Journal of the European Union Chamber of Commerce in China

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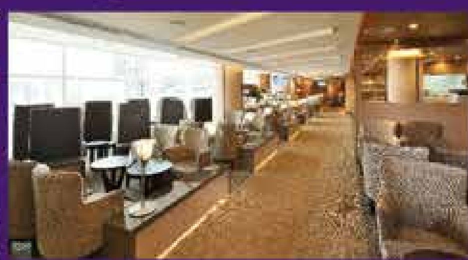

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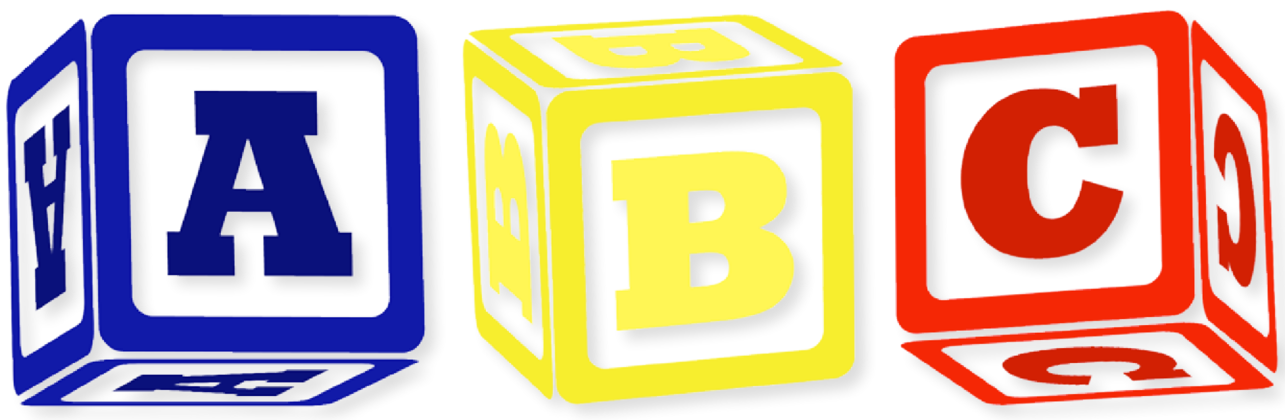

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RULE OF LAW

Jörg Wuttke
President of The European Union Chamber of Commerce in China

The European Chamber and our members take 'rule of law' to be a fundamental requirement for a functioning market economy and a prerequisite for sustainable economic growth. Ever since it was introduced as an option in the European Chamber's annual *Business Confidence Survey*, improved rule of law has been identified by European industry as the top potential driver for China's future economic growth.

China's leadership indicated in the 3rd Plenum's *Decision*, that a market economy is where China is headed. This has raised hopes for comprehensive reforms – not only within the international business community, but also among Chinese citizens.

In Article 2 of the *Decision* there is an acknowledgement that China must be governed according to the rule of law, so it is extremely encouraging that the 4th Plenum, to be held in November this year, is going to focus specifically on this subject.

It is useful to refer to the United Nation's official definition of the concept of 'rule of law':

"The rule of law is a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness and procedural and legal transparency."[1]

Based on this definition, we can assert that rule of law is comprised of the following four qualities: accountability, transparency, public consultation and an independent judiciary.

In China there is still a lack of constraint on administrative powers and thus the accountability of, for example, law enforcement agencies, is still limited. This has been apparent throughout the recent Anti-Monopoly Law (AML) enforcement cases, in response to which the European Chamber released an official statement on 13th August. As mentioned in this statement, the European Chamber had received numerous alarming anecdotal accounts from a number of sectors that administrative intimidation tactics were used to impel companies to accept punishments and remedies without full and proper hearings. Such governmental practices are not in line with the *Decision's* vow for governance in accordance with the rule of law.

There is also a lack of transparency in the promulgation, elaboration and implementation of laws and regulations by legislative, judiciary and administrative bodies. Despite efforts to improve transparency and consultation by the State Council Legislative Affairs Office, many ministries and commissions still do not allow for a consultation period of at least 30 days for public comments on draft regulations. For example, there was no public consultation on the revision of the China (Shanghai) Pilot Free Trade Zone (CSPFTZ) *Negative List* and the public consultation concerning the Administrative Regulation of the CSPFTZ was only open for 27 calendar days, covering a holiday period.

Rule of law requires predictability as it increases trust in the legal system. However, the often erratic legislative environment and the discretionary enforcement of regulations still remain the two most significant regulatory obstacles for European business in China, as identified by our members in the Chamber's *Business Confidence Survey 2014*.

Reform must ensure judicial independence, not just from local governments, but also from interference from prosecutors and any state actors. Without such independence, the system would still allow for official arbitrariness.

We are encouraged that China has indicated that it will embark on an overhaul of its legal system, and that the Party has communicated the need for rule of law. A fair and efficient legal system that inspires complete trust is crucial for business as it allows companies to plan their activities accordingly and safeguards the rules protecting the market economy.

The European Chamber is looking ahead to November's 4th Plenum with a mixture of anticipation and cautious optimism. As a member you can be assured that we will be watching these developments closely, and we will remain ready to liaise with the Chinese Government to offer our support and advice.

[1] *What is the rule of law?* - United Nations Rule of Law, http://www.unrol.org/article.aspx?article_id=3

YOU MUST COMPLY

Compliance and 'rule by law' in China

There seems to be a broad consensus, even within the Chinese media, that China has not yet fully implemented 'rule of law' say **William Soileau** from **Pinsent Masons LLP** and **Rosario di Maggio** from **Vistra.** They explain that, instead, in the last 35 years of reforms, China has in essence instituted a form of 'rule *by* law'. Regardless of the current state of play they encourage all foreign businesses operating in China to ensure that they are fully compliant with all prevailing laws and regulations.

Introduction

'Rule of law' in essence just means that society is governed by law, and that law givers and law enforcers are subject to the same rules as everyone else. China has developed a plethora of laws and legal-regulatory institutions, tools for governing all aspects of society. But the system is incomplete, and the rulers themselves remain above the law.

This situation poses compliance risks for individuals and businesses, and for foreigners in particular. This article will explore China's 'rule by law' and the implications for foreign business, and offer some suggestions for coping with this reality.

The following are some observations garnered from our practices over the years helping foreign business set up and operate in China.

Foreign opportunism

Foreigners, being aware of the more limited scope of law here, often seem to minimise the importance of compliance. This attitude is perhaps more common among new entrants to the market, and also perhaps to smaller companies with less developed cultures of compliance, and fewer resources to devote to it.

All foreigners should adopt a policy of full compliance in China. They should not assume that the consequences of non-compliance will be easier to bear than the costs of complying in the first place.

Legal ambiguity

With the rapid development and recent history of law in China it is not surprising that there should be gaps, inconsistencies and ambiguities in the legal and policy framework.

Rapid development means rapid change, as laws are constantly explained, revised and updated in line with shifting practical concerns and policy priorities. Often, overlapping series of regulations will affect fundamental changes in policy, imposing, reversing and modifying requirements in subtle ways. The foreign exchange control regulations are a good example of this, being subjected to major, frequent changes as policy has vacillated between tightening up and liberalisation.

Legal drafting is not always as clear as one would hope. Chinese drafters favour simplicity and directness, aiming to make laws intelligible to a far flung rural populace. But, as a result, there can be significant questions about new regulations. It can take quite some time for the import and workings of new regulations to become clear.

Of course, across China, there is significant local variation in the application of central laws and regulations. Local enactments cannot violate national law, but local authorities are free to innovate in implementing national regulations. These factors can make it difficult to know what the law actually is, resulting in increased discovery and compliance costs, and less certainty in choosing outcomes.

A particularly difficult situation can arise when local officials propose procedures that are beneficial to the foreign party, but that are of questionable legality. Since officials have broad powers to interpret the law, it is difficult (and could be deleterious) to question the legality of the officials' proposal. But if one also cannot say that the proposal is legal, the result is inevitably some modicum of residual risk.

Fundamental legal ambiguity can even affect whole areas of foreign investment. This is the case, for example, with so-called variable interest entity (VIE) structures, which are of questionable legality but have nevertheless been used by a large number of Chinese Internet companies that have listed abroad.

Bias against foreigners

Broad anecdotal evidence suggests that extra-legal discrimination against foreign enterprises is practiced widely by the administrations responsible for enforcing all types of domestic law. This is perhaps inevitable. Lacking natural allies in the local government, foreigners are simply much easier targets than domestic enterprises when it comes to tax, workplace safety, environmental, labour and any other type of enforcement.

This is a key factor causing increased compliance and enforcement risks for foreigners. Foreigners should be aware that their domestic competitors and disgruntled employees may have every incentive to whistle blow against them, for issues legitimate or otherwise.

There is also an element of commercial risk here, since one's domestic competitors may be able to gain competitive advantages by not complying with the law.

Local protectionism

Foreigners should always avoid going to court against a Chinese party in the Chinese party's home city. But local protectionism can also be a problem for Chinese parties from out of town. The smaller and more remote the venue, and the more influential the local party, the more likely the local court is to be materially biased in its favour.

Foreign investors often consciously choose a powerful local Chinese party as their joint venture partner. That tends to work fine as long as the interests of the parties are aligned. However, when the interests of the parties diverge, the foreign party will be at a definite disadvantage in any dispute with the strong local partner.

Enforcement problems

A range of problems arise in legal enforcement.

Enforcement of court and arbitral judgements still remains challenging, primarily because the courts' lack of certain contempt, seizure and other enforcement powers. Ultimately, this may result from a reluctance to subject all organs of the Party and government to the full scope of independent judicial power.

The quality of administrative enforcement varies widely, from time to place. At all times, the quality of administrative enforcement is impaired by gaps in the law and the discretion left with local officials not able or willing to honestly or effectively exercise it. Also the thoroughness and accuracy of enforcement are highest in top-tier cities, and decrease from there.

Judicial appeal of administrative decisions seems to be quite rare. Private parties are understandably reluctant to challenge their local bureaucratic masters. Administrators have broad discretion in exercising their authority, and any major action that they take is likely to be coordinated in advance through bureaucratic and Party channels. Peter Humphrey's show trial is perhaps a good example of this. No matter the merits, where there is no possibility of appeal the result will be a foregone conclusion.

Humphrey's case also illustrates the possibility for non-legal factors to play a large role in official proceedings. Sometimes, *who one deals with* can be as important as *what one does*.

In practical terms this all means that, once official enforcement action has begun, it is too late to exercise any real control over the situation. It is much better to scrupulously comply with the law, and to carefully manage one's personal relations in the first place.

The culture of compliance

Ultimately, China's underdeveloped culture of compliance may be both the most fundamental cause and most important result of its underdeveloped rule of law.

Chinese individuals, like people everywhere, are naturally reluctant to comply with the law when to do so is costly to them. But the underdeveloped legal system enables non-compliance. And the lack of voluntary compliance in turn directly undermines the policy power of law, and also the 'rule of law' as an ethical imperative in the broadest cultural sense.

Clearly, one lesson is that, if it will not be provided by society, companies themselves must inculcate a culture of compliance in their own businesses.

Conclusion

China's lack of 'rule *of* law' and its approach to 'rule *by* law' may create both challenges and opportunities for foreign enterprises here. But foreign companies should not assume that a lower standard of compliance should prevail here than at home. They should commit to full compliance in China.

Top local management and overseas headquarters should be actively involved in compliance processes in order to send the appropriate message from the top, ensure consistency with global best practices and help build a culture of compliance within organisations here. Eb

__Vistra__ is a global independent provider of trust, fiduciary, corporate and fund services, with 30 offices in 22 jurisdictions. __Pinsent Masons LLP__ is a London-based international law firm that has been in Greater China for over 30 years.

Professor Wang Xiaoye, Institute of Law, Chinese Academy of Social Sciences and advisor to the drafting committee of China's AML, delivers a lecture to the 10th NPC Standing Committee in 2005 on the topic *Anti-Monopoly Law is the Basic Rule of Law to Maintain the Order of the Socialist Market Economy*.

FAIR GAME

Competition law and the increasing cost of doing business in China

Although the Chinese Anti-Monopoly Law (AML) has been in force for over six years, competition law enforcement has only considerably intensified in the past several months. Today, competition law has become a key issue for companies doing business in China. **Adrian Emch** from **Hogan Lovells**, Beijing, analyses recent developments and says that companies in China need to strengthen their AML compliance and even be prepared to deal with the possibility of a dawn raid.

During the first months, perhaps years, following the AML's entry into force in August 2008, the Chinese competition authorities maintained a relatively low profile. One reason was their limited manpower. But, equally, the officials at the National Development and Reform Commission (NDRC), the State Administration for Industry and Commerce (SAIC), and the Ministry of Commerce (MOFCOM)—the three authorities with AML enforcement powers—dedicated time to drafting AML implementation rules at the beginning of their AML mandate.

Over time, China's competition authorities began to use their growing regulatory heft to investigate and decide on a number of significant cases. Of note, in early 2013, the NDRC imposed a (then) record fine of approximately EUR 43.6 million on a group of Korean and Taiwanese companies for fixing LCD panel prices. The substantial fine imposed in this case arguably portended the future of competition enforcement in China.

