



CHINA UPDATE 2009

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Inside

2009 Automotive Industry Development Policy Released	1
Supreme People's Court Interpretation Clarifies the PRC Property Law	4
SAIC Enacts Rules for Supervision Over Food Advertisements.....	5
China Banking Group Issues Self-Disciplinary Convention for the Factoring Business.....	7
Growth of Municipal-Supported Private Equity Investment Fund Enterprises	8
Articles, Publications and Other Media	10
Past Events	10

2009 Automotive Industry Development Policy Released

Key Points:

- ***New policy encourages sustainable development and growth of China's automotive sector, R&D in fuel-efficient and environmentally friendly low emission vehicles and remanufacturing of automotive cores for export only***
- ***Used vehicles prohibited from entry***
- ***All automotive products imported/sold in domestic market must meet CCC standards***

Effective September 1, 2009 the Ministry of Industry and Information Technology and the National Development and Reform Commission issued the national Automotive Industry Development Policy. The Policy sets forth general guidelines on industry consolidation and restructuring, resource allocation, investment approval procedures including equity ratios for foreign invested enterprises (FIEs), environmental standards, guidelines for imports and used vehicles/components, and guidelines for sales and marketing networks. The Policy also encourages the development of the automotive industry in step with urban transportation infrastructure and environmental protection, as well as the protection of consumer rights and interests. The Policy specifically encourages China-based automobile enterprises to strive to "pierce into the Fortune 500" by 2010.

The Automotive Industry Development Policy is an important document to reflect upon in light of the ongoing changes impacting the global industry players. In 2008 and 2009, automobile production and sales volume increased significantly in China, and China is anticipated to become the second largest automobile market in the world after the United States. To offset a decrease in demand for exports and maintain industry growth during the worldwide financial crisis, China's government has sought to guide the industry away from an emphasis on exports and toward developing the domestic industry.

The Policy further encourages the consolidation of domestic industry players to "achieve scale of production" and to encourage China-based enterprises to "enter the international automobile parts and component procurement systems and to aggressively compete internationally."

The Policy provides guidelines on technology policies and emphasizes that the state supports R&D investments and subsidies to encourage the development of fuel-efficient and environmentally friendly low emission vehicles. The automotive industry is instructed to comply with China's energy structure adjustment strategy and with emission standards in actively researching and commercializing electric vehicles and new forms of automotive power systems such as traction batteries for vehicles. The industry is also instructed to focus on the development of hybrid vehicle and

diesel engine technologies for sedans. The Policy provides that the government will financially support R&D for alternative fuels for vehicles, such as alcohol-based fuels, natural gas, hybrid fuels and hydrogen fuels, and encourages automobile manufacturers to develop and manufacture alternative-fuel vehicles.

Under the Policy, the government requires that by 2010 the average fuel consumption of new passenger vehicles be lowered by no less than 15 percent compared to 2003 levels. The state encourages research with respect to new vehicle materials, such as reduced-weight, recyclable and environmentally friendly materials. The Policy also indicates that, in the future, the government will adopt requirements for minimum content requirements for recycled materials used in new vehicle production.

All motor vehicles will be subject to mandatory national technical standards and such standards need to be consistent with the national economic development in China. Equally important, the state asks that domestic standards be consistent with global technical standards for vehicles. Motor vehicle products that fail to meet the mandatory requirements set forth in the technical standards may not be produced or sold in China, and access to the China market will be granted only to products that receive a China Compulsory Certificate (CCC)

mark. Certification will be based upon product design and development capabilities, production facility capabilities, production consistency and quality control capabilities, and product sale and after-sale service capabilities.

Special emphasis in the Policy is given to intellectual property rights and the need for manufacturers to strengthen their awareness of corporate and product branding and actively develop products that incorporate self-developed intellectual property. The state encourages enterprises to formulate their own brand development and protection plans, and strive to implement business strategies that prioritize brand awareness.

Under the Automotive Industry and Development Policy, the equity stake of a China-based party in a joint venture involving the manufacture of whole vehicles, special purpose vehicles, agricultural transport vehicles or motorcycles may not be less than 50 percent. A foreign investor may establish no more than two equity joint ventures in China producing the same category of vehicles (passenger vehicles, commercial vehicles or motorcycles). If a China-based or non-China-based automobile manufacturer invests in a project in an export processing zone to manufacture vehicles or vehicle engines for export, it may be exempt from the ownership restrictions and subject to approval by the State Council.

