago Exonerated*, Apr. 8, 2005, available at <http://www.cecc.gov/pages/virtualAcad/index.phpd?showsingle=9796>.

180. Ren min fa yuan di er ge wu nian gai ge gang yao [Second Five Year Reform Outline for the People’s Courts] (Promulgated by the Sup. People’s Ct., Oct. 25, 2005), paras. 1, 2, 11, [http://www.law-lib.com/law/law\\_view.asp?id=120832](http://www.law-lib.com/law/law_view.asp?id=120832) (last visited on Nov. 29, 2007), translated in <http://www.cecc.gov/pages/virtualAcad/index.phpd?showsingle=38564> (P.R.C.).

181. Several measures were issued before this year providing guidance for lower level courts and procurators in their administration of death penalty cases. See, e.g., Guan yu jin yi bu zuo hao si xing er shen an jian kai ting shen li gong zuo de tong zhi [Circular on Further Improving Court Hearing Work in Death Penalty Appeal Cases] (promulgated by the Sup. People’s Ct., Dec. 7, 2005), [http://www.law-lib.com/law/law\\_view.asp?id=120411](http://www.law-lib.com/law/law_view.asp?id=120411) (last visited on Nov. 29, 2007) (P.R.C.) (designating high people’s courts as appellate courts for all death penalty cases); Guan yu si xing di er shen an jian kai ting shen li cheng xu ruo gan wen ti gui ding [Trial Provisions on Several Issues Regarding Court Hearing Procedures in Death Penalty Appeal Cases], (promulgated by the Sup. People’s Ct. & Supreme People’s Procuratorate, Sept. 21, 2006), [http://www.law-lib.com/law/law\\_view.asp?id=174588](http://www.law-lib.com/law/law_view.asp?id=174588) (last visited on Nov. 29, 2007) (P.R.C.) (establishing death penalty procedures in trials).

In the last year, the SPC has specifically taken back responsibility for reviewing death penalty cases from lower courts,<sup>182</sup> except for those that require immediate adjudication, and has hired much additional staff to handle the increased workload.<sup>183</sup> As a result, a three-step process for capital cases now obtains, distinct from that followed in most criminal appellate matters.<sup>184</sup> After the trial, the High People's Courts are now, as a second step, conducting thorough re-examinations of the facts and law of the cases and are reviewing the entire record and all the evidence and testimony received. Finally, the SPC reviews the trial record and the review of the High People's Court of the original record. The goal of the changed procedure is apparently a change in the approach to capital punishment that reflects increased caution about its finality and the possibility of mistakes in adjudication.<sup>185</sup>

## B. NEW CHOICE OF LAW RULES FOR FOREIGN-RELATED CONTRACTUAL DISPUTES

On July 23, 2007, the SPC issued the Regulation on Choice of Law for Foreign Related Civil and Commercial Contractual Disputes to provide guidance on the enforceability of private choice of law provisions in civil and commercial contracts by Chinese courts and the appropriate law for the people's courts to choose in the absence of such a choice of law provision.<sup>186</sup> The Choice of Law Regulation applies to all foreign-related civil and commercial contractual disputes.<sup>187</sup>

182. Guan yu xiu gai "Zhong hua Ren min Gong he guo ren min fa yuan zu zhi fa" de jue ding [Decision on Amending the "Organic Law of the People's Courts"] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2006), [http://www.law-lib.com/law/law\\_view.asp?id=177859](http://www.law-lib.com/law/law_view.asp?id=177859) (last visited on Nov. 29, 2007) (P.R.C.); Consolidated Review Decision (including a list of provisions to be abolished that had delegated the SPC's authority to review death penalty decisions to the High People's Courts and military courts): Guan yu fu he si xing an jian ruo gan wen ti de gui ding [Decision on Some Issues Regarding Review of Death Penalty Cases] (promulgated by the Sup. People's Ct. Jan. 22, 2007, effective Feb. 28, 2007), [http://www.law-lib.com/law/law\\_view.asp?id=189904](http://www.law-lib.com/law/law_view.asp?id=189904) (last visited Nov. 29, 2007) (P.R.C.).

183. See, e.g., Ni Jian, *A Cold, Hard Look at the SPC's: "Expansion of the Ranks" of the Criminal Judges*, BEIJING NEWS, Nov. 21, 2007, translated in <http://www.duihua.org/hrjournal/2007/11/will-death-penalty-review-overwhelm.html> (last visited Feb. 17, 2008) (focusing on the increase and its cause—the large number of death penalty cases that will require review).

