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CHINA UPDATE

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FCPA Bounty Raises Compliance Issues in China

Key Points:

- ***The Dodd-Frank Act adopted on July 21 creates a "bounty" program for FCPA violations***
- ***Whistleblowers may collect a bounty in a judicial or administrative action brought by the SEC of 10 to 30 percent of any monetary sanction exceeding US$1 million***
- ***China operations encouraged to review compliance programs***

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), signed into law by President Obama on July 21, 2010, expands existing whistleblower bounty programs offered by the Securities and Exchange Commission (SEC). According to a recent US Senate report, whistleblowers' tips were responsible for 54.1 percent of uncovered fraudulent schemes in publicly traded companies. One of the goals of this new law is to increase enforcement actions through this whistleblower program. Under Dodd-Frank, a whistleblower bounty is available for anyone who reports securities or Foreign Corrupt Practices Act (FCPA) violations. Whistleblowers may be awarded a bounty of 10 to 30 percent of any monetary sanction exceeding US$1 million. The award will be determined by the SEC based on the significance of the information, the level of cooperation provided and whether the original information provided by the whistleblower leads to successful enforcement action by the SEC.

Whistleblowers will be unable to collect a bounty if they have been convicted of a criminal violation in relation to the probe. Most external auditors will not qualify as whistleblowers if the information they uncover was secured "through the performance of an audit of financial statements required under the securities laws and for whom such submission would be contrary to the requirements of Section 101A of [the Act], (15 U.S.C. § 78j-1)."

The Dodd-Frank bounty program raises several questions. Will minor violations go unreported because a whistleblower wants to wait for it to grow into a larger violation that might pay a bounty? Will whistleblowers forego talking to their company's auditors and instead talk to the SEC in order to qualify for a bounty? Will a company feel pressured to self-report more quickly than it otherwise would to avoid a whistleblower reaching the SEC before it does?

Companies should revisit their code of ethics and compliance operations to ensure, at a minimum, that their policies and procedures embrace the mandates of Dodd-Frank. Their codes should prohibit conduct that may give rise to a whistleblower complaint and contain related procedures to facilitate the reporting and resolution of employee complaints. Their reporting systems should enable individuals to make anonymous and confidential submissions, e.g., via a telephone or email-based hotline. Their codes should prohibit retaliation against employees who provide information or assist in an investigation related to an alleged violation of a securities law including the FCPA. In addition, companies need to have procedures in place to investigate reported violations promptly.

– *Rebekah Poston*

Beijing Municipal Government Issues Aggressive Measures Combating High Property Prices

Key Points:

- ***Banks will no longer fund the purchase of a third property by a family***
- ***Purchase of properties by non-natives will be restricted***
- ***More low-price properties will be supplied to the market***

Following the promulgation of the State Council's Circular on Curbing the Excessive Rise of Property Prices in Certain Cities, GuoFa 2010 No. 10 (State Council Circular), the Beijing Municipal Government issued the Notice Regarding the Implementation of the State Council's Circular on Curbing the Excessive Rise of Property Prices in Certain Cities (the Notice) on May 5, 2010, which set forth a series of harsh measures to slow the skyrocketing price of local real estate. In Beijing the Notice is generally viewed as clearly demonstrating the strong determination of the local government and is considered to be among the most aggressive implementation measures published by different cities over the past few months to combat overheated property markets.

Curbing Unreasonable Demand for Property Investment and Speculation

The Notice set forth several measures to suppress the demands on the housing market that are considered "unreasonable." First, a bank will be prohibited from loaning the property purchaser more than 70 percent of the full price unless the property in question is the family's first purchase and its floor plan is not bigger than 90 square meters. If the purchase is the family's second property, the loan shall not be more than 50 percent of the full price, and the interest rate applicable to the purchaser must be higher than 110 percent of the benchmark level. In addition, the bank must verify the number of properties owned by the family through the database of the government's real property exchange system.

In order to suppress speculation on the market, banks are required to stop providing loans for the purchase of a third piece of property or any additional properties beyond this. Non-native buyers who cannot provide supporting documentation demonstrating that they have paid more than a year's tax or social insurance in Beijing will be denied mortgage loans from banks. Furthermore, the Notice introduced an explicit moratorium for any family in Beijing to purchase more than one new property after the promulgation of the Notice. The duration of the moratorium is not specified.

