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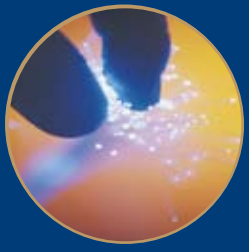
China Law Update



September 2008

With China's—and the world's attention—focused on the Beijing Olympics, summer was a relatively slow time for Chinese legislators. Still, officials in various branches of government found time to enact a number of regulations that are of particular interest to foreign investors. For regular readers, of *China Law Update*, this September 2008 issue will address familiar—and important—themes: the *PRC Anti-Monopoly Law* (*China Law Update*, October 2007); the *Labor Contract Law* (September 2007) and the *Law on Labor Dispute Mediation and Arbitration* (February 2008); rules governing foreign exchange (various issues); and the *Catalogue for the Guidance of Foreign Investment Industries* (January 2008).

In our first summary (page 4), we look at the *Regulations on Notification Thresholds of a Concentration of Undertakings* to see how the State Council is addressing some of the uncertainties in the landmark Anti-Monopoly Law, which took effect last month. More questions remain; more rules and regulations are likely to follow.

Our second summary (page 6) looks at an effort in Guangdong, China's largest and wealthiest province, to implement labor laws that have also received worldwide attention. In June, the Guangdong High People's Court and the Guangdong Labor Disputes Arbitration Committee passed the *Guiding Opinion on Application of the Labor Contract Law and the Law on Mediation and Mediation and Arbitration of Labor Disputes in Guangdong Province*.

Next, *China Law Update* summarizes China's latest effort to manage its foreign exchange system, the amended *Regulations on Foreign Exchange Control of the People's Republic of China*. (See page 9.)

Our final summary (page 11) looks at the *Measures for the Administration of Foreign-Invested Mineral Exploration Enterprises*, which were issued by the Ministry of Commerce and the Ministry of Land and Resources. These measures build upon the investment priorities in the *Catalogue for the Guidance of Foreign Investment Industries*, aiming to streamline and consolidate the approval process for foreign direct investment in the mineral exploration industry.

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Regulations on Notification Thresholds of a Concentration of Undertakings

Issuing Body: **State Council**

Issuing Date: **August 3, 2008**

Effective Date: **August 3, 2008**

In August 2007, after years of internal and external debate, the Standing Committee of China's National People's Congress adopted the *PRC Anti-Monopoly Law*. More than a decade in the making, that law attempted for the first time to systematically define and regulate antitrust law and antitrust law enforcement throughout China. Given its breadth and subject matter, the Anti-Monopoly Law, which became effective on August 1, 2008, is likely to have an enormous impact on China for years to come. We summarized this landmark legislation first in draft form (*China Law Update*, August 2007) and ultimately, as enacted, in the October 2007 issue of *China Law Update*.

Three government agencies share responsibility for enforcement of the Anti-Monopoly Law: The Ministry of Commerce (merger control), the National Development and Reform Commission (price fixing) and the State Administration of Industry and Commerce (abuse of dominant market position).

In many respects, the principles articulated by China's Anti-Monopoly Law are similar if not identical to concepts in EU and U.S. antitrust law. However, much as with the PRC Labor Contract Law (discussed below), this legislation left unresolved a number of important questions and issues. Given the importance of the Anti-Monopoly Law, *China Law Update* summarized a draft attempt to address those questions, the much-anticipated *Draft Regulations on Notification of a Concentration of Undertakings*, which was released by the State Council in March 2008 (*China Law Update*, August 2008).

The State Council released the official version of those rules, the *Regulations on Notification Thresholds of a Concentration of Undertakings* (Final Notification Regulations), on August 3, 2008. However, the Final Notification Regulations are less detailed and comprehensive than the draft regulations, leaving untouched many of the ambiguities and uncertainties contained in the Anti-Monopoly Law.

While the draft regulations, for example, contained 19 provisions, the Final Notification Regulations contain just five. And of the five, only two are substantive clauses.