184. Cong. Exec. Comm'n on China, 2007 ANN. REP. 54 (Oct. 10, 2007), available at [www.cecc.gov/annual/rpt/annualrpt07/ceccannrpt2007.pdf](http://www.cecc.gov/annual/rpt/annualrpt07/ceccannrpt2007.pdf).

185. *Id.* at 56 (citing a September 2007 decision of the SPC that limits the use of the death penalty to the most serious cases).

186. See Zui gao ren min fa yuan guan yu shen li she wai min shi huo shang shi he tong jiu fen an jian fa lu shi yong de ruo gan wen ti de gui ding [SPC Regulation on Choice of Law for Foreign Related Civil and Commercial Contractual Disputes] (promulgated by the Sup. People's Ct., Jul. 23, 2007, effective Aug. 8, 2007), [http://www.law-lib.com/law/law\\_view.asp?id=207645](http://www.law-lib.com/law/law_view.asp?id=207645) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter "Choice of Law Regulation"].

187. A foreign-related contract dispute is a dispute that involves foreign elements, either one party of the dispute is a foreigner, or the contract is to be primarily performed overseas, or the subject assets of the contract is located in a foreign country. See Zui gao ren min fa yuan guan che zhi xing "Zhong hua ren min gong he guo min fa tong ze" ruo gan wen ti de yi jian (shi xing) [SPC Opinion on Certain Questions Concerning the Implementation and Execution of "PRC Civil Regulation" (Trial Implementation)] (promulgated by the Sup. People's Ct., Jan. 26, 1988), art. 178, [http://www.law-lib.com/law/law\\_view1.asp?id=203](http://www.law-lib.com/law/law_view1.asp?id=203) (last visited on Dec. 5, 2007) (P.R.C.).



As a general principle, the Choice of Law Regulation directs the people's courts to respect choice of law provisions in civil and commercial contracts.<sup>188</sup> Such private choice of law is, however, limited to foreign substantive law. Private parties may not choose foreign procedural rules or foreign choice of law rules.<sup>189</sup> The selection of foreign substantive law does not have to be in writing, but it must be explicit.<sup>190</sup> The agreement on choice of law can be reached at any time before the trial panel retires for deliberation.<sup>191</sup> Private choice of law is not enforceable in China if it conflicts with China's mandatory rules or if the application of foreign law is deemed by the courts as inconsistent with public interests.<sup>192</sup> The regulation lists nine types of contracts for which application of Chinese law is mandatory.<sup>193</sup>

In the absence of a private choice of law, the Choice of Law Regulation directs the people's courts to apply the law of the jurisdiction most closely related to the contract at issue.<sup>194</sup> The PRC Contract Law lists seventeen categories of "named contracts." For each type of named contract, the SPC provides specific presumptions for the courts to apply when determining which jurisdiction will be considered the most closely related. These presumptions are rebuttable on clear evidence that another jurisdiction has a closer relationship with the contract.<sup>195</sup> Thus, for example, sales contracts should normally be governed by the law of the seller's legal domicile; however, the law of the purchaser's domicile should prevail if the contract was executed at the purchaser's legal domicile, or the contract specifies that delivery is to be made at the purchaser's domicile.<sup>196</sup>

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188. Choice of Law Regulation, *supra* note 186, at art. 4.

189. *Id.* at art. 2.

190. *Id.* at art. 3. One exception to the explicit rule is when the parties both cite to the same foreign law and none of the other parties object. This is deemed an effective consensual choice of law. *Id.* at art. 4, para. 2.

191. *Id.* at art. 4.

192. *Id.* at arts. 6, 7.

193. The contracts that must use PRC law are:

- Contracts for Sino-Foreign Equity Joint Venture;
- Contracts for Sino-Foreign Contractual Joint Venture;
- Contracts for Sino-Foreign Joint Exploration or Exploitation of Natural Resources;
- Contracts for Transfer of Shares of a Sino-Foreign Equity or Contractual Joint Venture, or a Wholly Foreign Owned Enterprise;
- Contracts for Foreign Individual or Entities to Manage a Sino-foreign Equity and Contractual Joint Venture Located within Chinese Territory;
- Contracts for Foreign Individual or Entities to Purchase Shares of a Domestic Enterprise;
- Contracts for Foreign Individual or Entities to Purchase Shares of a Domestic Limited Liability Company or Company Limited by Shares;
- Contracts for Foreign Individual or Entities to Acquire Assets of a Domestic Enterprise; and
- Other Contracts that Law and Administrative Regulations Mandates the governing by Chinese Law.

