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CHINA UPDATE 2009

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Inside

New SAIC Regulations on the Procedure of Investigation and Sanction of Monopolistic Agreements and Abuse of Dominant Market Position

Key Points:

- ***Define the jurisdiction of the SAIC over monopolistic agreement and abuse of dominant market position***
- ***Define the power and limitation of a lower level AIC***
- ***Outline the reporting procedures on possible violations***
- ***Outline the investigation procedure of the SAIC***

On May 26, 2009 the State Administration for Industry and Commerce ("SAIC") promulgated new Regulations on the Procedure of Investigation and Sanction of Monopolistic Agreement and Abuse of Dominant Market Position (the "SAIC Regulation"), which took effect on July 1, 2009.

Jurisdiction under the Anti-Monopoly Law is divided into three parts. Namely, the National Development and Reform Commission ("NDRC") is given the power to regulate monopoly related to price, the Ministry of Commerce ("MOFCOM") has power to regulate market concentration matters and the SAIC is provided the power to regulate unfair competition issues under the Anti-Monopoly Law, such as monopolistic agreements and abuse of dominant market position.

The SAIC Regulations are focused on the procedure of investigation and sanction and offer no significant reference on the substantive interpretation of the SAIC on the Anti-Monopoly Law. For example, no definition of monopolistic agreement and dominant market position is offered in the SAIC Regulations. As a matter of fact, the SAIC is working on the substantive regulations regarding the monopolistic agreement and abuse of dominant market position. The SAIC draft regulations on monopolistic agreement provide the following reference: "Business operators with competing relationships shall not reach written or oral agreement, decisions, implied or explicit accordance to (i) restrict the production or sales volume, (ii) divide distribution market or sourcing market, (iii) restrict purchasing new technology, new equipments, or development of new technology or products, (iv) boycott, or (v) bid rigging." With regard to the dominant market power, the SAIC's unpublished draft defines it as one business operator having the power to control the price, volume and other trading conditions within a certain defined market, or having the power to prevent or affect other business operators' entry into the defined market.

The SAIC Regulations provide that the SAIC will investigate and sanction any violation related to monopolistic agreement and abuse of dominant market position. Article 30 clearly excludes its jurisdiction over price-related monopolistic

agreement and abuse of dominant market power, which is an issue reserved for the NDRC. For example, if leading manufacturers of TVs reach an agreement on fixed prices for certain products, the SAIC would not take action to investigate or sanction the violators. All the price-related matters fall into the territory of the NDRC.

The SAIC has the power to investigate and sanction any violations. On the other hand, the provincial level Administration of Industry and Commerce (the "AIC") has the power to investigate and sanction any violation occurring in its jurisdiction only. Only the SAIC and provincial level AIC have the power of investigation and sanction. The SAIC Regulations clearly prohibit the provincial level AIC from further delegating the power to lower level AICs, which means that even if a county level or municipal level AIC finds a violation, it can only report to the provincial level AIC for further investigation and sanction. For a case involving more than one province, the SAIC will have the power to either conduct the investigation by itself or designate its power to one provincial level AIC.

The SAIC may take action to engage in investigation when a possible violation is (i) discovered by itself, (ii) tipped by other sources, (iii) transferred from other government authorities, and (iv) designated by an upper level government authority.

When any level of AIC receives information about a possible violation, it must report the tip to the provincial level AIC for verification. The SAIC system is required under the SAIC Regulations to keep information regarding informants confidential. For each case, upon verification, the provincial AIC is required to report to the SAIC about its decision on whether to conduct a full investigation.

Once the investigation commences, the SAIC will exercise the power to conduct an onsite investigation, interview relevant witness and collect and seize the documents from interested parties.

If the suspected company admits its violation and guarantees to correct its action and any effects of the violation, the SAIC may suspend the investigation.

In significant cases (undefined), the SAIC may issue sanctions and must report the case to the Anti-Monopoly Commission of the State Council. Once a sanction decision is imposed, an interested party may seek administrative review of the discussion.