Fast forward to 2014 – on 28th July and 6th August, seven offices of software giant Microsoft were searched in simultaneous raids by around 100 officials from the SAIC and its local counterparts. In parallel, on 20th August, the NDRC announced its decision against 12 Japanese car part manufacturers for cartel behaviour, setting a new record in imposing a fine of around EUR 153 million in total.

Even the MOFCOM, which had been perceived as the most experienced of the three authorities, shocked observers by prohibiting the P3 cooperation plan of three large European shipping lines—Maersk, CMA CGM, and MSC—while the European Commission (EC) and the United States (US) authorities decided not to object to that plan.

These developments underscore how important it is now for companies operating in China to follow AML developments closely.

NDRC and SAIC investigations

The NDRC and the SAIC are responsible for investigating and sanctioning monopoly agreements and abuse of dominance conduct.

The day after the simultaneous dawn raids on Microsoft's premises in Beijing, Shanghai and Guangzhou, the SAIC issued a statement explaining that it suspected Microsoft of engaging in illegal tying of the Windows operating system and Microsoft Office software with other products or services. Nearly one week later the SAIC raided Microsoft again, as well as Accenture in Dalian, to which Microsoft had outsourced its accounting.

Even before this case, the NDRC had already initiated several significant investigations, including those against InterDigital and Qualcomm. Both investigations relate to the way the US companies license their patents, including so-called standard essential patents, to Chinese companies. In the InterDigital case, the NDRC suspended its investigation in May 2014, as the company had acknowledged its wrongdoing and offered commitments to remedy the NDRC's concerns. The Qualcomm investigation is still ongoing, and its outcome is uncertain.

Apart from the patent-related cases, the NDRC has also focused its enforcement on so-called resale price maintenance (RPM). In essence, RPM occurs where a manufacturer sets the price that its distributor—to which it sells its product—can charge the distributor's own customers.

The AML prohibits such conduct to the extent that the distributor must respect the manufacturer's fixed or minimum resale price. In theory, RPM—as other potentially anti-competitive conduct—could be justified if pro-competitive effects are shown. Outside China, economists believe that RPM imposed by companies with low market shares are generally not harmful to competition.

Yet the NDRC's enforcement practice in previous cases involving white liquor and baby milk formula producers has shown that the regulator targets companies with large and small market shares, and does not seem inclined to consider a pro-competitive effects a reasonable defence.

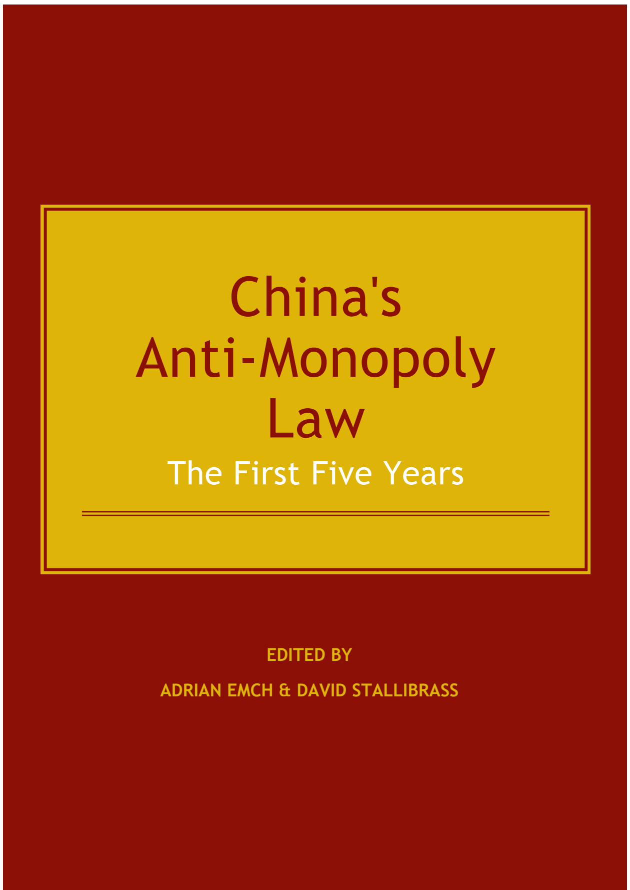
Turning to the SAIC, it appears this authority has focused predominantly on domestic cases for the first few years of the AML's enforcement. This trend has continued as the SAIC has recently been pursuing investigations involving domestic players. For example, in July 2013, the SAIC's local offices in Hunan province fined local insurance companies for collusion in relation to car insurance. Similarly, in January 2014, a local water supply company in Huizhou, Guangdong province, was fined around EUR 395,000 for tying water supply with the sale of its pipeline construction services vis-à-vis real estate developers.

Of course, the Microsoft investigation will easily be the SAIC's most eye-catching case – given the degree of publicity the investigation has attained, it would seem to be hard for the SAIC not to conduct a thorough examination of Microsoft's suspected AML violations.

MOFCOM merger cases

As noted, on 17th June, 2014, the MOFCOM prohibited the P3 alliance between Maersk, CMA CGM and MSC, and the companies' plan fell apart thereafter. This is the second merger prohibition by the MOFCOM, following Coca Cola's failed attempt to acquire local fruit juice maker Huiyuan in 2009.

Yet, unlike the P3 alliance and the Coca-Cola/Huiyuan case, over the past six years the MOFCOM has unconditionally cleared a majority of merger notifications submitted for review. In 24 cases they approved the



China's Anti-Monopoly Law: The First Five Years that Emch co-authored with David Stallibrass

notified transactions subject to certain conditions – such as the divestment of parts of the business, or behavioural commitments including pricing obligations during a number of years.

Apart from the actual intervention by the MOFCOM in a limited number of cases, one of the most frequently heard complaints by businesses involved in their merger control process has been that the regulator's review period was too long.

Since February this year there is some hope that this will change, as the MOFCOM has established a new system for so-called 'simple cases' that fulfil certain criteria. Similar to the EC's approach, these cases go through a process of consultation by way of public notice, and benefit from a marginally lower documentary burden. However, it may be still too early to conclude whether the new system really meets expectations.

AML compliance and raid preparation are now essential

Anti-Monopoly Law compliance has clearly become an increased cost of doing business in China. Yet, as the flurry of new cases with skyrocketing fines and public relations nightmares show, the costs can be even higher if a company fails to do the homework and becomes the target of an AML investigation.

Against this backdrop, companies need not only revisit their compliance levels afresh but should also prepare for the worst-case scenario of a 'dawn raid'.

In terms of compliance, European-headquartered companies should take an honest look at themselves, and recognise that—in practice—their businesses in China may be run differently than in Europe and may follow local practices. They should also note that in China the awareness of competition law is often not as widespread as it is in Europe. For instance, in the past, many manufacturing companies—local and foreign—have tended to have systems to set and monitor the resale prices of their distributors. This practice is now highly risky in the light of the NDRC's enforcement stance.

Even if a company is very confident about its level of legal compliance, it should still beef up, or consolidate, its 'dawn raid' reaction capabilities. The SAIC's investigation into Microsoft showed the new degree of 'sophistication' of Chinese competition regulators, as the raids took place at multiple offices simultaneously all over China. Past press reports also indicate that the regulators screen documents, and in the Microsoft case even seized several computers.

To prepare for such raids, companies need to make sure they are genuinely ready. In principle, everyone at the company's premises should know how to behave, and how not to behave – for example, the authorities can be expected to crack down hard on destruction of evidence. Certain personnel in the company play a key role in antitrust raids, be it the receptionist, the IT staff or the people in the legal department. They need to be at the top of their game if a raid occurs, and this sometimes requires specific training. In the extreme, a mock dawn raid is an option to 'stress test' the company's reaction capabilities.

As for the mergers filed with the MOFCOM, companies and their counsel need to understand—and accept—that merger filings in China can be complex, and even straight-forward cases are rarely a shoo-in. In addition, sometimes the MOFCOM reviews foreign-to-foreign transactions led by legal teams (in-house and/or with outside counsel) located abroad. In our experience, it is always good to have local input from legal and business teams who know the market and the stakeholders involved. Eb

__Hogan Lovells__ is a global legal practice with over 2,800 lawyers in more than 40 offices including three offices in Greater China, five offices in the rest of Asia, and 17 offices in Europe. The Beijing, Shanghai and Hong Kong offices provide a full range of services covering antitrust/competition law, banking and finance, corporate and contracts, dispute resolution, government and regulatory, intellectual property, media and technology, projects, engineering and construction, real estate, and restructuring and insolvency.

THE GREAT WALL AND CHINESE REFORMS

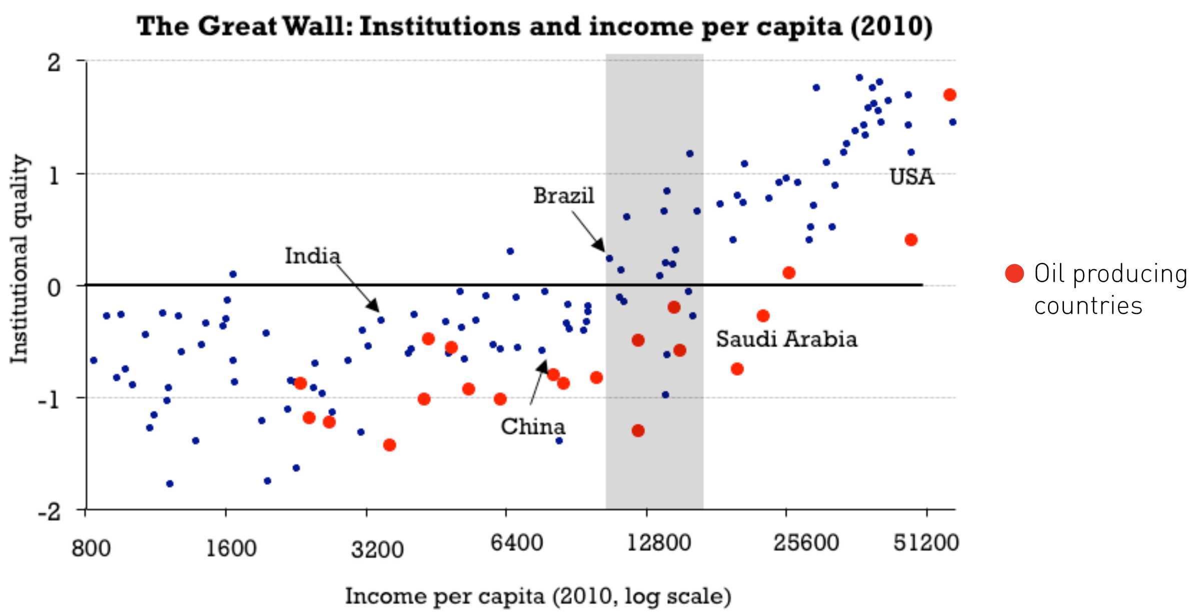
By examining the quality of a country's institutions relative to its gross domestic product per capita, a clear pattern emerges. **Antonio Fatás** and **Ilian Mihov** from **INSEAD** explain that there are two stages of development: in the first stage, a developing economy can achieve high growth regardless of the quality of its institutions; in the second stage it is a different story – countries with low-quality institutions do not become rich. The indicators of institutional quality used in this analysis are voice and accountability (i.e. democracy), political stability, quality of regulation, control of corruption, government effectiveness and rule of law. As China looks to continue its growth trajectory, addressing the need for reforms in these areas becomes crucial. Rule of law, they say, plays a central role.

Over the past 35 years China has grown at an unprecedented rate, which has helped to lift hundreds of millions of people out of poverty and has led to a dramatic change in the economic structure of the country. But how long can China's economy continue to grow? Not much longer, we suspect, unless the country engages in deep structural reforms that improve its institutions. It's well known that countries' economic performance is related to institutional quality, which is gauged by factors like political stability, government efficiency and the prevalence of corruption. China has sustained high growth rates in recent years despite its poor institutions because institutional quality is relatively less important in developing economies.

The argument that institutional quality is important for growth is not new and many have written about it, but our emphasis is on the changing relationship between institutions and growth at different stages of development. In the early phases of growth the relationship between institutions and income per capita is very weak (no need for radical reform), while it becomes very strong for higher levels of development.

In the chart below we show the relationship between institutions and income per capita (in USD) in 2010 (institutional quality is measured as the average of the six governance indicators produced by the World Bank;[1] gross domestic product (GDP) per capita is adjusted for purchasing power parity (PPP)).

1. http://info.worldbank.org/governance/wgi/index.asp



The chart suggests that there are two phases of growth. A first one where institutional reform is less relevant. When we look at the chart we see almost no correlation between quality of institutions and income per capita for low levels of development, i.e. in the lower left area. To be clear, not everyone is growing in that section of the chart so it must be that there is something happening in those countries that *are* growing (moving to the right). Success in this region is the result of good 'policies' in contrast with the deep changes in institutions that are required later (you can also call them economic reforms as opposed to institutional reforms).

