

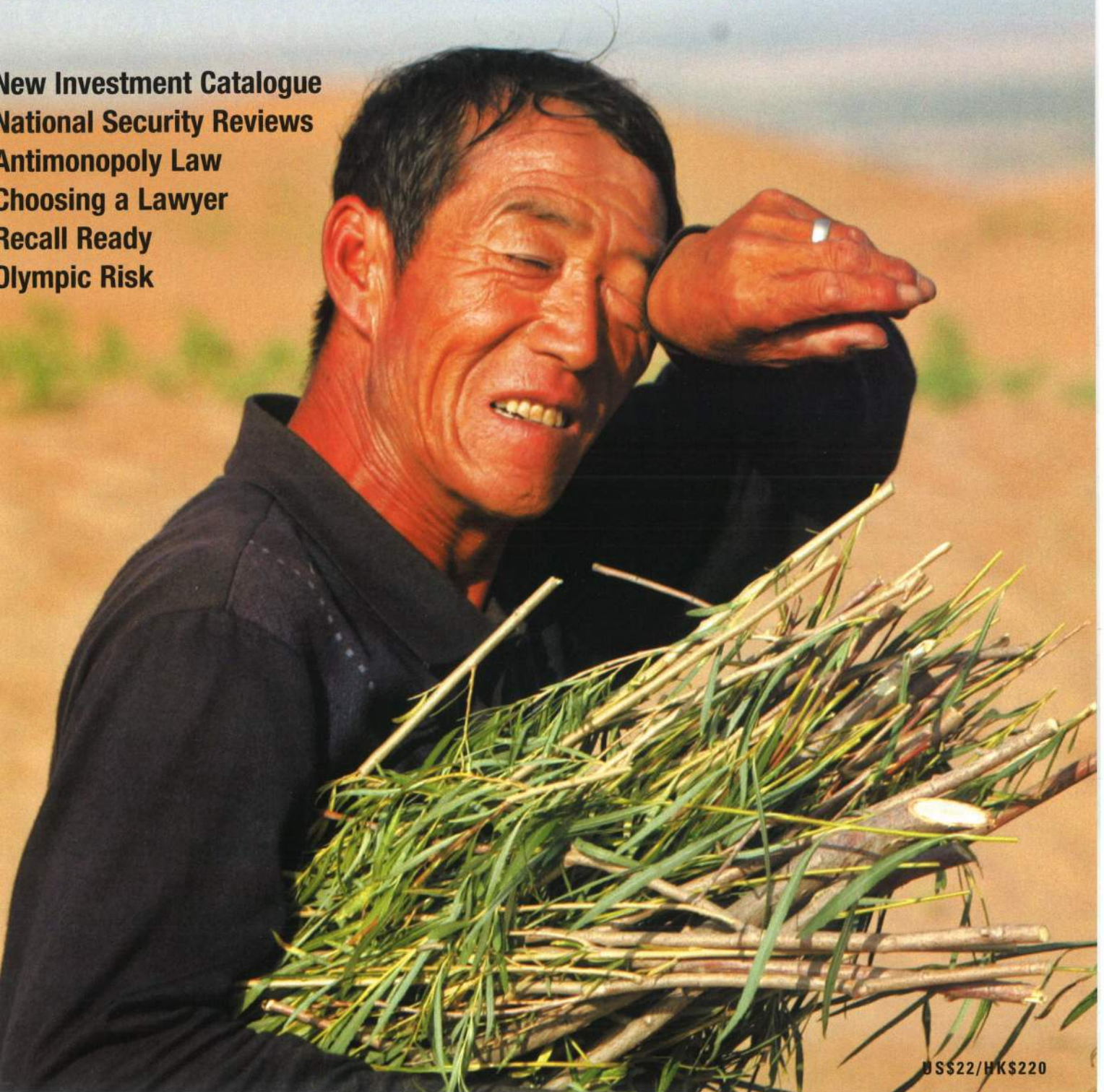
January-February 2008

# The China Business Review

THE MAGAZINE OF  
THE US-CHINA BUSINESS COUNCIL

## Hard Work Ahead Policies for China's Environment

New Investment Catalogue  
National Security Reviews  
Antimonopoly Law  
Choosing a Lawyer  
Recall Ready  
Olympic Risk

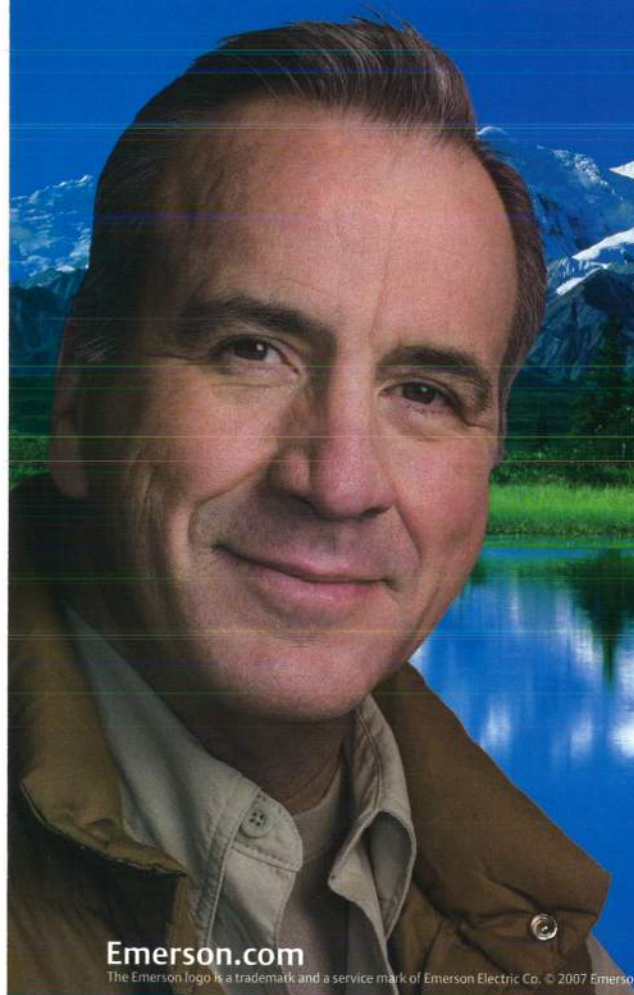


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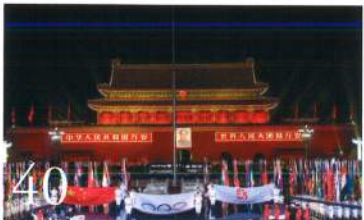
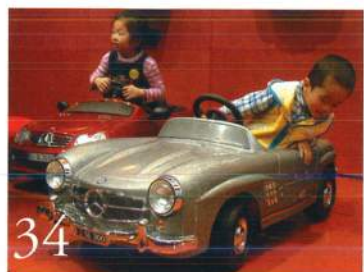
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Cover Design: Jesse Marth  
Cover Photo: Chen Jian/China  
Foto Press

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The *China Business Review* welcomes articles from outside contributors. Manuscripts submitted for consideration should be sent to the editor at the address below. The US-China Business Council obtains licenses for all rights to articles and artwork published in the *CBR*. Articles or artwork published in the *CBR* may be reprinted or reproduced only with the written permission of the US-China Business Council. Articles in the *CBR* do not reflect US-China Business Council policy, unless indicated.

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## Trade

The US International Trade Commission (ITC) in late November found no material injury or threat to US industry from imports of coated free sheet (glossy) paper, ending the first case that would have imposed countervailing duties (CVDs) on a nonmarket economy. The US Department of Commerce found that certain types of glossy paper were subsidized and sold in the United States at less than fair value and made a preliminary decision on March 30 to apply CVD laws on glossy paper imports from China. If allowed to stand, Commerce's affirmative decision would have reversed a 23-year policy of not applying CVD laws to nonmarket economies.

China in late November announced that it would terminate all the subsidies to Chinese and foreign firms challenged by the United States in a World Trade Organization case launched

CANADA	CAD	0.9512
CHINA	CNY	7.165
EURO	EUR	0.6544
JAPAN	JPY	109.00
SINGAPORE	SGD	1.3712
HONG KONG	HKD	0.0043

in February 2007. Most of the alleged subsidies were in the form of tax breaks to encourage the development of certain industries in China.

Having long treaded softly on trade issues with China, the European Union has stepped up its criticism of PRC trade policies and joined the United States in calling for a faster appreciation of China's currency. Ahead of the EU-China Summit on November 28, European Commissioner for External Trade Peter Mandelson gave several speeches in which he called on China to lower market access barriers and protect intellectual property more effectively.

## Banking & Finance

The Federal Reserve Board in November approved the China Merchants Bank Co. Ltd. to open a branch in New York, marking the first time in 16 years that a Chinese bank has done so. Two other Chinese banks, Bank of China Ltd. and Bank of Communications Co. Ltd., maintain US branches, which were approved before the Foreign Bank Supervision Enhancement Act took effect in 1991. The



Fed's approval letter cited China's strengthened supervision and anti-money-laundering regimes as reasons that China Merchants was approved, according to reports.

## Olympics

Controversy surrounding the Beijing Olympics will likely intensify in 2008 as international advocacy groups step up their lobbying efforts on China's human rights record, which will pose a challenge to some Olympic sponsors that wish to project a positive corporate image. For exam-



ple, US-based "Dream for Darfur," a group that criticizes China for its inaction on the Darfur, Sudan issue, called on 19 Olympic sponsors to raise the issue with the PRC government and

the International Olympic Committee. It then released a 100-page report that graded the sponsors on their subsequent actions. The report failed 13 of the 19 sponsors, including several US companies.

China plans to showcase its indigenously developed third-generation mobile technology standard (time division synchronous code division multiple access [TD-SCDMA]) during the Olympics, despite doubts about whether the technology will be ready in time, according to reports. The new technology reportedly underwent trials in eight Chinese cities at the end of 2007, and several domestic telecom equipment makers, including ZTE Corp., have already begun developing equipment to support the new standard.

## Laws and Regulations

The PRC National People's Congress (NPC), China's top lawmaking body, had a full legislative calendar in 2007, passing key laws such as the Labor Contract, Employment Promotion,

Enterprise Income Tax, Employment Service and Management, and Rural and Urban Planning laws. All of these laws took effect January 1. Collective bargaining regulations, passed by the Shanghai Municipal





## Bilateral Relations



ing on pharmaceutical and food product safety, agreements to prevent misuse of company names and cooperate on developing environmental technologies, and Approved Destination Status for the United States, among other results.

As the *CBR* went to press, the third round of the Strategic Economic Dialogue was convening on the outskirts of Beijing, where officials from both sides sought solutions to issues such as bilateral investment policies, energy and environmental cooperation,


food and product safety, and financial sector reforms and market openings. Early reports suggested that China will be unlikely to allow faster appreciation of the renminbi, one of the thorniest issues in the bilateral trade relationship.

The conclusion of the 18th session of the US-China Joint Commission on Commerce and Trade (JCCT) in mid-December brought incremental progress on issues important to US industry, but no single headline-grabbing outcome to satisfy critics of China's trade regime. Chaired on the US side by Commerce Secretary Carlos M. Gutierrez and US Trade Representative Susan C. Schwab, and Vice Premier Wu Yi on the PRC side, the JCCT produced several memoranda of understand-

People's Congress in August 2007, also took effect January 1. Shanghai's rules may act as a test case for the processes the Labor Contract Law will require nationally.

The new year will also prove to be a busy one for the NPC, which has several key draft laws slated for passage, including the Energy, Labor Dispute Arbitration, and Food Safety laws. In addition, the NPC recently announced that it will issue 20 supporting regulations on mergers and acquisitions before the Antimonopoly Law takes effect on August 1.

# Enter....



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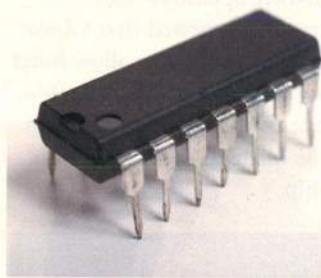


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January 2008–April 2008

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SEMICON China 2008 March 18-20

## Hong Kong Fashion Week

**JANUARY 14-17**

**Location:** Hong Kong Convention and Exhibition Center

**Organizer:** Hong Kong Trade Development Council

**Contact:** Andrew Tsui

**Tel:** 852-2240-4464

[exhibitions@tdc.org.hk](mailto:exhibitions@tdc.org.hk)

<http://hkfashionweekfw.tdtrade.com>

## Business Alliance China FastTrack

**JANUARY 24**

**Location:** Tysons Corner, VA: The McLean Hilton

**Organizer:** Business Alliance of George Mason University

**Contact:** Rachel Lubar

**Tel:** 1-703-993-4765

[rlubar@businessalliance.org](mailto:rlubar@businessalliance.org)

[www.businessalliance.org/chinafasttrack.html](http://www.businessalliance.org/chinafasttrack.html)

## Doing Business in China

**JANUARY 31–FEBRUARY 1**

**Location:** Bellevue, WA:

Bellevue Courtyard Marriott

**Organizer:** The Seminar Group

**Contact:** Cheryl Angle

**Tel:** 1-800-574-4852

[cheryl@theseminargroup.net](mailto:cheryl@theseminargroup.net)

[www.theseminargroup.net](http://www.theseminargroup.net)

## China International Optics Fair

**FEBRUARY 22-24**

**Location:** Shanghai Everbright Convention and Exhibition Center

**Organizers:** China Optometric and Optical Association; China Light Industrial Corp. for Foreign Economic and Technical Cooperation; Orient International Exhibition Co., Ltd.

**Tel:** 852-2789-3220

[orientex@netvigator.com](mailto:orientex@netvigator.com)

[www.siof.cn](http://www.siof.cn)

## ISPO China: International Tradeshow for Sports, Fashion & Lifestyle Brands

**FEBRUARY 24-26**

**Location:** Beijing: China

International Exhibition Center

**Organizers:** Messe München; China International Exhibition Corp.

**Contact:** Yi Zhang

**Tel:** 49-89-949-201-63

[zhang@ispo.com](mailto:zhang@ispo.com)

[www.ispochina.com](http://www.ispochina.com)

## International Integrated Circuit China Conference & Exhibition

**FEBRUARY 28–MARCH 11**

**Locations:** Chengdu, Sichuan (Feb. 28–29); Shenzhen, Guangdong (Mar. 3–4); Beijing (Mar. 6–7); Shanghai (Mar. 10–11)

**Organizers:** Global Sources; CMP Information Ltd.

**Contact:** Esther Guevara

**Tel:** 852-2814-5526

[eguevara@globalsources.com](mailto:eguevara@globalsources.com)

[www.english.china.iicexpo.com](http://www.english.china.iicexpo.com)

## China International Education Exhibition Tour

**MARCH 1-18**

**Locations:** Beijing (Mar. 1–2);

Xi'an, Shaanxi (Mar. 4–5);

Shanghai (Mar. 8–9); Changsha,

Hunan (Mar. 11–12); Guangzhou,

Guangdong (Mar. 17–18)

**Organizers:** PRC Ministry of Education, Chinese Service Center for Scholarly Exchange; Reliable International Exhibition Services Co., Ltd.

**Contact:** Etta Ho

**Tel:** 86-10-8589-8181

[cieet@reliable.org.cn](mailto:cieet@reliable.org.cn)

[www.cieet.com](http://www.cieet.com)

## Trade and Supply Chain Financing Conference Asia

**MARCH 4-5**

**Location:** Hong Kong:

Renaissance Harbor View Hotel

**Organizer:** Euromoney Seminars

**Contact:** Winnie Louie

**Tel:** 852-2842-6999

[winnie.louie@euromoneyasia.com](mailto:winnie.louie@euromoneyasia.com)

[www.tradefinanceconferences.com](http://www.tradefinanceconferences.com)

## Water, Wastewater & Water Treatment China

**MARCH 4-7**

**Location:** Guangzhou,

Guangdong: China Import and

Export Fair-Pazhou Complex

**Organizers:** China Foreign Trade

Center (Group); China Foreign

Trade Guangzhou Exhibition

Corp.

**Contact:** Rachel Lee

**Tel:** 86-20-2608-0422

[rachel.lee@fairwindow.com.cn](mailto:rachel.lee@fairwindow.com.cn)

<http://waterchina.fairwindow.com>

## China (Dongguan) International Textile & Clothing Industry Fair

**MARCH 5-8**

**Location:** Dongguan,

Guangdong: Guangdong Modern International Exhibition Center

**Organizer:** Paper

Communication Exhibition Services

**Tel:** 852-2763-9011

[textile@paper-com.com.hk](mailto:textile@paper-com.com.hk)

[www.textilenclothing-dongguan.com](http://www.textilenclothing-dongguan.com)

## Work Safe China 2008

**MARCH 5-8**

**Location:** Shanghai: TBD

**Organizer:** Avail Corp.

**Contact:** Mark Nee

**Tel:** 86-21-6229-1717

[mnee@availcorp.com](mailto:mnee@availcorp.com)

[www.availcorp.com/english/events\\_list.php?eventsid=129](http://www.availcorp.com/english/events_list.php?eventsid=129)

## China Focus: Offshoring Globalization and IT Services to China

**MARCH 10-14**

**Location:** Beijing: TBD

**Organizer:** The Localization Industry Standard Association (LISA)

**Contact:** LISA

**Tel:** 41-24-453-2310

[events@lisa.org](mailto:events@lisa.org)

[www.lisa.org/events/2008](http://www.lisa.org/events/2008)

[beijing/index.html](http://beijing/index.html)

## China: Latest Trends in International Finance

**MARCH 11-12**

**Location:** Shanghai: Pudong Shangri-La Hotel

**Organizer:** IFR Conferences

**Contact:** Katie Baron

**Tel:** 44-20-7369-7432

[katie.baron@thomson.com](mailto:katie.baron@thomson.com)

[www.ifrconferences.com](http://www.ifrconferences.com)



# China Conference Calendar

## SEMICON China 2008

**MARCH 18-20**

**Location:** Shanghai New International Expo Center  
**Organizer:** Semiconductor Equipment and Materials International China  
**Contact:** Steven Gan  
**Tel:** 86-21-6448-5666 x 217  
sgan@semi.org  
<http://semiconchina.semi.org/programsevents>

## Power Conversion Intelligent Motion China

**MARCH 18-20**

**Location:** Shanghai New International Expo Center and German Center for Industry and Trade  
**Organizers:** Mesago PCIM GmbH; Messe München GmbH; Shanghai Center for Scientific and Technological Exchange with Foreign Countries  
**Contact:** Tanja Frauendörfer  
**Tel:** 49-711-6194-6821  
[www.mesago.de/en/pcchina/main.htm](http://www.mesago.de/en/pcchina/main.htm)

## China Building 2008

**MARCH 26-29**

**Location:** Beijing Exhibition Center  
**Organizers:** PRC Ministry of Construction; China Building Materials Federation  
**Contact:** Nancy Yang  
**Tel:** 86-10-6836-1356  
yangm@ccpitbm.org  
[www.chinabuilding.org/index\\_en.asp](http://www.chinabuilding.org/index_en.asp)

