

## CHINA UPDATE

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## The Beginning of Competition Law in Hong Kong

### Key Points:

- **Competition Bill prohibits anti-competitive conduct in Hong Kong**
- **New statutory bodies created to facilitate implementation and enforcement**
- **General exclusions and exemptions defined**

On 2 July 2010, the long-awaited Competition Bill 2010 (the Bill) was gazetted by the Government of the Hong Kong Special Administrative Region (Government). The Bill was introduced into the Legislative Council by the Government for first reading on 14 July 2010 and commencement of second debate in the coming 2010-2011 session. The Government's competition policy is to enhance economic efficiency and the free flow of trade through promoting sustainable competition to bring benefits to both the business sector and consumers in Hong Kong.

### Objective and General Prohibitions of the Bill

The objective of the Bill is to prohibit and deter "undertakings" in all sectors from adopting abusive or other anti-competitive practices that have the object or effect of preventing, restricting or distorting competition in Hong Kong. The Bill provides for general prohibitions in three major areas of anti-competitive conduct as follows:

1. First Conduct Rule: Prohibits "undertakings" from giving effect to agreements, engaging in concerted practices or making decisions

that have an effect or object to prevent, restrict or distort competition in Hong Kong.

2. Second Conduct Rule: Prohibits the abuse of a substantial degree of market power to prevent, restrict or distort competition in Hong Kong.
3. Merger Rule: Prohibits mergers or acquisitions involving holders of telecommunication carrier licenses granted by the Telecommunications Authority. The rule applies only to such transactions that have, or are likely to have, the effect of substantially lessening competition in Hong Kong. Rules regarding mergers in other industries or a cross-sector regulation may be included after a review of the effect of the Bill to be conducted in a few years.

### Implementation and Enforcement

Both the First and Second Conduct Rules apply to conduct that has the "object or effect" of preventing, restricting or distorting competition in Hong Kong, regardless of where the conduct takes place. In other words, the conduct itself, or "*per se*," would not be a contravention of the Bill, without such object or effect. To enhance the certainty and clarity of the law, the Bill provides for the establishment of the following statutory bodies:

1. Competition Commission: Will be established to investigate and bring proceedings before the Competition Tribunal in respect of anti-competitive conduct either on receipt of complaints, on its own initiative or on referral

from the Government or a court. The Commission will be vested with the powers to accept commitment from, or issue an infringement notice bearing a sum of payment up to HK\$10 million to, a person allegedly contravening or having contravened the conduct rules.

2. Competition Tribunal: Will be established within the Judiciary as a superior court of record to hear and adjudicate competition cases brought by the Commission, private actions, as well as reviews of determination of the Commission. The Tribunal is empowered to apply a full range of remedies for contravention of a competition rule including pecuniary penalties not exceeding 10 percent of the turnover (including global turnover) for the year in which the contravention occurs; award of damages to aggrieved parties; interim injunction orders; or termination or variation of an agreement. Decisions of the Tribunal may be appealed in the Court of Appeal with leave.

The Bill also creates a number of criminal offenses (for fines and/or imprisonments up to two years) – e.g., if a person fails to comply with requirements and prohibitions under the Bill and/or destroys and falsifies documents in order to mislead and obstruct investigation into the anti-competitive conducts or search with warrant.

### **Exclusion and Exemptions**

Similar to competition laws in other jurisdictions, the Bill provides for several exclusions and exemptions. Specifically, the First and Second Conduct Rules will not apply in situations where:

1. An agreement enhances or would be likely to enhance overall economic efficiency;
2. An agreement is made to comply with a legal requirement; or
3. An undertaking involves the operation of services of general economic interest.

The Commissioner will be empowered to decide whether or not an agreement or conduct is excluded or exempted from the conduct rules. The Bill also empowers the Chief Executive in Council to exempt agreements or conducts from the conduct rules if he or she is satisfied that there are exceptional and compelling public policy reasons, or to avoid a conflict with international obligations under which the conduct rules should not apply.