The second phase of growth takes countries beyond the level of USD 10,000 – USD 14,000 of income per capita. It is in this second phase when the correlation between institutions and income per capita becomes strong and positive. No rich country has weak institutions, emphasising the importance of reform as a requirement for continued growth.

In a note for the *Harvard Business Review* (2009) we called the grey region 'The Great Wall'. Economies either 'climb' the wall to become rich or they hit it and get stuck. Economies that illustrate the notion of hitting the Wall are the countries from the former Soviet Bloc that collapsed in 1989 after not being able to 'climb' the Wall with its institutional setting (a centrally planned economy); or Latin American economies such as Venezuela or Argentina which have incomes around that level and do not seem to be able to take their economies to the next step.

We named that threshold 'The Great Wall' as a reference to China: a country that over the last decades has displayed the highest growth of income per capita in the world with a set of institutions that are seen as weak (at least relative to advanced economies). China is highlighted in our chart and what we can see is that, while it is still in the first phase of growth, it is getting closer and closer to the Wall. As expected, the growth rate of China slowed down in the past few years and the discussions about reform intensified. It is therefore not a surprise that the current government of China recognises reforms as the only way to address the challenge of the next phase of growth.

Characterising the two phases of growth and making explicit the necessary reforms that are needed to go from one to the other is not an easy task and it is likely to lead to different policy recommendations for different countries. It is instructive to look a bit deeper behind the six indicators of institutional quality. They are voice and accountability (i.e. democracy), political stability, quality of regulation, control of corruption, government effectiveness and rule of law. Interestingly, the indicator that shows almost the same pattern as in this chart is rule of law.

It is important to gain a deeper understanding of this relationship but one possibility is that advanced economies, i.e. the ones that have 'climbed' over the Wall, have succeeded in establishing unbiased courts and efficient contract enforcement. This is needed in order to facilitate further division of labour, creation of complicated value chains, where each producer, by specialising in doing one small task, becomes very efficient and thus contributes to bringing up the productivity in the country and, ultimately, income per capita. Of the six indicators, the rule of law seems to play a central role. If this is the case, then for China to continue its convergence to an advanced economy, it will be imperative to establish the appropriate rule of law. Eb

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THE NEW RULES OF THE GAME – INDUSTRIAL LAND USE IN CHINA

Since the first quarter of 2014, the Shanghai Government has issued three circulars regarding changes to the industrial land supply rules. As of 1st July, 2014, the granted land use terms for industrial projects in Shanghai were reduced from 50 years to no more than 20. This has triggered extensive concerns among foreign-invested companies, particularly those considering greenfield investment or business expansion in Shanghai. In addition to Shanghai, a number of cities like Beijing, Hangzhou and Zhuhai, issued similar rules. On 1st September, 2014, the national measures that strengthen industrial land supply took effect. In the following article **Cody Chen** and **Yang Cui** from **Taylor Wessing** interpret the new rules of the game.

Legislative background: not an overnight change

Since the PRC *State-owned Land Use Rights Grant and Transfer Provisions* were issued in 1990, China has undergone a vast urbanisation process and land supply-related revenue has become the financial cornerstone of local governments. However, in the last 20 years there has not been much progress in solving related long-term problems, which include under-priced industrial land; excessive granting of land use rights leading to scarce land resources; low use efficiency; low output; and increasing soil and ground water pollution. The Chinese Communist Party's response at their Annual Conference in November 2013 was an explicit requirement to adopt "higher industrial land prices", a "stricter construction land supply mechanism", and "measures to increase efficiency in the usage of State-owned construction land".[1]

Since 2008 the Ministry of Land and Resources (MLR) has been calling for more thrift and efficient use of land. Following the Shanghai local rules, the MLR officially issued the *Measures on Thrift and Efficient Use of Land* (*MLR Measures*) in May 2014, which became effective on 1st September, 2014.

Apart from Shanghai, which seems to have adopted the pilot changes, a number of cities, like Beijing, Hangzhou and Zhuhai, issued similar rules. Now the *MLR Measures* have come into effect, we may reasonably expect a nationwide roll-out of the industrial land supply reform we have seen in Shanghai.

New rules

Shortened industrial land use terms

Since China first adopted the legal concept of 'granting' State-owned land use rights to individual investors in 1990, the law has maintained that the granted term for industrial land usage is *up to* 50 years. Therefore, from a purely legal perspective, Chinese law has never stipulated that the industrial land use term *should* be fixed at 50 years. Because we have rarely seen a single case where an investor accepted industrial land with a use term less than 50 years, this has led to the assumption that the use term for industrial land is, and should be, 50 years.

In Shanghai, as of 1st July, 2014, the maximum term for industrial land use is now 20 years. In the Beijing Economic and Technology Development Zone and Shandong Linyi city, 20 years has also been adopted as a cap for industrial land use terms. In Hangzhou and Zhuhai, it is 30 years.

At the national level, the *MLR Measures* provide that local governments may implement shorter land use terms within the statutory permitted maximum term of 50 years. Until further updates are issued, local governments will retain autonomy in this respect.

Promoting the land lease model

The *Implementation Regulations on PRC Land Administration Law* issued in 1998 stipulate that an investor can obtain land use rights from the government by allocation, granting or lease of land. Allocated land use rights—where land use is basically free—is only available to State and military-owned public interest projects. Granted land use rights have been the dominant approach for enterprises in practice. Land lease only seems to exist in statutory law, though various local land bureau officials with whom we spoke either appeared to have no idea about leased land use rights, or declined to comment since it had never been implemented in reality.

Nowadays both the *MLR Measures* and some local rules promote 'lease'-related approaches for investors to obtain land use rights. These include:

a. standard plant lease;
b. leased land use rights; and
c. lease before grant.

Standard plant lease is a classic lease concept governed by the PRC Contract Law. Such leases, based on the PRC Property Rights Law, usually include the land use rights and the buildings.

Leased land use rights only, however, is a completely different legal concept. Based on the statutory rules, both national and local, enterprises may also obtain leased land use rights and enjoy exclusive use for the duration of the lease. Such exclusive use rights can be proven by a State-owned land use right certificate, with the lessee free to construct buildings on the land and obtain building ownership in its own name.

Lease before grant means that the local land authority first leases the industrial land to an investor, with specified pre-conditions to be met in the lease contract before granting land use rights.

Stricter planning indices

The statutory defined planning indices for industrial land mainly include investment intensity, plot ratio,[2] building density, supporting facility ratio (percentage of non-production building area compared to the total construction area of the plant) and greenery ratio.

On both the national and local level, there is a trend towards imposing more stringent planning indices for industrial land. For example, in Shanghai the minimum plot ratio was increased from 0.8 to 1.2 under the

[1] In China, State-owned construction land includes industrial land, residential land, commercial land, etc.

[2] Plot ratio refers to the ratio of a building's total floor area (gross floor area) to the size of the piece of land upon which it is built.

Breach of Contract	Old Version Contract	New Version Contract
Annual tax revenue	N/A	• Liquidated damages • Termination grant contract / take-back of land
Performance review	N/A	• Termination grant contract / take-back of land
Construction delay	Liquidated damages (rarely enforced)	• Performance bond • Liquidated damages • Termination grant contract / take-back of land
Contamination of underground water and soil	N/A	• Soil and underground water benchmark test report to be attached to the grant contract • Serious contamination: termination grant contract / take-back of land
LUR transfer (as a whole)	N/A	• Transfer under the conditions: ✓ transferred with building; ✓ grantor's consent. • Termination grant contract / take-back of land
Land separation and partial transfer	Restricted	• Generally prohibited • Termination grant contract / take-back of land
Equity transfer of the land use right owner company	N/A	• Grantor's consent • Termination grant contract / take-back of land

new rules. This is not practically possible for certain industries, such as heavy machinery. Based on unofficial government sources, the chemical industry is the only possible exception for the newly-adopted minimum plot ratio due to mandatory fireproof codes.

New land use rights grant contract in Shanghai

As of 1st July, 2014, Shanghai adopted a new version of the grant contract for State-owned construction land for industrial purposes. The new version places more restrictions on investors (grantees), some of which could be questionable as to their compliance with basic Chinese laws including the Property Right Law. The fact that one is unable to negotiate the grant contract has added to concerns among foreign industry. New contractual restrictions include performance reviews of a grantee's turnover and tax revenue and prior consent by local government for property and equity transfers. Violation of contractual obligations may lead to termination of the grant contract and take-back of the land by the government, adding further uncertainty to an investor's long-term business plan. The table at the top of the page summarises the major differences—in terms of breach of contract consequences—between the old and new versions.

Build-to-lease

There is a clear trend that the Chinese Government will continue to tighten up industrial land supply rules, both legally and economically. Under pressure from central government, more provinces and cities may follow Shanghai's pilot reform.

The result could be that we see less greenfield investment in the form of land acquisition, and certain industries and projects could relocate outside Shanghai where 50-year land use terms still exist. More investors may also consider other alternatives, such as acquisition or leasing of existing factory plants.

Build-to-lease may become increasingly popular among foreign investors. Under this model, both the land use rights and factory buildings are owned by the industrial zone. It differs from the standard plant lease model in that the entire factory plant is tailor made by the owner for the investor. Based on a well-drafted build-to-lease contract, the investor should be able to have a say in the entire process of engineering design and construction management.

Another advantage of this model is that the investor does not need to pay all at once for the fixed-assets expenditures. It is financially better for the investor to be able to amortise such costs into rent payable. For a long-term sustainable business plan, the build-to-lease model is also better than a normal plant lease. A build-to-lease contract usually has a much longer lease term with a mutually agreed and enforceable renewal mechanism. A landlord under the build-to-lease model always needs to think twice before terminating a contract or not renewing the lease, simply due to the tailor-made nature of the plant.

Tips for greenfield projects in China

- Thoroughly research and analyse local land supply policies. Look into possible local policy changes in the next year ahead, upon concluding an investment agreement.
- Negotiate a detailed investment agreement with the local government or industrial zone, including contractual protection in case of policy changes.
- Closely monitor the legal and policy development and communicate with the selected industrial zone, ideally via a designated project team. Eb

Cody Chen *is a partner at* ***Taylor Wessing*** *in Shanghai. Taylor Wessing is a full service law firm with approximately 900 lawyers in Europe, the Middle East and Asia, with offices in Shanghai and Beijing. For more information please visit www.taylorwessing.com.*

OPEN FOR BUSINESS

Legal challenges to online and offline retail in China

Whereas China has historically been an ideal destination for outsourcing manufacturing operations, its huge consumer market is now attracting more and more foreign companies to take control of their distribution and manage their own retail sales. **Rogier van Bijnen** and **Maarten Roos** of **R&P China Lawyers** discuss the legal challenges of this strategy and how China's rule of law may affect many trying to set up shop.

The pull of China's consumer market cannot be understated. Even manufacturing companies who do not conduct retail sales anywhere else in the world are being attracted by the dazzling numbers offered by China's (online) market. Initially many used B2B solutions, leaving Chinese distributors to sell direct to consumers. However, while this solution provides easy market entry, margins are thin and companies have no direct influence over marketing strategies. Now, numerous third-party online platforms, like Tmall (B2C), Taobao (C2C) and Alibaba (B2B), and the possibility of cheaply outsourcing delivery to logistics companies make setting up online retail operations in China seem easy. But is it?

Online selling: go local

China is at the forefront of online sales. In big cities, many middle-class consumers already purchase most of their consumables through the Internet. This presents two main options for foreign companies that do not wish to invest huge sums in brick-and-mortar stores: sell through a Chinese third-party platform, or develop one's own website in China.

Using a website outside of China is generally not recommended for a number of reasons predominantly established in law. Chinese consumers usually do not have foreign-currency credit cards, and so to avoid foreign-exchange restrictions a company would have to deal with expensive intermediaries. Also, delivery may be hampered by customs due to import restrictions and may be subject to import duties, plus the Great Chinese Firewall that protects Chinese Internet users will markedly slow traffic. If you really want to penetrate the Chinese market, you need to go local.

Third-party platform

The easiest way to sell online to Chinese customers is by operating a (web)shop on a third-party platform such as Tmall, JD.com (B2C), Alibaba or Taobao. Chinese customers are very familiar with buying on these websites, so there is already plenty of traffic, and the platforms are perceived as being reliable.

Before you can even think about selling online, you need to have your brand registered in China. None of the third-party platforms will allow anyone to open shop without a secure brand. This is the rule of law at work: since the amendment of the PRC Trademark Law (effective May 2014), parties who facilitate infringement may be held accountable.

Although officially no Chinese legal entity is needed to sell online in China, some of the platforms do require it (e.g. Tmall). We usually recommend this anyway, since importing goods and transactions with Chinese logistics providers are all much easier through a trading WFOE (wholly foreign-owned enterprise). This can be either a new WFOE or one that already exists and is engaged in other activities. Whether, in case of the latter, an expansion of the business scope is necessary depends on the proposed activities and the existing business scope. For example, as online sales is deemed an extension of a company's sale activities on the Internet, a duly licensed and registered foreign-invested manufacturing or commercial company may directly engage in online sales without specifically adding 'online sales' to its business scope.

