

## CHINA UPDATE

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July 2010

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## China Revises State Secrets Law

### Key Points:

- ***New law offers a clearer definition of “state secret”***
- ***Internet service providers’ obligations are specified***
- ***Notice issued regarding protection of secrets related to state-owned enterprises***

The Standing Committee of China’s National People’s Congress adopted a revised State Secrets Law on April 29, 2010, which will go into effect on October 1, 2010.

During the two decades since the State Secrets Law’s enactment in 1988, there have been substantial social, economic and political transformations in China, which made the corresponding amendment to this law necessary. When four employees of the Austria location of miner Rio Tinto were detained last year on charges involving state secrets, it immediately brought to the world’s attention China’s state secret-related legislation, as well as China’s foreign investment environment. Just a month before the promulgation of the new State Secrets Law, a Chinese court rendered its verdict convicting the four employees of receiving bribes and stealing commercial secrets, not state secrets, which again attracted attention to the definition of “state secret” under China’s legal system.

### Clearer Definition of “State Secret”

The old definition simply provided, in Article 2, that a state secret is a “matter that has a vital bearing on state security and national interests and, as specified by legal procedure, is entrusted to a limited number of people for a given period of time.” Under the new law, this definition is further explained as “information concerning state security and interests and [that], if leaked, would damage state security and interests in the areas of politics, economy and national

defense, among others.” In addition to military matters and foreign affairs, the seven categories of secrets include secret economic or social development projects, technology secrets, and “other secrets defined by the state secrets authorities.”

In addition, the new law clearly stipulates who is entitled to decide which kind of information belongs to the sphere of state secret. State secrets are classified under three categories and are subject to determination by governmental authorities and authorized units. Central and provincial authorities and units are entitled to determine all three levels of state secret, whereas municipal authorities and corresponding authorized units are allowed to label only “confidential(机密)” or “secret(秘密)” information other than that which is “top secret(绝密).”

### Internet Service Providers’ Obligations

Another hot topic in connection with this revision is the responsibility of Internet service providers to protect state secrets by handing over their users’ information. In accordance with Article 28 of the new law, “Internet and other public information networking operators and service providers must cooperate with public security, state security, and procuratorate organs in investigation of cases regarding leaking of secrets; when information involving leaking of state secrets is found to have been published through the Internet and other public information networks, transmission must stop immediately, relevant records must be kept, and reports must be made to public security organs, state security organs, or the departments for the administration and management of guarding state secrets; information involving leaking of state secrets must be deleted as required by public security organs, state security organs, or the departments for the administration and management of guarding state secrets.”

The new requirements are unlikely to make much difference to China-based companies, especially those

state-owned enterprises that have operated since the very beginning under the assumption that they must comply with government requirements for information. But it is not clear whether the revision will prevent foreign-owned Internet companies from entering China's market. In 2005 a journalist in China was sentenced to 10 years in prison for violating "state secrets" laws after authorities obtained information from Yahoo about an email he sent related to a confidential government document, which exposed Yahoo to heavy criticism by media and human rights organizations. Just one month before the new law was adopted, Google redirected its online search traffic in China to its Hong Kong site to avoid self-censorship demands. Furthermore, it is not clear whether this amended law could also present problems for other types of media, e.g., those transmitted via channels shared with the Internet. Communications companies already are often compelled to comply with investigations. In short, this revision brings considerable concern to human rights activists as well as foreign investors, especially foreign media service providers, that China's freedom of information statutes may be taking a step backwards.<sup>1</sup>

#### **State-Owned Enterprise Commercial Secret Protection Notice**

Apart from the new State Secrets Law, another action China's government has taken in relation to regulating the handling of classified information is a notice promulgated on April 26, 2010 by the State-owned Assets Supervision and Administration Commission (SASAC). The notice encourages those state-owned enterprises to improve their protection of "commercial secrets," defined as "any business or technical information not known to the public that can bring economic benefits for the enterprises." According to the notice, commercial secrets for state-

owned enterprises shall refer to information related to strategic plans, management, mergers, equity trades, stock market listings, reserves, production, procurement and sales strategy, financing and finances, negotiations, joint venture investments, and technology transfers.

#### **Conclusion**

Neither the new State Secrets Law nor the notice offers a clarification on how to further define and distinguish information as a state secret or commercial secret. Although the new law provides a clearer definition and scope of state secrets, it remains as sweeping as the original law and leaves much room for the government's discretion. Until any further guidance is rendered in this regard, it is recommended that foreign firms operating in China, in particular those engaging in media-related industries, adopt a strict compliance policy to avoid legal exposures.