– Weiheng Jia

New Rules for Virtual Currency Trading

Key Points:

- ***China issued new rules restricting virtual currency trade***
- ***Online gambling and lotteries are prohibited***

On June 4, 2009 China's Ministry of Culture and Ministry of Commerce jointly issued a notice aimed at restricting the use and trading of virtual currencies (the "Notice"). Virtual currencies are banned from being traded as "real" goods and services, and one company may not issue and trade virtual currencies at the same time. The Chinese government defines "virtual currency" to include prepaid cards, game currencies and game points of online games, but excludes costumes and weapons used in the games.

China is one of the world's largest markets for multiplayer online games, and many game players in China are involved in trading virtual currencies for "real" goods or cash. According to the China Internet Network Information Center, the total number of online game players in China reached 18 million by the end of 2008, which is an increase of 50% over 2007. Virtual currencies traded at a value of about RMB10 billion to RMB13 billion in 2008. As the trading of virtual currencies has become more active, and due to the absence of sufficient supervision, there has been a significant increase in disputes. Furthermore, with the rapid development of virtual currencies, some experts are concerned that they will have a negative impact on China's real financial/currency system. In 2007, 14 governmental authorities led by The People's Bank of China issued the Notice Enhancing the Supervision of Internet Bar and On-line Games, which prohibits the trade of virtual currencies for "real" goods.

According to the Notice, virtual currencies are only allowed to be traded for virtual goods and services provided by the currency's issuer, not real goods and services nor virtual goods and services provided by other companies. Also under the new rules, using virtual currencies for gambling and lotteries is prohibited.

The Notice also aims to set certain standards for companies engaged in virtual currency trade activities in order for the government to strengthen supervision. For example, the Notice requires all companies involved in virtual currency trade activities to register with the local Cultural Affairs Bureau within three months of establishment.

Some observers believe that the issuance of the Notice and tightening the supervision of virtual currencies may have a big impact on companies running a virtual currencies trade business and their revenue may drop significantly unless they can find new ways that are legal to bring in new revenue. Some commenters believe that this Notice is just

the beginning of the Chinese government enhancing the supervision of online games, and the government may issue more laws and regulations in the future.

– Jennifer Liu

Rural Land Contract Dispute Mediation and Arbitration Law Released

Key Points:

- ***A new mechanism will be introduced to settle rural land disputes***
- ***More simplified procedures and more flexibility compared with the Arbitration Law***

The "Rural Land Contract Dispute Mediation and Arbitration Law of the People's Republic of China" (the "Law") was promulgated by the Standing Committee of the National People's Congress and will come into force on January 1, 2010.

The Law provides that mediation of certain disputes over rural land contracts may be heard by the rural land contract arbitration commission, which shall issue the written mediation result when a mediation agreement is reached. When a mediation agreement cannot be reached, the arbitration commission shall timely award its arbitration decision.

The promulgation of the Law offers new methods to resolve disputes over rural land contracts; the affected party may choose mediation, arbitration or litigation to resolve disputes. Article 2 of the Law provides the scope of disputes that shall be governed by the Law; however, disputes arising from requisition of collectively owned land and the compensation thereof will not be accepted by the rural land contract arbitration commission. They may be settled by means of administrative reconsideration or lawsuits.

Compared with the Arbitration Law of the People's Republic of China (the "Arbitration Law"), the Law simplifies certain mediation and arbitration processes and formalities, and adds certain flexible practices according to the actual conditions of rural areas, which may lower the cost and improve the efficiency of the rural land contract commission.

Highlights of the Law include:

- **Arbitration agreements are not required.** In the event of disputes over the contracted rural land, the parties may accept mediation, apply to the rural land contract arbitration commission for arbitration or directly lodge a lawsuit in court. Unlike the Arbitration Law, even without an arbitration agreement, the affected parties may directly apply for arbitration.
- **Much more flexible requirements.** Written documents are not compulsory during the

process. Whether a party is applying for mediation or arbitration, oral application is acceptable. The parties may also use fingerprints instead of signing.