Additionally, if the merchandise is imported, the WFOE needs an import licence and the relevant products should meet the Chinese legal standards that apply to such products (e.g. product licensing, packaging and labelling standards, which also must be in Chinese). These rules are applied with increasing strictness, so companies for which a smooth completion of customs procedures is important should prepare in advance to ensure they fully understand all procedures and requirements.

Online payment, warehousing and delivery are usually outsourced. Delivery is not only difficult to organise but also subject to specific licences (as a transportation company), and to date no foreign company has obtained a licence to handle online payment in China.

Owning your website

To operate a website in China, you need an Internet Content Provider (ICP) license from the Ministry of Industry and Information Technology (MIIT). An ICP licence for 'commercial' purposes is very difficult to obtain for foreign investors. Unless you are Amazon, forget about getting an ICP licence to set up a third-party platform to compete with Alibaba (and even Amazon did it with a 49 per cent joint venture, since a foreign majority stake is not permitted).

On the other hand, if a company only sells its own products through its own website, then under China's legal definitions such a website is deemed to be 'non-commercial'. In this case only a filing with the MIIT is required to obtain the ICP licence and no prior approval is needed (yes, a flexible rule of law can sometimes be an advantage). But only legal entities incorporated in China are eligible to obtain an ICP licence, so you would need to set up a trading WFOE to establish a local website within the Great Firewall.

Offline selling: stores

For larger companies, establishing one's own retail network of brick-and-mortar stores is not only the best way to reach consumers, but it is often also part of the branding and marketing strategy. Allowing consumers to come in and touch the products before buying online is a concept that has been proven to work very well in the Chinese market.

The business scope of the Chinese headquarters of a retailer generally includes both wholesale trading and retail (which automatically includes online sales). The main office can be established at a retail outlet, but larger retailers generally prefer to establish the WFOE in an office building, and then establish each retail store as a branch (it is not permitted to operate multiple stores under one WFOE; each new location requires a separate branch). Alternatives are to use a franchise model, sell through store-in-store concepts or use commercial partnerships.

China's geography also plays a role. Large retailers generally wonder whether they should be establishing one WFOE with branches all over the country, or whether it is beneficial to have WFOE's in major geographical areas (e.g. Beijing, Shanghai and Guangzhou/Shenzhen) under which to structure the individual outlets. From a tax perspective there may be benefits to having more WFOE's, though this must be weighed against the additional administration as well as relative complexity in finance and governance.

General procedures for branch establishment

Each new store opening starts with finding the right location and subsequent negotiations with the landlord. It is currently a seller's market—demand for the best locations is extremely hot—and so these negotiations are never going to be easy. Moreover, landlords generally do not shy away from using loopholes in lease contracts to get a tenant out if they can get a better deal with someone else, so make sure your contract is properly negotiated. We also see that more and more landlords require evidence that the store's brand has been properly registered, mainly for two reasons. The landlord will be assured by a stable intellectual property (IP) situation, and will want to avoid any risk that it is facilitating the trademark infringement of others.

Once a lease contract has been signed (and all documents required from the landlord have been obtained), your lawyers can proceed to establish the branch. The formal set-up is not complicated, but obtaining the various licences can be time-consuming, especially in second- and third-tier cities, and strict coordination with the landlord regarding the required documentation and licences of the premises is an absolute necessity. The good news: since 13th August, 2014, the Public Place Hygienic Licence can be obtained after establishing the branch, instead of before (note that not every city requires this licence, and the criteria may vary per city). This means the licence can be obtained simultaneously with several other post-establishment steps (e.g. tax registration), thus reducing delays when setting up a new store.

R&P China Lawyers *(rplawyers.com) is a boutique firm with about 20 PRC licensed lawyers in Shanghai and Beijing. R&P assists international clients doing business in or with China, advising on corporate/M&A, commercial contracts, IP, employment and dispute resolution.*

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MAKING AMENDS

WHAT YOU SHOULD KNOW ABOUT THE PRC ADVERTISEMENT LAW AMENDMENT

In today's commercialised society the role of advertising has become hugely important for companies. Increased globalisation means that advertisements as sales stimulants play a crucial role in delivering information cross border. With more and more foreign companies now wanting to promote their products within the Chinese market, it is more important than ever to know and understand the PRC Advertisement law, says **Carlo Diego D'Andrea** of **D'Andrea and Partners.**

Following on the heels of economic reform the first regulation on advertising was introduced in China in 1982. The *Provisional Regulations on Control of Advertising* was issued by the State Council to promote the smooth development of the advertising industry. The current Advertisement Law of People's Republic of China came into effect on 1st February, 1995, and has not been amended for nearly 20 years.

China now is a complete different country compared to when the first Advertisement Law was promulgated, so it has become important for the authorities to issue a new amendment adapted to the needs of contemporary Chinese society. Many new problems emerged in recent years which the legislators could not have foreseen when the law was first promulgated, such as endless junk calls, mailings, text messages and emails. Some articles of the original law also conflict with World Trade Organisation (WTO) rules, which has helped to push the modification of the Advertisement Law firmly back on the agenda.

In February 2014, the State Council Legislative Affairs Office (SCLAO) started to solicit opinions from the general public on the consultation draft of the Advertisement Law of the People's Republic of China (Revised Draft) (the *Amendment*). It is understood that the content of the *Amendment* is almost double the length of the original law, with many articles being added, amended and improved, and detailed guidelines being provided.

Below we introduce and analyse several important points from the *Amendment* which are essential for businesses to understand.

Medicines and medical apparatus

The *Amendment* emphasises that the content of advertisements for medicine or medical apparatus should be based on factual information and in accordance with certified documentation approved by the public health administration department. Specific requirements have been placed on advertisements for prescription medicine, over-the-counter (OTC) medicine and medical apparatus. (Article 16 of the *Amendment*)

In order to protect the health and safety of consumers, it is clearly defined in the *Amendment* that except for the medicines, medical apparatus and medical advertising which have been approved by the authorities, advertisements for other products shall not in any way be related to disease treatment functions; the use of medical terminology or wording is strictly prohibited, so as to avoid these products being confused with genuine medical products. (Article 26 of the *Amendment*)

Protection for minors

The *Amendment* has added articles to protect underage people. It stipulates that advertising in middle schools, primary schools and kindergartens is forbidden. It is also forbidden to advertise in the textbooks, supplementary materials and exercise books, on school uniforms and on or inside school buses. Furthermore, it is now forbidden to publish advertisements for medicines, medical treatments, medical apparatus, online games and alcoholic beverages in any media that is specifically targeted at minors. (Article 20 of the *Amendment*)

Deceptive advertising

The *Amendment* confirms that any advertisement containing any kind of information that could potentially mislead consumers is deceptive advertising. The punishment for anyone found guilty of deceptive advertising is more severe than in the original law. Previously, a fine ranging from twice to less than five times the total cost of the advertisement was handed down for deceptive advertising infractions. Now, according to Article 56 of the *Amendment*, for cases of deceptive advertising, advertising supervision and administrative organisations will order the responsible advertisers, advertising agents or publishers to cease advertising. Advertising expenses will be confiscated and a concurrent fine of between RMB 200,000 and RMB 1 million will be imposed.

In addition, the *Amendment* states that the advertising endorser—the person acting in the advertisement—is not allowed to promote and/or authenticate products or services that he/she has not actually used before. It also clarifies that the advertising endorser will bear joint and several liabilities when recommending commodities or services through deceptive advertisements that cause damages to the legitimate rights and interests of consumers. (Article 60 of the *Amendment*)

Telecom operators and network service providers

Advertising through mobile communication networks and the Internet is now governed by the *Amendment*. Any network service provider who provides technical support to publish deceptive advertisements shall bear the corresponding legal responsibilities, if it is fully aware of them. (Article 46 of the *Amendment*)

The amendment to the liability of telecom operators and network service providers also brings it in line with the Tort Law and the *Regulation on the Protection of the Right to Network Dissemination of Information*. In accordance with Article 23 of this regulation, where a network service provider provides any searching or linking service to its service objects or cuts off the link to any infringing work, performance, or audio-visual product after receiving notice from the rightful owner, it is not required to assume the liabilities of compensation.

However, when someone is fully aware or should have known that any of the works, performances or audio-visual products it has linked to constitutes any

infringement, it shall be subject to the liabilities of joint infringement. In accordance with Article 36 of the Tort Law, a network user or network service provider who infringes upon the civil rights or interests of another person through a network shall assume the tort liability.

Other major amendments

The *Amendment* stipulates that any organisation or individual shall not send advertisements or make advertising phone calls to customers' telephone, mobile or email accounts without the customers' consent or request, or after the customer has expressed a wish to cease receiving such advertisements. (Article 45 of the *Amendment*)

Furthermore, the *Amendment* also strengthens the power and responsibilities of Administrations for Industry and Commerce (AIC) and its related advertising supervision departments. (Article 7 of Amendment)

In addition to the amendment to the Advertisement Law, we also believe that the *Measures for the Administration of Internet Advertising* will be published shortly, and that the *Measures for the Administration of Advertising Business Licenses* and the *Measures for the Inspection of Advertising Business Qualification* will also be modified within the year. As all the former measures are issued by the State AIC, their legal hierarchies rank below the Advertisement Law, and therefore they will only be modified or issued after the *Amendment* is promulgated.

Conclusion

In general, the foundations of the *Amendment* are grounded in the actual development of the advertising industry. It increases punishments for any deceptive and illegal advertising which addresses the public's major concern. It will also improve and refine the behaviour of advertising publishers and operators and clarifies the legal obligations and responsibilities of advertising endorsers.

However, there is room for further improvement. For example, the term 'advertisement' used in this law refers to commercial advertisements but does not include public service advertisements, such as campaigns focussed on environmental protection or those promoting anti-drug messages.

Currently, the soliciting of public opinion on the *Amendment* has already been completed and the executive meeting of the State Council discussed and passed it in June 2014. It will be submitted to the Standing Committee of the National People's Congress after further amendments, and it is anticipated that the new law will be issued within this year. Eb

With offices in China in Shanghai, Nanjing and Zhuhai and a network of professionals around the world, ***D'Andrea & Partners*** *assists European companies in China as well as Chinese companies wishing to enter the global market through the establishment of foreign-invested enterprises or by mergers and acquisitions. The team is composed of both Chinese and European professionals, many of whom have experience of legal practice outside their home country.*

DON'T HOLD BACK

A recently-published report has revealed the extent to which foreign investment is restrained in China. Authored by **Timothy P. Stratford** from **Covington and Burling LLP**, *Measures and Practices Restraining Foreign Investment in China* scrutinises more than 260,000 separate regulations promulgated by 39 central government agencies and five provincial-level governments. Commissioned by the European Commission's Directorate-General for Trade, the report goes through China's complex investment environment with a fine tooth comb. It lays bare all the issues—both horizontal and sectoral—in order to give both European and Chinese authorities a complete picture of the inherent systemic problems in order to help guide the ongoing negotiations for the EU-China Bilateral Investment Agreement. The hope is that if both sides are aware of the where the difficulties lie, the negotiations will be more progressive.

Goal, purpose and scope

This report aims to identify and describe the full range of Chinese legal measures and practices that restrain foreign investment in China. "What do we mean by restrain?" asks Stratford rhetorically, "It means that the measure or practice can result in more favourable treatment for at least one domestic investor or investment than is generally available for foreign investors or investments."

Its purpose is to help trade negotiators, trade associations and individual companies to prioritise issues that need to be addressed in trade negotiations currently underway in China.

In terms of the scope, the report tries to define or describe all the horizontal measures that affect companies, regardless of industry; then all of the sectoral measures that apply to the following 10 industry sectors: automobile manufacturing; chemical manufacturing; construction and infrastructure (including water supply and sewage treatment); distribution; energy; financial services (including banking, securities, and insurance); healthcare (including pharmaceutical, medical device, and cosmetics manufacturing and healthcare services); mining; professional services (including legal, accounting, consulting, and architecture); and telecommunications

The provincial-level governments selected were Beijing, Chongqing, Guangdong, Shanghai and Tianjin.

Methodology and regulatory landscape

There are 80 central government agencies that can promulgate laws, regulations and other measures.

"We looked at the whole list and decided that there are probably 27 of them that would likely issue measures that could affect foreign investors in China," says Stratford, "Then, in order to cover all of the agencies that might issue rules related to the 10 sectors, we added another 12 central government agencies to the list, which meant that we were dealing with 39 central government agencies. These agencies altogether have 137,328 regulations that are currently in effect."

Between them, the five provincial-level governments have 125,910 measures currently in effect, bringing the total number of measures that needed to be analysed to a staggering 263,238.

In order to look through this set of regulations Stratford and his team came up with 53 search terms they could use to carry out database searches, focussing on three categories of restraint:

1. Restraints that favour domestic investors or investments over foreign investors or investments;

2. Restraints that favour state-owned investors or investments over privately-owned (including foreign-owned) investors or investments; and

3. Restraints that possibly favour domestic investors or investments over foreign investors or investments, depending on whether foreign-invested enterprises (FIEs) established in China would be regarded as 'Chinese' entities and therefore deemed eligible to receive, on an equal basis, benefits made available to such entities.