– Doris Chen

### **New Regulation Governing Online Trading and Services**

#### **Key Points:**

- **All organizations and individuals must register their identity authentication information in order to open an online store or sell products online**
- **Online sales platform operators will bear more liability in supervising sellers and protecting consumers' interests**
- **Judicial jurisdiction over online shopping is clarified**

The Provisional Measures on Administration of Online Trading and Related Service (the Measures) were published on May 31, 2010 and went into effect on July 1,

<sup>1</sup> See <http://www.hrichina.org/public/contents/press?revision%5fid=174308&item%5fid=174305>.

2010. Before the Measures were adopted, China had no law specifically governing online trading, despite the fact that online sales revenues in 2009 in China reached RMB 250 billion.

The main purpose of the Measures is to protect consumers by incorporating various provisions from related laws and regulations – such as the Contract Law, Consumers' Rights Protection Law, Tort Liability Law and Products Liability Law – as well as new obligations for online sellers and website operators.

The provisions that might have a major impact on the online sales industry include the following:

#### **Identity Authentication Required**

Before the Measures were adopted, people could open an online store or sell products online without disclosing their true identity, which resulted in difficulties in bringing claims in case of seller defaults. Although some of the biggest online trading platforms, such as Taobao, have already started an authentication process to protect buyers' interests, such a process has not been legally required and smaller websites have not been doing so. According to the Measures, all persons, including organizations and individuals, must now register their legal name, address and other identity information in order to open an online store. An online trading platform operator has the obligation to review and authenticate the identity information. If the seller is a registered entity, it must publish its business license information or include a link to its business license on its store webpage.

#### **More Obligations for Platform Operators**

On a consumer-to-consumer (C2C) website such as Taobao or eBay, the site itself is not a seller of any products but rather a service that provides and operates a platform on which buyers and sellers can trade. Although a platform operator does not have the ultimate liability in terms of quality of products, the Measures impose a

number of obligations on the platform operator to regulate and supervise the actual sellers, which include:

- After authenticating the identity of a seller, a platform operator must periodically update its identify information;
- A platform operator must enter into an agreement with the seller detailing its obligations in terms of protection of customers' interests, guarantee of product safety and quality, etc.;
- A platform operator must supervise sellers' activities and report to the government if there is any violation of law;
- A platform operator should take necessary measures to protect trademark, copyright and other intellectual property rights and take action in the case of any claim of infringement according to the PRC Tort Liability Law; and
- A platform operator must build a dispute resolution and customer protection system.

#### **Jurisdiction of Enforcement Is Clarified**

The government agency that will implement and enforce the Measures is the State Administration of Industry and Commerce (SAIC) and its local counterparts (AICs). In the Internet realm, jurisdiction is always a tricky question. On a C2C website, the buyer, seller and platform operator may be located in different jurisdictions. The Measures make it clear that (i) only AICs at or above the county level have jurisdiction, given the complexity and high-tech involvement of online trading, and (ii) the AIC where the website operator is located should have jurisdiction, but in the event that the actual violator is located elsewhere and enforcement is therefore difficult, the AIC where the actual violator is located may take over.

– Lindsay Zhu

## Administrative Measures for Equities of Insurance Firms

### Key Points:

- ***Each shareholder shall not make more than a 20-percent capital contribution or own more than a 20-percent shareholding in an insurance firm***
- ***The registered capital of insurance firms must be made in currency by shareholders***
- ***Two insurance firms that are under the same institution's control or have a control relationship must not engage in competitive insurance businesses***
- ***The change of shareholders who own more than 5-percent equity or shares of insurance firms must be approved by the China Insurance Regulatory Commission***

The China Insurance Regulatory Commission (CIRC) recently released the Administrative Measures for Equities of Insurance Firms (the Measures), which went into effect on June 10, 2010. For the purposes of the Measures, "insurance firms" refer to those firms that are incorporated upon the CIRC's approval and registered lawfully with less than 25-percent capital contribution from or shareholding owned by non-China-based shareholders. If the percentage of foreign shareholders' capital contribution to or shareholding in an insurance firm is more than 25 percent, the regulations related to foreign-invested insurance firms shall be applied unless the CIRC provides otherwise.

### Shareholder Requirements and Restrictions

Investors that want to be shareholders of an insurance firm must meet the following requirements respectively.