The state has designated four coastal ports in Dalian, Tianjin, Shanghai and Huangpu (Guangdong), and inland ports in Manzhouli, Shenzhen (Huanggang), and Xinjiang (Alashankou) as the principal ports for the import of motor vehicles. The state prohibits the import of used automobiles, motorcycles or their parts or components by way of sale or donation. Also, the import of used vehicle assemblies or parts, under the guise of scrap iron and steel or scrap metal, for the purposes of dismantling and reconditioning is prohibited. The repair, remanufacture and refurbishment of used cores may be conducted in an export processing zone, although the dismantling and remanufacturing of used automobiles or motorcycles is prohibited. Notwithstanding the ban on used vehicles, the Policy encourages the second-hand vehicle market in China and states that the government will adopt various standards and policies to support the development of the used vehicle market.

For more information concerning the 2009 Automotive Industry Development Policy, contact your principal Squire Sanders lawyer or one of the lawyers listed at the end of this publication.

– James M. Zimmerman

Supreme People's Court Interpretation Clarifies the PRC Property Law

Key Points:

- ***Court gives clear guidance on the application of the Property Law***
- ***New interpretation effectively protects the lawful rights and interests of building owners***

On May 14, 2009 China's highest court issued the Interpretation of Several Issues Concerning the Specific Application of the Law in Disputes Over the Division of Ownership of Buildings (the Interpretation), which went into effect on October 1. The Interpretation elaborates on the definition of terms mentioned in the PRC Property Law – such as owner, exclusively owned parts, parts owned in common and materially interested owners – which gives clearer guidance to the application of the Property Law.

The Interpretation expands the scope of the meaning of an owner. In addition to those persons who have obtained legal titles, persons who have purchased an apartment or part of a building from a developer and lawfully occupied it will also be recognized as owners, even if they have not duly registered their ownership over the apartment. Such parties will have the same owners' rights and obligations as those owners under the Property Law.

The Property Law stipulates that if owners intend to change the usage of property from residential to

commercial, they should obtain consent from the “materially interested owners.” But no definition is given for this term. The Interpretation clarifies that this term refers to all other owners in the building where the residence in question is located and any other owners in any other block(s) within the same developed site who can demonstrate that the value of their premises or quality of life is or may be adversely impacted by such change of usage. In addition, the Interpretation requires that such owners need to obtain unanimous consent from all interested owners for change of usage.

The Property Law provides that planned parking spaces for the building(s) should be used to satisfy the needs of the owners first. However, there has been no clear rule to guide this practice. The Interpretation states that, by sale, lease or giving of the parking spaces to the owners in accordance with the planned parking space “allocation ratio” (i.e., the ratio of the number of parking spaces to the number of total apartments), the developer complies with this requirement. In addition, other than the planned parking spaces, any additional parking space that occupies the road or other common area in the planned premise of the building(s) will be jointly owned by all owners.

Besides the provisions of the Property Law on the matters subject to joint decision of the owners, the Interpretation supplements other areas such as

changing the usage of a common area, using a common area to conduct business activities, disposing of a common area and those matters that should be jointly decided by the owners as specified by the owners’ general meeting or under the management rules.

The Interpretation also specifically defines the provisions of “exclusive area” and the “common area” in the Property Law and stipulates the scheduled period for an owner to go to court for revocation of any decision made by the owners’ general meeting or owners’ committee that the owner believes infringes his or her legitimate rights.

– Cong Yang

SAIC Enacts Rules for Supervision Over Food Advertisements

Key Points:

- **Six types of fraudulent or illegal food advertisements identified as the main targets of law enforcement**
- **Media to assume heavier duties and face greater responsibility for compliance**

The State Administration of Industry & Commerce (SAIC) issued the Rules for Supervision Over Food Advertisements on September 2, 2009 (the Rules). The Rules spell out duties for authorities, the media, advertisers and self-regulated associations as they relate to supervision of food advertisements.