Effectively Increasing the Supply of Housing

The Notice emphasized that a land supply plan designed primarily for low-end properties will be formulated and implemented. In 2010, no less than 50 percent of the land supplied to the market will be for government-sponsored low-price housing projects. The specifications of the projects, such as sales price, number and sizes of units, timing of construction and delivery, and penalties for contract breaches, will be stipulated in the land assignment contract to ensure the property supply plan is consistently implemented and will thereby assist in stabilizing the market.

The government vowed to start building 136,000 and complete 46,000 low-price properties in 2010. In order to encourage demand to shift from purchasing to leasing, the government will continue to purchase properties for lease to the public at relatively low rent rates.

Reinforcing Market Supervision

The Notice declared that supervision of the real estate industry will be improved from several different angles. For instance, in the case of the presale of a housing project,

the real estate developer is required to disclose all the units that are available for sale within three days after obtaining the presale license. This will prevent developers from cornering the market and buying up the housing stock. Offending developers will face the risk of having their licenses revoked by the government.

– Peter Wang

The Economic Cooperation Framework Agreement Between Mainland China and Taiwan

Key Points:

- ***Cross-strait trade relations are normalized***
- ***The agreement offers a greater profile for Taiwan as a launch pad for foreign investors wishing to enter the Chinese market***

On June 29, 2010 representatives from Taiwan and mainland China finished four rounds of preparatory negotiations and signed the Economic Cooperation Framework Agreement (ECFA). The ECFA is a special economic framework agreement between the two governments that achieves the normalization of cross-strait trade and service relations. It contains five chapters and 16 articles; the main content is as follows.

Trade and Investment Liberalization

The ECFA, as a framework agreement, provides the scope and timetable for future discussions and negotiations over agreements on trade of goods and services, investment, intellectual property protection, the removal of tariff and nontariff barriers, dispute settlement mechanisms, and other topics to promote trade and investment liberalization.

Economic Cooperation

The scope of cooperation is expected to include, among other things, industrial cooperation, customs cooperation, customs clearance facilitation, goods inspection, investment protection and food safety. The two groups also agreed to establish a "cross-strait economic cooperation committee" that will continue negotiations on the relevant trade issues and be responsible for the implementation and interpretation of the ECFA.

Early Harvest List and Plan on Goods and Service Trade

The early harvest list and plan is a major component of the ECFA. It is expected to include a list of items and services eligible for early tariff reductions and early market access.

Goods Trade

Mainland China has agreed to confer benefits to 539 categories of Taiwanese goods and services, while Taiwan agrees to do the same for 267 types of Chinese goods and services. After the ECFA takes effect, more than 100 types of products sold to mainland China from Taiwan will be immediately exempt from tariffs. Tariffs on the remaining types of products will be reduced on three occasions over the course of two years. The goal is to reduce tariffs on the remaining products to zero by the end of the two-year period.

Services Trade

Nonfinancial Sector – A number of benefits will be granted to Taiwan. Examples include:

- Taiwan-based accountants may apply for temporary one-year permits allowing them to conduct audits in mainland China;
- Taiwan-based computer service enterprises and accounting enterprises will be granted access to the mainland China market;

- Joint ventures, partnerships and wholly owned Taiwan-based enterprises specializing in the field of professional design will be granted full access to the mainland China market;
- Taiwan-based enterprises will be granted access to China's airplane maintenance and repair market;
- Taiwan-based service providers may set up joint ventures, partnerships and wholly owned enterprises in mainland China to provide research and laboratory development services in natural science and engineering.

Among other activities, mainland China-based service providers may set up joint ventures, partnerships and wholly owned enterprises in Taiwan to provide airline electronic seating services, special product design services (with the exception of interior design services) and sports-related and recreational services. In addition, mainland China-based R&D enterprises will be granted access to the Taiwan market.

Financial sector – Taiwan-based banks may set up loan operations in mainland China to service Taiwan-based enterprises doing business in mainland China, while mainland China-based banks may set up representative offices in Taiwan and then, after one year, establish subsidiaries in Taiwan.

Dispute Settlement

Companies may choose Taiwan as the place to initiate litigation or arbitration; a dispute resolution mechanism may also be included under the ECFA in the future. Currently, the rights and benefits of Taiwan-based enterprises are protected under the Law of the People's Republic of China on the Protection of Investment by Companies from Taiwan and other relevant regulations. However, in practice, uncertainty and numerous restrictions are still not uncommon in the implementation of those rules in China. If a protected dispute resolution mechanism is eventually offered under the ECFA, foreign companies may choose Taiwan as the place for litigation or arbitration to protect their rights.