These search terms produced hits in 17,763 measures promulgated by the central government. Of these, 141 measures were identified as containing horizontal restraints, and 220 measures containing sectoral restraints for the 10 sectors selected.

A search of the measures promulgated by the provincial-level governments produced 11,979 hits with 351 measures identified as containing horizontal restraints and 129 measures containing sectoral restraints for the 10 sectors. It's quite notable that Tianjin has the lowest number by far with the most coming from Beijing and Chongqing.

In terms of administrative practices, Stratford explains that "you can't search databases because you're talking about things that are not necessarily written down." Instead they drew on major studies that talk about investment concerns issued by the European Chamber, AmCham, the US Chamber of Commerce, the US-China Business Council and the Office of the United States Trade Representative. They also talked with the leaders of the European Chamber and AmCham to hear members' experiences.

Findings

Three broad groups of restraints were identified:

1. Pre-establishment restraints that impede market access for foreign investment;

2. Post-establishment restraints that treat foreign-invested entities less favourably; and

3. Broad policy statements that potentially result in less favourable treatment for foreign investors and investments, during both the pre-establishment and post-establishment stages.

Pre-establishment restraints were grouped into four different types: local partner or equity requirements; market entry restrictions; approval process restraints; and technology transfer-related requirements.

Post-establishment restraints were grouped into three categories: targeted enforcement of foreign enterprises; government financial support; and government procurement.

The broad policy statements are especially important says Stratford, "as they tend to guide the way administrative discretion is used, and they also set the stage for more specific measures at either the central or local level

that are intended to carry out the broad policy purposes."

Pre-establishment restraints

Local partner/equity restrictions: These are regulations that explicitly require the foreign investor to partner with a local entity, or they restrict the percentage equity of the foreign investor in this type of project.

Market entry restrictions: These restraints prohibit a foreign investor from entering a specific sector at all, or from engaging in certain activities.

Additional approval requirements: These are regulations that subject FIEs to a more burdensome approval process than for domestic enterprises.

Requirements on technology transfer: There were not a lot of these identified in the measures, because they are actually strictly prohibited by China's World Trade Organisation (WTO) commitments.

Post-establishment restraints

Targeted enforcement: When it occurs, targeted enforcement is usually the result of discriminatory administrative practices, but sometimes it is explicitly called for in measures.

Government financial support: There are a variety of programmes and schemes that provide financial support to domestic companies but often exclude FIEs, either explicitly or through administrative practices. They appear in a variety of forms such as grants, loans and subsidies or provision of land below market prices. They are often seen in local or national development plans, which are then implemented through local measures.

Government procurement: This is often used at all levels of government to support domestic industries and indigenous innovation programmes.

Policy guidance: Many measures do not themselves establish concrete programmes favouring domestic companies, but they may lead central agencies, local governments and state-owned banks to provide favourable treatment. It is unclear whether FIEs would benefit from such programmes favouring domestic, private-owned enterprises.

Purposes of restraints

The purposes are often quite explicitly stated in the measures themselves. They can include:

- Promoting domestic Chinese champions to compete in domestic and international markets;
- Nurturing or protecting strategic industries;
- Assisting domestic industries in moving up the global value chain;
- Promoting exports;
- Fostering indigenous innovation; and
- Promoting global industries in companies to enhance local tax revenues, employment levels and social stability.

Restraining measures

In terms of the four types of pre-establishment restraints issued by central government, different approval processes for FIEs is one of the more significant methods.

It is noteworthy that restraints for the service sector, for instance financial services, has a lot of approval processes restraints and a lot of local equity and market entry restrictions. "That jibes with the general impression that manufacturing is still quite a bit more open than the service sector," states Stratford, "Telecommunications and professional services both stand out as having a lot of market access restrictions."

Restraining practices

Administrative practices have been broadly defined in the report to include all practices by agencies and officials at all branches and all levels of government, including executive, legislative and judicial actions. "Administrative restraints is defined as practices sometimes used to restrain, condition and otherwise frame foreign investment," explains Stratford, "This includes practices not explicitly authorised or compelled by published rules and also, in some cases, practices that actually conflict with what the rules say."

The report defines three characteristics of trans-administrative system that create systemic concerns for foreign investors. First, industrial policies explicitly designed to support the development of domestic industries and champions. Second, relatively opaque approval processes led by officials that are explicitly mandated to try and achieve these industrial policy goals. Third, a lack of effective recourse if the approval authorities have not complied with international commitments or China's own regulations.

Why is the ability to appeal administrative decisions so problematic? The report identifies four factors:

1. The standards that regulators are supposed to comply with to carry out their job are very broad, and they are granted a lot of latitude. This makes it difficult to demonstrate that an administrator has abused his discretion.
2. It is difficult to produce evidence to prove improper conduct because so much of what happens is opaque. Detailed written explanations of decisions are not necessarily forthcoming.
3. There is an expectation that the courts will support the same industrial policies that motivated the approval authorities to make their decision.
4. There are fears of retaliation if complaints are lodged against approval authorities.

These four elements of China's administrative system have a real impact on how the various measures are actually exercised in practice. Says Stratford, "It is often felt by foreign companies that administrative practices trump published rules as a source of investment restraints. Some observers believe that China is actually increasing its reliance on administrative practices to promote industrial policy goals, because China's immersion in international trade regimes has limited its ability to formally quantify foreign investment restraints."

Administrative practices can be grouped into four categories:

1. The rulemaking process;
2. Administrative approvals;
3. Standard setting; and
4. Judicial process and enforcement.

In terms of administrative approvals, regulatory ambiguity allows regulators to interpret the laws in ways that advantage local companies or impose special conditions on foreign companies; frequent administrative delays to deadlines for decisions hold off progress on projects; and oral instructions received by administrative authorities may go beyond what is required in law. Eb

To download the full report please go to http://trade.ec.europa.eu/doclib/docs/2014/august/tradoc_152739.08.10.pdf.

***Timothy Stratford** is managing partner of the Beijing office of **Covington & Burling LLP**, a leading international law firm headquartered in Washington, DC with offices in Brussels and London as well as in the US and Asia. He has lived and worked in China continuously since 1982, except for 2005-2010 when he was based in Washington, DC and served as the Assistant US Trade Representative responsible for US-China trade relations. Mr Stratford has previously served as Minister-Counsellor for Commercial Affairs at the US Embassy in Beijing, General Counsel for General Motors China operations, and Chairman of AmCham China.*

EUROPEAN CHAMBER LOBBYING HIGHLIGHTS

Meeting with German Chancellor

Chancellor Merkel (second left) and President Jörg Wuttke (second right)

European Chamber President Jörg Wuttke met German Chancellor Angela Merkel and German Ambassador Michael Clauss at a German Embassy reception on 7th July and discussed market access problems that European companies face in China. President Wuttke has met Chancellor Merkel on a number of previous occasions, and this visit represents the seventh time that she has visited China in an official role. Prior to the visit, Chancellor Merkel had been informed by the German Embassy about the findings of the European Chamber's *Business Confidence Survey 2014*.

Meeting with White House and US Embassy Delegation

On 8th July, Chamber President Jörg Wuttke met with a high-level delegation from the White House, including Rory MacFarquhar, Special Assistant to the President and Senior Director for Global Economics and Finance, as well as representatives of the US Embassy to China. In the meeting, President Wuttke presented the Chamber's *Business Confidence Survey 2014* and spoke about the end of the 'golden age' for foreign business in China, as well as the requirements for the Chinese Government to implement meaningful economic reforms and to improve on the implementation of China's WTO commitments in the face of a slowing domestic economy.

Meeting with Singaporean Ambassador

On 8th August, the European Chamber's Secretary General, Adam Dunnett, and Mark Rushton, Head of Communications, met with Stanley Loh, Ambassador of the Republic of Singapore to China. They discussed issues related to Free Trade Agreements between China and APEC nations, as well as issues related to the current Trans-Pacific Partnership negotiations.

Meeting with Chengdu Mayor

On 26th June representatives of the European Chamber, led by Stefan Gottwald, Member of the Board, Southwest China Chapter, met with the Mayor of Chengdu, Mr Ge Honglin, and Mr Qiu Xudong, Vice Director General of the Chengdu Hi-tech Zone (CDHT) at the 57th Symposium with Foreign Investors in Chengdu. They discussed how matters of public health could be improved for expatriates in Chengdu. Some of the problems expatriates face, such as a lack of foreign-language support at local hospitals, were discussed during the meeting. Mayor Ge subsequently instructed the Chengdu Health Bureau to follow up on the matter.

Meeting with the CFDA

On 19th May, representatives of the European Chamber met with Mr Teng Jiacai, Vice Minister, the China Food and Drug Administration (CFDA), as per the EU-China Food Safety Risk Assessment Training organised by Directorate-Generale SANCO and the CFDA. The Chamber representatives introduced the Chamber's Agricultural, Food and Beverage Working Group and discussed how cooperation can be further increased.

Other Lobby Activities:

European Chamber releases statement on China AML-related investigations

The European Chamber undertook lobbying and awareness-raising on the non-transparent conduct of the enforcement of China's Anti-Monopoly Law (AML). On 13th August the Chamber released a statement, urging the competent Chinese AML-enforcement authorities to increase the procedural transparency of their investigations.

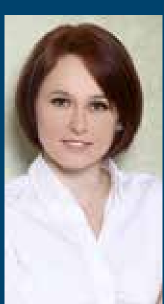
President Jörg Wuttke on CCTV's *Dialogue*

European Chamber President Jörg Wuttke on CCTV News' Dialogue

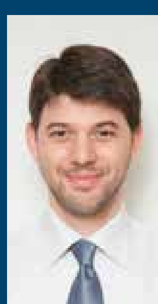
On 24th August, President Wuttke further elaborated on the Chamber's statement on an episode of CCTV News' Dialogue entitled China's Auto Anti-Monopoly Crackdown. Also on the panel was **Mr Zhang Jianping**, International Cooperation Director of the National Development and Reform Commission. President Wuttke and Director Zhang discussed the implications of recent anti-monopoly investigations from both the European and Chinese perspectives.

Staff recognition

The Chamber released the *European Business in China Position Paper 2014/2015* on 9th September. The 28 vertical industry position papers and nine horizontal, cross-sectoral position papers included in this publication are developed bottom-up by our working groups, but the publication would not be possible without the considerable efforts of our dedicated staff. For undertaking the crucial, and often thankless, task of overall coordination of the *Position Paper* we would like to recognise the hard work and organisational skills of Anna Rudawska. We would also like to recognise the achievements of Xavier Sans Powell and Bettina Buck who both contributed outstanding papers.



Anna Rudawska
Deputy General Manager, PRD Chapter



Xavier Sans Powell
Business Manager, Banking and Securities Working Group

Bettina Buck
Business Manager, Carbon Market Working Group

WELL POSITIONED

EXECUTIVE SUMMARY OF THE EUROPEAN CHAMBER'S EUROPEAN BUSINESS IN CHINA POSITION PAPER 2014/2015

The 'golden age' for business in China is drawing to a close. But it may yet be followed by the dawning of a new era that could be equally rewarding for China and for foreign investors. However, that positive transition will occur only if the new leadership remains steadfast and is courageous in urgently implementing the decisive reforms outlined during the Third Plenum, without this the commitment of foreign business to China may start to wane and, at worst, the economy could be headed for crisis.

President Jörg Wuttke presenting the key findings from the *European Business in China Position Paper 2014/2015* on 9th September, 2014.

Within two years of taking power, China's new leadership has already determined its economic blueprint, aptly named the '*Decision*'. At its core, the *Decision* is a framework for China to make the necessary shift to a new development model that can foster sustainable drivers of growth.

The new drivers of growth in this new model are rightly based around services, value-added, innovation and efficiency. These are things that business produces; therefore industry has to be the solution. And they are complex; so advanced, adroit and creative businesses must be fostered to provide them.

Such businesses can only be fostered through a real market economy – by market forces determining what is good, rewarding what is good, providing resources to those that are good, and therefore forcing companies to produce what the market deems as good and necessary.

The *Decision* shows that China's leadership increasingly understands this. By identifying the need for the market's role to be decisive, it provides a framework of the reforms required to drive growth, correct current economic imbalances and meet important societal needs. And by accepting that the government needs to fundamentally reorientate its role in the business environment, it can safeguard the platform that business needs to develop the required products and solutions.

Given China's significance to the global economy, this task is potentially the issue of foremost economic consequence in the world today. It was surely not easy to get this far. But the next steps are what count. Time is of the essence and implementation is key.

European companies want and need China to sustain its success story. The European Chamber's *Executive Position Paper* synthesises recommendations from European industry invested in China. It aims to show that, through steadfastly sticking to the principles of giving a decisive role to the market and limiting its interference in the business environment, the government can bring about China's necessary rebalancing (section one), and improve the quality of life of its citizens by helping to solve many of the problems that China is facing today (section two). The final section provides a global perspective on China's reforms.

1. The Role of the Market

- *Rebalancing the Economy*: As the underlying supporting factors of the state-led investment model are diminishing, industrial policies that direct cheap capital and resources into the industrial economy and into infrastructure development are leading to waste and unsustainable levels of corporate and local debt. Only the market can direct the flow of resources to productive areas of the economy.