- **More involvement of farmers in the arbitration tribunal.** A rural land contract arbitration commission shall be concurrently formed by representatives from the local people's government and from its relevant departments, representatives from relevant people's groups, representatives from rural collective economic organizations, farmer representatives, and professionals in law, economics and other relevant specialties. In particular, the number of farmer representatives and professionals in law and economics shall account for at least half of the arbitration commission.
- **No fees for mediation or arbitration.** According to Article 52 of the Law, no fees may be charged to any party for the arbitration. The operational funds for the arbitration work shall be financed by the fiscal budget.

The Law also seeks to promote the professional ethics of arbitrators (such as restrictions on conflicts of interests) and outlines penalties for arbitrator malpractice. However, considering the social development of China's rural areas, the measures for selecting members of the rural land contract commission are not specific, and supplementary measures are needed to ensure the efficient operation of rural land contract commissions.

– Edison Chen

Cross-Border RMB Trade Process Scheme Launched

Key Points:

- ***Eligible companies registered in five Chinese cities are allowed to use RMB to settle cross-border trades***
- ***Two options are available for settlement in RMB***
- ***RMB financing services are available for overseas participating banks and traders***

Because of big swings in the US dollar, the euro and other major settlement currencies, China-based exporters and importers and neighboring countries face relatively huge risks of exchange rate fluctuations. In order to reduce the risk and reliance on foreign currency for international trade, the State Council announced the pilot RMB Trade Settlement Scheme in April 2009. Following the announcement, the authorities promulgated the Pilot Cross-Border Trade RMB Settlement Administrative Measures on July 1, 2009. The implementing rules were also released on July 4, 2009 (collectively, the "RMB

Settlement Rules"). The People's Bank of China ("PBC"), the Hong Kong Monetary Authority and the Macau Monetary Authority have been working closely on the implementation of the pilot scheme, including the related arrangements for the cross-border settlement and clearing of RMB funds and amendments to the existing legal documents such as the clearing agreement for RMB business.

This pilot scheme currently allows eligible companies registered in five Chinese cities – Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan – to use RMB to settle cross-border trades with companies doing business in Hong Kong, Macao and Association of Southeast Asian Nations (ASEAN) member countries. Pursuant to the RMB Settlement Rules, enterprises eligible for RMB settlement shall be recommended by the local government at the provincial level. Based on the recommendation, agencies including the PBC, Ministry of Commerce, General Administration of Customs, State Administration of Taxation and China Banking Regulatory Commission will examine the candidates and finalize the list of eligible enterprises.

Companies participating in this pilot program may continue to settle their trades in other foreign currencies, as settlements in RMB are voluntary. Under Article Five of the RMB Settlement Rules, the PBC will closely monitor the aggregate amount of RMB settlements to ensure that they will not undermine China's macro economic policy objectives.

Under Article Six of the RMB Settlement Rules, companies that wish to settle their cross-border trades in RMB can choose between two options:

1. Settle the trades through commercial banks in Hong Kong or Macau that are approved by (i) the People's Bank of China and (ii) the Hong Kong Monetary Authority or the Macau Monetary Authority, whichever is applicable. These commercial banks must also be members of the People's Bank of China Large Value Payment System.

2. Settle the trade through a China-based bank operating in one of the designated cities under this pilot program. The China-based bank will serve as the agent bank for the overseas participating bank used by the non-China-based trading partner. To facilitate RMB settlements, the China-based agent bank will maintain an inter-bank fund transfer account denominated in RMB for the overseas participating bank. Under this arrangement, the China-based agent bank will also be responsible for disclosing the agency agreement and reporting any RMB account information to the People's Bank of China.

A China-based agent bank may purchase and sell RMBs per requests of an overseas participating

bank within the amount limit set by the PBC. Furthermore, a China-based agent bank may provide financing for the inter-bank RMB fund transfer account opened by an overseas participating bank in order to meet the latter's temporary liquidity demand. However, the China-based bank's total account balance used for financing with its overseas participating banks may not exceed 1 percent of the total RMB deposit balance at the end of the previous year, and the financing term may not surpass one month. In addition, a domestic settlement bank may provide RMB trade financing services for the overseas enterprise, subject to the amount of the trade contract.