Provision 3 of the Final Notification Regulations establishes two thresholds for mandatory advance notification of an impending concentration. An undertaking must notify the relevant authority under the State Council in either of the following circumstances:

- The total combined global turnover of all participants in the concentration exceeded RMB ten billion in the preceding fiscal year, and the Chinese domestic turnover of at least two participants each exceeded RMB 400 million in the previous fiscal year; or
- the total combined Chinese domestic turnover of all participants in the concentration exceeded RMB two billion in the previous fiscal year, and the domestic turnover of at least two participants each exceeded RMB 400 million in the previous fiscal year.

The other substantive section of the Final Notification Regulations, Provision 4, authorizes the Ministry of Commerce to initiate mandatory notification even if the above thresholds are not satisfied, provided that the ministry collects facts and evidence, in accordance with law, proving that the concentration of undertakings will restrict or eliminate competition.

The Final Notification Regulations do not include two important provisions that were contained in the draft regulations: the market share threshold and the definition of what it means to "control" another business or entity. The first provision would have required mandatory notification if as a result of a merger, acquisition or other concentration the participants, either individually or collectively would capture 25 percent or more of the market share in their industry within China. Without a clear definition control, the law may make it difficult for companies to determine whether a filing is required.

Guiding Opinion on Application of the Labor Contract Law and the Law on Mediation and Arbitration of Labor Disputes in Guangdong Province

Issuing Body: **Guangdong High People's Court and Guangdong Labor Disputes Arbitration Committee**

Issuing Date: **June 23, 2008**

Effective Date: **June 23, 2008**

China Law Update has been covering China's *Labor Contract Law*, which took effect on January 1, 2008, since before the National People's Congress enacted this sweeping legislation in June 2007. (For a comprehensive summary of the Labor Contract Law, see our September 2007 issue.) This far-reaching—and in some respects controversial—legislation governs the relationship between employers and employees throughout China, requiring written contracts for all employer-employee relationships, with many of the basic terms of those contracts being defined by law. From the time the law was passed, however, it was clear that it left many questions unanswered, and as a result implementing rules and regulations would be needed. In June 2008, *China Law Update* previewed efforts to fill some of those gaps, summarizing the State Council's *Draft of Implementation Regulations of the PRC Labor Contract Law*. The draft has not yet become final.

Also of great importance to China's labor and employment situation is the *Law on Labor Dispute Mediation and Arbitration* (Labor Dispute Law), which was passed by the National People's Congress and took effect on May 1, 2008. (See the February 2008 issue of *China Law Update*.) This law is designed to protect the rights and interests of employees by providing detailed provisions for mediation and arbitration in order to resolve labor disputes. Whenever a labor dispute arises between an employee and an enterprise, the employer and employee may negotiate to reach an agreement, or else either side may apply for mediation or arbitration. Except for certain specified disputes, either the employer or the employee may bring a lawsuit in court if the employer or employee is unsatisfied with an arbitration award.

Since enactment of the Labor Contract Law and the Labor Dispute Law, the number of labor disputes in China has reportedly increased, with many becoming deadlocked, in part because the rules and dispute resolution mechanisms outlined in these new laws have not been fully implemented. With China's national government yet to enact detailed rules implementing either of the new laws, the government of Guangdong Province, the wealthiest and most populous province in China, has chosen to act, with the Guangdong High People's Court and the Guangdong Labor

Disputes Arbitration Committee promulgating the *Guiding Opinion on Application of the Labor Contract Law and the Law on Mediation and Arbitration of Labor Disputes in Guangdong Province* (the Guangdong Guiding Opinion) on June 23, 2008. With passage of this legislation, Guangdong becomes the first province in China to formally clarify the mechanisms and rules for applying the Labor Contract Law and Labor Dispute Law. Given Guangdong's size—about a third of all labor disputes occur and are settled here—these rules will at the very least affect the many companies that do business in Guangdong. Beyond that, they may provide a model for other provinces or the national government to move forward in implementing the Labor Contract Law and Labor Dispute Law.