- *Financial Reform*: The use of market price signals, such as liberalised interest rates, and removing government influence over lending policies, would increase capital efficiency by incentivising banks to ensure that capital only flows to less risky and higher-return projects. It could also drive domestic consumption by giving greater returns to depositors and providing financing to more economic actors.

- *Fiscal Reform*: While risky, increasing fiscal resources for local governments and realigning their incentives would inhibit them from distorting the market through local protectionism and by promoting wasteful investments in order to secure needed fiscal resources.

- *State-owned Enterprise (SOE) Reform*: The *Decision* indicates that the government wants to continue to protect and maintain a dominant position for SOEs. Such a half step towards fostering market forces would not work. To produce SOEs that are world-class and globally competitive, SOE reform must stop the preferential treatment given to SOEs and open them up to full and fair competition. This is because SOEs will only truly improve efficiencies and invest in productivity-enhancing innovations if they are forced to by competition.

- *Market Access*: Foreign companies bring direct benefits to the economy through technologies and efficiencies. While this is important, granting full and fair market access to foreign companies is more important for its ability to foster global levels of competition in the marketplace. As China needs to move up the value chain, low costs and scale will no longer be enough. The instinct to protect domestic companies by raising investment restrictions and barriers for foreign companies to operate and sell their goods and services does not work as it inhibits forces that would push domestic companies to innovate and optimise their efficiency.

- *Institutional Restructuring and the Freedom to Choose*: Independent societal institutions help form the structure in which the market economy can play out freely. The freedom for industry to choose from supporting private institutions is vital to maximise corporate efficiency and ensure that the value generated in each link of a value chain is higher than the cost incurred.

2. Quality of Life

- *Innovation*: China's indigenous innovation framework, which is strongly centralised and which aims to use China's large marketplace to falsely promote domestic technologies, has worked contrary to intentions. Innovation must instead be led by industry and therefore requires an environment that rewards genuine innovation and fosters both competition and cooperation.

- *The Environment*: Changing the gross-domestic product (GDP) growth-related incentives of local governments to more environmental-based targets is critical. This can be done by increasing the weight of environmental and life-cycle criteria in public procurement processes, ensuring supervision agencies function independently, and ensuring that companies are held accountable for environmental violations and given appropriate levels of fines. Greater corporate transparency and access to local-level statistics would also spur environmental performances. Furthermore, greater market access would ensure that globally-leading environmental solutions and technologies are available to be deployed in China.

- *Urbanisation*: Removing market entry barriers and obstacles that impede equal treatment would contribute to China's sustainable urbanisation process by ensuring the availability of the most innovative and efficient global technologies and solutions.

- *Healthcare*: A healthcare system focused on value-based outcomes would help meet China's ambitious healthcare reform plans. To contribute to this, streamlining pre-market approval requirements would decrease the time to market of potentially life-saving medical devices and drugs, and the lifting of administrative price controls to allow product pricing to reflect real, market-based values would improve China's healthcare innovation environment and reduce long-term costs by improving clinical use.

- *Food Safety*: Increasing emphasis on risk mitigation throughout the entire food supply chain would improve food safety, and fostering greater communication and coordination amongst the ministries with competencies for food safety would improve the consistency of interpretations of food safety regulations and standards. Increasing local-level resources and increasing punishments for corporate violators and local government officials that ignore violations would increase enforcement and further deter violations.

- *Internet Management*: Decreased Internet restrictions would increase Internet speed and improve access to materials that would assist corporate operations and research and development (R&D) as well as help to attract more world-class researchers to China.

- *Rule of Law*: Greater transparency and consultation would improve law-making and enforcement processes, and greater accountability, judicial independence and predictability would safeguard the rules protecting the market economy and help companies plan their activities. A continued crackdown on anti-compliant practices would also help to foster a fair market environment in China, so long as the targeting and the investigations themselves are carried out fairly, transparently and in accordance with rule of law.

3. China and the World

Further harmonisation of China's regulatory and standards system will be critical in further integrating its firms into and moving them up the value chain in complex global supply chains. China's leadership in further advancing the World Trade Organisation (WTO) and in engaging meaningfully in bilateral investment agreements could also spur global liberalisation and progress China's internal reforms. Doing so would also improve China's image and that of its companies, in turn increasing the internationalisation chances of its domestic firms.

To download the full paper, the Executive Position Paper *or any of the individual working group's papers free of charge, please go to http://www.europeanchamber.com.cn/en/publications-position-paper.*

CAN YOU KEEP A SECRET?

PROTECTING TRADE SECRETS: PART II

Nearly all businesses in all industries and sectors possess trade secrets. They are a valuable and highly useful form of intellectual property rights (IPR). As the name suggests, however, trade secrets are a non-registerable form of intellectual property; they only enjoy legal protection as long as they are not publically disclosed. In the conclusion to this two-part article, the **China IPR SME Helpdesk** describes measures you can take to help ensure trade secrets aren't leaked via employees and third parties, as well as options available to you should your secrets be disclosed.

Don't Forget Your Employees

Most trade secret theft cases involve current or former employees, disgruntled or otherwise. A typical case involves an employee leaving a particular company for a competitor, with the company discovering shortly after that its competitor is selling a product that looks suspiciously familiar.

The best way to avoid such situations is to adopt an employee agreement with non-disclosure provisions. Employees should also be periodically reminded of their confidentiality obligations.

Exit interviews should be held with departing staff where they should return all company documents, materials, computers and files. If new employees signed non-disclosure agreements (NDAs) with their former employers, appropriate steps should be taken to ensure that you do not misappropriate their trade secrets. For important and senior-level employees who have intimate knowledge of your business it may be a good idea to utilise a non-compete agreement of a reasonable duration that complies with China's Labour Contract Law.

Trade secrets may be inadvertently disclosed by employees – an overzealous engineer may give away too much technical information when making a presentation for example. Also, particularly in China, employees may not have the same understanding of IP rights and proprietary information, or the expectations for protecting such information, as you do. For example, they may not immediately understand that a project proposal may contain valuable, sensitive information.

Dealing with third parties

Another common way trade secrets are disclosed is during business dealings or negotiations with potential partners, suppliers, contractors, licensees or customers. Generally, you should insist that both parties sign a mutual NDA before discussions begin or any documents are transferred. After negotiations have reached a certain stage, both parties should enter into a Memorandum of Understanding (MOU) outlining the structure of the deal, what information will be shared and the respective non-disclosure obligations of both parties. The final agreement should clearly identify who owns what information, what information was or will be exchanged and the respective non-disclosure obligations of both parties. Explaining that it is your policy to have a NDA in place before negotiations begin is a good way to demonstrate your professionalism and respect for your counterpart's IPR. Having the agreement already drafted also helps to minimise the issue so that you can move forward with your negotiations.

Many foreign small and medium-sized enterprises (SMEs) operating in China find it difficult to insist on a pre-negotiation NDA when dealing with Chinese parties who often claim that such requests are hostile or unnecessary. The prospect of losing a potential business opportunity often leads many SMEs to move forward with negotiations without an agreement. However, this may prove costly when the other party starts using the information to compete against you. Therefore it is important to know, before you enter negotiations, when to walk away. A party that refuses a reasonable request for a mutual NDA is also a party that is likely to misappropriate your trade secrets. Finally, being business savvy is also important; if the Chinese party requests to see your designs, you can request that they view them at your business premises or send only rough sketches to them.

Even after an agreement is signed, it is important to make sure you continue to monitor your partners, suppliers or licensees. You may wish to negotiate in your agreement the right to make unannounced visits and to conduct periodic audits.

What to do when your secret is out

The key to protecting your trade secrets is prevention, but if you find that your trade secrets may have been stolen the first step is to conduct an internal investigation and to preserve as much evidence as possible, including documents and emails. It may be necessary to engage the services of an external investigator to gather all the information, after which you and your lawyer can decide the best course of action.

Litigation is the primary means to pursue a remedy for the misappropriation of trade secrets in China. If you are successful, the court can require the infringer to pay you damages and order them to stop using the trade secret. In order to be successful in these cases, you need to prove with sufficient evidence that:

- You have, and own, the trade secret in question, including that it is tangible, has commercial value and you have taken measures to protect it;
- The defendant possesses information that is identical or substantially identical to your trade secret; and
- The defendant used improper means to obtain it.

The court will place a heavy burden on you to prove these three elements with direct evidence, which in a Chinese litigation scenario is almost exclusively in the form of documents as a court will usually not permit witnesses to testify. Although you can request the court to go to the defendant's business premises to obtain evidence, there is no guarantee that the court will find the evidence you need. Because of these reasons it is very important to have sufficient records and proper documentation already in your possession.

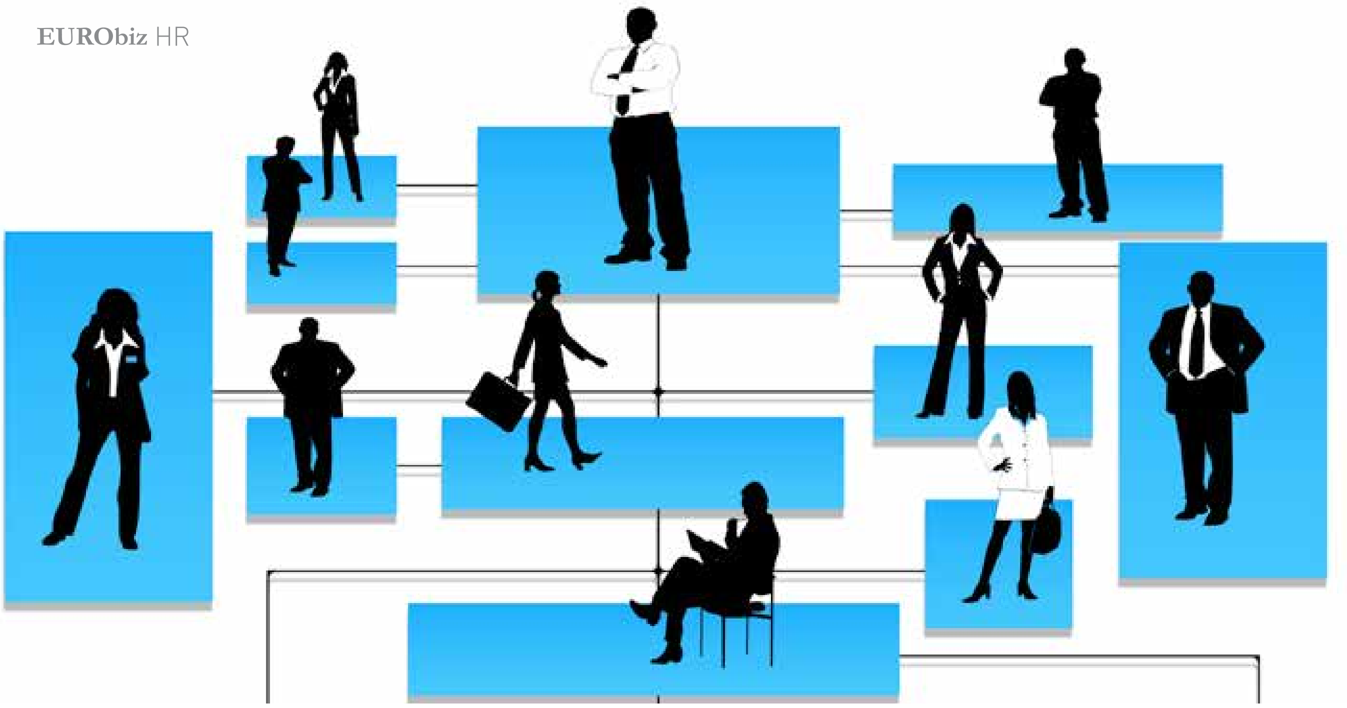
Unlike many other countries, China provides for administrative enforcement in trade secret cases in addition to litigation through the court system. Through the local Administration for Industry and Commerce (AIC) it is possible to stop the sale of products manufactured using your trade secret and to obtain administrative penalties against the infringer ranging from RMB 10,000 to RMB 100,000. However, in practice it can be difficult to get the AIC to accept your case, particularly if complex technology is involved.

Theft of trade secrets is also a crime in China where the loss to the injured party is more than RMB 500,000. If the Public Security Bureau conducts a criminal investigation, infringers may be fined and/or imprisoned for up to three years, or in very serious cases, such as those involving a loss of more than RMB 2.5 million, for up to seven years.

Take-away Messages

- As with most IP, the best way to protect trade secrets is a prevention strategy that ensures your employees have a clear understanding of what constitutes a trade secret and know their role in protecting it. Your business should also take extra steps to create clear contractual clauses to prevent leakage via employees and business partners.
- If you find your trade secrets have been stolen the first step is to conduct an internal investigation while preserving as much information as possible. It may also be necessary to consider hiring an external investigator.
- In China litigation is the main way to pursue a remedy for the misappropriation of your trade secrets. However, you must ensure that enough evidence has been collected for your case or else it can be very difficult for you to prove trade secret infringement.