After the settlement, if the China-based enterprise does not obtain the related RMB proceeds within 210 days after exporting the related goods, it must report the outstanding amount and other related information to the PBC's system within five working days via its China-based settlement bank. Nevertheless, the RMB Settlement Rules allow a China-based company to deposit its RMB export proceeds in an overseas bank, provided that it reports to the local PBC.

The Bank of China has launched RMB clearing services for trade settlement and carried out the first cross-border trade settlement denominated in RMB since the promulgation of the new measures regulating the pilot program for these transactions. The Shanghai branch of the Bank of China received its first cross-border RMB trade settlement deal from the Bank of China (Hong Kong) on July 6, 2009.

The RMB Settlement Scheme is a small but important step in "internationalizing" the RMB. With more China-based and overseas enterprises starting to use the RMB as settlement currency in international trade, more RMB will circulate overseas, which we believe will certainly promote RMB free convertibility in the future.

– Deborah Y. Cheng and Daniel Yao

Squire Sanders China Practice Focus: China Corporate Tax Issues

Interview with Sharon Xu, Associate, Beijing

What are the available corporate income tax incentives for companies in China? Are there any special tax incentives for foreign invested companies?

The new corporate income tax primarily abolished tax incentives available to foreign invested companies and removed tax preference geared to geographic locations. New preferential tax treatment aims to encourage industries and activities in various ways such as tax reduction or exemption, reduction of taxable income, tax holidays, reduced tax rates, tax credit and super

deduction. Some major tax incentives for qualified PRC companies are summarized as follows:

1. **Tax Reduction/Exemption on Income from Qualified Technology Transfer.** Income of up to RMB5 million derived from qualified technology transfer within a tax year is exempt from tax, and any income in excess of RMB5 million is taxed at a 50% reduced rate.

2. **Reduction of Taxable Income.** 10% of the income derived from the comprehensive utilization of resources is deductible in calculating income tax liability.

3. **Tax Holiday.** Starting from the first income generating year, qualifying public infrastructure facility projects, environmental protection, and energy- and water-saving projects are entitled to a three year tax exemption followed by a three year 50% reduced tax rate.

4. **Reduced Tax Rate.** High and new technology enterprises are entitled to a 15% reduced tax rate.

5. **Tax Credit.** Investment in qualifying environmental protection equipment, energy and water conservation equipment, and production safety equipment is entitled to a tax credit in the amount of 10% of the investment price. The excess credit can be carried forward for five years.

6. **Super Deduction.** For a period of more than two years, 70% of a venture capital investment in a small and midsize unlisted high and new technology enterprise may be deducted from the company's taxable income.

What are the top challenges that foreign companies have in China with respect to tax issues?

China tax authorities are now strengthening their revenue collection efforts and imposing penalties for noncompliance. In particular, transfer pricing has become a major focus for tax authorities. They have expanded their efforts in training tax officials at the local and state levels. Independent departments dedicated to fighting tax avoidance have been formed in major cities, and the number of officials involved in tax avoidance cases is increasing. Also tax officials have become more sophisticated in terms of transfer pricing investigation and their level of transfer pricing knowledge. In recent years tax authorities have launched a number of transfer pricing audits mostly targeting those multinational companies with a significant number of cross-border transactions with related parties. The new corporate income tax law awarded tax officials the authority to make retroactive adjustments for up to 10 years as well as introduced late payment interest for transfer pricing adjustments, which was waived under the old corporate income tax system. The price for noncompliance can be very high, and it is therefore essential that foreign operators in China

review their tax positions, especially their transfer pricing policies, and have a well managed tax compliance program in place to reduce the risk of audits and investigations.

What types of cross-border transactions are eligible for tax deferral treatment under the new M&A tax rule?