For a domestic investor:

- Its financial situation must be good and stable, and it must have profits;
- It must have good credit and tax records;
- It must have no record of serious violations of laws or regulations in the past three years;
- If it is a financial institution, it must meet relevant prudential criteria of the financial supervising authority; and
- It must meet other requirements provided by laws and regulations and the CIRC.

For a foreign investor that is a financial institution:

- Its financial situation must be good and stable, and it must have been profitable in the past three years consecutively;
- Its total assets at the end of last year must not be less than US\$2 billion;
- It must have no record of serious violation of laws or regulations in the past three years;
- It must meet relevant prudential criteria of the local financial supervising authority; and
- It must meet other requirements provided by laws and regulations and the CIRC.

Under the Measures, a shareholder (including its affiliated parties) shall not make more than a 20-percent capital contribution or own more than a 20-percent shareholding of an insurance firm. If a shareholder owns a 15-percent shareholding of an insurance firm, or its shareholding is less than 15 percent but it controls the major shareholder of the firm directly or indirectly, the shareholder must meet

the following requirements:

- It must have the capability of contributing the capital continuously, and it must have been profitable in the past three fiscal years;
- It must have sufficient funds, and its net assets must not be less than RMB 200 million; and
- It must have a great reputation and hold a leading position in the insurance industry.

If the shareholder meets the above requirements, it may obtain a 20-percent or greater shareholding of or make a 20-percent or greater capital contribution to an insurance firm upon the CIRC's approval.

#### **Capital Contribution**

The Measures stipulate that shareholders of insurance firms shall contribute the capital in currency rather than in noncurrency properties such as real materials, intellectual property, land use rights and so on. Fund contributions by the shareholders shall be examined by the accounting firms, which shall provide testimonials, as well.

#### **Control Relationship**

Shareholders must report relevant information regarding their controlling shareholder and actual controller to the insurance firm. The insurance firm must then report such information to the CIRC.

Unless the CIRC provides otherwise, if more than two insurance firms are subject to the same institution's control or have a control relationship, they must not engage in insurance businesses of the same type, as doing so might lead to interest conflicts or competition.

#### **Approval of the Change of Shareholders**

The change of shareholders who own more than 5-percent equity or shares of insurance firms must be approved by the CIRC. If an investor acquires shares of a listed insurance firm and thereby obtains a 5-percent share of the firm, the firm must report the fact to the CIRC for approval within five days of the share purchase. If the investor does not meet the requirements set forth in the Measures, the CIRC is authorized to request that it sell its shares of the insurance firm.

– *Olivia Zhan*

## Articles, Publications and Other Media

**Amy L. Sommers** was quoted in the June issue of DealFlow Media's *The Reverse Merger Report* regarding the impact of the US Foreign Corrupt Practices Act on China-based companies that trade in the United States.

**Weiheng Jia** was quoted June 19 by *Shukan Diamond* – Japan's premier business magazine – regarding M&A trends in China. Weiheng was also quoted June 17 on online manufacturing publication @IT MONOist regarding labor issues in China.

*The Daily Journal* quoted **James L. Hsu** June 2 about the challenges created for US-based companies doing business with state-owned enterprises (SOEs) in China. The employees of SOEs may be considered public officials, which means money, gifts or reimbursement for business-related expenses that SOE staff members receive from US businesses can result in prosecution under the US Foreign Corrupt Practices Act (FCPA).

**James M. Zimmerman** was interviewed by *China Brief* regarding his recently published "China Law Deskbook: A Legal Guide for Foreign-Invested Enterprises." Mr. Zimmerman also published an editorial in *The New York Times* May 25 regarding China's reaction to a request by the US government that China sanction North Korea for allegedly torpedoing a South Korean ship; the commentary was also published by the *International Herald Tribune*.

**Douglas R. Burnett** appeared on China Radio International on May 20 discussing the challenge of combating piracy.

**David M. Spooner** was quoted May 24 on Law360.com about the role trade issues will play in the China-US Strategic and Economic Dialogue.

**James Zimmerman** was quoted in the June issue of *InsideCounsel* about the impact of China's new tort law.

## Past Events

On May 20 a panel of FCPA lawyers including **Amy L. Sommers** examined the risks of FCPA violations when doing business in China, the interplay between the FCPA and local Chinese antibribery laws, and best practices for preventing FCPA violations. "[Foreign Corrupt Practices Act in China for 2010 – Compliance Strategies Given China's Unique Cultural and Governmental Intricacies](#)" addressed the following questions:

- What risk factors increase the exposure of companies conducting business in China to possible FCPA violations?
- How are the US and Chinese governments acting to enforce their respective antibribery laws against US-based companies?
- What are the best practices for companies to utilize in developing anticorruption compliance programs and due diligence efforts for their China operations?