*Id.* at art. 8. It should be noted that even for a contract that does not fall under any of the nine categories, a court may still refuse to enforce the private choice of law provision based on the public interest justification.

194. *Id.* at art. 5.

195. *Id.*

196. *Id.*

### C. CHINA'S RESTRICTION ON HAZARDOUS MATERIALS REGULATIONS COME INTO FORCE

The Management Measures for Pollution Control in Electronic Information Products came into force in China on March 1, 2007.<sup>197</sup> Commonly called China's answer to the European Union's Restrictions on Hazardous Materials Directive and known popularly as "China RoHS," the Measures portend some big changes for IT product manufacturers in China in the coming years. Many of those changes, however, are likely to be a long time in coming.

The Measures are primarily concerned with the elimination of the six hazardous substances considered most problematic.<sup>198</sup> In the initial period of implementation, however, companies only need to self-disclose information about potentially environmentally damaging aspects of their products; there is no requirement that these materials be eliminated from their products.<sup>199</sup> In addition, for all products already on the market as of March 1, 2007, no testing will occur to verify compliance with the Measures. The implementation and specific regulatory measures that will eventually make a phase-out of the hazardous materials necessary have not yet been promulgated. A catalogue of products that comply with the requirements will eventually be generated and inclusion in the catalogue will be necessary for products to be sold in China.<sup>200</sup>

### D. UPDATE ON INTELLECTUAL PROPERTY CASES AND REGULATIONS

Developments in all three major areas of intellectual property rights (IPR) regulation this year reflected continuing trends and foreshadowed that much more development is likely to occur in the next twelve months. The biggest development this year was the long-awaited ratification of the so-called World Intellectual Property Organization's (WIPO) Internet Treaties—the WIPO Copyright and the WIPO Performances and Phonograms Treaties of 1996.<sup>201</sup>

197. *Dian zi xin xi chan pin wu ran zhi guan kong li ban fa* (promulgated by the Ministry for Infor. Indus., NDRC, MOFCOM, China Customs, the State Admin. for Indus. & Commerce, the General Admin. of Quality Supervision, Inspection, & Quarantine, and the State Env't. Prot. Admin., Feb. 28, 2006, effective Mar. 1, 2007), [http://www.law-lib.com/law/law\\_view1.asp?id=143618](http://www.law-lib.com/law/law_view1.asp?id=143618) (last visited Dec. 5, 2007) (P.R.C.) [hereinafter "Management Measures"].

198. The six hazardous substances are lead, mercury, cadmium, hexavalent chromium, polybrominated biphenyls, and polybrominated diphenyl ether. *Id.* at art. 3(4).

199. See Michael Kirschner, *China RoHS Scope Clarified*, GREEN SUPPLY LINE, Mar. 27, 2006, <http://www.greensupplyline.com/showArticle.jhtml?articleID=184400064>.

200. Management Measures, *supra* note 197, at arts. 18-22.

201. *China Joins WIPO Internet Treaties*, INTELLECTUAL PROP. PROTECT. IN P.R.C., July 1, 2007, [http://english.ipr.gov.cn/ipr/en/info/Article.jsp?a\\_no=100913&col\\_no=934&dir=200707](http://english.ipr.gov.cn/ipr/en/info/Article.jsp?a_no=100913&col_no=934&dir=200707) (last visited Dec. 3, 2007). A case concluded before the ratification was effective confirmed that the Chinese courts already have the authority to address issues of infringement over the internet: in a case brought by the International Federation of the Phonographic Industry (IFPI) against Yahoo China in Beijing's No. 2 Intermediate Court, IFPI obtained an order requiring Yahoo China to delete links to websites offering free music downloads. Reuters, *Chinese Court Orders Yahoo China to Curb Music Links*, Apr. 24, 2007, <http://www.reuters.com/article/technologyNews/idUST11751420070424> (last visited Dec. 3, 2007).