Under the old corporate income tax law, foreign investors were allowed to transfer their equity interest in a PRC company on a cost basis without recognizing any gain or loss in the course of group restructuring. This preferential treatment is abolished under the new tax law. According to the M&A tax rule promulgated recently, only the following types of cross-border transactions are entitled to a tax deferral:

1. Transfer by a non-resident company to its 100% owned non-resident company of its interest in a China-based company, provided that the PRC capital gain withholding tax rate for the transferor parent is the same as that of the transferee subsidiary and the transferor parent does not transfer its interest in the transferee subsidiary within three years after the equity transfer.
2. Transfer by a non-resident company to its 100% owned PRC resident company of its interest in another PRC resident company.
3. Transfer by a PRC company of its assets/equity to its 100% owned non-resident subsidiary in exchange for the subsidiary's equity interest.

In addition the transaction must satisfy the following conditions to qualify for tax deferral treatment: (i) the transaction must have a *bona fide* business purpose and the primary purpose cannot be that of reducing, avoiding and deferring tax payment, and (ii) the original business operating activities of the target company must continue for 12 months after the reorganization.

What are the risks of using an offshore shareholding structure?

Offshore holding companies are widely used by foreign investors to structure their investments in China. The foreign investors will be able to enjoy the treaty benefits such as a reduced rate of dividend, interest and capital gain if the intermediate holding company is in a jurisdiction with a favorable tax treaty with China. However with the issuance of several rulings in recent months, the offshore holding structure no longer proves to be a viable tax planning vehicle in certain cases, and the entitlement to tax treaty benefits does not seem automatic.

In one ruling, the tax authority found out that a holding company in Singapore does not have any commercial substance. It does not carry on any business activities and has minimal registered

capital. The tax bureau decided that the holding company was set up with the primary purpose to take advantage of the preferential treatment under the Sino-Singapore tax treaty and to reduce or avoid tax payments. The tax bureau determined that the holding structure failed the "commercial viability test" under general anti-avoidance rules in China and thus redefined the transfer of the interest in the Singapore holding company as a *de facto* transfer of interest in the China-based subsidiary and denied the benefit of the Sino-Singapore tax treaty.

In another ruling, the tax authority rejected the application of a capital gain tax provision in a Sino-Barbados tax treaty in a disposal by a Barbados company of its PRC investment. The tax bureau concluded that the Barbados company does not have an adequate presence in Barbados to be considered a resident of Barbados. Although its is registered in Barbados, it does not have management there, all its three directors are US nationals and no director is based in Barbados. More importantly, the tax authority is concerned about the pre-structuring of a series of transactions and an apparent tax avoidance motive – e.g., the short timeframe between the establishment of the Barbados company and acquisition of the China-based company as well as that between the acquisition and disposal of the China-based company. The tax authority finally concluded that the transactions are structured to take advantage of the favorable capital gain rate under the tax treaty and denied the application of the treaty.

The offshore holding structure is under increased scrutiny by the tax authority. It is important that foreign investors review their holding structure to ensure that it has sufficient business substance and commercial activities as well as to maintain proper documentation that will support the reasonable business purposes of the holding company and withstand challenges from the tax authority.

Sharon Xu's practice focuses on general corporate and tax matters, customs and foreign exchange issues. Her experience includes advising international clients on a variety of corporate, commercial and tax matters related to foreign direct investment, corporate restructuring, cross-border transactions and foreign contract projects. Ms. Xu is the co-author of "Case Study: Tax Incentives for Purchasing Domestic Equipment" published in the June 2005 issue of China Tax Intelligence*. Prior to joining the firm, she worked for one of the Big Four accounting firms and an international law firm based in Beijing.*

Squire Sanders China Practice Focus: Communications Regulation

Interview with Nicholas Chan, Partner, Hong Kong

Who are the primary regulators of the telecommunications, broadcasting and Internet sectors in China?