Termination of Employment Contracts

The Guangdong Guiding Opinion restricts, to some extent, the liability of employers when terminating employment contracts. In the event that an employer and employee cannot reach agreement on an employment contract through consultation within one month of when the employee begins work, the employer may terminate the employment relationship without having to pay the remedies provided for in the Labor Contract Law. Similarly, if an agreement on an employment contract is not finalized within one year after an employee begins work, and if the employer has evidence to prove that the failure to reach agreement is because of the employee (and the employer is not at fault), the employer does not have to pay the compensation of two month's salary that is otherwise provided for in the Labor Contract Law. The employer does owe the employee severance pay, however, if the company desires to terminate the employment relationship with that employee.

Evasive Conduct by the Employer

Article 14 of the Labor Contract Law stipulates that employers must, with few exceptions, offer an open-ended employment contract (a contract without a termination date) to all employees who have worked for the employer for ten consecutive years, or who have fulfilled two consecutive fixed-term contracts. This provision, which offers powerful protection to companies' most senior employees, has been controversial. According to news reports, some employers have attempted in various ways—most notably, by firing senior employees before the law took effect, then rehiring them as "new" employees—to evade this provision and thus to avoid having employees with open-ended contracts. The Guangdong Guiding Opinion expressly forbids such evasive conduct.

Under the Guangdong Guiding Opinion, the following actions by an employer constitute evasive behavior and will be considered invalid:

- The employer forces an employee to resign, then enters into a new employment contract.
- The employer gets an affiliated enterprise to enter into employment contracts on its behalf.
- The employer hires individuals through an illegal staffing firm.
- The employer changes its name, legal representative, responsible person or investors so employees must sign contracts with the "new" company.
- Other evasive behavior that violates common principles of fairness and good faith.

Evasive conduct such as the above-proscribed actions shall not affect calculations of how long an employee has worked for the employer and thus the determination of whether the employee qualifies for an open-ended employment contract.

Provisions on Foreigners

The Guangdong Guiding Opinion specifies that the Labor Contract Law and the Labor Dispute Law shall apply to foreigners and residents of Hong Kong and Macao who work in mainland China. However, foreigners and Hong Kong and Macao residents must obtain a work permit before starting work. Otherwise, the individual will not be protected by the Labor Contract Law and the Labor Dispute Law. In that case, the only economic remedies to which employees are entitled are those stipulated in their individual contracts with the employer.

The Guangdong Guiding Opinion also specifies that the relationship between an employee and the representative office of a foreign enterprise is recognized as an employment relationship, and thus is governed by China's employment laws, including the Labor Contract Law and the Labor Dispute Law, so long as the representative office does not hire the employee or employees through a legitimate overseas employment service (in which case the individual would be an employee of the staffing service).

Regulations of the People's Republic of China on the Administration of Foreign Exchange

Issuing Body: State Council

Issuing Date: August 5, 2008

Effective Date: August 5, 2008

As China has moved over the past decades towards a market economy and full economic integration into world markets, it has shifted away from strict controls on the value of its currency, the renminbi (or yuan). Since 2005, for example, China has to some degree allowed the value of the renminbi to rise and fall, though it still manages trading of currency. (The renminbi was worth about 6.8 to the U.S. dollar in late August.)

Meanwhile—and possibly as a result, in part, of those controls—China has accumulated a vast reserve of foreign exchange, currently estimated at US$1.8 trillion. Speculative capital—so-called "hot money"—has flowed into the country at an unprecedented rate. Inflation has risen.

China Law Update has followed China's efforts to loosen restrictions on foreign exchange. In the March 2007 issue, for example, we summarized the *Measures on the Administration of Individuals' Use of Foreign Exchange* and the *Implementing Rules of the Measures on the Administration of Individuals' Use of Foreign Exchange*. In October 2007, we summarized the *Measures for the Administration of Foreign Exchange in Bonded Areas Under Customs Supervision* and the *Circular on Retaining Foreign Exchange Income in a Current Account by Domestic Entities*.

Now the State Council has issued the newly amended *Regulations of the People's Republic of China on the Administration of Foreign Exchange* (2008 Foreign Exchange Regulations). The Chinese government first promulgated this law in 1996 and amended it a year later.

The 2008 Foreign Exchange Regulations were comprehensively revised and adjusted to loosen restrictions on foreign exchange control, enhance foreign capital supervision, and pursue healthy economic development.

A key feature of the regulations is a provision authorizing steep penalties for the improper transfer or conversion of currency.