In the areas of trademark and patent law, the number of cases and patent applications continues to grow quickly.<sup>202</sup> According to media reports, China now ranks third in the world, behind only the United States and Japan, in the number of patent applications filed.<sup>203</sup> In both areas, large developments will come next year as a draft of a revised Trademark Implementing Regulation and a draft of the Patent Law have both been circulated and will likely result in new versions of these two key documents in 2008.<sup>204</sup>

#### E. SARA REGULATIONS ON REINCARNATION OF TIBETAN LAMAS

On September 1, 2007, Order Number Five of China's State Administration of Religious Affairs came into effect, claiming for the first time control for the Chinese government over the institution of reincarnation in Tibetan Buddhism.<sup>205</sup> While some media have commented that it is "absurd"<sup>206</sup> or "bizarre"<sup>207</sup> for an avowedly atheist government to involve itself in reincarnation, these regulations are designed to further the Chinese government's political goal of promoting "social harmony" by controlling Tibetan institutions and combating Tibetan nationalism.

The Order states that reincarnated Tibetan lamas should, *inter alia*, "respect and protect the principles of the unification of the state [and] . . . social harmony,"<sup>208</sup> reflecting the historical link between religion and nationalism in Tibet. It provides that the state may now determine whether a deceased lama may reincarnate, search for the reincarnation, approve the reincarnation through a "living Buddha permit," and install and control the education of the reincarnated lama.<sup>209</sup> This will allow China's State Council to name a competing Dalai Lama when the current Fourteenth Dalai Lama, who has stated he will reincarnate outside of Tibet/China, passes away.<sup>210</sup> Persons contravening these mea-

202. Several noteworthy trademark cases were handled by China's courts this year, including the resolution of Starbucks' claim of infringement by Xinbake Café Limited. See *Shanghai Xingbake Kafeiguan Youxian Gongsi v. Xingyuan Gongsi* [Starbucks Corporation] (Shanghai Higher People's Ct., Dec. 20, 2006); *Xingyuan Gongsi [Starbucks Corp.] v. Qingdao Xingbake Kafei Canyin Youxian Gongsi*, (Shandong Province Higher People's Ct., Jul. 5, 2007) ("Xingbake" is the name that Starbucks uses in Chinese characters). Also, China's courts handled the decision by a Shanghai appeals court against Pepsi for their infringement of a domestic Chinese company's trademark in "LANSE BAOFENG" or "BLUE STORM" due to its use in a Pepsi advertising campaign. See *Zhejiang Lanye Jiuye Youxian Gongsi v. Shanghai Baishi Kele Yinliao Youxian Gongsi* [Shanghai Pepsi Cola Drinks Limited], (Zhejiang Province Higher People's Ct., May 24, 2007).

203. *China Ranks World's 3rd in Handling Patent Applications*, CHINA VIEW, Oct. 18, 2007, [http://news.xinhuanet.com/english/2007-10/18/content\\_6902673.htm](http://news.xinhuanet.com/english/2007-10/18/content_6902673.htm).

204. China's Revised Draft of Patent Law Submitted for Examination, ASIA PULSE, Oct. 30, 2007. A draft of the new Trademark Implementing Regulation has been received by the ABA International Section and will be the subject of formal comments close to the start of 2008.

205. See Order No. Five (promulgated by the State Religious Affairs Bureau, July 18, 2007, effective on Sept. 1, 2007), <http://www.sara.gov.cn/GB/zcfg/89522ff7-409d-11dc-bafe-93180af1bb1a.html> (last visited Oct. 30, 2007), translated at <http://www.savetibet.org/news/newsitem.php?id=1159> (last visited Oct. 30, 2007) (P.R.C.).

206. Matthew Phillips, *China Regulates Buddhist Reincarnation*, NEWSWEEK, Aug. 20, 2007.

207. Economist.com, *Reincarnation Rules* (Aug. 22, 2007), [http://www.economist.com/world/asia/display\\_story.cfm?story\\_id=9678072](http://www.economist.com/world/asia/display_story.cfm?story_id=9678072)

208. Order No. Five, *supra* note 205, at art. 2.

209. See *id.* at arts. 5-10, 12.

210. See *id.* at art. 5 ("Living Buddha reincarnations . . . with a particularly great impact shall be reported to the State Council for approval").

tures—for example, by carrying out traditional reincarnation processes—are liable for criminal and/or administrative punishment.<sup>211</sup>

The order “empower[s] the Chinese Communist Party and government to gradually reshape Tibetan Buddhism by controlling one of the religion’s most unique and important features—lineages of teachers . . .”<sup>212</sup> As an expression of China’s official “harmonious society” policy, these regulations indicate that the state sees “harmony” as its ability to control various elements of society, rather than a result of building consensus and respecting popular aspirations.