### **Issues**

Further clarity on the following matters (in future judgments or regulatory guidelines) may be necessary in order to facilitate compliance by the business sector:

1. The definition of “undertaking.” The meaning seems to be too broad and may not be appropriate for Hong Kong’s small business environment – e.g., in the case of the invention of new technology or the

development of a new business model by small business enterprises.

2. Whether certain conducts or businesses empowered or appointed by the Government or other statutory bodies should be excluded or exempted in the Bill.
3. Whether efficiency gains by way of economies of scale need to be balanced against any lessening of competition and to what extent.
4. The meaning of having “substantial degree of market power.”
5. How efficiently and fairly the Chief Executive in Council and the Commission will be able to make exemptions to the general rules in situations where the agreements are actually enhancing economic efficiency. What are the checks and balances of such powers?
6. Why the Bill, which applies to all, includes exceptions regulating the telecommunication licensees only. Will there be any cross-sector merger control, especially in the ever-changing telecommunication environment?

### Conclusion

Competition is the cornerstone of Hong Kong's economic success. Any law or regulation designed to regulate the free market's capacity and promote economic efficiency needs to be carefully considered, drafted and debated during the legislative process. Otherwise, the Bill may not be able to serve the objective of enhancing competition

and may instead create an unnecessary barrier to economic efficiency and free trade in the Hong Kong market. Given the significant consequences of noncompliance, companies and businesses operating in Hong Kong should implement measures in their internal corporate governance procedures to ensure proper compliance with the requirements in the Bill.

– Daniel N. Leung

### China Opens Low-Altitude Airspace

#### Key Points:

- **Strict controls loosened**
- **Opportunities created for general aviation sector**

China's State Council and Central Military Commission jointly released the Opinion on Deepening Reform of Administration of Low-Altitude Airspace (Opinion) on 14 November 2010, announcing the relaxation of the longstanding control on China's low-altitude airspace. The highlight of the Opinion is the opening of China's airspace below 4,000 meters, which means flight at 4,000 meters or lower will be generally allowed. Historically, China's airspace has been strictly controlled by the army, and any flight except for fixed civilian flight routes must be approved well in advance.

According to the Opinion, the reform will be undertaken at three stages in five to 10 years. It will go into effect first in the Shenyang and Guangzhou regions in 2011 and will be further expanded to nationwide airspace by 2015. The eventual goal is to

build a comprehensive low-altitude airspace management system and put in place comprehensive regulations in this regard by 2020. The low-altitude airspace will be divided into three categories for the purposes of regulation: (1) airspace under control, where a flight must be approved; (2) airspace under surveillance, where a flight does not need approval but must be under surveillance by the authority; and (3) airspace where reporting is required only before a flight. Private investment and investment from local governments are welcome in construction of air service stations, though direct investment from the State is expected to continue to play a main role.

The general aviation sector – private aircraft and helicopters in particular – will benefit most from the new policy. Observers predict that China's private aircraft market will expand by 20 to 25 percent annually over the next 10 years, and the market potential is believed to be no less than RMB 1 trillion. It is expected that related sectors such as airport construction, pilot training, low-altitude airspace tour, private aircraft maintenance, and aircraft and components manufacturing will also see development in the long term.

This Opinion does not take the form of a law, and we anticipate further rules will be drafted and issued by respective airspace administration authorities in different regions to implement the reform envisioned by the Opinion.

– Lesley Li

## New Circular on Property Purchase by Overseas Organizations and Individuals

### Key Points:

- ***The circular requires new documents for improved government monitoring of compliance with existing rules***
- ***New guidelines show the government's intent to cool the overheated property market***

On 15 November, the State Administration of Foreign Exchange and the Ministry of Housing and Urban-Rural Development Bureau issued a notice on property purchase by foreign individuals and companies (Circular 186). It has been generally viewed as clearly demonstrating the determination of the government to cool the property market.

However, this circular does not impose any additional substantial restrictions on foreign individuals and companies, but rather stipulates extra measures that the government must take for improved monitoring of compliance with the existing rules.