## China International Clothing & Accessories Fair

**MARCH 28-31**

**Location:** Beijing: New China International Exhibition Center  
**Organizers:** Beijing Fashion-Expo Co., Ltd.; Beijing Convention and Exhibition Co.; China World Trade Center Co., Ltd.  
**Contact:** Zeng Qi  
**Tel:** 86-10-6505-0546  
zengqi@cwtc.com  
[www.chiconline.com.cn/eindex.asp](http://www.chiconline.com.cn/eindex.asp)

## International Medical Instruments & Equipment Exhibition

**APRIL 3-5**

**Location:** Beijing: China International Exhibition Center  
**Organizers:** People's Liberation Army, Health Dept. of the General Logistics Dept.; China World Trade Center Co. Ltd.; Hui Tong Xing Ye International Exhibition (Beijing) Co., Ltd.; Messe Düsseldorf China Ltd.  
**Contact:** Jiang Ling  
**Tel:** 86-10-6505-1018  
jiangling@cwtc.com  
[www.chinamed.net.cn](http://www.chinamed.net.cn)

## City Connect

**APRIL 7-8**

**Location:** Chongqing: Inter-Continental  
**Organizer:** City Connect Ltd.  
**Contact:** Stella Mak  
**Tel:** 852-2815-2113  
sam@cityconnect.com.cn  
[www.cityconnect.com.cn](http://www.cityconnect.com.cn)

## China International Petroleum & Petrochemical Technology and Equipment Exhibition

**APRIL 7-9**

**Location:** Beijing: New China International Exhibition Center  
**Organizer:** Zhenwei Exhibition Group  
**Contact:** Liu Wenjuan  
**Tel:** 86-10-5823-6586

[lwj@chinazhenwei.com.cn](mailto:lwj@chinazhenwei.com.cn)  
[www.cippe.net](http://www.cippe.net)

## Next Generation Networks

**APRIL 10-11**

**Location:** The Sheraton Shanghai  
**Organizer:** Marcus Evans  
**Contact:** Lim Am Mee  
**Tel:** 603-2723-6763  
lima@marcusevanskl.com  
[www.marcusevans.com](http://www.marcusevans.com)

## China Electronics Fair

**APRIL 11-13**

**Location:** Shenzhen Convention and Exhibition Center  
**Organizer:** China Electronic Exhibition & Information Communication Co., Ltd.  
**Contact:** Elaine Hao  
**Tel:** 86-10-5166-2329 x56  
cef@ceac.com.cn  
[www.icef.com.cn](http://www.icef.com.cn)

## The Boao Forum for Asia (BFA)

**APRIL 18-20**

**Location:** Boao, Hainan: BFA International Conference Center  
**Organizer:** BFA  
**Contact:** Han Xiumei  
**Tel:** 86-10-6505-7377 x 619  
liuyoujia@boaoforum.org  
[www.boaoforum.org](http://www.boaoforum.org)

## Aviation Technology Expo China

**APRIL 27-29**

**Location:** Beijing: Agricultural Exhibition Center  
**Organizers:** AVIC International Exhibition Co., Ltd.; E.J. Krause & Associates, Inc.  
**Contact:** E.J. Krause & Associates, Inc.  
**Tel:** 1-301-493-5500  
info@ejkrause.com  
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## Event Wrap Up

### WASHINGTON

#### November

##### Breakfast Roundtable

Featured Hong Kong Secretary for Commerce and Economic Development Frederick Ma, who discussed the latest developments in Hong Kong, as well as issues in financial services, intellectual property rights (IPR), information technology, and logistics, among others.

##### Issues Luncheon

Featured US Department of Commerce Acting Under Secretary for International Trade Christopher A. Padilla, who shared his thoughts prior to the December 2007 Joint Commission on Commerce and Trade (JCCT) and Strategic Economic Dialogue (SED) meetings in Beijing.

#### December

##### Luncheon Program on Resolving Commercial Disputes with Chinese Parties

The program presented panels on the latest trends in resolving commercial, investment, and trade disputes with PRC government

parties and private enterprises through international arbitration and World Trade Organization mechanisms. Yu Jianlong, secretary general of the China International Economic and Trade Arbitration Commission, delivered the luncheon keynote address. Cosponsored by the District of Columbia Bar, the US-China Business Council (USCBC), and other organizations.

##### Gala 2007

(see p.13)

##### IPR Update

The roundtable luncheon featured Mark Cohen, IPR attaché at the US Embassy in Beijing.

##### Issues Luncheon on EU-China Trade Engagement

Featured Nikolaos Zaimis, counselor for Trade and Agriculture, Delegation of the European Commission to the United States.

### BEIJING

#### November

##### SED Breakfast

Featured Ambassador Alan F. Holmer, the US Treasury's Special

Envoy for China and the SED, who met with the US business community in Beijing to discuss the December SED. Cosponsored by USCBC and the American Chamber of Commerce (AmCham)-China.

#### December

##### JCCT and SED Reception

The reception with US government officials visiting Beijing featured principals and deputies from the US departments of Treasury, Commerce, and Agriculture, the Office of the US Trade Representative, and the US Embassy. Nearly 140 guests attended the event.

### SHANGHAI

#### November

##### China Operations Conference 2007

(see below)

##### SED Breakfast Featuring Ambassador Holmer

Holmer met with the US business community in Shanghai to discuss the December SED. Cosponsored by USCBC and AmCham-Shanghai.

## Upcoming Events

### WASHINGTON

#### Issues Luncheons

January 17, 2008

February 21, 2008

March 20, 2008

#### Forecast 2008

##### Reception and Conference

January 30–31, 2008

For more information, see p.13

For more information on USCBC events, see [www.uschina.org](http://www.uschina.org)

#### December

##### New Developments in US Companies' IPR Protection Efforts in China

The luncheon featured Brian Williams, senior regional manager (North Asia), Anti-Counterfeiting and Internet Safety, Legal and Corporate Affairs, Microsoft Corp.; Gabriela Kennedy, Intellectual Property, Media, and Technology (IPMT) partner, Lovells LLP; and Christine Yiu, IPMT associate, Lovells.

## USCBC Holds Shanghai China Operations Conference

The US-China Business Council (USCBC) held its Shanghai China Operations Conference 2007 on November 2. Following welcoming remarks by Bob Poole, USCBC's vice president of China Operations, An Qinghu, director general of the PRC State Administration for Industry and Commerce's Trademark Office, delivered the keynote address on developments in trademark enforcement and regulation. Next, Qing Wang, chief economist-Greater China at Morgan Stanley, provided an update on China's economy. A panel discussion on the 17th Chinese Communist Party

Congress featured Benjamin Lim, chief political correspondent, Greater China, Reuters, and W. John Hoffman, co-founder and principal, XRG-Exceptional Resources Group. Peter Scher, partner, Mayer Brown LLP, and former US special trade negotiator and chief of staff to Senator Max Baucus (D-MT), provided an update on China politics in the 2008 US presidential campaign.

The luncheon presentation, "Foreign-Invested Enterprises (FIE) and Shanghai's Financial Services Reforms," was given by Fang Xinghai, deputy director of the Shanghai Financial Services Bureau and vice



Harrison Xiao

Guests listening to the morning keynote address at the Shanghai China Operations Conference

general manager of the Shanghai Stock Exchange. A panel on the changing

regulatory environment for FIEs followed. Simon Tan, partner, Research and Development Tax





## USCBC FORECAST 2008 January 30-31, 2008

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### Washington Reception: January 30, 6:00-8:30 pm

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### Conference: January 31, 8:30 am-2:00 pm

Top experts look at the year ahead for China's economy and business environment, US election-year politics and prospects for trade legislation, and bilateral relations.

### Lodging on January 30 and 31:

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For more details, including fees, lodging, and registration information, see [www.uschina.org](http://www.uschina.org)

Contact: Gloria González-Micklin, Director of Programs, USCBC (202-429-0340; [programs@uschina.org](mailto:programs@uschina.org))

## USCBC Hosts Gala 2007 in Washington, DC

Services, Greater China, Deloitte Touche Tohmatsu CPA Ltd., discussed China's new tax regime; John Leary, partner, White & Case LLP, spoke on mergers and acquisitions and the PRC Antimonopoly Law; and Liang Yanling, partner, King and Wood LLP, discussed preventing and responding to labor disputes.

Next, Michael Robert Nelson, director and head, China, Network Relationships, Global Commercial Bank, Citigroup, spoke on new banking and finance capabilities for PRC multinational corporations. Damon Paling, director, Customs and Trade,

PricewaterhouseCoopers, delivered comments on managing customs and the new value-added tax rebate regime. A panel on shared services and business process outsourcing featured Stephen Chen, site manager, HP (Dalian) Global Delivery Operations Center, Hewlett Packard Co., who discussed implementing global shared services in China; Charlie Liu, president, China, VXI Inc., who spoke on outsourcing options in China; and Bill Heidke, staffing executive, IBM China Global Delivery Center, who discussed staff management in a high turnover market.

The US-China Business Council (USCBC) held its Gala 2007 at the Ritz-Carlton Washington on December 5. USCBC President John Frisbie opened the event by welcoming the nearly 500 leaders from the business, government, diplomatic, and think-tank communities who attended. USCBC Chair and Chair, President, and CEO of the Boeing Co. W. James McNerney, Jr. then introduced US Secretary of the Treasury Henry M. Paulson, Jr., who was honored for his leadership of the Strategic Economic Dialogue. Following

Paulson's address, USCBC Vice Chair and Chair and CEO of the Dow Chemical Co. Andrew Liveris introduced Representatives Rick Larsen (D-2nd WA) and Mark Kirk (R-10th IL), who were recognized for their role in promoting a balanced approach to China issues in Congress as the co-chairs of the US-China Working Group. Larsen and Kirk also delivered remarks that sounded the theme of active engagement with China. Thanks to the enthusiastic and generous response from many member companies, the Gala was filled to capacity.



# The Perils of Central Planning

Godfrey Firth



In late August or early September of each year, it is not unusual to find the China and Asia-Pacific management teams of US companies gathering to begin the arduous process of drafting the next year's operational plan for submission to headquarters. These meetings, usually held at a company's China headquarters, often here in Shanghai, are never easy. This year's were particularly challenging. Sweeping but frustratingly opaque regulatory changes in China, steadily rising costs, uncertainty surrounding the direction of both China's and the world's economies, and heightened expectations from headquarters were all weighing on the minds of Shanghai-based China presidents at US companies. Peering into the crystal ball and pulling together the PowerPoint and financial projections for the next year has never been quite so difficult.

### Regulatory indigestion

The PRC National People's Congress (NPC) legislated with a vengeance in 2007, passing a wide array of laws that will affect every company in China. Particularly worrisome is the fact that key government ministries and regulators charged with issuing the vital implementing regulations, which provide explanatory details on how the often vague laws will be enforced, did not keep pace with the NPC, and, as the *CBR* went to press in early December, many key sets of regulations had not yet been passed. Perhaps distracted by China's landmark political event, October's 17th Chinese Communist Party Congress, these government bodies spent the last few months of the year besieged by clamoring interest groups and struggling to issue these vital regulations.

In taxation, the Enterprise Income Tax Law, which took effect January 1, has significantly altered the financial landscape for foreign firms. While the new, unified enterprise income tax rate of 25 percent was widely expected, as the *CBR* went to press, uncertainty surrounds changes to the qualifications for high- and new-tech status (and the preferential 15 percent tax rate that goes with it); withholding tax rates, which are expected to rise to 10 percent; and the extent of tax benefits special economic and development zones will be able to grant under the new law. In the last few months of 2007,

companies scrambled to transfer ownership of China-based legal entities to Hong Kong- and Singapore-based holding companies before the end of 2007, to take advantage of lower withholding tax rates on dividends offered to these jurisdictions under China's tax treaties and to avoid a tax on such asset transfers, which also took effect on January 1.

On the human resources front, the new Labor Contract Law has kept labor lawyers and human resources departments poring over old and new employment contracts and revising employee handbooks. The related Employment Promotion Law has human resources managers reviewing their hiring and recruiting practices and taking a careful look at antidiscrimination provisions. Both of these laws took effect on January 1. The efforts of various localities to raise awareness of the new laws in their jurisdictions—by issuing sample contracts, for example—further complicated the picture for companies still grappling with the changes on the national level.

In mergers and acquisitions, companies have generally learned the ropes and assembled the piles of documentation required for the PRC Ministry of Commerce's merger reviews, which were launched in fall 2006. On August 1, 2008, however, the new Antimonopoly Law will take effect, bringing with it two new government entities under the State Council—the Antimonopoly Authority and the Antimonopoly Commission (see p.46). How these still non-existent bodies will operate—and who will staff them—remains a wide open question, and one relevant to any company with a significant market share or the intention to explore or undertake acquisitions. Recent comments by an NPC vice chair indicating that China plans to pass another 20 regulations on foreign merger and acquisition activity in China even before the law takes effect further clouds an already murky regulatory picture.

### Higher expectations ahead

And then there's the good news. As the US-China Business Council's (USCBC) latest survey of its membership shows, companies are doing well in China (see the *CBR*, November–December 2007, p.54). Largely focused on serving the domestic market, they are increasingly profitable and expanding their investments, operations, and staff. Many have higher margins in China than globally. Conversations with Shanghai-based



# Letter from Shanghai

## *A slew of new laws and murky economic forecasts have made planning for 2008 particularly difficult*

executives in late 2007 indicated that most expected to hit their often quite ambitious revenue targets.

This, of course, means that the bar will be set higher for 2008. As the US economy shows signs of slowing, global management in headquarters will increasingly look to emerging markets for revenue growth and cost savings. China, as one of the fastest-growing emerging markets and the site of choice for low-cost procurement and sourcing, is often the centerpiece of these raised expectations.

For executives on the ground, however, peering at the tea leaves and investment bank reports on China's economy offers little guidance. On the macro level, asset bubbles in stock and property markets and rising inflation are signs of potential overheating, while on the micro level, higher commodity and input costs are raising supplier prices. Wages continue to rise rapidly, especially for key staff, and human resources shortages remain the top concern. Keep your team in the office too late, and it could disappear to any of several hundred other companies that are single-mindedly stalking talent, including direct competitors.

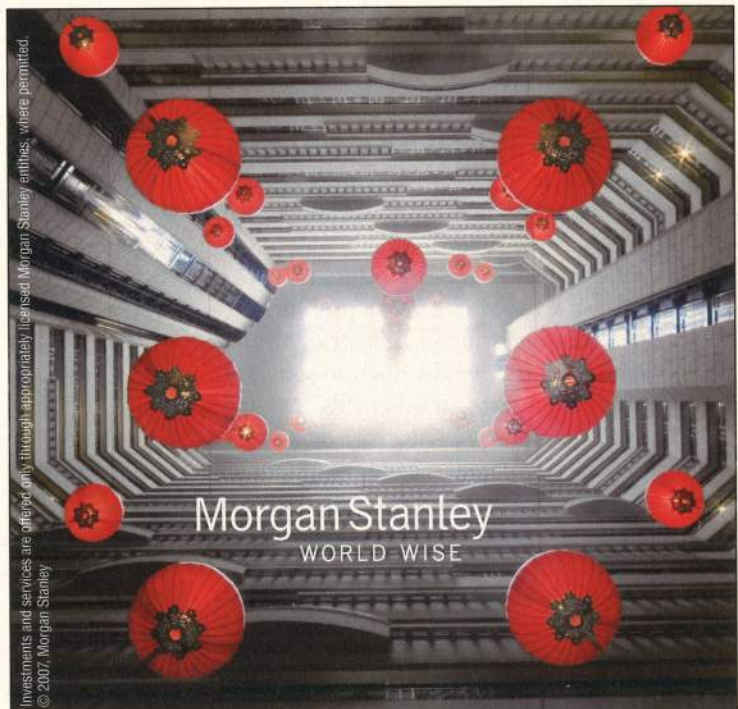
### Hitting the pause button

The annual planning exercise provides a chance to pause from the headlong rush of managing US companies' expansion in the China market. It is a welcome, mandated chance to step back and assess, in a strategic fashion, where a company is going and what potential pitfalls await. From Shanghai, the perspective is still optimistic, but the optimism is more guarded than a year ago. Protectionist rumbles in the United States and China continue, and the height of the US political process—the 2008 presidential election—will likely crank up the heat. All eyes will turn to China for the Beijing Olympics, bringing with it a spike in the scrutiny of China by media, nongovernmental organizations, and other stakeholders (see p.40). A weakening world economy or an overheating China could put pressure on bottom lines.

Whatever 2008 brings, one thing is certain—Shanghai executives can expect more midnight conference calls with headquarters. Though no battle plan remains intact once the first shot is fired, in China a business can consider itself lucky if its plan lasts up to the start date. Fortunately most US businesses here, particularly USCBC member companies, are seasoned veterans of the volatile China business environment, with its ever-changing regulations

and rapidly obsolete projections, and they continue to share information, pool resources, and find creative ways to keep on growing. 完

*Godfrey Firth is chief representative, Shanghai, at the US-China Business Council.*



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## China's 2007 Foreign Investment Guide

**C**hina recently revised its Catalogue Guiding Foreign Investment in Industry to bring foreign investment in the country into closer alignment with the government's policy goals. PRC policymakers have long used the catalogue to manage and direct foreign investment. Similar to the 2002 and 2004 editions, the 2007 catalogue divides industries into three basic categories: encouraged, restricted, and prohibited.

Foreign-invested enterprises (FIEs) in encouraged industries are often permitted to establish wholly foreign-owned enterprises (WFOEs). They are also generally eligible for investment incentives, although China is currently adjusting many preferential policies for foreign investment, particularly tax-related policies. Industries in the restricted category may be limited to equity or contractual joint ventures, in some cases with the Chinese partner as the majority shareholder. Restricted category projects are also subject to higher-level government approvals. Industries in the prohibited category are closed to foreign investment. Industries not listed in the catalogue are generally open to foreign investment unless specifically barred in other PRC regulations.

The revisions present a mixed bag for investors—some industry sectors will see more support and openness, while other sectors will find ownership or other restrictions on new investments. The PRC National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) jointly issued the catalogue, which took effect December 1. The revised catalogue affects new investments approved after its implementation date; the revisions should not affect existing FIEs, according to US-China Business Council conversations with senior PRC officials.

### Highlights of the 2007 catalogue

The 2007 catalogue reflects the PRC government's current policy priorities. In the notice on the release of the catalogue, NDRC and MOFCOM list five major policy objectives for the catalogue:

- To encourage foreign investment while improving the overall quality and industrial composition of investment projects, particularly in high-tech sectors;
- To encourage investment in environmentally friendly and energy-saving technologies;
- To curtail and eliminate policies that "solely" serve to promote exports, to address China's trade surplus;
- To encourage balanced development between the relatively prosperous coast and the less-developed western, central, and northeastern regions; and

■ To protect "national economic security" and only cautiously open sensitive and strategic industries to foreign investment.