#### F. UPDATED FRANCHISING REGULATIONS

In 2007, the State Council adopted a new regulation<sup>213</sup> and the Ministry of Commerce adopted two new measures<sup>214</sup> governing all franchises operating in China.<sup>215</sup> Both took effect on May 1, 2007.<sup>216</sup> These replace the somewhat controversial Measures for the Administration of Commercial Franchising that went into effect February 1, 2005.<sup>217</sup> The new regulation and measures hopefully represent a new stability for franchise regulation in China, one that satisfies both the need to implement market order and to prevent fraud internally with less restricted access for foreign franchisors.<sup>218</sup>

One of the highlights of the changes is the amendment to the requirement that a franchisor must have operated two locations in China for a minimum of one year.<sup>219</sup> The new regulation now provides that “for a franchisor to be engaged in franchising it must have at least two directly-operated company-owned stores and have operated them for at

211. See *id.* at art. 11.

212. U.S. Congressional Executive Commission on China Virtual Academy, New Legal Measures Assert Unprecedented Control Over Tibetan Buddhist Reincarnation, <http://www.cecc.gov/pages/virtualAcad/index.php?showsingle=98716> (last visited Oct. 30, 2007).

213. Shang ye te xu jing ying guan li tiao li [Commercial Franchise Admin. Reg.] (promulgated by the St. Council, Jan. 31, 2007, effective May 1, 2007), [http://www.law-lib.com/law/law\\_view.asp?id=189412](http://www.law-lib.com/law/law_view.asp?id=189412) (last visited Dec. 3, 2007), translated at <http://www.jonesco-law.ca> (last visited Dec. 3, 2007) (P.R.C.) [hereinafter “Regulation”].

214. Shang ye te xu jing ying xin xi pi lu guan li ban fa [Commercial Franchise Info. Disclosure Admin. Measures] (promulgated by the Ministry of Commerce, Apr. 6, 2007, effective May 1, 2007), [http://www.law-lib.com/law/law\\_view.asp?id=201116](http://www.law-lib.com/law/law_view.asp?id=201116) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter “Disclosure Measure”]; Shang ye te xu jing ying bei an guan li ban fa [Commercial Franchise Registration Administrative Measures] (promulgated by the Ministry of Commerce, Apr. 6, 2007, effective May 1, 2007), [http://www.law-lib.com/law/law\\_view.asp?id=201115](http://www.law-lib.com/law/law_view.asp?id=201115) (last visited on Dec. 3, 2007) (P.R.C.) [hereinafter “Registration Measure”].

215. Regulation, *supra* note 213, at art. 2.

216. *Id.* at art. 34; Disclosure Measure, *supra* note 214, at art. 12; Registration Measure, *supra* note 214, at art. 20.

217. Shang ye te xu jing ying guan li ban fa [Commercial Franchise Administrative Measures] (promulgated by the Ministry of Commerce, Dec. 30, 2004, effective Feb. 1, 2005), [http://www.law-lib.com/law/law\\_view.asp?id=87781](http://www.law-lib.com/law/law_view.asp?id=87781) (last visited Dec. 3, 2007) (P.R.C.) [hereinafter “Previous Measures”].

218. For a discussion of this regulatory tension, see Guo wu yuan fa zhi ban, shang wu bu fu ze ren jiu “shang ye te xu jing ying guan li tiao li” you guan wen ti da zhong guo zheng fu wang wen [Questions and Answers Regarding the “Commercial Franchise Administration Regulation” as presented by Members of the State Council Legislative Affairs Office and the Ministry of Commerce], Feb. 16, 2007, available at <http://www.ccf.org.cn/end.jsp?id=36040> (last visited Dec. 3, 2007) [hereinafter “Questions & Answers”].