Previously, general requirements related to the purchase of property by foreigners were stipulated in the Circular on Regulating the Access to and Administration of Foreign Investment in the Real Estate Market issued on 11 July 2010 (Circular 171). Circular 186 specifies additional requirements for the purchase of property:

- Foreigners (excluding those from Hong Kong, Macau and Taiwan) must now provide proof of having worked in China for at least one year before the purchase and provide a written statement proving they do not own

any other properties in the country when buying a new property;

- Foreign buyers from Hong Kong, Macau or Taiwan need to provide documentation to confirm they are working, studying or residing in China in order to purchase property;
- An official approval and registration certificate regarding the establishment of a subsidiary or representative office by a foreign company must be issued by the relevant government department; and
- A written statement must be issued by a foreign company providing that the purchased property is for the actual business operation in China.

Meanwhile, the circular states that the local foreign exchanges banks designated by the State Administration of Foreign Exchanges shall strictly handle the foreign exchange issues related to the purchase of property according to relevant regulation, and shall strictly examine and verify the documents submitted by foreign companies and individuals.

It would appear that Circular 186 is a reiteration of the existing Circular 171, and it seems to be focused on ensuring compliance with existing rules by individual or representative office buyers who are not required to receive approval from the Ministry of Commerce. Nothing new in this circular indicates that there is any impact on the foreign real estate investor who has received specific approval for a given real estate investment project.

– Cong Yang

## CBRC Tightens Control Over Real Estate Fundings

### Key Points:

- ***The aggressive expansion of real estate trust businesses is considered “indiscreet”***
- ***Local branches and the trust companies themselves are required to strengthen their compliance checks and risk monitoring***
- ***Sanctions would be imposed in the case of violations***

The China Banking Regulatory Commission (CBRC) issued a Notice on Being Cautious of the Risks Brought About by Real Estate Related Trust Businesses Conducted by Trust Companies on 12 November 2010 (Notice). This Notice is viewed as another attempt by China’s government to curb high housing prices and to prevent the real estate market from being further destabilized by excess liquidity.

### Risk Evaluations to Be Carried Out by the Trust Companies on Each of the Real Estate Projects

The Notice is addressed to all the local bureaus of CBRC as well as trust companies that are supervised by CBRC. CBRC declared at the beginning of the Notice that real estate trust businesses have been growing rapidly and some trust companies are not conducting this type of business discreetly. In order to effectively implement the State’s policy of regulating the real estate market, and to reduce risks for trust companies, CBRC requires all trust companies to immediately conduct thorough evaluations of their compliance with

existing law and risk exposure within their real estate trust businesses.

The evaluations to be carried out by the trust companies for each of the real estate-related trust deals will cover the following factors:

- The completeness of the permissions and approvals (commonly known as “four certificates”) required for the real estate project funded by the trust, the minimum qualifications for the real estate developer and its controlling shareholder, and compliance with the government’s requirement for the maximum funding leverage within real estate projects;
- The adequacy and reliability of repayment sources;
- The adequacy of pledge, mortgage or other forms of security; and
- The solvency of the project company and backup plans to address insolvency risks.

#### **Supervision and Monitoring by Local Bureaus of CBRC to Be Strengthened**

The Notice further requires local bureaus of CBRC to enhance their risk and compliance monitoring of the companies’ real estate-related trust businesses within the respective jurisdictions of the bureaus. In conjunction with the results obtained from the stress tests that were conducted earlier this year, and based on the aforementioned self-evaluations to be conducted by the trust companies themselves, the bureaus will examine the merits and legality of the individual deals entered into by the trust companies, with a particular emphasis on the type of transactions

that were designed to disguise the purpose of providing loans in the name of debt transfers on the face. If violations are identified during the self-evaluation or the bureaus’ examination, the bureaus will take immediate actions to order the relevant trust companies to cure the offenses or to penalize such offenses. The Notice further sets a timeline for all local bureaus to report the results of their actions to CBRC before 20 December 2010, and declares that CBRC will consider sanctioning the bureaus or the responsible officials that fail to enforce the Notice effectively.

The harsh actions being taken by CBRC towards the trust deals financing real estate projects are not ungrounded. An official within the regulatory body points out that the stringent monetary policy and the shortage of funds that used to be primarily provided by the banks have increasingly driven real estate developers to reach out to trusts, real estate funds or overseas funding sources. The data published by China’s Trust Industry Association suggests that the money that was raised through trusts and went to the real estate industry had a sharp year-on-year increase of 57 percent as of the end of September 2010, despite the relatively high interest rates (some of which may have been as high as 15 percent per year) charged. However, the regulatory bodies obviously hold a different view as to the risks and broader consequences that may be brought about by this trend, despite the financial performance of the market.