The Rules declare that the primary task is to crack down on various types of fraudulent and illegal food advertisements, with particular focus on the following six types of fraudulent or illegal food advertisements:

1. Advertisements that contain fraudulent or exaggerated descriptions, especially as related to health food;
2. Advertisements that claim the food has a disease prevention or treatment effect;
3. Health food advertisements that are not examined and approved by the relevant advertisement examination authority;
4. Advertisements that use the names or images of government authorities, public servants, medical institutions or doctors, as well as those that use the names or images of experts or consumers to testify to the health benefits of the food;
5. Advertisements that are published in the guise of news reports or health news articles; and
6. Advertisements that contain recommendations of food safety supervisory authorities, food testing and inspection institutions, food industry associations or consumer associations.

The Rules vow to establish and improve the accountability system for food advertisement examination. To achieve that goal, they urge food advertisers and advertisement operators to fulfill their examination duties in line with the Guidelines for Several Issues Relating to the Work of Advertisement Examinants previously issued by the SAIC.

The Rules emphasize the role and obligations on the part of the media in examining the content of food advertisements. The SAIC will provide guidance and conduct inspections to ensure the media fulfills their food advertisement examination duties. The media as advertisement operators are required to set up and improve their internal rules and procedures regarding the acceptance and registration of food advertisement demands, verification of relevant supporting documents, verification and examination of advertisement content, file administration for customers and so on. In the event of material food safety accidents as a result of the media's inadequate advertisement examination rules or failure to fulfill its examination requirements, the respective media leaders or accountable persons will be found liable under the law.

The Rules also require a precautionary and dynamic surveillance system be established and reinforced for food advertisements. The Rules identify the media, which publish a high number of food advertisements with widespread and broad

social influence, as the focus of the surveillance. They prescribe that the advertising regulatory authority, advertisement examination authorities and media regulatory authorities work closely to expand the coverage of food advertisement surveillance and enable information sharing.

The SAIC may order the suspension of certain food advertisements if the advertisements are suspected of promoting food that does not comply with food safety requirements.

In the event of serious violations, an advertisement operator can be banned from the advertising business temporarily or permanently. The Rules stipulate that the advertisement operator's business license may be suspended or cancelled in the event the fraudulent or unlawful food advertisement causes damage to the public interest, personal injury, loss of property or other serious consequences. In the case of multiple violations or failure to cure rampant violations of food advertisement rules on websites, in newspapers or other media, the media operator may permanently lose its advertisement license.

– Peter Wang

China Banking Group Issues Self-Disciplinary Convention for the Factoring Business

Key Points:

- ***Guidelines include best practices for management in the factoring business, an internal risk control system, position responsibilities, operating instructions and a code of conduct for practitioners***
- ***Guidelines emphasize the need for fair competition in the factoring sector and privacy safeguards***

The China Banking Association issued the "Self-Disciplinary Convention for the Factoring Business in the China Banking Industry" (the Convention) on July 3, 2009 to promote the healthy and rapid development of the factoring business in China's banking industry and foster fair competition in the market. The Convention was drafted and executed by the Factoring Committee of the China Banking Association, a professional organization responsible for the administration of the factoring business in the banking industry. Because neither the China Banking Association nor the Factoring Committee is a legislative authority in China, the Convention is not a law or regulation and it is binding only for association members.

The Convention requires that members establish sound measures for managing the factoring business, an internal risk control system, position responsibilities, operating instructions, a code of

conduct for practitioners and accounting measures. Furthermore, members are required to actively cooperate with and support the Factoring Committee and the supervisory authorities in their work and promote the establishment of industry policies and regulations and a credit environment.

Members and practitioners shall abide by the business ethics. They shall not defame the business integrity of another member in any form, interfere with or influence the order of the factoring market by making use of any improper means, or divulge the trade secrets of clients. In addition, they must prevent and eliminate market activities that result in unfair competition.

The Convention encourages members to:

- Establish a complete information management system and provide an efficient, safe and reliable electronic support system for the factoring business;
- Continually take advantage of available resources and develop new factoring business products with a broader service area and richer service content; and
- Strengthen business communication and cooperation with each other and share information with respect to commercial clients with bad records in order to avoid risk.

– Olivia Zhan

Growth of Municipal-Supported Private Equity Investment Fund Enterprises

Key Points:

- ***Various city governments adopting rules for private equity investment vehicles***
- ***NDRC and CSRC anticipated to develop national rules on private equity***
- ***Private equity funds set to drive growth in SME and high-tech sector***

The city of Beijing is expected to formally release guidelines on the establishment of private equity investment funds. The new rules provide guidelines on how non-China-based firms can operate domestic investment vehicles and new rules on fund investment.