Loosening of Controls on Foreign Exchange

Before implementation of the 2008 Foreign Exchange Regulations, domestic institutions and individuals had to transfer all foreign exchange income back to China, where it would be sold to a qualified financial institution and then converted to renminbi through the People's Bank of China.

The 2008 Foreign Exchange Regulations no longer require a mandatory transfer of foreign exchange income back to China. As a result, Chinese institutions and individuals may either transfer foreign exchange income back to China or deposit it overseas. The State Administration of Foreign Exchange (SAFE) is expected to issue new regulations defining the conditions and terms of such transfers and deposits.

Likewise, in accordance with the 2008 Foreign Exchange Regulations, domestic institutions no longer must sell all foreign exchange income to domestic (Chinese) banks. As a result, those institutions are now allowed to keep foreign exchange income in other currencies rather than converting it to renminbi.

Adjustments to the Foreign Exchange Rate System

When China shifted away from a fixed exchange rate system in 2005, it moved to a managed floating exchange rate system that was aligned to a combination of foreign currencies, including the U.S. dollar. Under the 2008 Foreign Exchange Regulations, the exchange rate will be determined by and linked to a combination of foreign currencies, also taking into account market demand and supply. To avoid sharp fluctuations, however, the exchange rate will still be managed and restricted to a certain range.

Strengthened Powers of Supervision

The 2008 Foreign Exchange Regulations strengthen the capacity of SAFE and its local bureaus to supervise and regulate all types of foreign exchange operations, and to investigate and penalize individuals or institutions that violate the law in exchanging foreign currency. SAFE and its bureaus may conduct a variety of investigative activities, including on-site inspections, investigations of relevant persons, and reading or copying transactions and financial files relevant to allegedly illegal acts.

SAFE is also authorized to imposed steep penalties: a fine of up to 30 percent of the capital involved in an illegal exchange of currency, either into or from renminbi, and either into out of China.

These stronger enforcement mechanisms are designed to curtail the illegal flow of foreign currency into China, which is thought to contribute to both the country's enormous foreign exchange reserve and inflation.

Measures for the Administration of Foreign-Invested Mineral Exploration Enterprises

Issuing Body: **Ministry of Commerce and Ministry of Land and Resources**

Issuing Date: **August 20, 2008**

Effective Date: **August 20, 2008**

In October 2007, the National Development and Reform Commission and the Ministry of Commerce jointly issued the *Catalogue for the Guidance of Foreign Investment Industries* (2007 Foreign Investment Catalogue), updating four previous versions of the catalogue that had been published between 1995 and 2004. As the basic starting point for foreign investment policy in China, the catalogue groups hundreds of types of foreign investment projects into distinct categories: those which are "encouraged"; those which are "restricted"; and those which are "prohibited." Any type of foreign investment project not specifically listed in the 2007 Foreign Investment Catalogue is deemed "permitted" or "allowed." (For a full summary of the 2007 Foreign Investment Catalogue, see *China Law Update*, January 2008.)

Foreign-invested enterprises in "encouraged" industries enjoy benefits such as lower levels of required governmental review, tax breaks and other financial incentives. Foreign firms that are involved in restricted industries are subject to greater scrutiny, at higher levels of government.

The changes contained in the 2007 Foreign Investment Catalogue aimed mainly to direct foreign investment in China into industries that promote energy saving, environmental protection and technological innovation, with the broader goal of bringing higher-quality jobs to China. In addition, China signaled a shift away from its encouragement of exports.

The *Measures for the Administration of Foreign-Invested Mineral Exploration Enterprises* (Mineral Exploration Measures), which were issued jointly by the Ministry of Commerce and Ministry of Land and Resources on August 20, 2008, expand upon the policies outlined in the 2007 Foreign Investment Catalogue. The Mineral

Exploration Measures reflect the Chinese government's intent to develop the country's mineral exploration industries. As part of this policy, the government is encouraging foreign investors to bring certain new technologies into the country. The measures mainly focus on streamlining and consolidating the approval process for foreign direct investment in certain types of mineral exploration.