These priorities are reflected in some of the catalogue's major changes. For instance, more environmental and energy-saving technologies appear in the encouraged category. New to the catalogue, high-end services sectors—such as logistics and business process outsourcing—have been added to the encouraged category. Significantly more-specific and later-generation technical criteria appear in the encouraged machinery manufacturing sectors. Finally, a general provision that automatically qualified any FIE that exported 100 percent of its production as encouraged has been removed, reflecting recent policies to curb export processing growth.

In addition, certain sectors with significant foreign investment—such as chemicals, auto parts, and edible oil processing—face new restrictions, and long-standing prohibitions on media-related industries—such as print and publishing, film and TV production, and Internet content—remain firmly in place.

Also of note—the catalogue does not make any new openings beyond China's World Trade Organization (WTO) commitments. Areas such as financial and telecom services remain almost entirely unchanged, for instance.

### WTO compatibility

Many foreign companies have been analyzing whether the catalogue complies with existing trade and investment agreements that China has made, most notably its WTO accession documents. The central government's use of a catalogue to detail areas open to foreign investment does not inherently violate WTO commitments. Investment is only covered by the WTO insofar as it affects trade in goods and services; investment issues are usually addressed through bilateral investment treaties.

The 2004 revision brought many elements of its catalogue into line with China's WTO commitments. Many of China's specific WTO commitments in services are reiterated in the 2007 catalogue. For example, China committed in its accession agreement to allow WFOE real estate companies to manage "luxury" hotels but maintains restrictions on foreign real estate companies managing "high-standard" hotels ("high

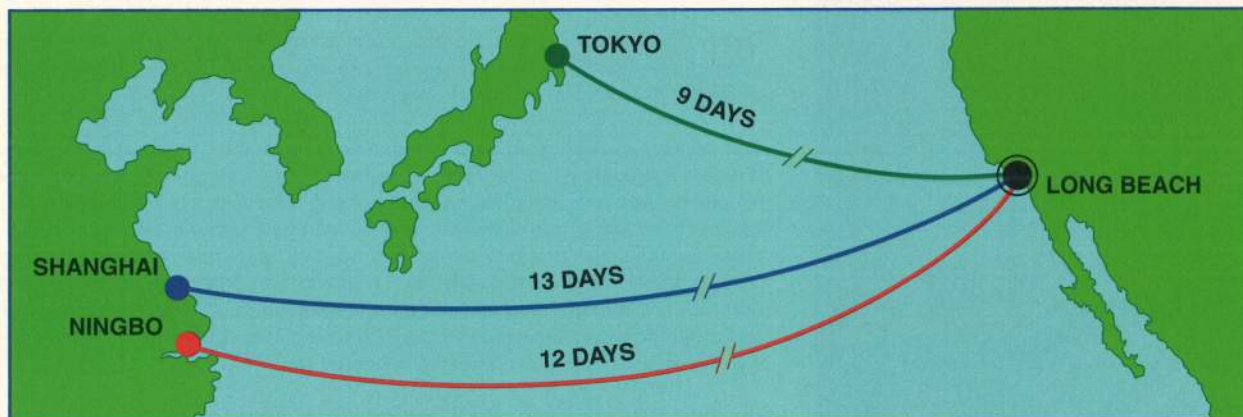
*This article is adapted from news reports that first appeared in China Market Intelligence, the weekly members-only newsletter of the US-China Business Council, publisher of the CBR.*





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standard" is not defined). The 2007 catalogue continues to restrict foreign investment in high-standard hotels and does not mention luxury hotels, meaning that foreign investment is permitted. In financial services, WTO-consistent equity caps on foreign ownership of financial firms—including life insurers (50 percent), securities companies (33 percent), and fund management companies (49 percent)—remain unchanged in the 2007 catalogue. Foreign investment in medical facilities continues to be limited to joint ventures, also part of China's WTO commitments.

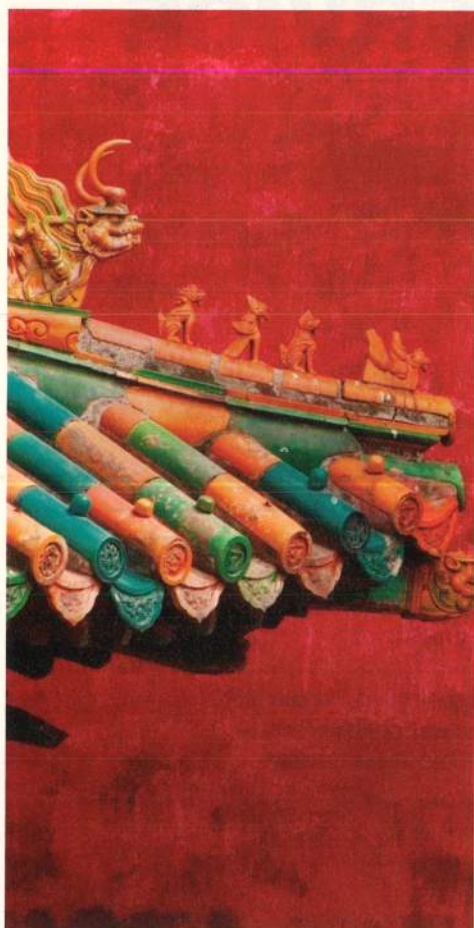
Several areas of the 2007 catalogue are unclear, however. For example, the catalogue maintains restrictions on the extent to which foreign companies may provide value-added and basic telecom services, which is consistent with China's WTO commitments. But the catalogue also prohibits foreign investment in some Internet-based services. Since China's WTO commitments do not specifically mention Internet-based services, which many companies consider a telecom service, it is unclear whether the prohibition on foreign companies providing Internet-based services is WTO-inconsistent.

Distribution is another area that needs clarification. Since December 11, 2006, China has allowed WFOEs to engage in wholesaling of certain products, such as vegetable oils, autos, and chemical fertilizers, in accordance with its WTO commitments. The 2007 catalogue appears to reiterate restrictions from earlier editions of the catalogue that limit wholesaling of these products to majority Chinese-controlled joint ventures. If this is the case, then such a restriction would violate China's WTO commitments.

## Translations of the 2007 catalogue

China has posted both the original catalogue in Chinese ([www.ndrc.gov.cn](http://www.ndrc.gov.cn)) and its English translation ([www.fdi.gov.cn](http://www.fdi.gov.cn)).

USCBC members can access a more detailed version of this article, as well as an unofficial translation that shows changes between the 2004 and 2007 catalogues, at [www.uschina.org](http://www.uschina.org). 完



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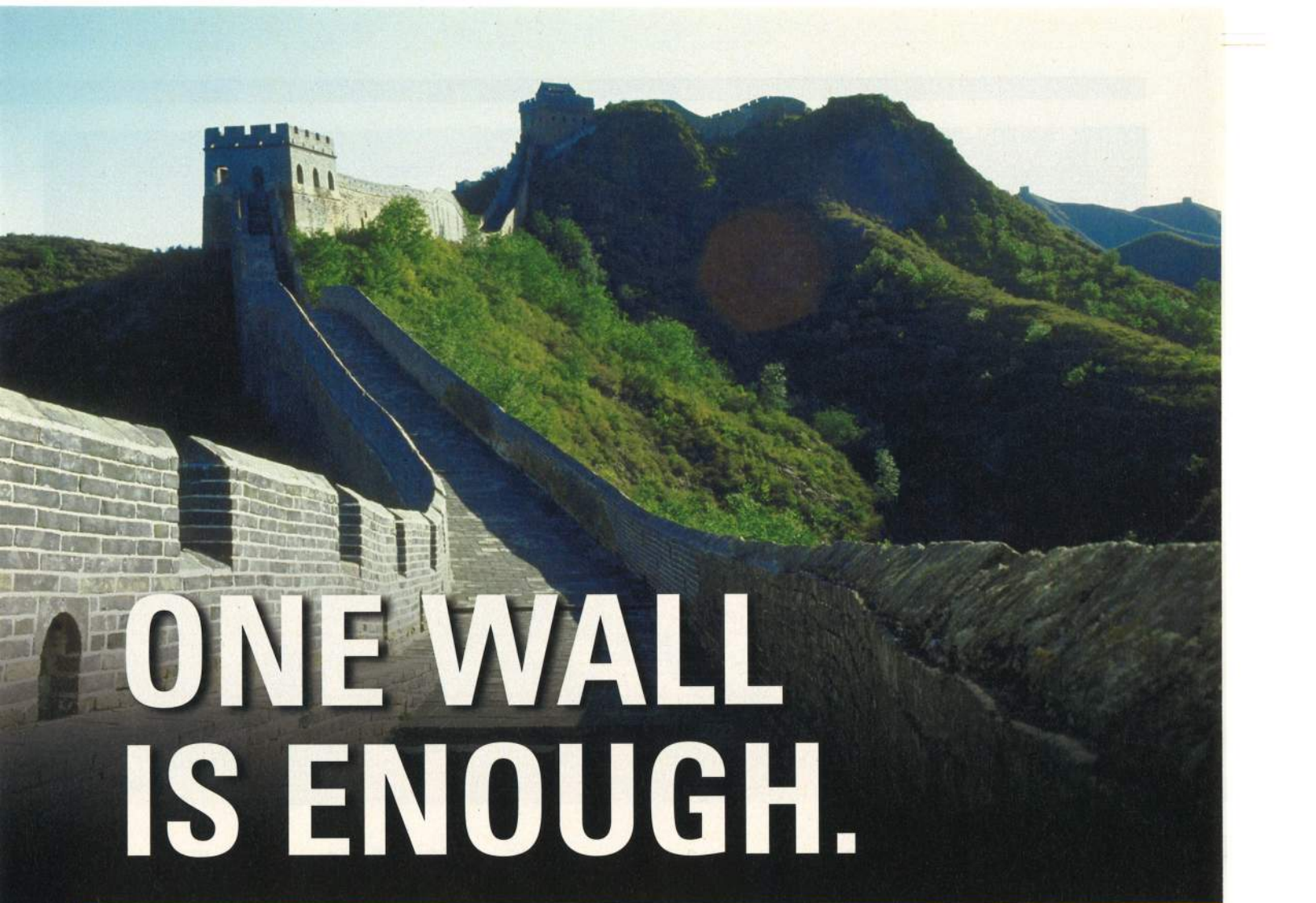
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China FourPress

# Who's Cleaning Up This Mess?

Rising environmental awareness is affecting business in China

Charles R. McElwee II

**T**he consequences of 20 years of China's "produce now, clean up later" growth model fill today's headlines. Beijing's new skyscrapers are shrouded in smog and sit on a depleted aquifer. China's rivers—when they flow at all—run black and red, and thousands of acres of once productive farm land have turned into desert or been contaminated with hazardous wastes. All layers of Chinese society now realize that an environmental crisis exists. Private citizens, the press, and some segments of the PRC government are demanding that something be done. Though PRC officials are still contemplating what that something will be, some of the ways that rising environmental awareness in China will affect foreign-invested enterprises (FIEs) are clear.

## New environmental laws and regulations

China has already enacted a comprehensive set of environmental laws. The statutory scheme is not perfect, however.

For instance, penalties for noncompliance with some of China's environmental laws are so low that it is often cheaper not to comply and pay fines than to undertake the actions necessary to meet the statutory mandates. In other instances, companies have disregarded statutory requirements because the PRC government has not yet issued implementing regulations. But China's lawmakers cannot be entirely blamed for the current state of the environment; China's law enforcers—and the lack of a compliance ethic among Chinese businesses—are the chief culprits.

Though China lacks environmental enforcement—not environmental laws—the PRC government apparently views the promulgation of more laws and regulations as a big part of the solution. The pace of legislative and regulatory activity in China's environmental arena has increased dramatically over the past two years (see Table). Numerous agencies, in addition to the PRC State Environmental Protection Administration (SEPA), are churning out ever-stricter regula-



tions and standards in the name of environmental improvement (see p.22). Every aspect of operating in China now has some environmental component: from making a corporate acquisition, buying property, designing a facility, or selling a product to dealing with products on a post-consumer basis. Simply building a plant that will make or use hazardous substances (which are broadly defined in China) can require five separate permits. Keeping up with this barrage of new laws and regulations can be the biggest environmental challenge that FIEs in China face today.

Many of the new laws reflect the shift that has been taking place in China's national environmental policy over several years. Given the country's high economic growth rates, China will be unable to significantly reduce total pollutant discharges in the future by simply enforcing the end-of-pipe regulations that have traditionally formed the backbone of its environmental regulatory system. For example, even if all existing coal-fired power plants complied with China's current sulfur dioxide (SO<sub>2</sub>) emission limits and cut their emissions by 10 percent, total year-on-year SO<sub>2</sub> emissions would still rise if new coal-fired generation increased at an annual rate higher than 10 percent.

In an attempt to change this bleak reality, China has shifted its environmental regulatory model from "command and control" (where the control component was often ignored) to "sustainability," or, as it is known in China, "the circular economy." This model relies more on EU and Japanese precedents than on the less-developed US "sustainability" concept. China took its first significant step in this direction when it passed the Clean Production Law, which took effect in January 2003. This law requires companies building or upgrading a production line to replace hazardous raw materials with non-hazardous ones in its products and adopt production processes and equipment with high resource utilization rates and little pollutant generation. Where economically and technically feasible, facilities must recover and use their own production wastes and waste heat or transfer these wastes to other facilities or persons with the ability to use them. Articles 27 and 28 of the law impose post-consumer recycling obligations on companies with products listed in a compulsory recycling directory and require companies that use or discharge toxic or hazardous materials to conduct periodic "cleaner production audits."

The PRC National People's Congress reviewed the draft Circular Economy Law in September 2007. The law, which may pass in 2008, aims to significantly reduce production- and consumption-related waste by promoting recycling and the reuse of materials; it will reinforce and strengthen the requirements of the Clean Production Law and impose sever-

al new sustainability requirements on companies. According to the draft law, such requirements include implementing water-saving plans; adopting advanced water-saving technology, processes, and equipment; and employing advanced recovery technology and equipment to achieve a comprehensive utilization of residual heat and pressure from the production process.

Finally, China has set ambitious energy efficiency goals and has enacted legislation (including recent amendments to the Energy Conservation Law) to achieve these goals.

China wants to increase energy efficiency per unit of gross domestic product by 20 percent from 2005 to 2010. The results to date have not been particularly encouraging (the yearly reduction targets were not met in 2005 or 2006), but the central government has confirmed that it will not rescind the goal. In fact, central government officials are eager to push local officials to comply with the energy efficiency goal. Beijing believes that energy efficiency can be achieved without sacrificing economic growth and can help moderate

China's growing reliance on imported oil. Consequently, meeting energy efficiency improvement targets has become an important component in the factors used to evaluate local political leaders, and energy efficiency mandates are finding their way into many regulations and policies.

## Enforcement

If one factor had to be identified as the cause of China's environmental crisis, it would be lax enforcement of the existing environmental laws—the practical manifestation of the "clean up later" policy. Over the past two years, central authorities have repudiated the clean up later model and demanded that government agencies at all levels get tough on polluters. Actions to back up this rhetoric have been tentative to date: Certain environmental metrics (SO<sub>2</sub> and chemical oxygen demand) have been added to the criteria used to evaluate local political cadres, SEPA has set up regional offices to increase national oversight of local environmental officials, and bank loans in certain sectors have been tied to proof of environmental compliance. Though the central government's steps are encouraging, they are likely to produce only slow, incremental, and geographically uneven increases in local enforcement levels; China's more economically developed coastal regions will generally be stronger enforcers than less-developed western regions.

Western companies that invest in China usually subscribe to corporate social responsibility principles that require them to comply with the environmental laws and regulations of the countries where they operate, regardless of whether those laws are enforced. Thus, improved enforcement should not

## Quick Glance

- China's government, people, and media are all paying more attention to the environment.
- Foreign companies must do more than merely comply with environmental regulations, or they may find themselves the center of unwanted attention.



significantly affect the China operations of most FIEs. Anecdotal evidence suggests that FIEs are sometimes the first targets when local officials feel the need to show they are "getting tough" on polluters, however.

On balance, whether stronger enforcement efforts in China increase costs for an FIE probably depends on whether its operations in China are primarily engaged in supplying the domestic market or in exporting products. FIEs that supply the domestic market often welcome efforts to achieve more universal compliance because such efforts help level the playing field by ensuring that domestic competitors pay their share of environmental compliance costs.

## China's Major Environmental Laws and Regulations

Law/Regulation	Effective Date
Environmental Protection Law	1989
Law on Prevention and Control of Environmental Pollution by Solid Waste	1995; amended 2005
Law on Prevention and Control of Atmospheric Pollution	1995; amended 2000
Law on Prevention and Control of Water Pollution	1996
Law on Prevention and Control of Pollution from Environmental Noise	1997
Energy Conservation Law	1998; amended 2008
Regulations on Labor Protection in Workplaces Where Toxic Substances Are Used	2002
Impact Assessment Law	2003
Clean Production Law	2003
Renewable Energy Law	2006
Administrative Measures on the Control of Pollution Caused by Electronic Information Products (also known as China's RoHS)	2007
Regulations on Waste Electrical and Electronic Equipment	Forthcoming
Circular Economy Law	Forthcoming

Sources: Charles R. McElwee II; *China Law & Practice*, April 2007

## PRC Environmental Regulators

The PRC State Environmental Protection Administration (SEPA) is China's top environmental regulator. In 1998, it was upgraded into a full ministerial-level agency, but not given cabinet status. SEPA has less than 300 employees at its Beijing headquarters and only 2,200 total employees on its payroll. (Local environmental protection bureaus [EPBs], which are not on the SEPA payroll, have additional staff.)

Except for high-profile matters, SEPA is not directly involved in enforcing environmental regulations or in issuing permits to regulate pollutants. Such tasks are handled by EPBs, which exist at the provincial, municipal, county, and township levels. Though they take direction from SEPA, the local EPBs are funded, and thus controlled, by local government authorities.

—Charles R. McElwee II

For exporters, to the extent that environmental compliance raises costs in China generally, it could result in higher costs of materials or products purchased from Chinese suppliers.

## Power to the people

Government actions make up only half of the effort to improve China's environment today. Ordinary citizens and the press have also entered the stage as major actors, and their effect on environmental operations in China can be significant.

In the last few years, citizens have protested against pollution sources that acutely affect their health or livelihoods. These protests, some of which have taken the form of civil disobedience, are generally aimed at state-owned enterprises (SOEs) and reflect, at least in part, the public's frustration with its inability to achieve effective redress through formal channels. In fact, citizens can employ several legal mechanisms to stop harmful pollutant discharges and obtain restitution for past harm. Though these mechanisms may be ineffective against politically powerful SOEs, they may be effective against FIEs.

For example, in China, individuals injured by solid waste can seek recovery of their damages in a lawsuit where the burden of proof is placed on the defendant—the generator of the solid waste. In other words, to avoid liability in China the defendant must prove that there was no connection between its solid waste and the plaintiff's injuries. (This contrasts sharply with US environmental tort jurisprudence, where the burden of proof lies with the plaintiff.) Moreover, several of China's environmental statutes provide a cause of action similar to a private nuisance action in the United States. These actions are of particular concern to facilities that were initially constructed in relatively unpopulated areas but are now in the path of encroaching residential developments.