219. Previous Measures, *supra* note 217, at art. 7(4).

least one year.”<sup>220</sup> This new wording is interpreted as permitting franchisors to qualify if they have operated two units outside China for at least one year.<sup>221</sup>

Chapter 3 of the regulation sets out the general<sup>222</sup> and specific obligations of the franchisor with respect to disclosure.<sup>223</sup> Franchisors are required to set up a complete disclosure system<sup>224</sup> and to provide a prospective franchisee with all information required pursuant to Article 22 not less than thirty days before the signing of the franchise agreement.<sup>225</sup> The required disclosures under Article 22 include basic information about the franchisor, its system, and its ability to deliver support to the franchisee; the cost and terms and conditions for items to be purchased from the franchisor; and financial statements. Article 22(8) specifically requires disclosure of the existing franchise outlets in China and “an assessment of their business performance.” Initially there was considerable discussion as to the meaning of this phrase. But the Disclosure Measure issued later made it very clear that this meant an earnings or financial performance claim.<sup>226</sup> In other words, this phrase should be interpreted broadly.

## VII. Hong Kong Ten Years After Its Return to China

Two important developments in Hong Kong during 2007 illustrated both the challenges to and the continuing vitality of the rule of law tradition in Hong Kong ten years after the transfer of sovereignty from the United Kingdom to the People’s Republic of China.

In early July 2007, the Hong Kong SAR Government published a Green Paper on Constitutional Development to consult the public on the models, roadmap, and timetable for electing the Chief Executive (CE) and for forming the Legislative Council (LegCo) by universal suffrage.<sup>227</sup> This document discusses the different options and timetables for introducing universal suffrage on a “one person, one vote” basis. The Green Paper does not seek to settle this issue but discusses all timetables, including universal suffrage in the 2012 elections for the CE and LegCo at some point after the elections of 2017.<sup>228</sup>

In August 2006, LegCo passed a controversial covert surveillance law, which also mandated public reporting on the law’s implementation.<sup>229</sup> In November 2007, the first Report of the Commissioner on Interception of Communication and Surveillance was

220. Regulation, *supra* note 213, at art. 7, para. 2.

221. See Registration Measure, *supra* note 214, at art. 5(6).

222. *Id.* at art. 23.

223. Arguably Chapter 3 is the interpretation in a regulation of the disclosure obligations of a franchisor under Article 42 of the Contract Law. As such readers should be cautioned against interpreting the disclosure obligations in a narrow common law manner.

224. Regulation, *supra* note 213, at art. 20.

225. *Id.* at art. 21.

226. Disclosure Measure, *supra* note 214, at art. 5(VIII)(2). See also Paul Jones & Erik Wulff, *Franchise Regulation in China: Law, Regulation and Guidelines*, 27 FRANCHISE L.J. 57 (2007).

227. Hong Kong SAR Gov’t, *Green Paper on Constitutional Development*, July 2007, <http://www.cmab-gpcd.gov.hk/doc/GPCD-e.pdf> (last visited Dec. 5, 2007).

228. Hong Kong SAR Gov’t, *Constitutional Reform Green Paper Unveiled*, <http://news.gov.hk/en/category/administration/070711/html/070711en01006.htm> (last visited Dec. 5, 2007).

229. Interception of Communications and Surveillance Ordinance, (2006) Cap. 589 (H.K.).

released to the public.<sup>230</sup> It recounted how specially appointed “Panel Judges” strove to maintain the rule of law despite the wire-tapping and spying now permitted the Independent Commission Against Corruption (ICAC) and the Police and the Immigration Department. Over the first four months, the Panel Judges had dealt with 542 applications. Written applications supported by sworn statements had to be scrutinized, and oral hearings were held in some or all of the cases. As requested by the Commissioner, detailed weekly reports had to be prepared. The CE has the power not to release the report in full or in part, and in spite of some delay in the release of this first report, seems inclined to keep releasing the reports.

## VIII. International Developments

### A. WTO CASES INVOLVING CHINA FILED IN 2007<sup>231</sup>

#### 1. IPR Cases Filed by the United States Against China

On April 10, 2007, the United States filed two requests for consultation with China at the World Trade Organization (WTO) concerning China’s market access barriers affecting the U.S. copyright industry and deficiencies in China’s IPR laws.<sup>232</sup> While acknowledging that China has taken steps towards improving its protection and enforcement of

230. Commissioner on Interception of Communication and Surveillance, Annual Report 2006 to the Chief Executive (June 2007), available at [http://www.info.gov.hk/info/sciocs/eng/pdf/Annual\\_Report\\_2006.pdf](http://www.info.gov.hk/info/sciocs/eng/pdf/Annual_Report_2006.pdf). The report covers only the end of 2006, and it was only released to the public November 2007.