– Peter Wang

## Application of Laws on Foreign-Related Civil Relations

### Key Points:

- **China clarifies application of laws on various foreign-related civil relations**
- **The Law intends to protect the weak and certain groups such as consumers**
- **Party autonomy is highly respected**

The Law of the People's Republic of China on Application of Laws on Foreign-Related Civil Relations (the Law) was adopted at the 17th session of the Eleventh Standing Committee of the National People's Congress of the People's Republic of China on 28 October 2010 and will go into effect on 1 April 2011.

Before promulgation of the Law, rules regarding the application of laws on foreign-related civil relations were spread among the General Principles of the Civil Law, different divisional laws and judicial interpretations (collectively the "existing related laws"). The Law aims to provide comprehensive and uniform guidelines with regard to application of laws on foreign-related civil relations. It does not automatically make all existing related laws obsolete unless they conflict with the Law. In addition, if there are other specific provisions on application of laws on certain foreign-related civil relations, such specific provisions shall prevail.

The Law is organized into the following eight chapters, with 52 articles in total:

- General Provisions;
- Civil Subjects;

- Marriage and Family;
- Inheritance;
- Real Rights;
- Claim-Rights;
- Intellectual Property Rights; and
- Supplementary Provisions.

### Principles Established

The Law specifies several principles with regard to the application of laws on foreign-related civil relations, including but not limited to (1) freedom of choice of the governing law to the extent allowed by law, (2) application of the law with the closest connection to the foreign-related civil relations in the absence of express provisions under the Law and other related PRC laws, (3) direct application of PRC compulsory laws on some foreign-related civil relations, and (4) exclusion of foreign law if application of such foreign law could harm the public interests of China.

The Law clarifies that the statute of limitations shall be governed by the substantive law applicable to the foreign-related civil relations and the determination of the nature of a civil relation shall be governed by *lex fori*. The Law imposes the burden of proof of foreign law on the party that chooses the foreign law as applicable law; if this party fails or the foreign law is silent, PRC law will apply.

### Noticeable Provisions

If the locality of registration of a legal person or its branch differs from its main operational location, the law at its main operational location may determine its

capacity for civil rights or civil actions, organizational structure and shareholder's rights and obligations and others. (The Law, Article 14)

The laws of the locality where an agency act takes place shall apply, but the civil relation between the principal and the agent shall be governed by the law of the location where the agency relation is concluded. In addition, the parties have the right to choose the governing law for entrusted agency by agreement. (The Law, Article 16)

*The Law expressly displays its intention to protect the rights and interests of the weak or other special groups.*

The Law states that the laws at the mutual habitual residence shall apply to the personal and property relations between parents and children; if there is no mutual habitual residence, the law at the habitual residence or of the state of nationality of one party, which is in favor of protecting the rights and interests of the weak, shall apply. (The Law, Article 25)

Regarding foster parenting, the law at the habitual residence, of the state of nationality, or at the locality of the main properties of one party – which is in favor of protecting the rights and interests of the persons being fostered – shall apply. (The Law, Article 29)

Regarding guardianship, the law at the habitual residence or of the state of nationality of one party – which is in favor of protecting the rights and interests of the persons under guardianship – shall apply. (The Law, Article 30)

For consumer contracts, the law at the habitual residence of the consumer shall be the governing

law; however, if the consumer chooses the law in effect where the products or services are provided, or the operator has no business activities in the consumer's habitual residence, the law at the location of provision of products or services shall apply. (The Law, Article 42)

The law at the working location of the employee shall be the applicable law for the employment contract; if it is difficult to determine the employee's working location, the law at the main operational location of the employer shall apply. Regarding secondment, the law at the destination where the individual is seconded shall apply. (The Law, Article 43)