While many of the civil protests in China to date have involved existing polluting facilities, some protests herald an incipient NIMBYist ("not in my backyard") attitude on the part of the Chinese public. For instance, in spring 2007, thousands of street demonstrators in Xiamen, Fujian, protested against plans by a private entity to build a new petrochemical plant in an industrial zone near the city center. Although the government strongly discourages such protests, it has recently encouraged, through new SEPA regulations, greater public participation in the environmental impact assessment process, which is required before constructing projects in China. Consequently, when building a new facility or expanding an existing one, companies should engage and seek to address the concerns of neighbors, who are becoming newly emboldened and empowered stakeholders.

Like many other countries, China publicizes the names of entities that violate its environmental laws; generally, China's local environmental protection bureaus release the information. In 2007, the Institute of Public and Environmental Affairs (IPEA), a nongovernmental organi-



zation with ties to SEPA and other government organizations, published lists of companies that reportedly violated China's water pollution law. Although the number of US companies on the list is small (less than 1 percent of the total) and the violations ascribed to them mainly involve temporary problems such as equipment malfunctions or other one-off events (not systematic flouting of China's environmental laws), these companies, along with a handful of other multinational corporations, have been singled out by the domestic and foreign press.

This focus on FIEs by the Chinese press has increased in intensity in recent months, in part as a reaction to the perceived unfairness of foreign press reports that have highlight-

ed recent lapses in food and product safety by Chinese companies. As a result, the notion that FIEs are no longer models of environmental citizenship is gaining traction in China. Leading Chinese environmentalist and IPEA Director Ma Jun said in an August 2007 *Environmental Leader* article: "These enterprises are serious towards environmental protection at home, but their Chinese subsidiaries here seem to have slackened their efforts."

An even more troublesome proposition that is attracting Chinese and foreign believers attempts to blame a large part of China's environmental degradation on US consumers (or

*Continued on page 45*

## Environmental Compliance Strategies

To manage environmental compliance efforts effectively in China, foreign-invested enterprises (FIEs) should consider taking the following actions.

### **Assume responsibility for the environmental impact assessment (EIA)**

FIEs undertaking a project in China with a local joint venture (JV) partner should take responsibility for arranging the EIA, because the local partner may not have all environmental impacts adequately assessed or may use unpalatable means, by Western standards, to obtain regulatory approvals. These actions can cause delays in project approval or potential problems in subsequent plant operations. The EIA should be performed correctly in the first instance, and all applicable approvals and permits should be obtained based on a full review of the project's environmental impacts.

### **Employ a China environmental manager**

FIEs should also employ a China environmental manager who reports directly to the global headquarters' environmental or environmental health and safety department. The manager should be responsible for all China operations—across business groups, product lines, and business types (such as wholly foreign-owned enterprises and JVs). Simply staying abreast of China's rapidly changing regulatory regime can be a full-time job, and creating a corporate-

level position responsible for environmental compliance will free each plant or business line from the task of creating its own environmental-knowledge base and developing its own environmental management system. This manager should coordinate with the company's local government affairs department to ensure that all applicable regulatory developments are tracked.

### **Closely monitor plant-level compliance efforts**

FIEs would also do well to implement a mechanism to ensure that plant-level environmental personnel fulfill their environmental responsibilities and report the results of their efforts to the China environmental manager. This can be accomplished by defining a number of performance outputs, such as daily wastewater monitoring reports, derived from the responsibilities of each individual in the environmental compliance chain. A number of contractors provide environmental reporting software tailored for China.

Audits of environmental performance at all facilities should be undertaken on a regular basis. An environmental audit is a systematic check to establish whether all activities are being carried out in accordance with the environmental management system. Audits—performed either by internal teams or outside auditors—should cover both local and corporate-wide environmental standards.

### **Get employees involved and keep the neighbors happy**

Companies must develop training programs to ensure that all staff comply with environmental standards. Training must occur across all levels of the organization, from senior management to the staff responsible for the daily operation of pollution-control equipment. For US-listed corporations, training should include the applicable provisions of the Foreign Corrupt Practices Act (see the *CBR*, November–December 2006, p.22).

Companies should encourage all employees to become involved in environmental management, compliance, and innovation. Experience has shown that a significant amount of environmental innovation originates with "shop floor" employee recommendations.

Though plants that flout environmental regulations run a high risk of conflict with their neighbors, plants that operate within permit limits may also find that their neighbors do not like the smells coming from the plant. Unless these issues are resolved they can lead to lawsuits—where compliance with the applicable law is not necessarily a defense. Companies should cooperate with neighborhood groups to address any concerns they may have before conflicts escalate into formal complaints to regulators or lawsuits.

—Charles R. McElwee II







# A Market Solution

Instituting market-based mechanisms may be an effective way to address China's environmental woes

Richard L. Sandor

**E**merging economies struggling to balance the need for economic development with the need for a cleaner environment are beginning to consider market-based mechanisms such as emissions trading to address local air quality and global climate change. These emerging markets, particularly China, bring new responsibilities, risks, and opportunities for corporations and traders. The International Energy Agency reported in its 2007 *World Energy Outlook* that China will become one of the biggest contributors to global increases in energy use and emissions by 2030. The report notes that China will surpass the United States in energy consumption by 2010 and that projected sulfur dioxide (SO<sub>2</sub>) emissions will rise from 26 million tons in 2005 to 30 million tons in 2030. China is turning to these pressing environmental issues with a heightened sense of urgency, and market-based mechanisms could serve as a useful tool to address them.

Over the last 40 years, futures trading has undergone subtle but important changes. It has expanded from trade in primary commodities to incorporate financial commodities, such as interest rate and currency futures and stock index futures. Financial markets are now beginning to address environmental issues, and environment-related trading holds great market potential.

## The global carbon trade market

As the issue of global warming receives intensified and sustained attention from corporate leaders to academics and average citizens, market-based mechanisms such as emissions trading—which allows companies and other entities to buy and sell “credits” earned from emission reductions pursuant to an emissions cap—have become widely accept-

### Quick Glance

- Projected to become the biggest emitter of greenhouse gases in the next decade, China is looking for various solutions, including market-based mechanisms, to address its pressing environmental concerns.
- Creating a market for emissions trading could help to achieve China's twin goals of curbing pollution and perpetuating economic growth.
- Any design for an emissions exchange market should take into account flexibility, transparency, enforcement, and coordination among government bodies.

ed as a cost-effective method of addressing climate change and other environmental concerns. Market-based mechanisms are tools that can complement regulatory systems by providing price transparency, reliability, and flexibility.

The global market in greenhouse gases (GHGs), sometimes also referred to as the “carbon market,” was valued at more than \$30 billion in 2006, a 200 percent jump over 2005 figures, according to the World Bank, and daily traded volume averaged about 4.4 million metric tons, worth roughly \$100 million. The Chicago Climate Exchange (CCX) (see p.26) saw its traded volume soar from 10.8 million metric tons of carbon dioxide (CO<sub>2</sub>) in 2006 to more than 17.4 million in 2007. The global carbon market is also attracting diverse entrants—from small entrepreneurs in India to

farmers in Cambodia—all of whom are exploring the possibility of entering the global GHG market, often through the creation of mitigation or offset programs.

This surge of interest is occurring in mandatory compliance markets, such as the EU Emissions Trading Scheme (ETS), and CCX's legally binding voluntary programs, signaling that global markets for emissions trading may be maturing.

## Will China embrace market-based environmental solutions?

With CO<sub>2</sub> emission levels projected to account for more than one-quarter of the global total by 2030, China is looking for ways to curb emissions (see p.27). One successful program it has been studying is the US cap-and-trade program for SO<sub>2</sub>. In 1995, the United States established a cap-and-trade system to reduce SO<sub>2</sub> emissions, which cause acid rain, under the 1990 US Clean Air Act Amendments.



## The Chicago Climate Exchange

Established in 2003 as the world's first, and North America's only, multinational and multi-sector marketplace for reducing and trading greenhouse gas (GHG) emissions, the Chicago Climate Exchange (CCX) is a voluntary but legally binding program that allows participants to reach their emissions-reduction objectives through onsite emissions-reductions, allowance trading, and the use of various tradable offset projects. (The CCX Environmental Compliance Committee oversees member compliance with reduction targets. Members that do not meet the targets must purchase Carbon Financial Instrument contracts through CCX to meet their annual reduction requirements.)

CCX has a diverse membership, boasting more than 360 global entities. Members fall into three categories: emitters, who commit to reduce their emissions; indirect emitters, who commit to offset their energy use; and other participants, including offset and liquidity providers. The exchange's members span four continents, and they have already cut their emissions by more than 23.5 million metric tons of carbon dioxide worldwide. Recent expansion in CCX membership means that the program's legally binding reduction commitments—4 percent below baseline (annual average emissions from 1998–2001) during Phase I (2003–06) and 6 percent below baseline during Phase II (2007–10)—now cover 540 million metric tons of carbon dioxide equivalent, which is more industrial GHG emissions than any other national emissions-reduction program. Phase III is currently in the nascent stage of planning.

The CCX offset model includes projects in forestry, agriculture, renewable fuels, and fuel efficiency and allows rural areas to bring environmental projects to the market and participate in new income opportunities. Not only can such mitigation projects help address climate change challenges, they can also be significant sources of income in poor and rural areas. In fact, reducing poverty is a key goal of the Clean Development Mechanism (CDM), which was established through the Kyoto Protocol to allow developing countries to establish GHG

mitigation projects that would also generate revenue through the sale of carbon credits and increased local investment.

Meanwhile, CCX has registered several projects—including innovative approaches to energy efficiency and heat recovery—provided by PRC enterprises that, for various reasons, do not fall under the CDM framework or timetable. This serves CCX's broader goals of building market institutions and infrastructure, developing human capital in environmental trading, and sustaining a viable multi-sector and multinational system for GHG emissions trading.

CCX and its participants are currently building the infrastructure and market mechanisms that can provide price signals and incentives for industry to shift toward cleaner and more efficient use of energy to reduce GHG emissions. Price transparency provided through CCX's electronic trading platform helps businesses, governments, and entrepreneurs to gauge investment return and the value of innovation. In fact, entrepreneurs have already used CCX prices to secure investment to finance promising new technologies. Existing businesses can also gauge which investments will yield the highest level of GHG emission reductions at the lowest cost.

### Case Study: CCX's Experience in the United States

In the United States, CCX provides an effective vehicle for farmers and foresters to deliver GHG emissions-reduction credits from carbon sink activities to the market place. Through the agricultural offset program, more than 1 million acres of conservation tillage and grassland in several midwestern states have been registered, verified, and sold through the exchange, as well as several agricultural methane destruction projects. The forestry offset program includes standardized protocols for reforestation, afforestation, and avoided deforestation. In addition to several commercial forest companies, CCX currently has forest offsets registered in Costa Rica. These programs—along with emission audits, CCX's electronic trading platform,

and a self-governance system—form an end-to-end carbon market infrastructure for participants of the exchange.

CCX is also active in the market for criteria pollutants—six common air pollutants including carbon monoxide and sulfur and nitrogen oxides—covered by the mandatory cap-and-trade program created under the US Clean Air Act Amendments in 1990. CCX's wholly owned subsidiary, the Chicago Climate Futures Exchange (CCFE), is the world's first environmental derivatives exchange that handles the criteria pollutants market. As the market developed, market participants needed hedging tools to manage risk in a cost-effective way. CCFE currently offers standardized and cleared Sulfur Financial Instrument futures and options contracts and Nitrogen Financial Instrument futures and options contracts. CCFE's participants may secure transparent pricing, standardized futures, and options contracts on an anonymous electronic trading platform. The hedging tools offered by CCFE, including prompt and deferred years for both futures and options, have increased liquidity and eased volatility in the sulfur dioxide market. To date, the sulfur dioxide program has formed a solid institutional base in terms of compliance, trade, and environmental performance.

### A nascent market with potential

Participants in CCX have achieved significant reductions and gained practical experience in building an efficient emissions management and monitoring system. The recent successes of CCX and other similar exchanges mark what many analysts consider the beginning stage of a global GHG market that is destined to blossom into one of the biggest financial markets in the world. Given China's increasing emphasis on energy efficiency, renewable energy, and improved air quality, the adoption of market-based mechanisms could offer a flexible and cost-effective path to achieving the twin goals of maximum environmental benefit and economic growth.

—Richard L. Sandor



Under the cap-and-trade program, total emissions are capped, and polluting entities are allotted an emissions quota. Entities that emit less than their quota may sell the remainder to those that emit more than their quota, thus creating an economic incentive to reduce emissions.

enue but also increase energy efficiency. A cap-and-trade program would provide critical flexibility, price transparency, and a rules-based system to support sales of project-based credits from China and help expand the nation's knowledge of energy efficiency and emission reductions.

## Market-based mechanisms complement regulatory systems by providing price transparency, reliability, and flexibility.

According to the US Environmental Protection Agency (EPA), the program in 2005 had reduced SO<sub>2</sub> emissions by more than 5.5 million tons from 1990 levels, or roughly 35 percent of total emissions in the power sector. While the program will cost about \$3 billion per year by 2010, the environmental and health benefits will total more than \$100 billion, according to the EPA.

China could also use such a cap-and-trade program to address its mounting GHG emissions. Such a program would not only help Chinese industries generate new rev-

China understands the GHG problem, has ratified the Kyoto Protocol, and actively participates in the Clean Development Mechanism, one of three mechanisms under the Kyoto Protocol that allows participants to earn "certified emission reductions" based on their carbon-reduction efforts (see the *CBR*, November-December 2002, p.26).

In recent years, China has notably stepped up its focus on the environment, driven by increasing incidents of public unrest related to pollution as well as statistics that show the poor state of its environment (see p.30). There

### Emissions Trading in China

China has been researching various emission trading schemes since the early 1990s and has collaborated extensively with the US Environmental Protection Agency (EPA). In the last decade, China set up several pilot programs to trade sulfur dioxide emissions, notably in Benxi, Liaoning; Taiyuan, Shanxi; and Nantong, Jiangsu. The programs in Benxi and Nantong, part of a cooperative project between the PRC State Environmental Protection Administration (SEPA), EPA, and the US-based nongovernmental organization Environmental Defense, were later extended to four provinces (Henan, Jiangsu, Shandong, and Shanxi) and three cities (Liuzhou, Shanghai, and Tianjin), according to a May 2003 report from the US embassy in Beijing.

In February 2007, the United Nations Development Program (UNDP), the PRC Ministry of Science and Technology, and the PRC Ministry of Commerce jointly announced a project to expand the Clean Development Mechanism (CDM) Framework in 12 western provinces. The

\$1.7 million project, largely funded by ArcelorMittal, will establish CDM technical service centers in the 12 provinces. The project aims to improve access to sustainable resources in western China and "use carbon trading as a tool to generate income for impoverished communities in China's western region by increasing investment and job opportunities through promoting 'green' industry," according to a UNDP press release.

The Beijing Equity Exchange also announced in November 2007 plans to set up an exchange to handle environmental pollutants. No timeline was given for the exchange's establishment. Also in November, China established its first CDM fund, which will be managed by the Ministry of Finance and will receive \$3 billion from the \$15 billion generated by the 885 CDM projects currently in China, according to official reports. These projects—which are expected to provide more than 1 billion metric tons of carbon credits—aim to improve energy

efficiency and use clean technology to generate power.

#### More work to be done

These pilot projects have given China some emissions trading experience, but the country likely still needs to take several steps before it can set up an effective trading system. First, analysts seem to agree that China needs a formal legal structure for emissions trading, including an effective compliance system. As with other laws in China, enforcement will be crucial. Beijing will also have to establish a quota-allocation method, a national registry or tracking system for quotas, and a way to measure and verify emissions. For trading schemes that involve the power sector, price reform is also an issue. Finally, an effective trading system will require consistent coordination among government actors at all levels.

—CBR staff



is considerable interest in and enthusiasm for, developing market-based solutions to environmental issues in China, as shown by the numerous studies conducted by Chinese and international experts over the years on the use of

and PRC objections to mandatory GHG reduction levels proposed by the European Union, reports have emerged that indicate a compromise may soon be reached and a final agreement signed.

## A cap-and-trade program would help Chinese industries generate new revenue and increase energy efficiency.

market-based mechanisms to address problems such as SO<sub>2</sub> emissions and the impact of GHGs. Perhaps a sign of growing interest in emissions trading exchanges in China, Beijing Shenwu Thermal Energy Technology Co. Ltd. joined CCX in 2006 as its first China-based member.

As the *CBR* went to press, the 13th United Nations Climate Change Conference was convening in Bali, Indonesia. The international community assembled at the conference will likely look to China to play a leading role in addressing the issue of climate change. Despite initial US

If China decides to pursue a route that takes market-based solutions as part of its overall emissions-reduction strategy, any market design must take into account specific Chinese economic conditions and provide structures to ensure price transparency, effective monitoring and enforcement, and other attributes of a functioning market. 完

*Richard L. Sandor is chair and chief executive officer of the Chicago Climate Exchange. Sandor is also a member of the International Advisory Council of Beijing University's Guanghua School of Management.*



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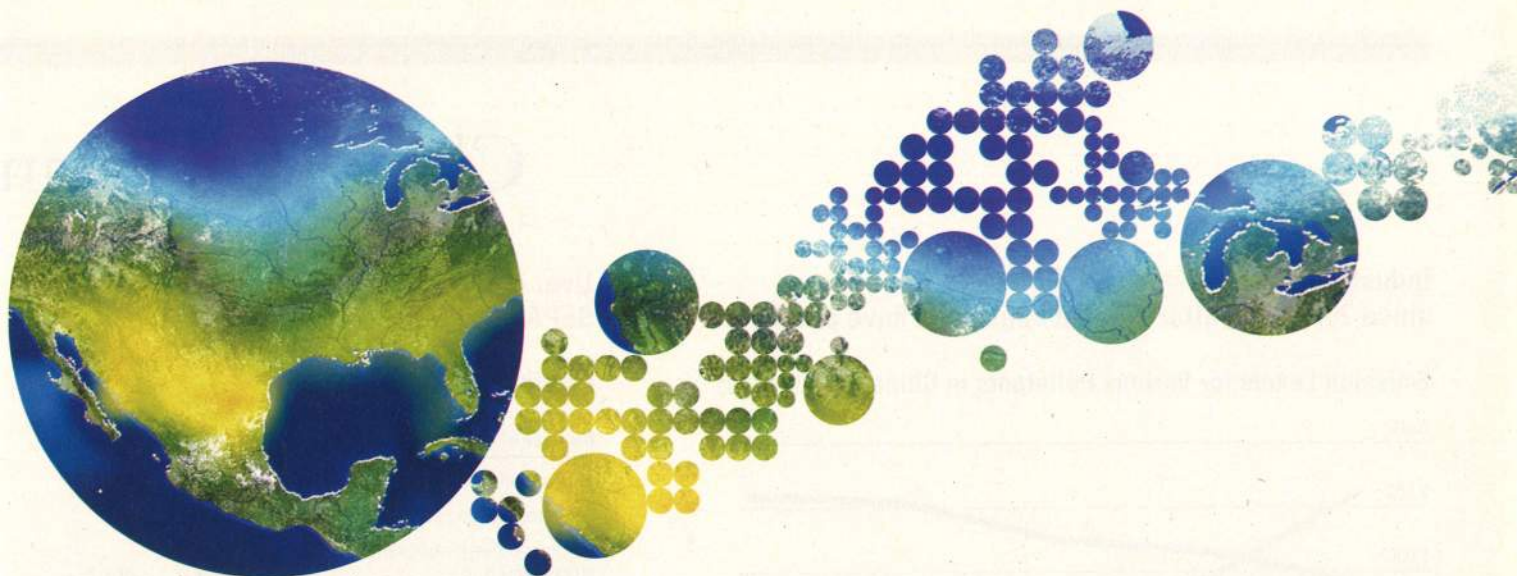
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climate change and  
the demand for energy.