231. China and the United States concluded a Memorandum of Understanding, ending its on-going WTO Dispute regarding impermissible subsidies in many basic industries in China. Request for Consultations by the United States, *China—Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments*, WT/DS358/1 (Feb. 7, 2007). China agreed to end the subsidy programs and the U.S. Trade Representative declared victory: “Under the MOU, China has committed to complete a series of steps by January 1, 2008 to ensure that the WTO-prohibited subsidies cited in the U.S. complaint have been permanently eliminated, and that they will not be re-introduced in the future.” Office of the U.S. Trade Representative, *China to End Subsidies Challenged by the United States in WTO Dispute*, Nov. 29, 2007, [http://www.ustr.gov/Document\\_Library/Press\\_Releases/2007/November/China\\_To\\_End\\_Subsidies\\_Challenged\\_by\\_the\\_United\\_States\\_in\\_WTO\\_Dispute.html](http://www.ustr.gov/Document_Library/Press_Releases/2007/November/China_To_End_Subsidies_Challenged_by_the_United_States_in_WTO_Dispute.html) (last visited Mar. 2, 2008).

232. Request for Consultations by the United States, *China—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/1 (Apr. 16, 2007) [hereinafter “Market Access Dispute Settlement Case”]; Request for Consultations by the United States, *China—Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/1 (Apr. 16, 2007) [hereinafter “IPR Dispute Settlement Case”]. Procedurally, by the end of 2007, the cases were both headed for resolution before a dispute settlement panel after consultations failed to resolve the disputes and the United States requested the formation of panels for both disputes. Request for the Establishment of a Panel by the United States, *China—Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/7 (Aug. 21, 2007); Request for the Establishment of a Panel by the United States, *China—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/363/5 (Oct. 11, 2007). The Dispute Settlement Body of the WTO granted the request for a panel in the IPR Dispute Settlement Case at its monthly meeting in September 2007, Proposed Agenda—25 September DSB Meeting, WT/DSB/W/364 (Sept. 21, 2007); *China’s IPR Action to Be Probed*, CHINA DAILY, Sept. 27, 2007, [http://www.chinadaily.com.cn/bizchina/2007-09/27/content\\_6138245.htm](http://www.chinadaily.com.cn/bizchina/2007-09/27/content_6138245.htm) (last visited Feb. 1, 2008). The Dispute Settlement Body also planned to grant the request to form a panel in the Market Access Dispute Settlement Case during its November 2007 meeting. Proposed Agenda—19 November DSB Meeting, WT/DSB/W/364 (Nov. 15, 2007).

IPR, the United States does not believe China has taken strong enough action to protect IPR and provide U.S. copyright industry access to its rapidly growing market.<sup>233</sup>

Instead of filing a single complaint, the United States sought to distinguish the two distinctive causes for the high levels of piracy and counterfeiting in China arising from WTO violations. First, China's continuing restrictions on importation and distribution of copyrighted products deny the U.S. copyright industry the ability to import and distribute their own products.<sup>234</sup> China specifically agreed to provide any firm that applied for trading rights (the right to import and export) and distribution rights with such rights no later than December 11, 2004, three years after China's WTO accession.<sup>235</sup> The U.S. request for consultations cited measures that restrict rights to import and distribute home entertainment products and various publications, including those published by electronic means.<sup>236</sup>

The U.S. case on China's IPR protection system asserts that several aspects of the legal regime are insufficient. First, the thresholds for criminal enforcement are insufficient, and the unavailability of criminal penalties for those making unauthorized copies does not comply with Articles 41.1 and 61 of the WTO TRIPS Agreement.<sup>237</sup> Second, China violates Article 46 and 59 of the TRIPS Agreement when it permits seized goods to re-enter the market.<sup>238</sup> Finally, the period during which copyrighted products are forbidden to enter China and denied copyright protection while awaiting censorship review violates Articles 3.1, 9.1 (incorporating Berne Convention Article 5(1) and (2)), 14, and 41.1 of the TRIPS Agreement.<sup>239</sup> These cases should both result in panel decisions in 2008.