China has yet to enact an overarching "Telecommunications Law," and regulation of the sector is based on various administrative regulations, the telecom catalogue, notices and judicial interpretation. China's Ministry of Industry and Information Technology (MIIT, formerly known as the Ministry of Information Industry until June 29, 2008) is the primary regulator of the telecommunications industry. China's State Administration of Radio, Film and Television (SARFT) is the primary regulator of the broadcasting industry. The convergence of the telecommunications industry and the broadcasting industry in the form of Internet television and mobile television over 3G networks creates potential regulatory conflicts and business uncertainty. The worldwide trend is to merge communications authority with the broadcasting association (e.g., the merger of the Australian Broadcasting Authority (ABA) and the Australian Communications Authority (ACA) into Australian Communications and Media Authority in 2005, and the merger of the UK Office of Telecommunications (Oftel) and its broadcasting, television and radio commissions and authority into the Office of Communications (Ofcom) in 2003).

What are the top three legal issues and challenges affecting the IT sector in China?

The convergence and explosive development of technologies and business models in the field of broadcasting, communications, Internet and information technologies have out-grown the current regulatory constraints and led to legal uncertainty and business risks when conducting triple-play, quadruple-play, Internet broadcasting and social networking business in China.

Content regulation has impeded or otherwise cast doubts on the commercial longevity of otherwise very viable business models.

Foreign ownership restrictions and homegrown technological standards have made it more difficult for foreign operators to enter in a big way and introduce offerings riding on VoIP, VPN, mobile TV and data center services.

What are the foreign ownership restrictions and geographic restrictions for investors who wish to enter China's telecommunications market?

The restrictions are 49% for mobile operators and fixed network operators, and 50% for value added services providers. All geographic restrictions have been removed. Some specific services such as domestic IP-VPN services are still not open for

foreign participation. Other lucrative services (e.g., Internet data center operation and call center services) are only open for foreign investment via a Hong Kong company that is certified under the Closer Economic Partnership Agreement (CEPA) entered into between the Hong Kong government and the mainland Chinese government.

Can foreign investors obtain economic benefits from a joint venture beyond the permissible foreign ownership percentages?

Yes, but with some limitations as the parties could establish variable interest entities (VIEs) (Financial Accounting Standards Board Interpretation No. 46) and enter into a series of offshore and onshore agreements. Typically such offshore and onshore agreements may include some form of a loan, a cooperation or services agreement, the creation of certain nominee/trust structures and a power of attorney and pledge agreement. The type of structure required would depend on the particular services and infrastructure the operator requires/provides, and the more regulated the industry, the more complex the structure and the more documentation it would likely entail.

Do you foresee any additional laws or regulations in the pipeline that impact the IT sector?

We presently expect that new telecommunications legislation will be introduced in 2010. The legislation is expected to further regulate the sector through giving more power to the MIIT and related authorities.

Do you see opportunities in the IT sector in the second- and third-tier cities? If yes, what challenges do foreign investors have in these areas that they might not have in the major cities?

The first-tier cities in China are definitely experiencing slower growth and bigger competition compared to second- and third-tier cities. The benefit of second- and third-tier cities is not only the lower cost of operation, but also local governments' greater leniency and stronger support for the growth of niche services to compete with neighboring cities.

It is important to note that second- and third-tier cities' infrastructure is still being developed, and their business practices on contracting and servicing and local governments' processes for approving/regulating new technology and communications offerings are relatively immature compared to first-tier cities. The extra effort and investment needed should be considered and weighed with the savings due to the lower cost base.

Nicholas (Nick) Chan is an experienced private equity/venture capital, merger and acquisition, commercial and compliance, TMT, employment, competition and regulatory lawyer with a computer science background and a regional practice covering 22 countries focusing on telecommunications, broadcasting, information

technology, emerging technologies, health care, aviation, energy, real estate, entertainment, advertising, logistics, global sourcing, petroleum and related industries. His expertise has been recognized in AsiaLaw Leading Lawyers *since 2004. The awards recognize his expertise and leadership in the areas of venture capital and private equity; mergers and acquisitions; intellectual property (IP); IT, media and telecommunications; competition and antitrust; corporate governance; general corporate practice; labor and employment; and regulatory and government.*

Survey Confirms "in China for China" Shift Among Foreign-Invested Enterprises

Key Points:

- ***Recent study shows more foreign-invested enterprises in China are targeting China-based markets***
- ***As companies migrate away from export-driven models, they will adjust sales structures to meet demand in Western China and second-tier cities***

Foreign-invested enterprises (FIEs) in China are coping with the global economic crisis, and subsequent slump in exports, by targeting China-based markets, according to a survey done by Squire Sanders and EAC- Euro Asia Consulting.