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we have to address both.

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- Initiated the Global Climate and Energy Project (GCEP) at Stanford University to identify technologies in areas such as solar, hydrogen,

biofuels, advanced transportation and carbon capture and storage. GCEP now funds research programs in the United States, Europe, Australia and Japan.

- Reducing emissions through new high-efficiency processes and technologies at our own facilities
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Balancing energy demand with the risks of increased emissions is a huge challenge. But with consumers, policymakers and industry all playing their part, we can keep things moving forward.

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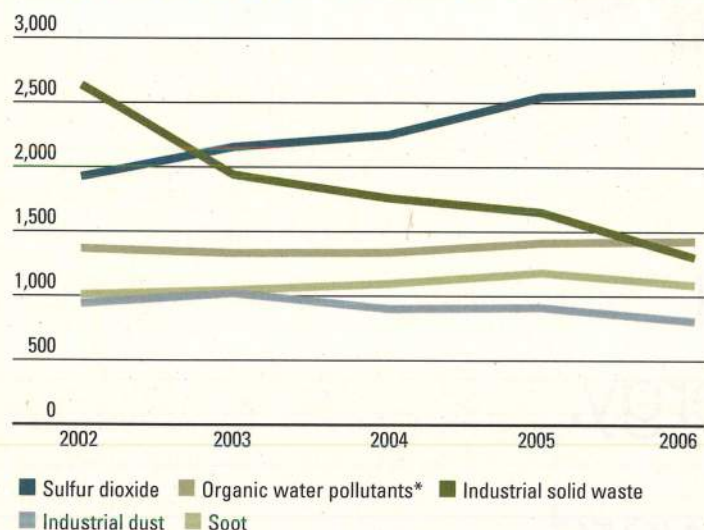
Taking on the world's toughest energy challenges.™



# China's Environment

**Industrial solid waste has fallen sharply since 2002, but sulfur dioxide emissions have climbed.**

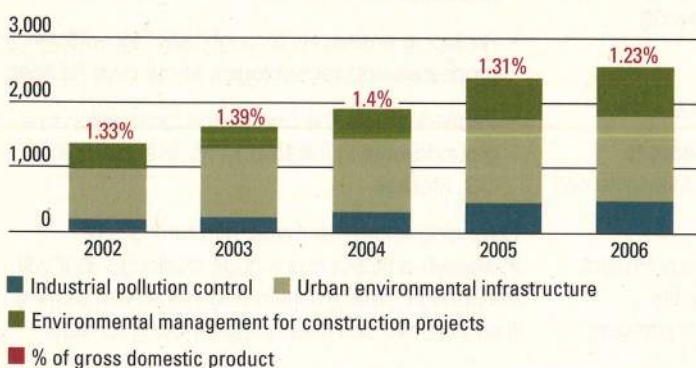
**Emission Levels for Various Pollutants in China (10,000 tons)**



Note: \*Measured in terms of chemical oxygen demand.

**China has spent more on combating pollution, but that spending has shrunk as a percentage of GDP.**

**Investment in Environmental Protection (RMB 100 million)**



**Over the last few years, SEPA has stepped up its activities...**

**Environmental Regulations**

Number of	2005	2006	% change
SEPA regulations enacted	6	7	16.7
Local regulations promulgated	30	38	26.7
Administrative punishments implemented	93,265	92,404	-0.9
Administrative cases reconsidered	211	208	-1.4
Cases resulting in administrative fines	10	15	50.0
Litigation cases closed	399	353	-11.5
Criminal cases closed	2	4	100.0

**...which may explain the decline in pollution incidents.**

**Environmental Pollution Incidents**

	2005	2006	% change
Water pollution	693	482	-30.4
Air pollution	538	232	-56.9
Oceanic pollution	19	10	-47.4
Solid waste pollution	48	45	-6.3
Noise pollution	63	6	-90.5
Other	45	67	48.9
<b>Total</b>	<b>1,406</b>	<b>842</b>	<b>-40.1</b>
<b>Economic loss (RMB million)</b>	<b>105.2</b>	<b>134.7</b>	<b>28.0</b>

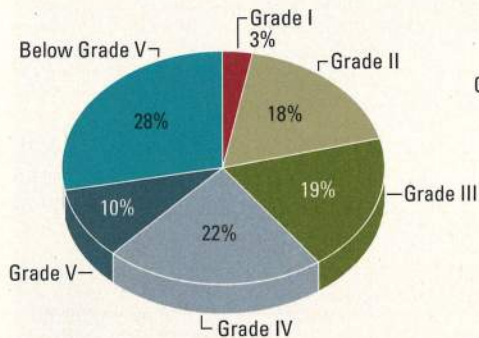
Note: Does not include losses from the Songhua River pollution incident.



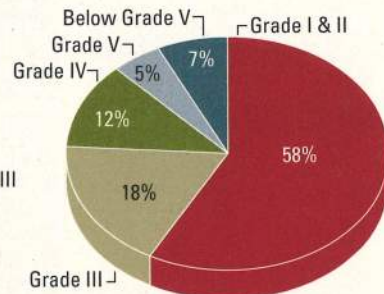
# Environmental Report Card

## Water, water, everywhere, but few drops to drink.

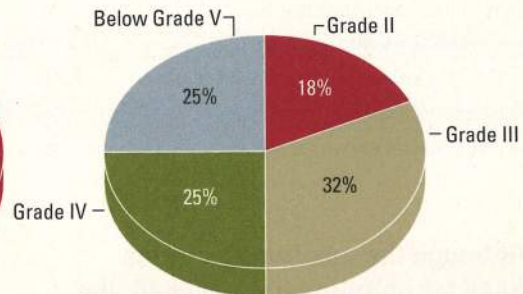
### Freshwater Quality, 2006



### Yangzi River Water Quality, 2006



### Yellow River Water Quality, 2006



Grade I = Spring water; water from national nature preserves

Grade II = Medium-grade drinking water; appropriate for aquaculture

Grade III = Inferior-grade drinking water, appropriate for certain types of aquaculture

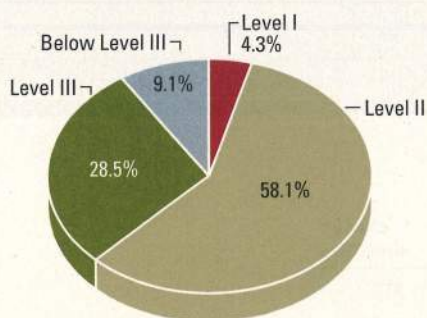
Grade IV = No direct human use; appropriate for use in most industries

Grade V = No direct human use; appropriate for use in agriculture

Below Grade V = Not appropriate for human use

## Few Chinese cities score high on air quality, and Beijing's not one of them.

### Urban Air Quality, 2006\*



Note: \*Includes 559 cities throughout China.

Level 1 = Good air quality

Level 2 = Moderate air quality

Level 3 = Bad air quality



Liu Jianfeng/China Foto Press



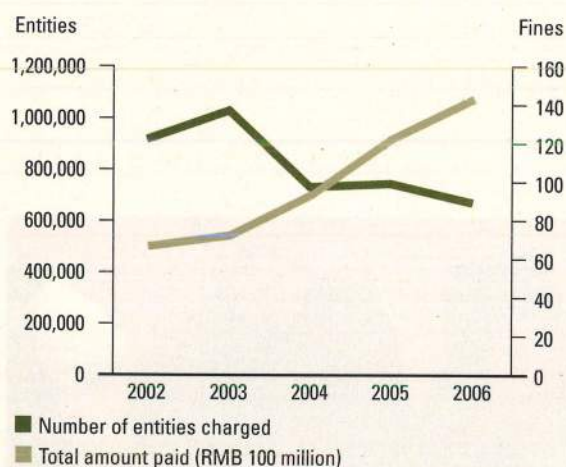
**Although the number of environmental agencies and personnel has grown at every level, lax local enforcement continues to hinder environmental protection.**

#### Environmental Agencies and Personnel at Various Levels

	2006			
	National	Provincial	City	County
Environmental protection agencies	41	352	2,005	7,680
Environmental monitoring stations	1	39	396	1,886
Environmental review agencies	1	32	404	2,366
Personnel in environmental protection organs	2,065	10,911	43,084	109,839
Environmental monitoring personnel	108	2,825	16,143	28,613
Environmental review personnel	45	772	9,169	42,859

**Although the number of entities fined for pollution has dropped, the total amount of fines collected has risen.**

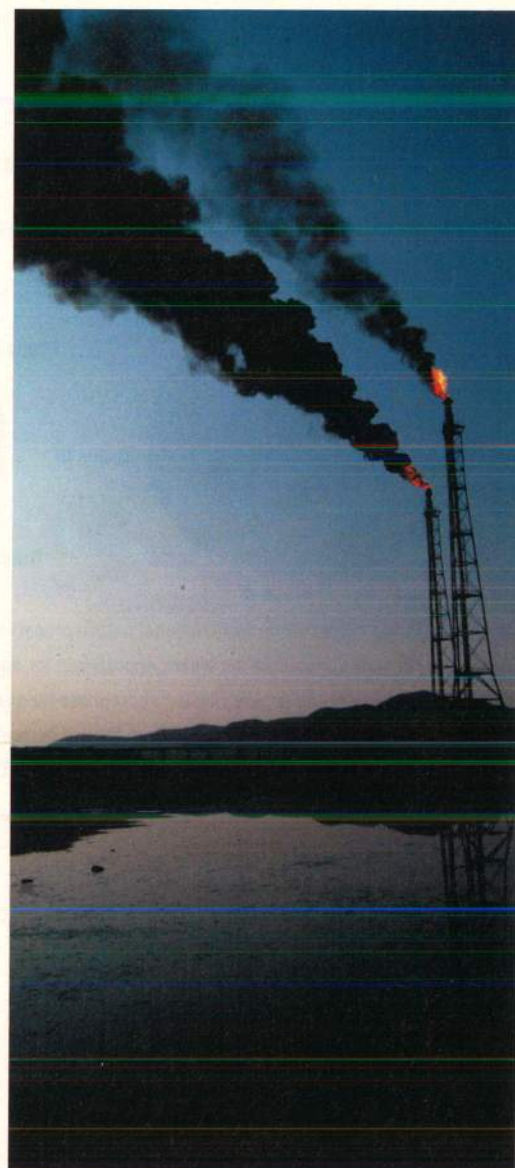
#### Fines Paid by Polluters



#### Ecological Protection

	2002	2003	2004	2005	2006	% change since 2002
Total nature preserves	1,757	1,999	2,194	2,349	2,395	36.3
National level	188	226	226	243	265	41.0
Provincial level	609	654	733	773	793	23.2
City level	304	340	396	421	422	38.8
County level	656	779	839	912	915	39.5
Area of nature preserves (10,000 hectares)	13,294.5	14,398.0	14,822.6	14,994.9	15,153.5	14.0
% of China's total land	13.2	14.4	14.8	15.0	15.8	19.7
Breeding grounds for endangered animals	1,121	641	313	164	164	-85.4
Cultivation fields for endangered plants	194	211	127	77	77	-60.3
Ecological pilot demonstration areas	322	484	528	528	528	64.0
Designated national ecological demonstration areas	82	82	166	233	233	184.1

Sources: State Environmental Protection Administration, *National Environmental Statistics Report, 2002-06*; *2006 Report on Environmental Conditions in China*.



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# Careful Contracts Reduce Risk

*A contract with watertight insurance provisions can save retailers, distributors, and importers expenses that result from recalls of defective Chinese products*

Grace Parke Fremlin

Defective products imported from China have caused alarm on Capitol Hill and among US consumers and businesses. Mattel, Inc.; Menu Foods, Ltd.; and other US and Canadian companies have incurred huge costs for recalls and suffered massive losses in revenue, profit, stock price, and reputation. Besides

shouldering recall costs, these companies are burdened by expensive class action lawsuits and other legal costs.

Retailers, distributors, and importers can no longer treat recalls that result from defective Chinese products as remote possibilities that will not happen or that will go undetected. That retailers, distributors, and importers are not manufac-



turing the defective goods does not shield them from US regulators that hold them responsible for protecting consumers from defective products nor from product liability, tort, or class action litigation. As the deep-pocketed last links in the supply chain before a product reaches consumers, these retailers, distributors, and importers are the most likely to be hauled into US courts by plaintiffs or fined and penalized by US regulators. One strategy to mitigate such risks is for the contract to require the Chinese manufacturers to procure product liability and recall insurance policies with acceptable scopes and provisions of coverage and that these policies also cover the US buyers.

### Negotiating a good supply contract

Negotiating a good purchase and sale or supply contract with the Chinese supplier is essential. A good contract sets the legally required quality standards for the product as well as the legal recourse that the US buyer has against the Chinese supplier if there is a breach in quality requirements. The Chinese supplier and US buyer must vigilantly monitor and test the quality procedures, materials, and products for adherence to the contract's quality requirements.

A good supply contract will set forth the covenants, representations, and warranties related to product quality, design, specifications, prototypes, samples, inspections, and testing—all of which will impose on the Chinese supplier obligations to manufacture and deliver quality goods without safety defects. Concurrently, contract provisions related to defects, product liability insurance, recall insurance, and indemnification will provide for legal recourse against the Chinese supplier for a contract breach; they will also allow US buyers to make claims against the Chinese supplier's insurer if product liability and recall coverages were required under the contract and are effective at the time of recall. Ultimately, the legal recourse will allow the US buyer to recoup costs, first from the insurance company under the policies or, if necessary, from the Chinese supplier under the indemnity—if the Chinese supplier remains solvent after the recalls. Thus, the US buyer, as part of its supplier due diligence, should select financially strong suppliers with clean track records for delivering quality products.

Whether US buyers can hold a Chinese supplier responsible for the costs of product liability lawsuits and recalls depends on whether the Chinese supplier agreed to be liable for these costs under the supply contract.

### The responsible party

Product liability lawsuits and product recall costs that stem from safety defects in goods imported from China should be the responsibility of the party that caused the

defects. In most cases, the responsible party will likely be the Chinese manufacturer (or its subcontractors or material suppliers) unless the defect is a design defect for which the US buyer was responsible. Contractually, the Chinese manufacturer should represent and warrant that the product is free of any defects and complies with its (or the buyer's) intended design and quality standards. If the contractual responsibilities of the Chinese supplier are not upheld and the products contain defects that are the supplier's responsibility, the supplier will have breached the product warranty and will become liable for the damages and costs that arise from the defect. The US buyer could then make claims under relevant provisions of the contract such as product warranty, recalls, insurance, and indemnity.

### Quick Glance

- Companies should draw up comprehensive contracts with Chinese suppliers.
- The contract should be with a financially sound supplier.
- The contract should require the supplier to have product liability and recall insurance that also covers the US buyer.

### Product liability insurance

The contract should mandate that the Chinese supplier deliver to the US buyer a certificate of insurance affirming that the supplier has purchased the agreed amount of product liability insurance, which must provide US or worldwide coverage. The policy should name the US buyer as an additional insured, include a waiver of subrogation (whereby an insurer relinquishes the right to hold a third party accountable for a loss suffered by an insured), and require that the US buyer receive advance notice of any cancellation or non-renewal. The contract provision should also state that the supplier is responsible for any deficiencies or gaps in coverage or deviations from the specified insurance terms. The supplier's product liability policy should cover the legal costs incurred by the insured—both the US buyer and Chinese supplier—in defending product liability lawsuits. It should also require the insured to pay damages and claimants' costs and expenses that result from bodily injury or property damage arising from the insured's defective product.

A US buyer of Chinese imports typically has its own comprehensive liability coverage, which commonly includes product liability coverage. To manage risk, the US buyer should require the Chinese supplier to have product liability coverage on products sold and exported from China. Product liability coverage is available to Chinese manufacturers, but they rarely buy it unless it is a contractual requirement. During the contract phase, explicitly addressing the insurance coverage that the Chinese supplier must have helps the US buyer assess the risks it is taking and make wise commercial decisions about whether to proceed with a particular Chinese supplier.

### Recall insurance coverage

Ideally, recall insurance coverage should also be required of the Chinese supplier. This is usually a stand-



alone policy in addition to the product liability or general liability policy, but it can also be obtained as part of a combined product liability and recall policy. Unlike a product liability policy, a recall policy need not name the US buyer as an additional insured or contain waiver of

Chinese suppliers may resist having to obtain recall insurance coverage under the supply contract. The US buyer should thoroughly explore the insurance angle of protection against defects in Chinese imports before concluding whether to require it and what types and levels of

## A good contract sets legally required quality standards and the legal recourse that the US buyer has against the Chinese supplier if quality requirements are breached.

subrogation language. Under a recall policy, the recall cost of the Chinese manufacturer and of the US buyer and its customers are covered. The costs of replacing and repairing recalled products are also covered. It is important to remember, however, that liability assumed under contract by the insured and recall expenses in a forced recall by a governmental authority are not covered.

insurance to require. To date, US buyers have not consistently required Chinese suppliers to have product liability coverage. Recall coverage is much more complex and, as a practical matter, has rarely—if ever—been imposed on Chinese suppliers. The need to rethink this practice is clearly evident after the many recent recalls of Chinese imports. What is absolutely clear is that no US buyer should waive

### Selected US Inspections/Recalls of Chinese Imports, 2007

Date	Recall
November 7	The US Consumer Product Safety Commission (CPSC) announces the recall of 4.2 million sets of Aqua Dots, a product sold by Toronto-based Spin Master Ltd., because their coating contains a chemical that can be toxic if ingested.
October 9	Seattle-based Starbucks Corp. issues a recall for 250,000 plastic children's mugs that are easily broken when dropped, presenting sharp edges and a choking hazard.
October 4	CPSC announces the recall of more than 635,000 products made in China, including 555,000 products recalled because of excessive lead. Affected products include key chains, rattles, bookmarks, water bottles, and wooden toys sold in a variety of retail outlets, including Toys R Us, Sports Authority, and Dollar General.
September 26	CPSC jointly announces seven recalls of Chinese-made toy products because of excessive amounts of lead paint, for a total of roughly 600,000 toys. These include metal jewelry, puppetry sets, more than 350,000 gardening tools and lawn chairs sold at Target and Jo-Ann Fabrics, and more than 200,000 Thomas the Tank Engine Toys made by RC2 Corp.
September 4	Mattel Inc. announces a third global recall of products manufactured with lead paint, including 848,000 products sold under the Barbie and Fisher-Price labels. It also announces a new three-step check system for lead paint on all of its toy products.
August 14	Mattel announces a global recall of 18.6 million Chinese-made toys, including the recall of: <ul style="list-style-type: none"> <li>• 18.2 million toys containing magnets that, if swallowed, could cause intestinal blockage or perforation. The products are a risk because of a design flaw.</li> <li>• 436,000 toy cars (featuring "Sarge" from the movie Cars) made using lead paint.</li> </ul>
August 2	Mattel's Fisher-Price division issues a global recall of 1.5 million plastic Chinese-made toys—including toys featuring popular characters such as Elmo, Big Bird, and Dora the Explorer—because of lead paint hazards.
July 29	California Department of Public Health warns consumers not to eat fresh ginger from China because of insecticide residue.
June 28	The FDA blocks imports of several categories of Chinese seafood, including catfish, eel, and shrimp, citing contamination by carcinogenic antimicrobial drugs.
June 27	The National Highway Traffic Safety Administration orders New Jersey-based Foreign Tire Sales, Inc. (FTS) to recall 450,000 Chinese-made light truck tires because of missing components that made the tires unsafe. FTS does so on August 9, issuing a product recall for roughly 255,000 tires.
June 1	The FDA issues an import alert for Chinese-made toothpaste sold under various brands because of the presence of diethylene glycol, a cheap substitute for glycerin. FDA also announces it has detained at least one shipment of toothpaste at the border.
May 14	RC2 Corp. announces a recall of about 1.5 million Thomas the Tank Engine toy trains and components manufactured in China because of lead paint contamination.
March 16	Canadian pet food importer Menu Foods Ltd. issues a precautionary recall of some of its dog and cat food because of melamine contamination, beginning the first in a series of recalls of more than 100 brands of dog and cat food across the United States between March and April.