Apparently, to take advantage of the ECFA, foreign companies in the industries covered by the early harvest list and plan may choose Taiwan as their gateway for entering the Greater China market. As the ECFA is designed to remove or reduce custom duties and noncustom barriers to trade, early harvest foreign goods may pass through Taiwan and enter mainland China without the burden of tariffs. Therefore, foreign enterprises can reduce operating costs by setting up companies or factories in Taiwan because tariff charges for goods sold to mainland China from Taiwan will be lower than tariffs for the same goods sold to mainland China from European countries and the United States.

The policy of free movement of goods and workers between mainland China and Taiwan facilitated by the "three direct links" (*Da San Tong*) provides an additional incentive and stimulus for foreign enterprises to establish operations in Taiwan.

It is worth pointing out that high-tech and R&D companies may wish to choose Taiwan as their R&D center for expansion into mainland China. Taiwan has become a place of global strategic importance in the field of high technology. In particular, the country has a more sound legislative system and stronger intellectual property rights laws than mainland China does. In addition, the ECFA enhances protection of the intellectual property rights of Taiwan-based companies.

– *Cong Yang*

Mediation in Hong Kong

Key Points:

- ***Hong Kong Civil Justice Reform strongly encourages parties to settle disputes through mediation***
- ***Adverse cost orders can apply if a party "unreasonably fails" to engage in mediation***

The Hong Kong Civil Justice Reform (CJR), which went into effect on April 2, 2009, has adopted many changes to the civil proceedings of the High Court and District Court in Hong Kong (including changes to primary legislation and the courts' rules and practice directions). The main rationale behind the CJR is to create procedures that can provide speedier, less expensive and less adversarial access to justice for civil litigants in Hong Kong. In order to achieve this underlying principle, the CJR has imported mediation as a permanent feature of Hong Kong's civil procedure that is applicable to the full range of disputes filed in Hong Kong.

Practice Direction 31 (PD 31), which went into effect on January 1, 2010, aims to encourage parties to settle disputes through mediation. It applies to all civil proceedings in the Court of First Instance and the District Court that have been commenced by writ. According to the CJR, parties are required to complete a timetable questionnaire that indicates to the court whether or not they have attempted to settle the case through alternative dispute resolution – e.g., mediation. If any party is unwilling to attempt mediation, it will run the risk of judicial censure, and adverse cost orders may be imposed by the court on a party that has "unreasonably failed to engage in mediation."

Under PD 31, the process of mediation commences when one party serves a mediation notice to another party and files a copy of such mediation notice with the court. The mediation notice shall be in the form specified in Appendix C of PD 31, which sets out the details of the mediation proposal, such as the identity of the mediator, the venue and the timeframe. Within 14 days of receipt of such mediation notice, the respondent must file and serve a mediation response in the form specified in Appendix D of PD 31, indicating whether or not it agrees to engage in mediation. If the parties agree to engage in mediation, such agreement shall be made in writing in a minute known as the mediation minute signed by both the applicant and the respondent or their solicitors. The mediation minute shall also be filed with the court within three days after it has been signed by or on behalf of both parties. These documents may be taken into account by the court on questions of costs.

If the parties have agreed to engage in mediation, the court may, on the application of one or more of the parties or of its own motion, stay the proceedings or any part thereof for the purpose of mediation for such period and on such terms as it thinks fit, after taking into consideration the importance of avoiding disruption to the milestone dates and of avoiding any postponement of the trial dates.

As stated above, there can be an adverse cost consequence for any party that fails to engage in mediation. The usual rule of litigation is that the losing party shall pay the costs of the winning party. However, PD 31 makes it clear that unreasonable failure to engage in mediation could entail adverse cost consequences – i.e., a successful party may be deprived of some or all of its costs on the grounds that it has unreasonably refused to agree to mediate. Whether a party has unreasonably failed to mediate should be determined on a case-by-case basis after taking into account various specific circumstances of a particular case, including but not limited to the nature of the dispute, the merits of the case, the extent to which other settlement methods have been attempted, whether the costs of mediation would be disproportionately high,

whether any delay in setting up and attending mediation would have been prejudicial, and whether mediation had a reasonable prospect of success.