More than 230 managers from companies in Asia, Europe and the United States participated in the survey. Respondents included leaders in company headquarters located outside China and China-based subsidiaries. Participating companies operate in industries such as automotive, health care, machinery and pharmaceuticals.

"This survey was a great opportunity to learn how our clients are faring during these historic economic times," said Rainer Burkardt, a Squire Sanders partner in the Shanghai office whose practice focuses on foreign direct investment and corporate transactions. "Our research confirmed the steadily growing trend of companies in China aggressively seeking new business models – 'in China for China' has become the rule, not the exception. This change will have a lasting impact on their long term business strategies."

Priorities for Thriving in China

In the midst of the worldwide economic crisis, China's economy, the third largest in the world, grew 7.9 percent in the second quarter of 2009, up from 6.1-percent growth in the first quarter. That growth was reportedly driven by an ambitious economic stimulus program and aggressive bank lending.

That growth is also reflected in FIEs' optimistic take on opportunities in China. More than half the companies surveyed report profit margins ranging from 5 to 20 percent, and 60 percent expect their business in China to be more successful in 2009 than their parent companies.

That said, survey results indicate that China FIEs face a number of challenges, the most significant being rising labor costs, mounting competition and increasing commodity prices. In response, many are reducing administrative costs, manpower and executive bonuses.

Daniel Berger, EAC's chief representative in Shanghai, said the survey provides valuable insight on how specific industries are managing costs.

"Automotive and health and pharmaceutical companies followed the general pattern of cost cuts – focusing on general costs (such as travel), external services and bonuses – whereas machinery companies are focused more heavily on reducing local and non-China-based personnel," Mr. Berger said.

Rather than lowering production capacity, most respondents are negotiating better deals with suppliers.

"In the automotive sector, nearly three-quarters of respondents said they are increasing sourcing in low-cost countries such as China and improving warehouse/inventory management," Mr. Berger said. "For health care players, optimization of logistic chains is on the agenda, while machinery companies are reevaluating 'make versus buy' decisions."

A large majority (91 percent) of FIEs is refocusing sales efforts in hopes of avoiding sales force cuts.

As they migrate away from export-driven models to target markets within the country, they will adjust sales channel structures to account for growing opportunities in Western China and second-tier cities, according to the survey. Of the respondents, 44 percent indicated they are already producing locally for China markets.

The Outlook for FIEs in China

More than 40 percent of China-based FIEs believe the country will recover from the global economic crisis by the end of 2009, and 35 percent see a recovery in mid-2010. By comparison, most respondents believe the global crisis won't be finished until the end of 2010.

That said, business leaders surveyed pointed to future obstacles such as increasing competition, decreasing international demand and lack of reliable forecasting. In particular, the technical capabilities of local competitors to FIEs are increasing as local businesses transition from copycats to innovators.

The survey identified trends in the following areas:

- "In China for China and other emerging markets" continues to be a growing trend for FIEs
- Initiatives FIEs are undertaking to lower costs, improve financial management, optimize supply chains, adjust project portfolios and fine-tune sales structures

- FIEs' planned and implemented reductions of local and foreign personnel
- Short-term measures survey respondents are taking to ensure the solvency of their operations

"Businesses with an interest in China can take comfort from knowing that the country has potential to become an attractive sales market, and they should take note that companies that create an 'in China for China' approach are more likely to ride out the financial storm," Mr. Burkardt said.