Source: US-China Business Council



either the product liability or recall insurance coverage requirement without compelling commercial reasons or without having searched seriously for other suppliers.

#### Recovering costs of recalls from the supplier

When the Chinese supplier lacks product liability or recall insurance, the US buyer must impose reimbursement responsibility for product liability and safety recall costs and liability through contract provisions that explicitly state the supplier's obligations.

When a safety recall—even a voluntary one—occurs, the contract should obligate the Chinese supplier to reimburse the US buyer for all costs of the recall, including defending lawsuits. The rationale for the supplier to be responsible for the costs of a recall makes legal and business sense since the intent of such a contract provision is to place the responsibility for safety defects squarely on the party that caused the defect or must deliver quality products under the contract. If the contract does not explicitly or adequately address reimbursement from the Chinese supplier for costs of a recall, an innocent US buyer—even a vigilant one with stringent safety standards—will have little or no chance of recovering recall costs from the supplier.

#### An indemnity obligation

A strong indemnity obligation from the Chinese supplier to the US buyer for product defects is recommended in a supply contract. Even under ideal circumstances in which the US buyer obtains the insurance coverages it wants from the Chinese supplier, there could be deficiencies and gaps in what the insurance covers and in the scope of the obligations the US buyer wants to impose on the Chinese supplier under the contract. These gaps are best covered by an indemnity provision from the Chinese supplier to the US buyer that provides the US buyer with legal recourse against the Chinese supplier for costs and liabilities not covered by insurance, or as a backup to the insurance.

#### An international arbitration clause

Another essential provision in a cross-border US-China supply contract is an international arbitration clause. In the

event of a dispute with the Chinese supplier, the US buyer may need to pursue the Chinese manufacturer to enforce the contract. It is important that the supply contract mandate that disputes be resolved through international arbitration governed by US law. Preferably, the parties will have agreed to international arbitration somewhere in the United States using the International Rules of the International Dispute Resolution Center, the international arm of the American Arbitration Association. If the parties cannot agree on arbitration in the United States, the US buyer should insist on US governing law with the arbitration in a

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neutral jurisdiction, such as London, Paris, Vancouver, Sydney, Hong Kong, Singapore, Tokyo, or Seoul, administered by an arbitral body such as the International Chamber of Commerce or the arbitral body of the selected neutral jurisdiction.

A fundamental reason for providing for international arbitration is that China is a signatory to the New York Convention on Foreign Arbitral Awards, which requires signatories to recognize and enforce foreign arbitral awards. (In contrast, China has no obligation to recognize and enforce US court judgments.)



will not give the US buyer legal recourse against the Chinese manufacturer.

When a US buyer is dealing with a US sales subsidiary of a Chinese manufacturer, the US buyer could do one of three things. It could require the Chinese manufacturing parent company to be the contract seller, ignoring the US sales subsidiary for purposes of the contract. Alternatively, the buyer could require the Chinese parent to be a contract party in addition to the US sales subsidiary, making the supply con-

tract a three-party agreement with both the Chinese parent and the US sales subsidiary jointly and severally liable. Finally, the US buyer could sign the supply contract with the US sales subsidiary but require that the Chinese parent guarantee the performance of its subsidiary. In most cases, the financially strong counterparty will be the Chinese manufacturer with a factory and other assets in China, not its US sales subsidiary.

The financial strength of a contract party matters a great deal in the event of product liability lawsuits and recalls if the US buyer wants to seek reimbursement of these costs and liabilities from its supplier. There is no question that major recalls have in some cases put the US buyer and the Chinese manufacturer out of business. The US importer, Foreign Tire Sales, Inc., filed for bankruptcy after the recall of 250,000 tires it purchased from a Chinese tire manufacturer. In the case of toy recalls, hundreds of Chinese toy manufacturers have had their business licenses in China revoked, putting them out of business.

### Legal recourse

The legal recourse that a US retailer, distributor, or importer has against its Chinese supplier depends on the contract terms between the US buyer and the Chinese supplier. Careful contract negotiations, agreements, and documentation on all the terms and conditions of the agreement, including those that deal with product defects and recalls, are essential to ensure the availability of legal recourse. Supply contracts, however, often consist of a purchase order with or without terms and conditions. And, even when there are terms and conditions, they may be unsuitable for the cross-border, US-China context, or they may be superseded by the seller's confirmation order, which may have its own terms and conditions. This sets

### Other international legal provisions

International legal provisions, in addition to international arbitration, are required in the cross-border, US-China context. International contracts cannot be treated like domestic contracts, even when the domestic contract is comprehensive, well-drafted, and carefully considered. Provisions that may require different treatment or that may need to be added in the cross-border, US-China context include governing law (which country's law will govern the terms of the contract and any disputes), importer of record, customs, shipping terms, foreign currency, governing language, and translations.

### Contract with the appropriate party

Contracting with a credible and financially strong Chinese supplier is critical. This fundamental legal and commercial principle is often violated in the China context because foreign firms typically contract with a "middleman" or "shell entity" that has little or no assets. US buyers often contract with a third-party sourcing company, unaffiliated with the Chinese manufacturer. This results in a situation where the contract seller is not the manufacturer of the goods, and when a product defect is uncovered, the US buyer has legal recourse only against the contract party, not the Chinese manufacturer. All too often, the contract party is a third-party supplier that has no assets and offers no risk mitigation for the US buyer.

In some cases, the US buyer may be dealing with a US sales subsidiary of a Chinese manufacturer. These entities exist solely for marketing and sales purposes and typically have few or no assets in the United States. A contract with the US sales subsidiary of a Chinese manufacturer



up the classic legal “battle of the forms,” an expression that characterizes the exchange of written communications between the contract parties in which each party presents its own terms and conditions, making it difficult to determine whose terms and conditions actually apply.

have conducted—as part of the underwriting process—some risk assessment that involves the Chinese supplier, factory, production processes, and product inspections for the insurance coverages, adding a layer of quality assurance and risk management. US companies today, more than

**When a safety recall—even a voluntary one—occurs, the contract should obligate the Chinese supplier to reimburse the US buyer for all costs of the recall.**

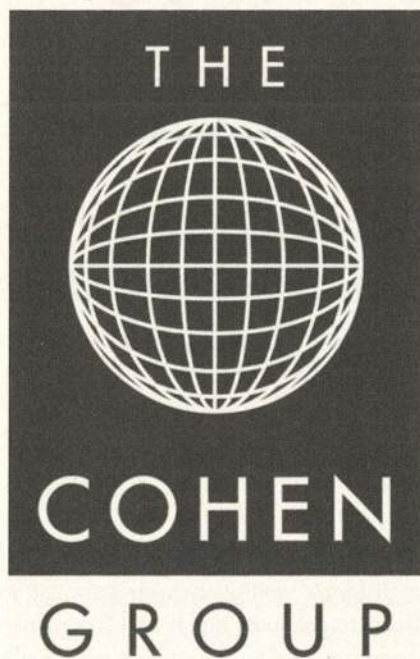
By entering into a comprehensive supply agreement, the US buyer and the Chinese supplier will avoid a dispute over what constitutes the contract terms and delineate clear and enforceable rights and obligations.

#### **A clear contract reduces risk**

Clear contract terms and product liability and recall insurance policies provide risk-mitigating benefits. First, specific contract terms related to product liability and recalls in a supply contract with international terms will offer the US buyer legal recourse for product defects. Second, if insurance coverages are provided, the insurer will

ever, are aware that purchasing decisions should not, and cannot, be made solely by purchasing managers without the input and approval of both international lawyers and risk managers. With a good supply contract and insurance coverages in place, the executive in charge of global procurement will be able to sleep at night. 完

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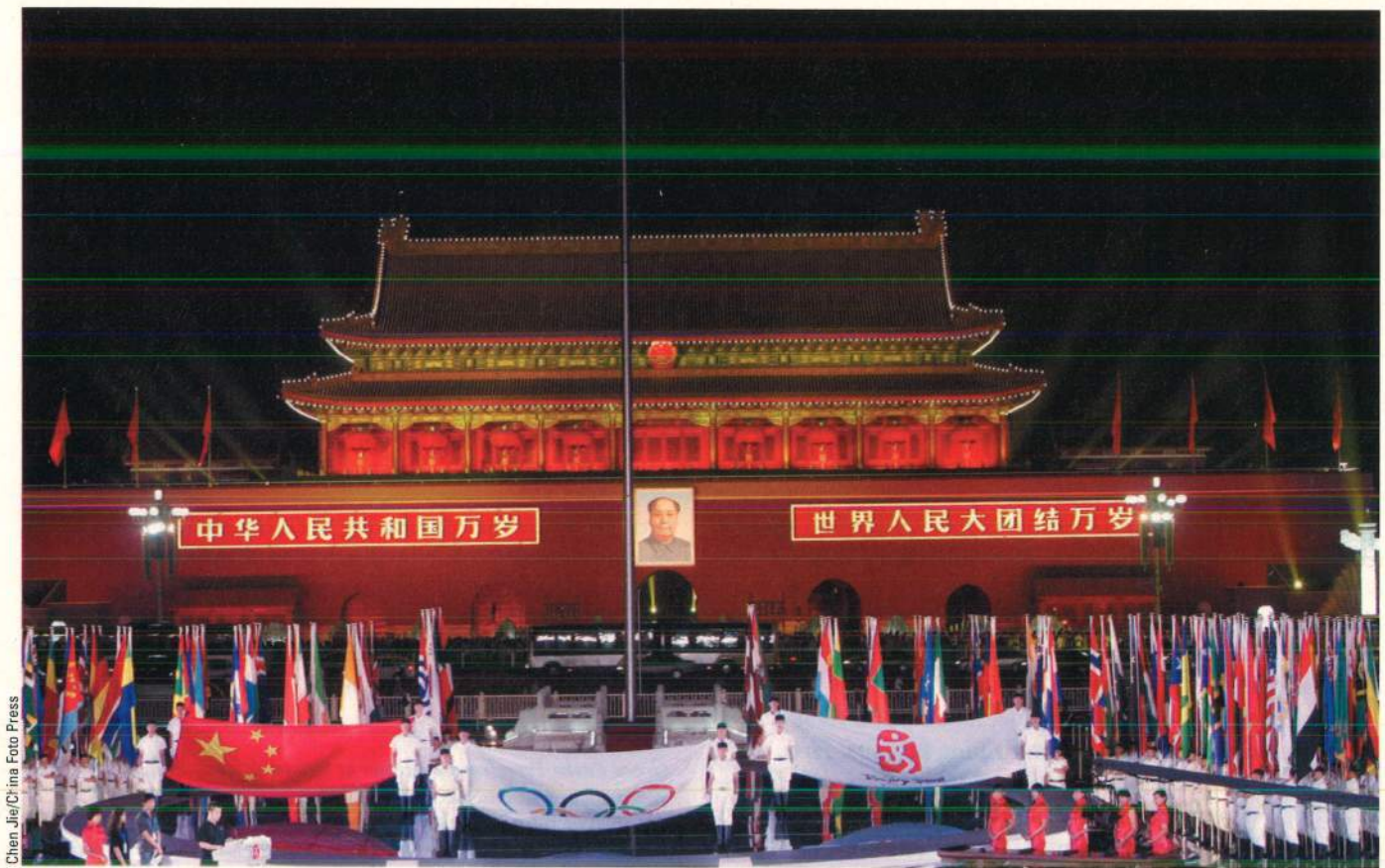
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# Beijing Olympics: More at Stake than Gold Medals

*Although largely celebrated as China's global coming-out party, the Beijing Olympics poses uncertain risks and challenges for Olympic organizers and foreign corporate sponsors*

Drew Thompson

As the Omega clock in Tiananmen Square counts down to the opening ceremony of the summer Olympic Games on the auspicious day of August 8, 2008, Beijing will increasingly be the focus of world attention. That attention will bring significant opportunities and risks to Beijing, Olympic sponsors, and international companies that invest in China. With thousands of foreign media and an unknown number of activists prepared to descend on

Beijing, the PRC leadership would be naïve to believe that it can present a one-dimensional, exclusively positive image to the world. Despite efforts to shape its image as a "responsible" country and emerging power, China cannot realistically expect negative preconceptions and critical reporting to melt away in such a highly politicized environment.

Although Beijing officials hope the spotlight will be forgiving, whether the international media will act



accordingly is unclear. With growing international economic and political clout, China will confront myriad issues that are not directly related to the 2008 Beijing Olympics. International concerns about China's product safety, trade surplus, assertive foreign policy, and growing eagerness among activists of all political persuasions to capitalize on the international attention present significant risks to Olympic organizers and sponsors.

While PRC leaders are concerned about maintaining social stability and projecting a positive image associated with the games, corporations, particularly large and high-profile companies, will face risks from negative media portrayals and activists with specific agendas. PRC officials have voiced their concerns about image and security risks but have determined that the benefits of holding the Olympics outweigh the risks. Quoted in the *China Daily* in August 2007, Jiang Xiaoyu, an executive vice president of the Beijing Organizing Committee of the Games of the XXIX Olympiad (BOCOG), noted that "Great achievement is always accompanied by great challenges." The PRC government has actively sought to mitigate risks associated with the Olympics, and multinational corporations (MNCs) linked to the games should take similar precautions.

### China's challenges and risks

As part of its efforts to present a positive image to the world, China has taken several critical steps to ensure that the Olympics will be successful.

#### Infrastructure and pollution

Although construction of imposing and architecturally significant Olympic venues is on schedule and relatively free of controversy, air quality is posing a greater challenge. Beijing's efforts to address the city's notorious traffic woes—a major source of pollution in the capital—have been tested during events such as the December 2006 China-Africa Forum. Other efforts include relocation of polluting factories and a massive tree planting scheme, which are expected to reduce the likelihood of a sandstorm hitting the capital next August. Despite these efforts, air quality remains poor in the capital. Propaganda officials no longer hype the "Green Olympics" slogan. Instead, they hope that visitors to Beijing in August 2008 will merely be spared the gray skies that often plague the city.

#### Press freedom

As Beijing prepares to welcome an influx of journalists, China has expanded media freedoms for foreign journalists under regulations that took effect in 2007, though coverage of what China vaguely defines as "state secrets" is still prohibited.

A 2006 Foreign Correspondents Club of China survey of the Beijing-based international press corps revealed, however, that although the media landscape has improved, foreign journalists are still dissatisfied with the pace and quality of the new freedoms granted to accredited foreign journalists. The survey cited at least 38 incidents of detainment since 2004, primarily when foreign journalists were covering sensitive issues such as land disputes, antipollution protests, and HIV/AIDS. China also recently began to compile a database of all foreign journalists expected to cover the Olympics. Although PRC officials claimed that the list will help them to better serve journalists, many foreign journalists remain skeptical about the list's purpose, according to news reports.

As foreign journalists covering China during the Olympics fan out across the country, ham-fisted local cadres, particularly those unaccustomed to Chinese or foreign reporting on issues normally considered sensitive, will create ample opportunities for journalists to cover "oppressive" government restrictions. Journalists already have some latitude to cover unflattering issues, such as rural poverty and environmental degradation. Nevertheless, despite the significant strides in transparency that China has made over the past 20 years, a "transparency gap" with Western nations is likely to remain prior to the opening ceremony, virtually ensuring that press freedoms will fall short of many visiting journalists' expectations.

#### Quick Glance

- Companies operating in China, particularly Olympic sponsors, need to be aware of possible risks related to next summer's games.
- These companies should consider now how they will respond to events that could have a negative effect on their corporate image.

#### International pressure

Some of the organizations and activists that make up international civil society pose a management challenge for Beijing and Olympic sponsors. Well-funded US-based coalitions and celebrity activists, such as those focused on Darfur, Sudan, human rights, HIV/AIDS, and other issues, have achieved some success in influencing China's foreign and domestic policy behavior.

Reflecting the intensifying influence of globalization and economic interconnectedness, China has adjusted its longstanding foreign policy principle of non-interference in other nations' internal affairs, in part because of international non-governmental organization (NGO) and foreign government advocacy efforts. UN and US officials responsible for Sudanese affairs have commented that China was instrumental in motivating the Sudanese president to open negotiations with rebels and accept peacekeepers in Darfur, presumably in response to international pressure.

Other examples of China responding to international public opinion include the country's prominent role in the six-party talks over North Korea and in moderating the behavior of Myanmar generals during the crisis in the fall of 2006. In the domestic sphere, China's constructive



response to a growing and unchecked HIV/AIDS epidemic, which began in 2003, also reflects the influence of external actors, including the Joint United Nations Program on HIV/AIDS, the World Health Organization, and the Geneva-based Global Fund to Fight AIDS, Tuberculosis, and Malaria. Likewise, China's approach to press freedoms has evolved steadily over time, in part because of pressure to conform more closely to US and EU norms.

## Challenges for foreign companies during the games

### Managing corporate image

MNCs sponsoring the 2008 Olympics face considerable risks that cannot be easily mitigated. PRC officials and MNCs have a decidedly different calculus when it comes to protecting national and corporate images, respectively. Moreover, the Chinese state has more tools at

As the Olympics approach, NGOs will likely increase the volume and frequency of their activities, posing risks for companies and organizations associated with the event.