Beijing issued the new rules to coincide with the nation's 60th anniversary celebrations. In addition, Beijing announced the creation of a new RMB 2 billion to RMB 5 billion guidance fund that would be able commit capital to help establish private equity investment funds in the city.

The new rules are anticipated to set forth guidelines for fund structure, standards for investors and management, registered capital, application procedures and preferential treatment for private equity investment funds, and allow foreign investors to set up locally registered enterprises, which may provide a platform for easier access to the China market given that the rules appear to resolve the legal status of global investment funds that seek to

operate in China. Having a legal presence in China will make it easier for private equity firms to raise local currency funds. Under the current structure, private equity firms are limited to operating as investment consulting companies or representative offices with limited business scope.

China has experimented with different approaches to regulating private equity investments since at least 2007, when aviation industrial park Tianjin Binhai set up what was supposedly the first guidance fund in China. The Tianjin Binhai fund, which involved RMB 2 billion as guidance funds, is viewed as a model for other cities including Chongqing, Suzhou, Wuxi, Guangzhou, Jilin City and the Pudong area of Shanghai to set up guidance funds of their own.

Shanghai's municipal government entered the market in June 2009 with the adoption of policies on the establishment of foreign-funded equity investment management enterprises. Under the new Shanghai policy, all foreign-funded venture capital and private equity companies in the Pudong district may be re-registered as foreign-funded equity investment management enterprises. Companies in Shanghai can register as foreign-funded limited liability equity investment management enterprises, and with a minimum registered capital of US\$2 million. Then, in August 2009 Shanghai's government publicly announced

that the US-based Blackstone Group had signed a financial-cooperation memorandum with the Pudong District government to set up a RMB 5 billion fund to invest in China-based companies. Other funds were set up in Shanghai by CLSA Ltd. and First Eastern Investment Group.

The rules adopted to date have been designed and implemented at the local levels. The national government is in the process of developing its own set of rules to be jointly issued by the National Development and Reform Commission (NDRC) and the China Securities Regulatory Commission (CSRC). The NDRC has drafted rules to encourage China-based private companies to invest in more sectors including infrastructure, public services, finance, culture and education. Any rules adopted by the CSRC may override any policies at the local and provincial level. It's an open question as to whether the local rules and anticipated national rules will be effectively implemented.

— *James M. Zimmerman*

Articles, Publications and Other Media

Charlie R. McElwee II was interviewed Sept. 29 on National Public Radio's "On Point" program regarding China's role in the race to develop clean energy.

WELT ONLINE cited results of a Squire Sanders survey in a Sept. 7 article on China-based investment.

Daniel F. Roules published an article in *21st Century Business Herald* regarding China-based business investments in the United States.

David M. Spooner was quoted Sept. 26 by *The Washington Post* regarding recent trade cases brought against China by US-based unions. Media such as *The New York Times*, *Financial Times Deutschland*, *Bloomberg.com*, *The Washington Post*, *BusinessWeek.com*, *Reuters* and *Inside US-China Trade* have also quoted Mr. Spooner recently regarding the controversial tire tariff imposed by the US government on tires made in China. In related coverage, **James M. Zimmerman** was quoted on *LATimes.com* regarding the decision's impact on US automobile and chicken product exports.

Song Zhu was quoted Sept. 17 on *Law360: Intellectual Property* regarding President Obama's decision to impose tariffs on tires imported from China.

Daniel F. Roules published the following white paper on the Squire Sanders website in October: [China's Outbound Investment: Lessons From the Past](#).

Past Events

On Sept. 18 **Rainer Burkardt** discussed "Corruption and Fraud Risk Management in Procurement Departments in China" at the [BME China Sourcing Conference](#) in Shanghai. The conference focused on recent purchasing trends and the future outlook for buying operations in China. On September 19 he led the workshop "Producers and Vendors Liabilities Under P.R. China Laws – The Legal Framework."

On Sept. 25 **Amy L. Sommers** and **Song Zhu** presented on intellectual property (IP) protection concerns for China business strategies as part of a special luncheon session of the Greater Cleveland Partnership in Squire Sanders' Cleveland office. The discussion, "[Savvy China Strategies Start With IP Protection](#)," covered topics such as how US companies can prevent the infringement of their IP rights by China-based business partners and employees, as well as whether it's worthwhile for US-based companies to register their IP in China.



CHINA UPDATE OCTOBER 2009

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