*The **China IPR SME Helpdesk** is a European Commission funded project that provides free, practical, business advice relating to China IPR to European SMEs. To learn about any aspect of intellectual property rights in China, visit our online portal at www.china-iprhelpdesk.eu. For free expert advice on China IPR for your business, e-mail your questions to: question@china-iprhelpdesk.eu. You will receive a reply from one of the Helpdesk experts within seven working days. The China IPR SME Helpdesk is jointly implemented by DEVELOPMENT Solutions and the European Union Chamber of Commerce in China.*



LABOUR DISPATCH: A LEGAL UPDATE

Dr Iris Duchetsmann, Partner at **Clyde & Co**, explains how new regulations have further restricted labour dispatch in China. She says that it must be noted that labour dispatch is simply not a tool that can be used to achieve flexibility of workforce and headcount as it is European countries. Duchetsmann specialises in labour law and has previously served as Vice Chair of the European Chamber's Human Resources Working Group in Shanghai.

As of 1st March, 2014, China implemented the new *Interim Regulations on Labour Dispatch* (*Regulations*) and further regulated labour dispatch practices, followed by local regulations. A number of companies have reportedly reorganised their employment structures to ensure compliance with the stricter rules.

Restriction on positions

The *Regulations* re-affirm that dispatched employees may "only" (instead of "mainly" as was the situation before the initial change of the Labour Contract Law in 2013) be used for three types of positions:

- Temporary positions, which refer to those existing for a period of no more than six months;
- Auxiliary positions, referring to positions which serve for non-primary business and support positions conducting main business; and
- Substitutable positions, meaning positions which may be taken by other employees during the period when an employee of the labour accepting entity is absent for study, vacation or other reasons.

While the above definition of the positions in the *Regulations* repeat the provisions of the Labour Contract Law, the *Regulations* further require a labour accepting entity to conduct collective consultation when it defines its auxiliary positions. The collective consultation procedure includes gathering comments and suggestions raised by the employee representative congress or from all the employees, confirming the positions with the in-house trade union or employee representatives and publishing the final decision.

If the company fails to complete the collective consultation procedure, the labour accepting entity may have an administrative warning and a rectification order imposed upon it. Additionally, in any case where a dispatched employee suffers damage, the labour accepting entity will be required to pay compensation.

Cap on dispatched employees

The *Regulations* cap the number of dispatched employees at 10 per cent of the total headcount of the labour accepting entity (including non-dispatched and dispatched employees). A grace period of two years is provided to labour accepting entities to reduce the current ratio down to the cap. Before reaching the cap, a labour accepting entity is not allowed to accept new dispatch employees.

Social insurance

Social insurance contributions must be made at the place where the labour accepting entity is located. If it is a case of cross-region dispatch, and the labour dispatch firm has a branch at the location of the labour accepting entity, this local branch will be responsible for the relevant formalities; otherwise, the labour accepting entity is in charge of handling the formalities.

Return and termination

In general, only under the limited statutory situations, a labour accepting entity may return dispatched employees to the labour dispatch agency. The *Regulations* adds some new scenarios to those provided by the Labour Contract Law for clarification.

Under the Labour Contract Law and the new *Regulations*, a labour accepting entity may return dispatched employees in any of the statutory situations which would allow individual or mass dismissal in the case of direct employment. The *Regulations* now clarify that also in case of closure of the labour accepting entity (due to bankruptcy, liquidation or revocation of business license, etc), substantial change of objective circumstances, statutory situations for mass lay-off and expiration of a labour dispatch service agreement return is possible. However, if any of the statutory situations prohibiting dismissal as provided by the Labour Contract Law applies to a dispatched employee (e.g. a female employee during maternity leave), the same protection applicable to termination applies to the return of dispatched employees; the labour accepting entity has to retain the employee until such a situation ceases to exist.

For risk and cost analysis it's important to note that the return by the accepting entity does not necessarily justify a following dismissal by the labour dispatch firm (e.g. closure of a labour accepting entity). Any costs the labour dispatch firm will incur to maintain the contract with the early-returned employee will be part of the service agreement between the dispatch firm and the accepting entity.

Comments

The overall structure and reasoning of the laws related to labour dispatch show that direct employment is further promoted and labour dispatch is supposed to only play a minor role in personnel structures. Companies are advised to conduct internal checks in order to ensure that positions taken by dispatched employees and staffing arrangements conform to the new rules. Direct employment provides for a clear structure as well as minimises risks of de facto employment claims. If a company does not have a delegated human resources (HR) department, outsourcing HR work to a service provider may be an alternative solution. Eb

With over 2,500 staff across six continents, ***Clyde & Co*** *is particularly well known for expertise in relation to international trade, emerging markets and in relation to high profile and/or difficult dispute resolution work.*

The firm's core sectors of focus centre around infrastructure, insurance, international trade, transportation and natural resources, and with a fast-growing reputation in other industries as well. Clyde & Co's strategy and whole-hearted commitment is to be the best and most complete provider of legal services to businesses engaged in our core sectors and practice areas.

WUXI: THE BIRTHPLACE OF CHINA'S MODERN INDUSTRY

Since the Ming Dynasty, Wuxi has been an important rice and silk market and one of the main cultural centres of the south Yangtze region. It is now recognised as one of the birthplaces of modern industry in China and is making the transition from a textile manufacturing base into a high-tech industrial hub. In this article, **Rainy Yao** from **Dezan Shira & Associates** takes a closer look at the 'pearl of Lake Tai'.

Economic overview

In 2013, Wuxi's gross domestic product (GDP) exceeded RMB 807 billion and grew at an annual rate of nine per cent. The city's primary industry contributed RMB 14.85 billion and its secondary industry RMB 420.74 billion. The remaining RMB 371.42 billion came from the service sector, which notably accounted for nearly 50 per cent of the city's GDP thanks to industry restructuring. Tourism, which brought in RMB 113.24 billion (12.3 per cent growth) in 2013, accounted for a major portion of service sector revenue, with close to 70 million foreign and domestic tourists visiting the city last year alone.[1]

For the first time in its history, Wuxi's GDP per capita exceeded RMB 124,600 (USD 20,400) in 2013—making it the highest-ranked city in Jiangsu Province three years in a row. This represents a doubling in per capita GDP in just five years.

New industries, such as cloud computing and high-end equipment manufacturing, also played a vital role in Wuxi's economic development, with an industrial output of RMB 807.4 billion (a 14.1 per cent growth). Among these, software and services outsourcing made great advances and grew at an amazing rate of 32 per cent annually.

Development zones

Wuxi's main development zones include:

Wuxi New District (WND)

Originally approved in 1992, the WND was upgraded to a national development zone in 1995. It consists of six small development areas including the Wuxi High-tech Development Zone and the Lake Tai International Technology Park. Pillar industries in the zone include precision machinery, electronics, bio-pharmaceuticals, fine chemicals and new materials. Besides manufacturing, the software and outsourcing industries are also rapidly emerging in the WND.[2]

Yixing Industrial Park for Environmental Science & Technology (ES&TP)

1. http://www.wuxi.gov.cn/zxzx/wxyw/6688685.shtml
http://www.wuxi.gov.cn/blind/zfxxgk/szfxxgkml/ywgz/6688922.shtml

2. http://en.wnd.gov.cn/www/NDintro/

Often referred to as the 'environmental capital' of China, the ES&TP was established in 1992 as the only zone in China dedicated to the environmental protection industry. Over the past two decades, the ES&TP has cooperated in environmental protection and research and development (R&D) programmes with more than 20 countries and regions, including the United States, Germany and the Netherlands.[3]

Wuxi Huishan Economic Development Zone (HEDZ)

Approved in July 2001 by the Jiangsu provincial government, the HEDZ is an important part of the Shanghai Economic Area with a planned area of 76 square kilometres. Major industries include automobiles and key components, new energy, service outsourcing and science and technology.[4]

Jiangsu Jiangyin Economic Development Zone (JEDZ)

Established in 1992, the JEDZ was approved as a national-level development zone in 2011. The zone mainly focuses on new materials (metals), textiles, IT and machinery manufacturing. To date, 292 foreign companies have set up operations in the JEDZ, 16 of which are among the Fortune 500.[5]

Jiangyin Harbour Economic Development District (HED)

The development and construction of the HED was officially launched in September 2006. Located in the centre of the Yangtze River Delta (YRD), the HED is expected to be an important transport hub connecting the areas to the south and north of the Yangtze River. Major industries include high-tech equipment and engineering services, precision machinery, logistics and new materials.[6]

Yixing Economic & Technology Development Zone (YETDZ)

Newly established in 2013 by the State Council as a national-level development zone, the YETDZ was bestowed the honour of the "most valuable zone" in the YRD region. It features industrial sectors in new energy, optoelectronics, new materials and high-end equipment manufacturing. More than 800 enterprises have been established in the zone in its single year of operations.[7]

Investment opportunities

The output and export value of the city's high-tech products ranks sixth among all the cities in China, with close to 1,000 high-tech enterprises established in the city. The city has built a diverse manufacturing system based on five pillar industries:

- Digital information
- Automobile manufacturing
- Textiles and clothes
- New energy and materials
- Bio-pharmaceuticals

Wuxi is also the cradle of China's micro-electronics industry. Since 1980, Wuxi has been one of two micro-electronics industrial bases in China. In 2013, the municipal government released the *Development Plan for the Micro-electronics Industry (2013-2020)*, according to which the micro-electronics technology developed in Wuxi is expected to be among the best in the world by 2020.[8] The city has also established a foreign-invested enterprises (FIEs) service centre website in a bid to provide a better service for FIEs.

In addition, the municipal government provides the following preferential policies to foreign investors:

Financial support and subsidies

Eligible scientific talent will be provided with free offices and apartments (each with an area of over 100 square kilometres) for three years. Supporting funds ranging from RMB 1 million to RMB 5 million will be granted to eligible scientific projects according to each project's total investment.[9]

Tax incentives

High-tech enterprises will pay corporate income tax (CIT) at a reduced rate of 15 per cent. Newly-established regional headquarters with a tax revenue of over RMB 10 million will be eligible for a 100 per cent local tax rebate for the first three years, and a 60 per cent rebate for the following three years.[10] Eb

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3. http://www.hky.gov.cn/default.php?mod=article&do=detail&tid=494901

4. http://baike.baidu.com/view/6227867.htm?fr=aladdin

5. http://www.joind.gov.cn/english/itj/2071.html

6. http://www.lgjjkfq.gov.cn/eng/bar3.html

7. http://baike.baidu.com/view/4293724.htm?fr=aladdin

8. http://www.wuxi.gov.cn/zfxxgk/szfxxgkml/zcfg/szfwj/6446886.shtml

9. http://www.wuxi.gov.cn/zt/bqysxjqysn/6142026.shtml

10. http://www.wuxi.gov.cn/web101/zxzx/xwfbh/xwfbh/5953986.shtml

WORKING WITH TODAY'S CHINESE BUSINESS LEADERS

A recent report by the **EU SME Centre** explains how to leverage similarities and differences of Chinese and European leaders to develop a truly global leadership team in China.

China's changing talent pool and growing market competition pose new challenges for European business and SMEs in particular. To better tackle the challenges and continue success in a more volatile environment, having a strong and effective leadership team becomes even more important.

However, a number of existing stereotypes about Chinese leadership styles hinder European companies from recognising the potential strengths of Chinese leaders. The EU SME Centre's new report *Developing a Truly Global Leadership Team* aims to shed a different light on interpreting Chinese leadership practices, in order to help European SMEs in China to develop a cohesive and effective international leadership team capable of running a successful business in the Chinese market.

By analysing the leadership profiles of 20,184 mid- and senior-level leaders across 18 industries in China and five European countries, the research focuses on how to leverage both similarities and differences between Chinese and European leadership practices, rather than purely identifying the deficiencies of Chinese leaders.

In terms of the type of companies included in the Chinese leader sample, the data collected represents foreign companies operating in China; private Chinese companies and state-owned enterprises are not represented in this research.