Articles, Publications and Other Media

James M. Zimmerman was quoted on July 17 on LATimes.com and on July 13 by *The Wall Street Journal* regarding the impact of China's decision to detain employees of a major mining company on suspicion of espionage. He was also quoted on June 20 by *The Los Angeles Times* about China's reaction to the H1N1 flu epidemic, as well as on June 16 on FT.com regarding China's new "Buy China" policy. On July 1 Mr. Zimmerman was quoted by the Associated Press and *The Los Angeles Times* regarding China's move to require personal computer producers to supply government-endorsed filtering software with every personal computer. The Associated Press article was picked up by Forbes.com.

David Spooner was quoted on USATODAY.com and Dow Jones Newswires on June 23 regarding a complaint to the World Trade Organization (WTO) made by the US government and the European Union regarding China's export limits. He was also quoted on June 24 by BusinessWeek.com.

Shanker Singham was quoted on Forbes.com on June 23 regarding the WTO complaint against China. He was also quoted on July 8 by *Inside US-China Trade* and *Trade Policy* regarding handling of state-owned enterprises.

The China Blog of TIME.com on July 2 noted a post by **Charlie McElwee** on the China Environmental Law blog regarding the China Ministry of Environmental Protection site, which posts updated water quality data every four hours. Mr. McElwee was also quoted on June 10 on Telegraph.co.uk regarding China's interest in renewable energy.

Squire Sanders released the following China Alerts in June and July: Key Points in the Draft Administrative Measures on Food Distribution License and New FDA China Office Staff Members Arrive.

Past Events

Amy L. Sommers, partner in Squire Sanders' Shanghai office, presented the Pre-Conference Workshop "The Fundamentals of FCPA Compliance: The U.S. Foreign Corrupt Practices Act Demystified" at the 2nd China Summit on Anti-Corruption on June 15 in Shanghai. She discussed core FCPA issues, focusing on the "nuts and bolts" and supplying a foundation for dealing with day-to-day issues, and moderated the panel "Dealing With Requests for Bribes or 'Consideration' When Obtaining Regulatory Approvals or Responding to Local Government Investigations/Audits."

Ms. Sommers also shared her perspective on recent anticorruption actions in the People's Republic of China and the ramifications for companies doing business there during the FCPA/Anticorruption Developments: What They Mean to You and Your Company event in Palo Alto on July 22.

At the Infrastructure Financing and Opportunities in China event in Seattle on August 6, Ms. Sommers discussed China's stimulus plan, infrastructure financing models in China, the availability of public and private partnerships in China, and key elements of China's pilot bond finance project and whether it is likely to make US-style "municipal" financing vehicles more available to local governments

Squire Sanders partner **James M. Zimmerman** shared his expertise on China's growing green economy at the Clean Tech: China Opportunity – Asia Desk Business Series II on July 16 in San Diego. Mr. Zimmerman discussed opportunities a green China can bring to US-based companies. His PowerPoint on China's clean technologies, policies, and business opportunities in China from the event is now available for download.

Upcoming Events

On September 3 **Amy L. Sommers** will join an authoritative panel – **Foreign Corrupt Practices Act in China: Compliance Strategies Given China's Unique Cultural and Governmental Intricacies** – to discuss the risks of FCPA violations in China, interplay between the FCPA and China's antibribery laws and best practices for preventing violations. The panel will address which risk factors increase the exposure of companies conducting business in China to possible FCPA violations, how the US and Chinese governments are enforcing their respective antibribery laws against US companies and the best practices for companies to utilize in developing anticorruption compliance programs and due diligence efforts for their China operations. The panel discussion will be followed by an interactive question and answer session. To register please visit the Strafford Publications website.

Honors and Distinctions

Effective July 2, 2009 **Rainer Burkardt**, partner in our Shanghai office, was appointed as a "trusted lawyer" of the Austrian Consulate General in Shanghai for Shanghai Municipality as well as the provinces of Anhui, Jiangsu and Zhejiang.

James M. Zimmerman was appointed the Liaison of the American Bar Association; Section of International Practice to the All China Lawyer's Association for the term running from August 4, 2009 to August 5, 2010.

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