Regarding product liabilities, the law at the habitual residence of the infringed shall apply. If the infringed chooses the law at the infringer's main operational location or at the locality where the damage takes place, or the infringer has no business activities in the habitual residence of the infringed, the law at the infringer's main operational location or the locality where the damage takes place shall apply. (The Law, Article 45)

*The Law clarifies the applicable laws for many foreign-related civil relations, which were not addressed in existing laws and rules.*

The Law grants the parties the right to choose the applicable law for the real rights of chattel. In the absence of applicable law chosen by the parties, the law at the locality of the chattel where the legal fact takes place shall apply. (The Law, Article 37) In addition, the parties may choose the applicable law for a change of the real rights of chattel in transit,

and in the absence of a chosen applicable law, the law at the transport destination shall apply. (The Law, Article 38)

The Law also clarifies that if the parties do not choose an applicable law for a contract, the law at the habitual residence of the party whose performance of his or her obligation can best reflect the feature of the contract or other laws with the closest connection to the contract shall apply. (The Law, Article 41)

With regard to intellectual property rights, the Law specifies that the law at the locality where protection is claimed shall apply to the ownership and content of intellectual property rights. The parties also have the right to choose the applicable law for assignment or license of intellectual property rights, and in absence of a chosen law, the applicable law shall be decided according to Article 41 of the Law as discussed above. Regarding liabilities for infringement of intellectual property rights, the law at the locality where protection is claimed shall apply; however, if the parties agree to choose *lex fori* as the

applicable law, such agreement will be respected. (The Law, Article 48-50)

### **Pending Issues**

The Law makes remarkable advances in clarifying the application of laws on many foreign-related relations. However, there are some matters or terms that require further legislation or judicial interpretations for implementation of these provisions in the future. For instance, both Article 42 and Article 45 provide that if the operator or infringer has no business activities in the habitual residence of the consumer or the infringed, the law at the habitual residence of the consumer or the infringed will be excluded; however, PRC law has yet to provide an express definition of “business activities.” Furthermore, the Law repeats the principle of exclusion of application of foreign law by “public interests”; however, there is no clear definition of “public interests.” The lack of clear definitions for some key terms increases the risk of abuse of these provisions to exclude application of foreign laws.

– Brenda Xu

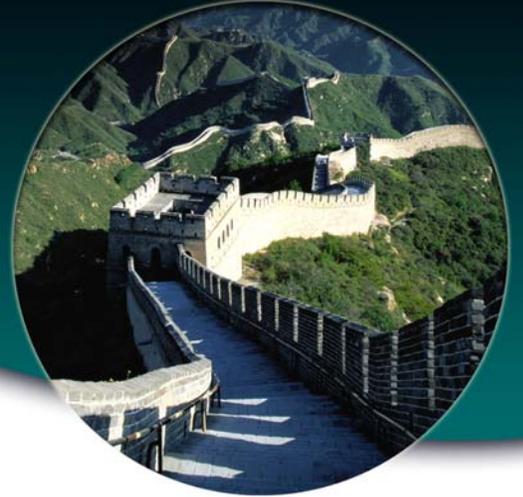
## Articles, Publications and Other Media

The American Bar Association (ABA) released the third edition of the [China Law Deskbook](#), authored by Beijing partner **James M. Zimmerman**. For 12 years this authoritative treatise has been one of the ABA's top publications and a must-read for lawyers and business people engaged in China.

## Past Events

**James V. Dick**, **Thomas T. Liu** and **Charles F. Donley** presented an aviation antitrust seminar in Shanghai on 9 November 2010. The seminar provided China-based airlines with an introduction to US antitrust laws and an overview of the application of these laws to the international aviation industry.

On 18 November 2010 **Amy Sommers** was a featured speaker in the morning session "[Tackling Corruption – A Practical Guide to Help Enhance Economic Sustainability](#)" at the American Chamber of Commerce in Shanghai's Sixth Annual Corporate Social Responsibility (CSR) Conference and Awards Ceremony. Ms. Sommers' session featured best practices, case studies and practical tools for anticorruption initiatives in China. Other topics at the conference included communicating CSR to stakeholders, selecting an NGO partner, corporate engagement in disaster preparedness and building an educational program into a CSR portfolio.



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