Definitions

As referred to in the Mineral Exploration Measures, foreign-invested mineral exploration enterprises are foreign-invested enterprises that are incorporated inside China according to relevant laws, and that are engaged in investments in mineral exploration (except petroleum, natural gas and coal seam gas) and other relevant activities.

The Mineral Exploration Measures apply to all types of foreign-invested mineral exploration enterprises, including wholly foreign-owned enterprises (WFOEs), equity joint ventures (EJVs) and cooperative joint ventures (CJVs). The rules apply to any type of foreign investors, whether individuals, enterprises or other economic organizations.

Scope

In general, the scope of mineral exploration that foreign investors are allowed to engage in is specified in the 2007 Foreign Investment Catalogue. The following chart reflects those classifications (prohibited, restricted, encouraged, permitted) and the requirements for foreign investors who want to engage in exploration for particular minerals inside China.

CLASS	MINERALS	REQUIREMENTS
Prohibited	Tungsten, molybdenum, stannum, antimony and fluorite	Foreign investors can not engage in exploration for such minerals.
	Thulium	
	Radioactive minerals	
Restricted	Some special and rare types of coal	Foreign investors are forbidden to be controlling shareholder.
	Barites	Foreign investors may only establish EJVs and CJVs.
	Noble metals	No specific requirements.
	Diamonds	No specific requirements.

CLASS	MINERALS	REQUIREMENTS (continued)
Encouraged	Coal seam gas	No specific requirements.
	Petroleum and natural gases	Foreign investors may only establish EJVs and CJVs.
	Irregular petroleum resources such as oil shale, oil sand, heavy oil and extra heavy oil	Foreign investors may only establish CJVs.
	Iron ore and manganese ore	No specific requirements.
	Flammable ice (methane hydrate) in sea floor	Foreign investors may only establish CJVs.
Permitted	Others	No specific requirements.

Regulatory Authorities

In accordance with the Mineral Exploration Measures, the Ministry of Commerce is responsible for the establishment and administration of foreign-invested mineral exploration enterprises engaging in exploration for minerals within the "restricted" class under the 2007 Foreign Investment Catalogue. Local commercial authorities at the provincial level are responsible for the establishment and administration of foreign-invested mineral exploration enterprises that engage in other types of mineral exploration or mining.

Filing and Approval Requirements

In accordance with the Mineral Exploration Measures, mandatory filing and approvals are required throughout the operation of a foreign-invested mineral exploration enterprise.

First, a foreign investor must apply to the relevant regulatory authority for permission to establish a foreign-invested mineral exploration enterprise and obtain an approval certificate for such establishment.

The Mineral Exploration Measures further require that if a foreign investor's plans involve any type of exploration operations, the investor must apply for exploration certificates before the start of operations.

Additionally, while a foreign-invested mineral exploration enterprise is in operation, it must report in writing to approval authorities before March of every year about its operations, tax and fee payments, environmental protection activities, land use activities, and annual inspections.

Finally, if the foreign-invested mineral enterprise finds a certain mineral resource, it must apply to the regulatory authority for a mining certificate and make changes in the enterprise's business scope before mining the mineral resource, in accordance with the *Administrative Measures for the Administration of Mining Registration*, which were issued by the State Council in 1998.

Faegre & Benson's Greater China Practice

Faegre & Benson LLP has extensive experience advising U.S., European and Asian clients on entering the China business environment, as well as on investment, trade and commercial matters throughout the Greater China region. From our offices in Shanghai and Minneapolis, lawyers in our China practice regularly provide international structuring, documentation and negotiation assistance for transactions both inbound to and outbound from Mainland China, Taiwan and Hong Kong.

The core of our team includes highly experienced legal professionals who have studied and practiced in both the U.S. and in China. In addition, we collaborate with an extensive informal network of local law firms, which possess expertise vital in an often ambiguous regulatory environment, where local customs and practice can vary.

Lawyers in our China practice represent clients ranging from privately held emerging companies to Fortune 50 multinationals in connection with their cross-border business dealings involving China. Our experience includes work in the industrial manufacturing, consumer products, telecommunications, hospitality, financial services, software, automotive, engineering, chemical products, pharmaceuticals, infrastructure, restaurant, and construction industries.

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