These and other modest achievements are unlikely to satisfy activists who are heavily invested in those causes, however. Some activists and NGOs are arguably opportunistic, using the Olympics and negative global impressions of China to boost their relevance and exposure. International Olympic Committee member Hein Verbruggen, who leads the group that oversees Beijing's preparations, told CNN in August 2007, "The way in which the games are being used as a platform for groups with political and social agendas is regrettable."

As the Olympics approach, NGOs will likely increase the volume and frequency of their activities, posing particular risks for the PRC government and companies and organizations associated with the event. One senior BOCOG official, quoted in the *China Daily* in August 2007, pointed out that there is limited room for dialogue, stating: "We welcome constructive criticism on our faults and defects, but we resolutely oppose the politicization of Olympic affairs, for this is not in accordance with the Olympic spirit and Olympic charter."

At this point, there are few indications that PRC government reactions to political protests will be tempered or nuanced, especially given the fact that it is unaccustomed to substantive engagement with international civil society. How China manages foreign and domestic NGOs or protesters during the Olympics will be closely scrutinized. During a briefing on security plans in November, the deputy director of the Olympics Security Command Center said that protests and demonstrations will be dealt with promptly in accordance with PRC law and noted that any legal demonstration will require advance approval from authorities. If the government responds with force or in an overly heavy-handed way to demonstrations, otherwise minor incidents could generate significant media attention.

its disposal to quell dissent, notably a colossal security force and a court system subordinate to political authorities. Protestors of any stripe will likely be unwelcome at event venues, and some high-profile MNCs may find it difficult to escape controversy.

For instance, the Coca-Cola Co., a sponsor of the Olympics since 1926, has agreed to support the torch relay, despite controversy over the relay route through the Tibet Autonomous Region and objections from Taiwan over the island's political status. General Motors Corp. has distanced itself from controversy by recently announcing its intention to not sponsor the Olympics, though it is unclear whether such a move was motivated by political or financial considerations. Nonetheless, General Motors' presence is already visible in the United States through its sponsorship of the US Olympic team, and it is well-known in China as a major foreign investor. McDonald's Corp. has also faced pressure from within China, including from the All-China Federation of Trade Unions, over working conditions and wages, underlining a potential vulnerability that might resurface during the Olympics.

US corporations should not rely on either the PRC or US government to provide significant support when faced with a public relations crisis associated with the Olympics. PRC officials would invariably respond to a peaceful protest in front of a government ministry differently than they would to one in front of a Chinese or foreign company. Protests aimed at a company, for instance, would likely be met with a milder response because demonstrations that focus on corporate interests are a lower priority for government security organs. In addition, US government officials may be reluctant or unable to effectively support a US company linked to politically sensitive issues in China. One US congressional representative has already urged major companies to be "responsi-



ble sponsors” and use their leverage to lobby PRC officials on the Darfur issue.

Worldwide, the growing influx of information from the Internet, including digital bulletin board service chatter and blog rants, has made managing corporate image more challenging in recent years. With all eyes trained on China during the Olympics, MNCs must be especially attuned to their strategies, policies, practices—and quick shifts in public opinion.

### Nationalism and sportsmanship

Perhaps the ultimate risk to China and the MNCs associated with the Olympics is the long-term impact of the event on China’s international relations—which, in part, depends on the management of the games—and the image the country wishes to project to the rest of the world. Chinese expectations for a successful Olympics are palpable and will translate into intense pressure on Chinese athletes to perform well and secure medals. A focus on medal counts will undoubtedly

With all eyes trained on China during the Olympics,  
MNCs must be especially attuned to quick shifts in public opinion.

### Ensuring food and product safety at the games

In addition to foreign policy and human rights issues, the PRC government and several MNCs have faced a significant international public relations crisis related to food and consumer product quality over the past several months (see p.34). Most senior PRC officials have recognized the gravity of the issue and have engaged with international government counterparts to begin implementing regulations and procedures to improve product safety.

Extensive media reporting and high-level official dialogues on the issue ensure that China will seek to mitigate the risk from unsafe food, maintain the focus on food and product safety, and raise the expectation that the benefits of enhanced oversight will extend beyond the Olympics. Although a high-tech tracking and tracing system—which Beijing pledged to implement—is a positive step toward ensuring the safety of food supplies for Olympic athletes, risks remain. Poor animal husbandry practices, a dilapidated healthcare system, and widely varied hygiene and manufacturing practices increase the risk that a public health, food safety, or consumer product crisis could emerge at an inopportune moment, with little guarantee that local or central government officials will respond appropriately.

Although recent product safety issues are not directly related to the Olympics, they reveal many MNCs’ vulnerability to external pressure and the challenge of maintaining a positive public image in the complex business environment in China. The potential consequences of mismanaging public relations can extend beyond the Chinese market to home markets. While a misstep in China, such as negligence in a manufacturing or procurement process, might affect relationship-centered business opportunities in China, legal liabilities resulting from those missteps can multiply in the United States.

ly serve as an indication of “national strength” for some Chinese citizens. The distinction between average Chinese sports fans and ardent nationalists might become difficult to distinguish as the differences between athletic triumph and China’s status as an emerging superpower become blurred.

PRC Olympic officials and commentators have admitted that there is the potential for overreaction when nationalism spills into sport, stating: “We must be a friendly and professional audience.” According to one Beijing resident quoted in the *China Daily* in August 2007, “We want foreigners to discover Chinese culture and to know that China is a strong country now.” Nationalistic sports fans can potentially engage in unsavory behavior, such as poor sportsmanship, violence, and flag burning, that can sully the host country’s reputation. This issue may be particularly salient in China because the Chinese Communist Party has linked its legitimacy to nationalistic concepts, and the Olympics could easily fan collective nationalism.

Such rabid nationalism surfaced when Chinese fans booed during the Japanese national anthem at the 2004 Asian World Cup final between China and Japan and heckled the Japanese team at the Women’s World Cup in Hangzhou, Zhejiang, earlier this year. A mob of fans even surrounded the Japanese team’s bus and pelted it with rocks. As a result, former Beijing Mayor Wang Qishan ordered cheering squads to train Beijingers who “will fill stadiums with the polite noise of rhythmic clapping and drumming and a pre-approved roster of 20 chants,” according to a November 2007 *Telegraph* article. Because China has never before hosted a sporting event of such magnitude, it is impossible to predict whether Chinese fans will misbehave in response to a particular situation, regardless of the nationality of the competitors involved.

The emphasis on the medal count may prove to be a “Catch 22” for China’s efforts to shape its global image over the long term. Widespread media coverage of China’s



economic development and an overall victory in the Olympic medal count could negatively impact public perceptions about China. If China takes home the most medals, it may ultimately "lose" favorable international public opinion because such a victory could cause foreign viewers, particularly those in the United States, to ask how the Chinese have "caught up," thus adding another dimension to what the Chinese refer to as "the so-called China threat." PRC officials have sought to play down the medal count issue, noting that though Chinese athletes have a home court advantage, global audiences should not over-estimate their prospects for victory. To date, PRC officials have been cautious in predicting China's total medal haul. Corporate sponsors should nonetheless consider the broader implications of overly nationalistic images of Chinese victories in terms of whether they can capitalize on those images or whether the images could negatively affect their performance in other markets.

### What can companies do?

Companies can take several steps to prepare for, and prevent, negative publicity during the Olympics.

■ **Perform a risk assessment** Conduct research on likely or potential areas of controversy with which your company could be associated, including relationships with corporate vendors or customers and government partners. Issue areas, such as the environment, labor, media freedom, foreign policy, and human rights, also deserve scrutiny. MNCs would do well to review supply-chain information to ensure that vendors comply with legal requirements and corporate standards and to track Chinese and international public opinion.

■ **Develop crisis plans** MNCs should ensure that a crisis plan is in place and prepare in advance to respond honestly and directly at the outset of a crisis. Plans should involve corporate headquarters as well as local China offices and identify spokespersons and corporate resources (see the *CBR*, September–October 2007, p.40). Moreover, MNCs should develop an engagement plan with government, media, academics, and "opinion leaders" in key communities and create "stakeholder maps" of Chinese and international stakeholders. Having such a plan in place would help to identify critical issues and areas of expertise or influence where each stakeholder will add value to a strategic response. Plans should include corporate security responses to non-violent, direct actions by NGOs, such as demonstrations in front of company offices or factories.

■ **Corporate social responsibility (CSR)** MNCs should review their corporate China and global CSR initiatives prior to the Olympics (see the *CBR*, May–June 2007, p.20). Fact sheets and communications that clearly describe corporate objectives and achievements should be readily available. Foreign companies should also consider linkages between their CSR inventory and crisis topics. Such a strategic review can be more than an academic or "defensive" enterprise.

### Uncertainties remain

The PRC leadership has defined the 2008 Beijing Olympics as the ultimate manifestation of China's emergence as a normal member of the international community. The games will usher in a "new-new era" for China, putting the political turmoil of the Mao era and the unrest of 1989 behind it. Just as China's reemergence as a global power both defines and challenges how the world perceives it, the country, and the MNCs heavily invested in it, must be cautious to avoid becoming victims of their own success.

The potential challenges facing the games' organizers give rise to critical questions that will shape how the world accommodates an "emerged" giant. How will global audiences, particularly those in the United States and neighboring Asian countries, respond to the extensive media coverage, both positive and negative? Will overly positive images of meticulously groomed cities and victorious Chinese athletes undermine China's insistence that it seeks peaceful and harmonious development and that it is not a military or economic threat to the global community? Will those same images reinforce Washington's insecurity about ceding its competitive edge to Beijing? Will PRC leaders be forced to confront an increasingly nationalistic, medal-counting public at home at the expense of maintaining good relations with Japan, South Korea, and the rest of Asia? Already worried by a ballooning trade deficit and uncertainties in Iraq, will the US public find its global vulnerabilities reflected in Chinese national pride?

China's management of all these risks will determine how the Olympics are ultimately perceived in the global public eye. Despite the controversy and activism that will likely accompany the Beijing Olympics, there is some reassurance in the fact that the Olympics are still fundamentally about sports and should be appreciated as such. 完

*Drew Thompson is director of China Studies and Starr senior fellow at the Nixon Center in Washington, DC.*



## Who's Cleaning Up This Mess?

Continued from page 23

at least the companies that sell to these consumers). Andy Xie, former chief economist for Morgan Stanley, summarized the argument in the *Wall Street Journal Online* last summer: "Prices in the US are artificially low. You're [US consumers are] not paying the costs of pollution, and that is why China is an environmental catastrophe." The logical contortions required to produce such an argument are breathtaking, but even if one subscribes to the premises, the conclusion is patently false. According to Xie's own estimates, only "about 20 to 30 percent of China's water pollution comes from manufacturing goods that are exported." The total share of these exports bound for the United States fluctuates between 20 to 25 percent. Using the highest numbers in each range, US exports account for, at most, 7.5 percent (25 percent of 30 percent) of China's water pollution—hardly enough to bear the blame for China's national catastrophe.

### Keeping up with developments

These are interesting times in China's environmental development: New laws and regulations are being promulgated at a breakneck pace, sustainability concepts that are more developed than those in the United States are gaining ground, new construction projects may face increased opposition from a newly empowered populace, and established facilities may be the targets of tort or nuisance lawsuits. FIEs operating in China have lost their "shining knight" status on the environmental front, and their environmental performance is now under a microscope. Given these factors, the China-based environmental function of an FIE must be as sophisticated and well-funded as its US equivalent (see p.23). Failure to keep pace with China's quickly shifting environmental landscape can prevent an FIE from fulfilling its corporate goals, land it in a Chinese court, or cause its corporate name to be featured in an unflattering headline. 完

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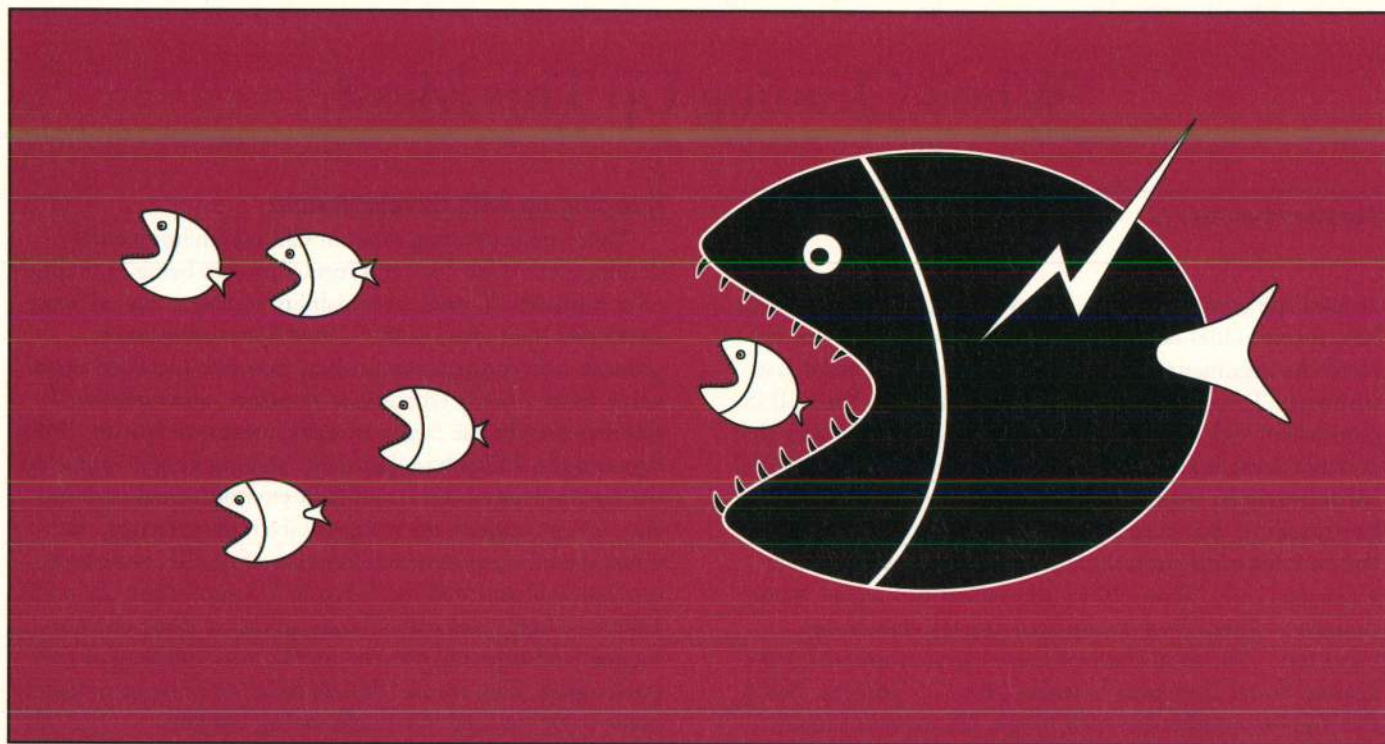
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# Anticipating Chinese Antitrust Policy

*The new Antimonopoly Law overhauled China's competition laws, but key questions about its interpretation and enforcement remain unanswered*

Nathan Bush

After 13 years of sporadic drafting, debate, and bureaucratic infighting, the Standing Committee of the PRC National People's Congress (NPC) enacted the PRC Antimonopoly Law (AML) on August 30, 2007. The finish line of this marathon legislative process is, however, best viewed as a mere milestone in the evolution of PRC antitrust law and policy. Though the final text affirms China's intent to adopt rules analogous to the antitrust laws of the United States, European Union, and other advanced economies, it leaves many crucial questions to be answered through the implementation process. Some of these questions should be resolved before the new law takes effect on August 1, 2008, but many will not. The immediate challenge for US businesses is to anticipate the future course of PRC antitrust enforcement and position their China operations to minimize compliance burdens and potential liability.

## A viable, pliable text

The final text of the AML is clearly recognizable as a "modern" antitrust law. Most provisions are modeled on foreign competition laws and enforcement practices. The European Commission model proved to be the most influential, and elements of German, Japanese, South Korean, and US practice were also adopted.

Scrutinizing the AML's final text in light of foreign practices is illuminating, but inconclusive. Although the AML clearly incorporates key principles of foreign antitrust laws, it lacks many vital details and nuances of foreign antitrust doctrines. This is unsurprising because most countries' general competition laws are brief and abstract, hinging on economic concepts and judgments of "fairness." The substance and subtleties of antitrust typically lurk in agency guidelines, implementing regula-



tions, and case-by-case rulings by courts and enforcement agencies.

The AML is no exception. The final text provides ample room for PRC antitrust policy either to converge with prevailing best practices of foreign antitrust authorities or to diverge in pursuit of other policy goals. In some cases, missing elements of foreign doctrines might be restored through implementing measures or simply read into the law in specific cases. In other cases, however, the many open-ended "catch-all" clauses and "public interest" exceptions might be exploited to block pro-competitive conduct or to excuse gravely anticompetitive behavior. Though the NPC finalized the text of the AML, it did not finalize the substance of China's antitrust policy.

### Three principal targets

The AML addresses three types of "monopolistic conduct," mirroring the three principal targets of antitrust enforcement worldwide.

#### Monopolistic agreements

The AML prohibits certain anticompetitive "monopolistic agreements" among multiple firms. Several types of horizontal agreements among competitors, such as price-fixing cartels and agreements to divide markets, and certain vertical agreements limiting the prices at which purchasers may resell products to their downstream customers are expressly prohibited. "Catch-all" provisions allow authorities to prohibit other unspecified anticompetitive agreements, likely based on a balancing of pro-competitive and anticompetitive effects. Moreover, otherwise-prohibited agreements may be exempted if they aim to achieve certain beneficial goals (such as the development of technical product standards, environmental protection, and the promotion of small and medium-sized enterprise competitiveness), consumers can share "fairly" in the resulting benefits, and competition is not wholly eliminated in the relevant markets.

#### Abuse of dominant market position

The AML prohibits the "abuse of a dominant market position." Following European practice, the AML prescribes a two-step inquiry. Is the firm dominant? If so, has it "abused" its dominance through certain exclusionary or predatory conduct? Dominance is essentially defined in terms of market power—the ability to "control prices, quantities, and other transaction terms" or "affect or prevent market entry" in a relevant market. An allegedly dominant firm's market power may be gauged through analysis of the market structure, barriers to entry, extent of dependence of customers, and other relevant factors. The AML also provides presumptions of dominance by any single firm with a market share that exceeds 50 percent, by any

two firms with a combined market share that exceeds 66 percent, or by any three firms with a combined market share that exceeds 75 percent (excluding any firms with market shares under 10 percent). These presumptions may, however, be rebutted with evidence that demonstrates the lack of market power. Listed abuses reflect foreign rules against predatory pricing, refusals to deal, exclusive dealing, tying, and discrimination. Significantly, the AML only prohibits such practices when they are made "without justification," perhaps signaling the intent to weigh the pro-competitive and anticompetitive effects of these practices on a

case-by-case basis (similar to the US "rule of reason"). Dominant firms are also barred from "selling products at unfairly high prices or buying products at unfairly low prices."