The implementation of PD 31 will inevitably increase substantially the demand for mediation in Hong Kong as well as the uncertainty as to when and how the adverse costs order would be imposed on a party that fails to engage in mediation. From the experience of England (where a similar court-mandated mediation scheme was introduced), there will likely be a gradual decrease in the number of cases proceeding to hearing, as there will be pressure on the parties to settle their dispute at an early stage. As a result, litigation practitioners need to obtain as much information about the case as possible at the very beginning of the proceeding to help their client analyze the case, identify key issues and decide whether the case is fit for mediation. This will certainly increase the fact-finding burden and responsibilities of litigation practitioners at the early stage of a case.

– Daniel Leung

The Supreme People's Court Details Rules on Exclusion of Illegally Obtained Evidence in Criminal Cases

Key Points:

- ***Procedures to exclude illegally obtained verbal evidence are clarified***
- ***Prosecutor bears burden of proof regarding legality of defendant's statements it provides***
- ***Police officers who conducted interrogations can be ordered to testify regarding the legality of evidence before the court***

The Supreme People's Court, the Supreme People's Procuratorate, the Ministry of Public Security, the Ministry of State Security and the Ministry of Justice jointly promulgated the Rules on Service Issues Regarding Exclusion of Illegally Obtained Evidence in Criminal Cases on June 24, 2010 (the Rules). The Rules are intended to specify the procedures for excluding illegally obtained evidence in criminal cases as part of an effort to reduce the number of trumped-up criminal cases, especially death penalty cases.

The Rules clarify that statements made by the defendant or criminal suspect obtained through torture or other illegal means, as well as witness statements by the victim obtained through violence, threat or other illegal means, are illegal verbal evidence and shall not be used to determine a case.

The Procuratorate and the Court to Exclude Illegally Obtained Evidence

The agencies' obligation to exclude illegally obtained verbal evidence in performing their functions is clarified.

The Rules provide that the people's procuratorate shall exclude illegally obtained verbal evidence in review and approval of an arrest and in initiating a public prosecution. After a public prosecution is initiated, the people's court shall assume responsibility for investigating whether a claim of evidence being illegally obtained is true. The public prosecutor is obligated to cooperate with the court in the investigation and verification process.

Procedures to Exclude Illegally Obtained Statements by Defendant Clarified

A defendant can raise a claim that his or her statements made before the trial were illegally obtained; the defendant or his or her defender can also raise such a claim during the trial but before close of the debate. The people's court must examine and investigate the claim. The defendant and his or her defenders are required to provide basic

information such as who conducted the illegal evidence collection; when, where and how they did so; and what evidence was involved.

The people's procuratorate bears the burden of proof with regard to the legality of the defendant's statements obtained prior to the trial. The public prosecutor is required to provide the original records of inquiries, sound and video recording, or other evidence of the police interrogating the defendant. The public prosecutor can request the court to order others who were present during the interrogation or other witnesses to testify in the court. If there is still doubt as to whether the defendant's statements were obtained by torture, the public prosecutor can request the court to order the police officers who interrogated the defendant to testify before the court. The police officers are obligated to do so upon receiving a proper notice by the court. This is an important new rule and is considered a big step in determining the legality of evidence in a prompt and efficient manner.

In addition, the Rules grant the prosecutor and the defender the right to cross-examine and debate the legality of evidence. Evidence provided by the public prosecutor to prove the legality of the defendant's statements must be reliable and sufficient; otherwise, the defendant's statements in question shall not be used as evidence to determine the case.

Exclusion of Other Types of Illegally Obtained Evidence

Under the Rules, evidence that may be excluded if illegally obtained is not limited to the defendant's statements. During the trial, if the prosecutor, the defendant, or his or her defender raises a claim that the statements of a witness or victim who is not present in the court were obtained in an illegal manner, the party who provided the statements shall bear the burden of proof with regard to their legality. The court shall conduct an investigation and verification on such a claim in a similar manner as discussed above.

Additionally, if any physical or documentary evidence obtained illegally cannot be supplemented or corrected, or if no reasonable explanation can be provided to justify the manner in which it was obtained, such evidence shall not be used as evidence to determine a case.

– *Brenda Xu*

Past Events

Squire Sanders hosted 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 presentations included:

- 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 covered, Mr. Zimmerman discussed:

- 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

Upcoming Events

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.

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