The panel was followed by an interactive question and answer session.

Lawyers from Squire Sanders' Shanghai office hosted a May 28 discussion on some of the key elements of international contracts that airline in-house lawyers must consider. See [The Basics of International Contracts for the Aviation Industry](#) for more details.

On June 3 **Amy Sommers** took part in a panel for a teleconference and live audio webcast to provide practical insights on doing business in the PRC including FCPA trends. "[A Practical Guide to Addressing FCPA and Anti-Bribery Compliance Issues in the People's Republic of China](#)" was presented by The American Bar Association (ABA) Section of Litigation Criminal Litigation Committee and the ABA Center for Continuing Legal Education. There was also a discussion of recent enforcement actions in both the United States and the PRC that impact the manner in which US-based companies direct compliance efforts in the PRC.

On June 18 Squire Sanders' Shanghai office hosted an informative [talk from Alexandra Wrage](#), founder and president of TRACE International and one of the leading figures in the field of cross-border anticorruption compliance. Ms. Wrage spoke about TRACE, its work and how it supports companies operating in China and in other jurisdictions with high risks of noncompliant practices.

Squire Sanders took part in the American Conference Institute and C5 Group's [3rd China Summit on Anti-Corruption](#) in Shanghai June 22-23. **Amy Sommers** joined RTKL Associates Inc. Senior Vice President Greg Yager in presenting "Minimizing Bribery Risks in Public Procurement Contracts" from 10:15 to 11 a.m. on June 23. Their discussion addressed:

- How to detect public procurement situations that trigger a request/offer for a bribe or facilitating payment
- Assessing the role of your company's government relations strategy in the procurement context – does it increase or lessen the risk of corruption?
- What your compliance team can do in the procurement process to lessen risks of corruption in fulfilling contracts
- What not to do when dealing with requests for bribes at the bidding stage
- Forced marriages: Reducing risks when facing political pressure to use a specific design institute, intermediary or third party

## Upcoming Events

Squire Sanders is hosting an informative [series of discussions](#) across the United States about the latest opportunities and trends in China with **James M. Zimmerman**, partner and chief representative of the Squire Sanders Beijing office. The schedule of past and upcoming presentations includes:

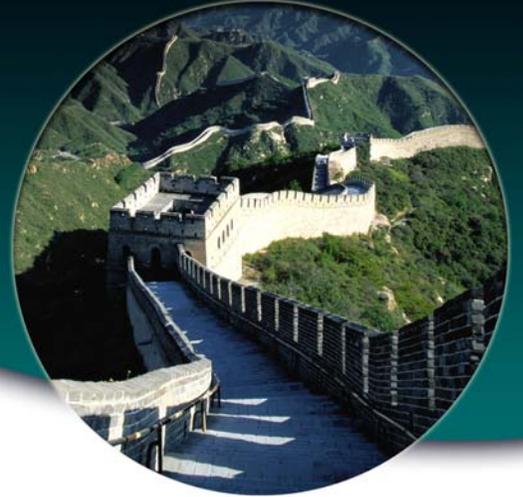
- July 6: Cleveland
- July 7: Columbus
- July 8: Cincinnati
- July 9: Washington DC
- July 13: San Francisco

- July 14: Palo Alto
- July 22: San Diego

Among the topics being covered, Mr. Zimmerman will discuss:

- Opportunities and policy trends affecting business in China
- Current real-time examples of issues affecting both inbound and outbound China business
- Insights concerning recent foreign direct investment (FDI) and overseas direct investment (ODI) statistics
- Issues affecting US businesses exporting to or investing in China such as industrial policy, indigenous innovation policies, intellectual property protection, procurement practices and sales to government agencies, judiciary trends and recent legal developments
- Insights with respect to the outcome of the recently held Strategic and Economic Dialogue between the US and PRC governments, along with information on how businesses can prepare and position themselves to tap into China-based opportunities

As part of the American Conference Institute's [5th FCPA Boot Camp](#) in California, **Amy Sommers** and of counsel **David A. Saltzman** will co-present the post-boot camp workshop "Overcoming FCPA Compliance Challenges in China" on September 29. This workshop will address the FCPA landscape in China, local antibribery laws, the impact of recent FCPA decisions and compliance programs.



## CHINA UPDATE

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