## 2. Case Filed by China Against the United States

On September 14, 2007, China brought its second WTO dispute settlement case against the United States since joining the WTO, seeking consultations on the U.S. Department of Commerce's (Commerce) preliminary decision to impose countervailing duties on coated free sheet paper (CFS Paper) imported from China.<sup>240</sup> Commerce currently treats China as a non-market economy (NME) for anti-dumping purposes. While Commerce claims that U.S. law does not restrict the application of U.S. countervailing duty (CVD) law<sup>241</sup> to market economies, it has not applied CVD laws to NME

233. Office of the U.S. Trade Representative, *United States Files WTO Cases Against China Over Deficiencies in China's Intellectual Property Rights Laws and Market Access Barriers to Copyright-Based Industries*, Apr. 9, 2007, [http://www.ustr.gov/Document\\_Library/Press\\_Releases/2007/April/United\\_States\\_Files\\_WTO\\_Cases\\_Against\\_China\\_Over\\_Deficiencies\\_in\\_Chinas\\_Intellectual\\_Property\\_Rights\\_Laws\\_Market\\_Access\\_Barr.html](http://www.ustr.gov/Document_Library/Press_Releases/2007/April/United_States_Files_WTO_Cases_Against_China_Over_Deficiencies_in_Chinas_Intellectual_Property_Rights_Laws_Market_Access_Barr.html) (last visited Mar. 2, 2008).

234. *Id.* ("These [copyrighted] products are favorite targets for IPR pirates, and the legal obstacles standing between these legitimate products and the consumers in China give IPR pirates the upper hand in the Chinese market").

235. Report of the Working Party, *On the Accession of the People's Republic of China*, WT/MIN(01)/3, paras. 83(d) (trading rights), 84 (distribution) (Nov. 10, 2001).

236. Market Access Dispute Settlement Case, *supra* note 232.

237. IPR Dispute Settlement Case, *supra* note 232, at 1, 6.

238. *Id.* at 3.

239. *Id.* at 3-6.

240. Request for Consultations by China, *United States – Preliminary Anti-Dumping and Countervailing Duty Determinations on Coated Free Sheet Paper from China*, WT/DS368/1 (Sept. 18, 2007) [hereinafter CFS Paper Case].

241. 19 U.S.C.A. § 1671 (2002).

countries since deciding in *Georgetown Steel* that such application raised theoretical problems.<sup>242</sup>

On a petition filed against Chinese exporters of CFS paper, Commerce reexamined its position in *Georgetown Steel*, and on November 20, 2006, it decided to initiate a CVD investigations against the Chinese CFS industry.<sup>243</sup> On April 9, 2007, Commerce issued its preliminary determination, which found six subsidy programs to be countervailable and assessed a preliminary countrywide CVD rate of 18.16 percent *ad valorem*.<sup>244</sup> Commerce finalized its determination on October 18, 2007, with the expectation that the U.S. International Trade Commission (USITC) would issue a final injury determination shortly thereafter.<sup>245</sup> Commerce launched four additional CVD investigations against Chinese exports in the months before China brought this action at the WTO.

China's complaint alleges that Commerce's preliminary determination failed to substantiate its finding that the subsidies found to be countervailable were specific as required by Article 2.4 of the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement); erred in concluding that China's policy lending program conferred "benefit" to the Chinese exporters as defined in Articles 1 and 14 of the SCM Agreement; and miscalculated the countervailing duty rate and the antidumping rate in violation of relevant provisions of the SCM and Antidumping Agreements.<sup>246</sup>

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242. See Monroe Leigh, *Countervailing Duties—Applicability of U.S. Countervailing Duty Law to State-Controlled Economies*, 81 AM. J. INT'L L. 212-214 (1987).

243. Coated Free Sheet Paper from the PRC, Indonesia and the Republic of Korea, 71 Fed. Reg. 68,546 (Dep't of Commerce Nov. 27, 2006).

244. Coated Free Sheet Paper from the PRC, 72 Fed. Reg. 60,645 (Dep't of Commerce Oct. 25, 2007).

245. International Trade Administration Fact Sheet (Dep't of Commerce Oct. 18, 2007). In fact, the USITC determined that the U.S. CFS industry does not suffer from material injury or face the likelihood of material injury and declined to make the finding necessary for a permanent countervailing subsidy order to issue. News Release 07-115, Coated Free Sheet Paper from China, Indonesia, and Korea Does Not Injure U.S. Industry, Says ITC, Nov. 20, 2007, [http://www.usitc.gov/ext\\_relations/news\\_release/2007/er1120ee1.htm](http://www.usitc.gov/ext_relations/news_release/2007/er1120ee1.htm) (last visited Mar. 2, 2008). While this is a setback for the U.S. CFS industry, it does not change the underlying issues at stake at WTO Dispute Settlement, although it may have a procedural impact on the case.

246. CFS Paper Case, *supra* note 240.