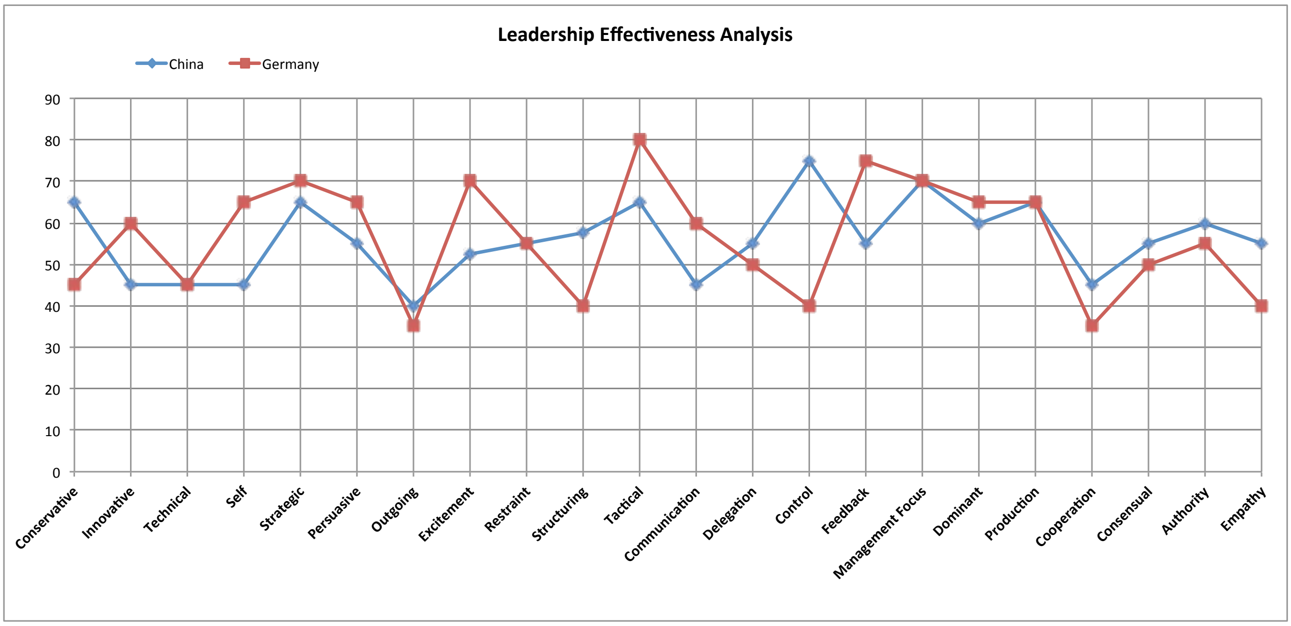
The top five leadership practices that differentiate the most effective Chinese senior leaders include persuasiveness, communication, strategic skills, technical ability and tactical ability. This research also finds significant similarities exist between effective European and Chinese senior leaders, such as being strategic, persuasive and having management focus.

The five European countries that participated in this research were France, Germany, Poland, Spain and the United Kingdom. The graph below provides a comparison between Chinese and German leaders.

Despite exhibiting unique strengths in different areas, overall European leaders excelled in being innovative when compared to their Chinese counterparts. This has proven to be a unique competitive advantage for many European SMEs in the Chinese market. Chinese leaders, on the other hand, exhibit strength in the area of empathy, which is essential in creating a culture that will attract Chinese generation Y and Z employees and is also instrumental for developing a global mind-set in operating international businesses. There are also common areas for improvement for both Chinese and European senior leaders, most notably in the area of communication and cooperation.

Findings in this research can be used to guide European SMEs to discover or develop high-potential Chinese leaders with a global mind-set, and improve communications to foster a culture that facilitates dialogue among Chinese and European leaders. Here are the recommendations for SMEs:

Relative Importance of Leadership Practices for Effectiveness – Chinese Senior Leaders



- **Encourage mid-level Chinese leaders to become strategic thinkers:** Make strategic planning a regular part of the job for mid-level leaders, encourage them to set a regular time aside for strategic planning, and identify senior mentors to work with them.

- **Reward new ideas:** Include diverse leaders in brainstorming sessions, provide a more flexible culture that appeals to Chinese generations Y and Z and encourage interaction and networking outside the organisation. Reward people who come up with several solutions to a given problem or the solution with the greatest long-term benefit for the organisation.

- **Improve communication and influencing skills:** Senior leaders should take more time to act as role models to mid-level leaders to help them become more persuasive in presenting proposals and business solutions, listen more and understand different perspectives.

- **Develop a global mind-set:** Assess candidates' potentiality as well as past performance when selecting leaders for global projects. Provide them with experiences such as leading virtual teams, working in different functions and managing a variety of internal and external stakeholders. Foster a culture of sharing similarities rather than focusing only on identifying differences. Eb

To get more advice on developing successful leadership team in China, download the full report from the EU SME Centre's website.

*The **EU SME Centre** is a support service provider for European small and medium-sized enterprises (SMEs) facilitating market access in China. Financed by the European Union, the Centre provides practical information, confidential advice, training and business tools to better equip SMEs to develop their business and tackle challenges faced in the Chinese market. All services are available on the Centre's website after registration, please visit: www.eusmecentre.org.cn.*

EUROPEAN CHAMBER EVENTS GALLERY

BEIJING CHAPTER


1


2

3


4

Joint Ventures in China (1)
On 28th August, this seminar featured a discussion on how to avoid the pitfalls of operating a joint venture in China and planning for your exit strategy.

People Matters: Employee Retention: Holding on to Happy Local Talent (2)
On 16th July, the European Chamber held 2014's 2nd edition of People Matters on Employee Retention. It was sponsored by Career International and CEIBS.

M&A Conference 2014: The Changing Landscape and Opportunities for China Outbound Investments (3)
On 10th July, more than 100 people attended the European Chamber's annual M&A Conference. It was co-organised with the China Group Companies Association (CGCA) and was sponsored by GIDE, KPMG and Zhong Yin Law Firm.

Legal representative: potential risks and legal liability (4)
On 9th July, the European Chamber held this seminar for presenting an overview of the legal liability exposed to directors and senior management under Chinese law, and the best practice to manage and mitigate their risks.

PRD CHAPTER


1


2


3

IPR Seminar (1)
The European Chamber PRD Chapter held an IPR seminar on 3rd July to discuss patent protection issues covering strategy, administrative, judicial and online enforcement in China.

InterChamber Networking (2)
This Shenzhen event was held on 27th August at the Galleon Restaurant and Bar, Intercontinental Shenzhen. More than 100 people from different chambers attended.

TÜV Rheinland Laboratory Tour (3)
Held on 15th August, the tour ended with a table football tournament in the staff entertainment room.

SHANGHAI CHAPTER


1

2


3

Yangtze River Delta SME Forum: Practical Solutions to Help You Think Big (1)
The second edition of this forum was held on 29th August, and was jointly organised with the China IPR SME Helpdesk, and supported by DUSA and the Association of Western Invested Enterprises.

European Business in China Position Paper Launch 2014/2015 (2&3)
The Shanghai launch at the Westin Bund Center Shanghai was attended by more than 120 members.

SOUTHWEST CHAPTER


1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4


5

Business Confidence Survey (1)
The *Business Confidence Survey* launch in Chongqing drew in about 25 professionals from different fields.

Women In Business: Work, life and Thrive (2&3)
Over 50 participants attended this event on 26th August at the Kempinski Chongqing.

InterChamber Mixer (4)
On 3rd September, the Chamber co-organised the InterChamber Autumn Mixer with three other foreign chambers. Over 200 participants attended.

Tax Seminar (5)
On 11th September, the Chamber and Deloitte co-organised a tax seminar on Transfer Pricing and Royalty Issues. Over 20 companies attended.

TIANJIN CHAPTER


1


2

InterChamber Networking (1)
This sightseeing cruise of Haihe took place on 21st August, 2014

2014 Employee Relationship and Labour Law Conference (2)
This well-attended event took place on 29th August, 2014.

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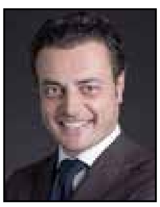
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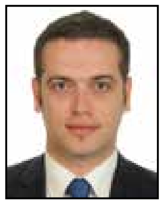
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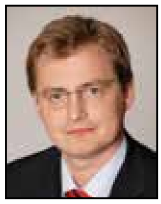
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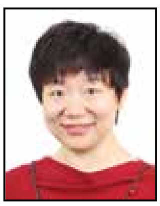
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JOIN THE MISSION FOR GROWTH TO CHINA

Given that today's most vibrant economies exist outside of Europe the European Commission (EC) is taking measures to build and maintain strong relationships with emerging economies, at both the political and business level. The overall objective is to promote European Union (EU) investments and help EU companies emerge from the current economic crisis stronger and more competitive than before. Viewing these countries through the eyes of European business will also afford EU officials a better understanding of their respective business environments.

As the European Commissioner responsible for industry and entrepreneurship, Vice President Antonio Tajani is driving this initiative. Following the successful Mission for Green Growth to China, by Vice President Tajani and Commissioner Potočnik, from 18th-19th July, 2013, Director General of Industry and Enterprise Daniel Calleja will lead a technical Mission for Growth to Chengdu from 21st-23rd October, 2014.

The current economic challenges experienced by European countries means that is vital to help companies from the EU—in particular small and medium-sized enterprises (SMEs)—to develop their activities at home and abroad, while simultaneously reinforcing industrial relations and strengthening the links of Enterprise policies with third countries. The Missions for Growth organised by Vice President Tajani will help Europe to effectively communicate and promote its policies.

Consisting of political and business meetings and discussions in areas of mutual interest in the fields of enterprise and industry, participation in these missions is open to all interested businesses bearing their own travel and accommodation expenses.

Objectives

The purpose of this visit is to confirm the strong political relationship between the EU and China and to strengthen cooperation in strategic fields.

Director General Calleja will lead a delegation of representatives of business associations and entrepreneurs to discuss with Chinese politicians and entrepreneurs how to foster European industrial cooperation. As with previous missions the objectives of the mission are to: promote sustainable and inclusive growth in the EU and China; help European companies, and in particular SMEs, to operate internationally by exploiting business opportunities in China; and promote EU-China industry in targeted sectors by participating in matchmaking events with local entrepreneurs.

The following sectors have been identified according to the specific interests of European and Chinese industries:

- Environmental protection
- Renewable energy
- Bio-pharmacy and bio-technology
- Modern agriculture (including organic agriculture, food quality and security, research and development in agricultural science and technology)
- Aviation
- Information and communication technology (ICT)

The Mission for Growth to China will take place in conjunction with the EU-China Business and Technology Cooperation Fair IX. Since its inception this event has attracted 3,255 Chinese companies and 1,572 European companies in total. More than 10,000 bilateral meetings have taken place with one third of them resulting in successful matches.

This year's fair is expected to gather around 1,000 representatives from SMEs, clusters, business associations, research and development institutions and government bodies. The EU-China Business & Technology Cooperation Fair IX is organised by the EU Project Innovation Centre (EUPIC), a member of the Enterprise Europe Network responsible for West China. Eb

To register for the Mission for Growth, please visit http://ec.europa.eu/enterprise/initiatives/mission-growth/missions-for-growth/daniel-calleja/asia/china/registration-form_en.htm.

For more information on the EU-China Business & Technology Cooperation Fair IX, please visit https://www.b2match.eu/ninth-eu-china-cooperation-fair.

COSMETICS MEETING

The Cosmetics Advisory Committee/Project Team (CAC/PT) met in Chengdu on 22nd August for the second time since its formation in 2009. Officials from the Chengdu Food and Drug Administration (FDA) were invited to attend, along with Ms Wang Gangli from the Food and Cosmetics Inspection Centre of the National Institute for the Control of Pharmaceutical and Biological Products (NICPBP). Other attendees included representatives from Chanel, Clarins, Colgate, Elizabeth Arden, Estee Lauder, JNJ, L'Oreal, LVMH, Mary Kay, P&G, Sephora and Sisley.

In attendance from the European Chamber were Maggie Xie, Acting General Manager of the European Chamber Beijing, Cocoa Liu, Business Manager of the Cosmetics Working Group and Steven Fan, Board Member of the Chamber's Southwest Chapter.

Maggie Xie opened the meeting by providing an update on Chamber lobbying strategies and shared best practices from other desks. The group then moved on to discuss lobbying priorities for the year ahead and key concerns and projects that are currently being worked on by the team.

In the afternoon the meeting decamped to the beautiful Luxelakes Eco-city, where discussion focussed on how to work closer with sister organisations and how efforts can be combined, for example joint lobbying for the review of the Cosmetics Hygiene Management Regulation (CHMR).

Ms Wang Gangli from the NICPBP spent an hour discussing industry updates with our members. Her team was heavily involved with information collection, analysis and drafting of the ingredients list, and also the revision of the Hygiene Standard.

The Hygiene Standard

The Hygiene Standard is still under consultation. According to their plan, Ms Wang explained that the revision will be ready by the end of this year, and will be based on the old version of the CHMR. She mentioned that oral health products are not going to be included in the revised standard and that forbidden substances in the annex will be reordered according to pinyin, or the number of strokes in the Chinese characters. Most importantly, the hygiene standard will be a dynamic revision list, and will be updated annually.

Chengdu FDA

Chengdu only has 35 local cosmetics manufacturers, but it has around 8,000 wholesalers and retailers of cosmetics products. Sichuan Province ranks number two in sales value of cosmetics, with more than 50 per cent coming from Chengdu. The Chengdu FDA formed the Cosmetics Supervision Division on 15th January, 2014, to aid healthy development of the cosmetics industry.

Mr Cai Kai, the first director of this new division, explained that they have already carried out a lot of regular supervisory checks of circulation and distribution channels. He explained that they have discovered some issues with packaging and labelling. They have already instigated a special programme to address safety issues in distribution channels, which will conclude on 20th September. Their next steps, he says, will be to improve the regulatory system and to strengthen regular checks of cosmetics retailers and wholesalers in shopping malls and markets. Eb

THE ADVISORY COUNCIL OF THE EUROPEAN CHAMBER

The 30 members of the European Chamber's Advisory Council are particularly active in representing and advising the Chamber, and make an enhanced contribution to the Chamber's funding.

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