#### Mergers and acquisitions

The AML outlines a new scheme for reviewing certain mergers, acquisitions, and other transactions on competition grounds. It will replace the rudimentary procedures for antitrust review of deals involving foreign parties pursuant to the

Provisions on Acquisitions of Domestic Enterprises by Foreign Investors (see the *CBR*, September–October 2007, p.36). Unlike the current merger review rules, the AML applies to both foreign and domestic parties. Potentially reportable transactions are defined as "concentrations" involving changes in control over companies or their assets. Any concentration that satisfies thresholds to be determined by the State Council must be reported for antitrust review and may not be consummated until the review process is complete. The review process will entail an initial 30-day review period, at the end of which the parties may proceed with the transaction unless the authorities opt to conduct a further 90-day review that may be extended for another 60 days in certain circumstances. Concentrations that may "exclude or restrict competition" are to be blocked or approved under restrictive conditions (such as requiring parties to sell off assets to third parties to avoid concentration in areas of competitive overlap), unless the parties demonstrate that the pro-competitive effects outweigh the anticompetitive effects or that "the concentration is in the public interest."

#### Divergent goals

Substantial disagreement persists among PRC officials and scholars about the proper goals of the AML. Some embrace the growing international consensus that antitrust policy should promote consumer welfare and economic efficiency through vigorous competition. Many reformers also tout the AML as a weapon against "administrative monopoly"—the misuse of official power by local authorities and industry regulators to protect or promote

#### Quick Glance

- China's Antimonopoly Law incorporates elements used in international competition law and enforcement practices.
- Whether the law will be used as a tool to carry out industrial policy depends on how it is implemented.



avored firms. Other policymakers, however, view the AML as a means of shielding the proverbial "little guy" from larger, more efficient rivals. More worrisome for foreign-invested enterprises are calls to use the AML as an instrument of industrial policy, whether to protect vulner-

(SOEs) vital to the economy or national security or by state-sanctioned monopolies. The AML exhorts SOEs in these sectors to respect and advance consumer interests and admonishes regulators to safeguard the interests of these incumbent firms. Which sectors will be affected and

## Although the AML clearly incorporates key principles of foreign antitrust laws, it lacks many vital details and nuances of foreign antitrust doctrines.

able domestic firms from foreign rivals or to cultivate world-class "national champions" in strategic sectors. Each of these views finds precedent in past foreign practices (including populist periods of US antitrust policy), textual support in different passages of the AML, and adherents in different corners of the PRC government.

The NPC Standing Committee also introduced several new provisions that reflect current concerns among PRC policymakers. One new provision calls for special consideration of sectors dominated by state-owned enterprises

the precise balance between the interests of the incumbent SOEs and their consumers remains to be seen.

Another new provision underscores the requirement that any mergers with or acquisitions of domestic firms by foreign investors that implicate national security will face review on national security grounds under separate regulations, regardless of the outcome of the antitrust review under the AML. The initial outcry from foreign quarters was somewhat misplaced. The United States also separates the review of mergers on antitrust grounds by the Federal

### A Turf War on Many Fronts

Divvying up authority over antimonopoly policy was perhaps the most contentious issue during the drafting of the Antimonopoly Law (AML). The National People's Congress delegated the task of designating the primary enforcement authority (or authorities) to the State Council. The Ministry of Commerce (MOFCOM), the State Administration for Industry and Commerce (SAIC), and, to some extent, the National Development and Reform Commission (NDRC) are all vying for the job. Each has its own strengths, weaknesses, constituencies, and agenda. Although a single enforcement agency would be ideal, the most likely outcome (at least initially) is to charge each body with enforcing different chapters of the law. Merger review will likely fall to MOFCOM, which leads antitrust reviews of mergers under the current rules. SAIC, which currently enforces certain rules against predatory and unfair conduct under the Anti-Unfair Competition Law, and NDRC, which currently supervises the enforcement of the Price Law by local price

bureaus, will likely enforce the rules against abuse of market dominance and anticompetitive agreements. In the future, these functions might be consolidated under a single agency.

On the "administrative monopoly" front, sector regulators and local and provincial authorities sought to protect their regulatory turf—and their power to pick the winners in the marketplace. The AML's drafters were divided between those who aspired to tackle "administrative monopoly" with robust new provisions in the AML and those who feared diluting the AML's focus on private anticompetitive conduct with an unwinnable war on administrative misconduct. The final text includes detailed rules against common tactics for shielding local enterprises from competitors in other regions or protecting favored incumbent firms from new challengers, but most of these provisions simply repeat existing and largely ineffective measures. Moreover, each government department has the prerogative, though not necessarily the

incentive, to police its own subordinate divisions for acts of administrative monopoly. The antimonopoly authorities may advocate pro-competitive policies, but they cannot directly enforce the administrative monopoly rules against officialdom.

Anticipating the risks of inconsistent enforcement and bureaucratic deadlock, the AML's drafters took the unusual step of calling for a new interagency, dubbed the Antimonopoly Commission, to coordinate enforcement efforts and formulate policy. The State Council has yet to announce the commission's composition, but it will likely include the chief enforcement authorities and select sector regulators and could include legal experts and economists. If the commission structure receives sufficient political backing from above, the commission could provide a viable channel for managing turf fights and avoiding bureaucratic deadlock.

—Nathan Bush



Trade Commission and Department of Justice from the review of foreign investments on national security grounds by the Committee on Foreign Investment in the United States (see p.51). Moreover, national security has long been a factor in the approval of foreign investment in China.

member Zeng Xianzi declared that “a number of high-tech, well-capitalized foreign companies have achieved market dominance in China by mergers and acquisitions.”

In principle, the government will likely seek to advance the interests of consumers, vulnerable companies, and

## The final text provides ample room for PRC antitrust policy to converge with prevailing best practices of foreign antitrust authorities or to diverge in pursuit of other policy goals.

The risk remains, nonetheless, that national security concerns could seep into the separate antitrust inquiries.

Many multinational corporations are concerned that the enforcement program will disproportionately target foreign investors and firms. Though the text of the AML applies equally to domestic and foreign firms, industrial policy and protectionism could hijack this neutral text, or regulators could “make an example” of a foreign target to send a message to more influential Chinese firms. To allay such anxieties, the director of the Multinational Enterprise Research Center, which is affiliated with the PRC Ministry of Commerce (MOFCOM), published a paper in September declaring that China “does not face an imminent risk of monopoly by foreign companies in any industry.” Contrary sentiments nevertheless remain strong in the PRC government. In 2004, the State Administration for Industry and Commerce published a controversial report cataloguing alleged anticompetitive practices by dominant foreign firms in China. And during the final NPC discussion of the law, Standing Committee

ascendant national champions under the banner of adapting foreign antitrust practices to suit China’s unique needs. As a practical matter, tension between these often irreconcilable goals will ultimately be resolved by the enforcement authorities on a case-by-case basis.

### High stakes for foreign firms

Whereas most of China’s existing competition rules are largely toothless, the penalty provisions of the AML are formidable. Violations of the rules against monopoly agreements and abuse of dominance can lead to disgorgement of illegal gains and fines of 1 to 10 percent of the offenders’ turnover from the preceding year. If the mandatory minimum fines are based on worldwide turnover from all product markets, minor infractions in China could incur mammoth fines. Consummating mergers that violate the AML may result in orders to unwind transactions and fines of up to ¥500,000 (\$67,360). Moreover, the AML creates a private cause of action for individuals or companies injured by violations of the law. Although

## AML and Intellectual Property

The intersection of intellectual property (IP) and antitrust policy remains controversial in even the most mature antitrust jurisdictions, and IP issues lie near the heart of many of the cutting-edge cases now in US courts or before the European Commission. In China, the same novel issues will arise amid a fledgling antitrust regime, malnourished IP system, and industrial policies aimed at fostering domestic innovation.

Unfortunately, the final text of the Antimonopoly Law (AML) sheds little light on China’s likely approach to licensing restrictions, patent pools, deceptive conduct during standards setting, mergers

of IP holders, compulsory licensing as a remedy for abusive conduct, the obligations of “dominant” IP holders, and other IP-related antitrust issues. The single provision on IP simply provides that the AML shall not “apply” to the “exercise of intellectual property rights pursuant to the...laws and administrative regulations relating to intellectual property” but “shall apply to actions taken...to eliminate or restrict competition by abusing intellectual property rights.” This syntax, borrowed from Japan, fits poorly with US practice. IP rights are neither uniquely immune from US antitrust rules nor uniquely suspect; US courts and agencies

are simply admonished to account for unique features of IP (notably the ease of misappropriation) when applying general antitrust rules. More to the point, the AML does not clearly distinguish “abuse” from “legitimate” exercises of IP rights.

Detailed implementing guidelines will likely reflect the sensitivity and complexity of these issues. Whether such guidelines can compensate for weaknesses in China’s IP system while balancing the goals of innovation and competition remains to be seen.

—Nathan Bush



the scope, preconditions, and procedures for such claims have yet to be clarified by the Supreme People's Court, local PRC courts may face a wave of private antitrust suits in the near future.

### Mergers and acquisitions

Though complying with rules against monopoly agreements and abuse of dominance simply requires abstinence from misconduct, the new merger control scheme imposes

## Most of China's existing competition rules are largely toothless, but the penalty provisions of the AML are formidable.

### Precautionary measures

Despite the uncertainty surrounding the future enforcement of the AML, US companies can take steps to reduce potential liabilities and compliance burdens before the AML takes effect.

### Monopoly agreements

US companies and FIEs in China should determine whether cooperative arrangements with competitors or restrictive provisions in intellectual property (IP) licenses and distribution arrangements would comport with antitrust rules in the United States, European Union, and other established antitrust jurisdictions. They should also focus on involvement with domestic industry associations. Trade associations are fertile ground for collusion; indeed, many of the pathbreaking cartel cases in the United States involved trade associations. Reports that domestic trade groups facilitated price-fixing for certain foods in the summer of 2007 provoked a strong response from the National Development and Reform Commission and prompted the NPC to add last-minute provisions to the AML that target trade associations.

### Abuse of dominance

PRC enforcement authorities will likely embrace internationally accepted techniques for defining "relevant markets" for antitrust analysis: What is the likelihood that market shares in any plausible relevant market trigger a presumption of dominance? To what extent do entry barriers, IP considerations, and other factors support or refute an inference of dominance? The greater the risks of qualifying as a dominant firm, the greater the need to review current commercial practices in China in light of foreign antitrust rules governing unilateral conduct. The presence of upstart Chinese competitors, particularly in strategic or high-tech sectors, or a history of liability for abuse of dominance in other jurisdictions increases the risks for foreign firms.

an affirmative burden on foreign and domestic firms to report any transaction that triggers the notification thresholds—including wholly offshore deals. Although the current merger review rules also apply extraterritorially, the lack of meaningful penalties for failure to notify offshore transactions has resulted in many otherwise reportable offshore deals going unreported for the last four years. As noted above, the AML's new penalty provisions add teeth to the merger filing obligations in China. Although some continuity with MOFCOM's current procedures is likely, it is difficult to predict the burden of complying with the AML because the notification thresholds have not been set, the scope of reportable "concentrations" has not been clearly defined, and the data and documents required for a complete notification have not been clearly defined. Moreover, if the AML is bent to serve PRC industrial policy, the incentives to condition approvals on the divestiture of assets or the licensing of IP rights or to block transactions altogether might be substantial. Thus, foreign companies may want to accelerate some planned acquisitions to avoid the uncertainties of the post-August 1 merger regime.

Much of the AML's ambiguity stems directly from the inclusion of abstract foreign antitrust doctrines. Consequently, enforcement officials may find precedents set by foreign antitrust authorities persuasive when construing analogous provisions of the AML—absent overriding political pressures. As a practical matter, the enforcement of the AML in specific instances will likely vary with the industry, region, and political clout of the parties involved. In gauging enforcement risks under the AML, the context may prove more decisive than the text of the law. 完

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# Foreign Investment and National Security

*New approaches to national security screening of foreign investments in the United States and China could subject deals to closer scrutiny*

Harry L. Clark and Lisa W. Wang

Both the United States and China have recently produced legislation that is expected to broaden and intensify government scrutiny of foreign direct investment based on national security considerations. The US Congress has overhauled the Exon-Florio amendment on the basis of which the inter-agency Committee on Foreign Investment in the United States (CFIUS) conducts national security screening of acquisitions by, and mergers with, foreign companies. The Foreign Investment and National Security Act of 2007 (FINSIA), which took effect

in October 2007, establishes a variety of new statutory requirements for screening by CFIUS. China's new Antimonopoly Law (AML), which will take effect in August 2008, mandates examinations of transactions for national security concerns in addition to competition policy screenings. The AML will build on China's existing national security screening regulations, which were passed in August 2006.

National security screening has already proven to be a significant complication for foreign investment in both



countries. For example, PRC authorities have insisted on radical reductions in the Carlyle Group's proposed investment in China's largest manufacturer of construction machinery, Xugong Group Construction Machinery Co. Ltd. In the United States, China National Offshore Oil Co. (CNOOC) eventually withdrew its 2005 bid to buy Unocal Corp., reportedly for reasons related to national security screening.

How the US and PRC governments implement their respective new laws could significantly affect international investment in and between the United States and China. Particularly intriguing is the impact that implementation of new policies in one country could have in the other. Given the susceptibility of national security screening to action based on commercial and political considerations, it is to be hoped that each country will seek to adhere rigorously to standards that are based on legitimate national security concerns.

## United States

### Exon-Florio

The Exon-Florio amendment to the Defense Production Act of 1950, which was originally enacted in 1988, authorizes the president to block or order divestment of a transaction that gives a foreign entity control over US business operations if there is credible evidence that a foreign entity "might take action that threatens to impair the national security of the United States" and existing provisions of law do not provide "adequate and appropriate" authority to protect national security.

The president has delegated responsibility for Exon-Florio screening to CFIUS, a 13-member inter-agency committee chaired by the Secretary of the Treasury. (Until FINSA took effect, CFIUS agencies included the departments of the Treasury, Commerce, Defense, State, Justice, and Homeland Security; the Office of Management and Budget; the Council of Economic Advisors; the Office of the US Trade Representative; the National Security Council; the National Economic Council; and the Office of Science and Technology Policy. FINSA added the Department of Energy and, on a non-voting basis, the Department of Labor and the intelligence community.)

US law does not require that transactions be screened, but parties often voluntarily submit transactions for examination by CFIUS to avoid adverse action under Exon-Florio. Adverse action can include blocking of transactions in whole or part, or forced divestment of acquired interests.

CFIUS screening is designed to last no longer than 90 days, although informal consultations with CFIUS and other factors can result in delays. For most transactions, CFIUS examinations are completed at the end of an ini-

tial 30-day review period. Relatively few examined transactions are also subjected to a formal 45-day investigation. And CFIUS has referred only a handful of transactions to the president for a decision following an investigation. (FINSA has not changed this process or timing.)

Only once has a US president taken formal action under Exon-Florio. President George H. W. Bush ordered a PRC government buyer to divest its ownership of a US aerospace firm in 1990. But Exon-Florio screening has complicated, delayed, and resulted in changes to many transactions. Transactions are sometimes delayed when parties are induced to withdraw and refile notifications,

thereby "restarting the screening clock." Furthermore, some prospective buyers have dropped acquisition efforts because they thought their proposals would not receive Exon-Florio clearance.

One such aborted effort was CNOOC's bid to acquire Unocal in 2005. CNOOC's bid drew criticism from a US competitor and from many members of Congress. Although it submitted an Exon-Florio notification, CNOOC subsequently withdrew its bid when obtaining CFIUS clearance appeared unlikely. The PRC Ministry of Foreign Affairs strongly criticized the

reception that CNOOC's bid received in Washington, demanding "that the US Congress correct its mistaken ways of politicizing economic and trade issues and stop interfering in the normal commercial exchanges between enterprises of two countries."

In early 2006, Dubai Ports World's acquisition of a UK company that held certain US sea port operations created even more controversy. Although CFIUS cleared the transaction, Dubai Ports World agreed to divest its ownership of the port operations when it became evident that Congress would probably pass legislation mandating divestment.

### FINSA

Largely a response to concerns about the CNOOC and Dubai Ports World acquisition efforts, FINSA is a comprehensive re-write of the Exon-Florio amendment. FINSA codifies a variety of changes to Exon-Florio, many of which the current Bush administration had already implemented in response to congressional pressure:

- Mandatory assessment of a transaction's impact on US "critical infrastructure," energy assets, and "critical technologies";
- A requirement that transactions involving state-owned or controlled foreign entities or critical infrastructure be subject to a formal, 45-day investigation;
- Establishment of a clear legal footing for "mitigation agreements" between the government and transaction par-

### Quick Glance

- Regulatory changes in the United States and China could lead to closer scrutiny of foreign investments from a national security perspective.
- How these reviews are conducted in one country could influence the way they are conducted in the other.



ties. The US government can penalize parties for violating these agreements, even by reopening its examination of cleared transactions in some circumstances.

■ Mandatory analysis of screened transactions by the US director of National Intelligence; and

■ A system of congressional notification to expand congressional oversight of CFIUS screening.

## Considerations for foreign investors in the United States and China

Though the full impact of the statutory changes imposed by FINSA and the AML will become clear as administrative practice and precedent emerge, the new legislation and other changes have several obvious implications for foreign investors in the United States and China.

# Recent practice in China and AML provisions on national security screening suggest that scrutiny of foreign direct investment in China may be increasingly politicized.

## China

Following CNOOC's failed bid for Unocal and domestic controversy over foreign investment in perceived "important" Chinese industries, the PRC government has taken an increasingly restrictive approach to foreign investment.

The US investment fund Carlyle Group, for example, encountered major hurdles when it announced in October 2005 plans to acquire an 85 percent stake in Xugong Group Construction Machinery. The transaction raised concerns that foreign investors were gaining excessive control of a strategic Chinese manufacturing sector. Following more than a year of regulatory delay, the PRC Ministry of Commerce (MOFCOM) has yet to approve the transaction even though Carlyle agreed in March 2007 to reduce its proposed ownership stake in Xugong to a 45 percent minority interest.

Largely in response to calls for greater protection of domestic industries from foreign control, six PRC government agencies jointly issued the Provisions on the Acquisition of Domestic Enterprises by Foreign Investors in August 2006. The regulations require MOFCOM approval of foreign acquisitions of "important" industries that have an effect on "national economic security." The regulations modified previous rules that required MOFCOM approval only for foreign mergers and acquisitions valued at more than \$100 million.

China codified national security screening requirements for the first time in national legislation in August 2007 when it adopted the AML. In addition to competition policy screening, the AML states that foreign mergers with, and acquisitions of, domestic companies "should go through national security checks according to relevant laws and regulations. . . ."

In the United States, CFIUS is treating acquisitions of infrastructure, such as oil refineries and toll roads, which would not have even been notified for screening in the past, as having national security importance. In addition, FINSA formalizes more intensive oversight by Congress, which, in turn, may increase opportunities for competitors to use Exon-Florio examinations to delay and disrupt transactions. Recent practice in China and AML provisions on national security screening, particularly the codification of a "national economic security" standard, suggest that scrutiny of foreign direct investment in China may be increasingly politicized.

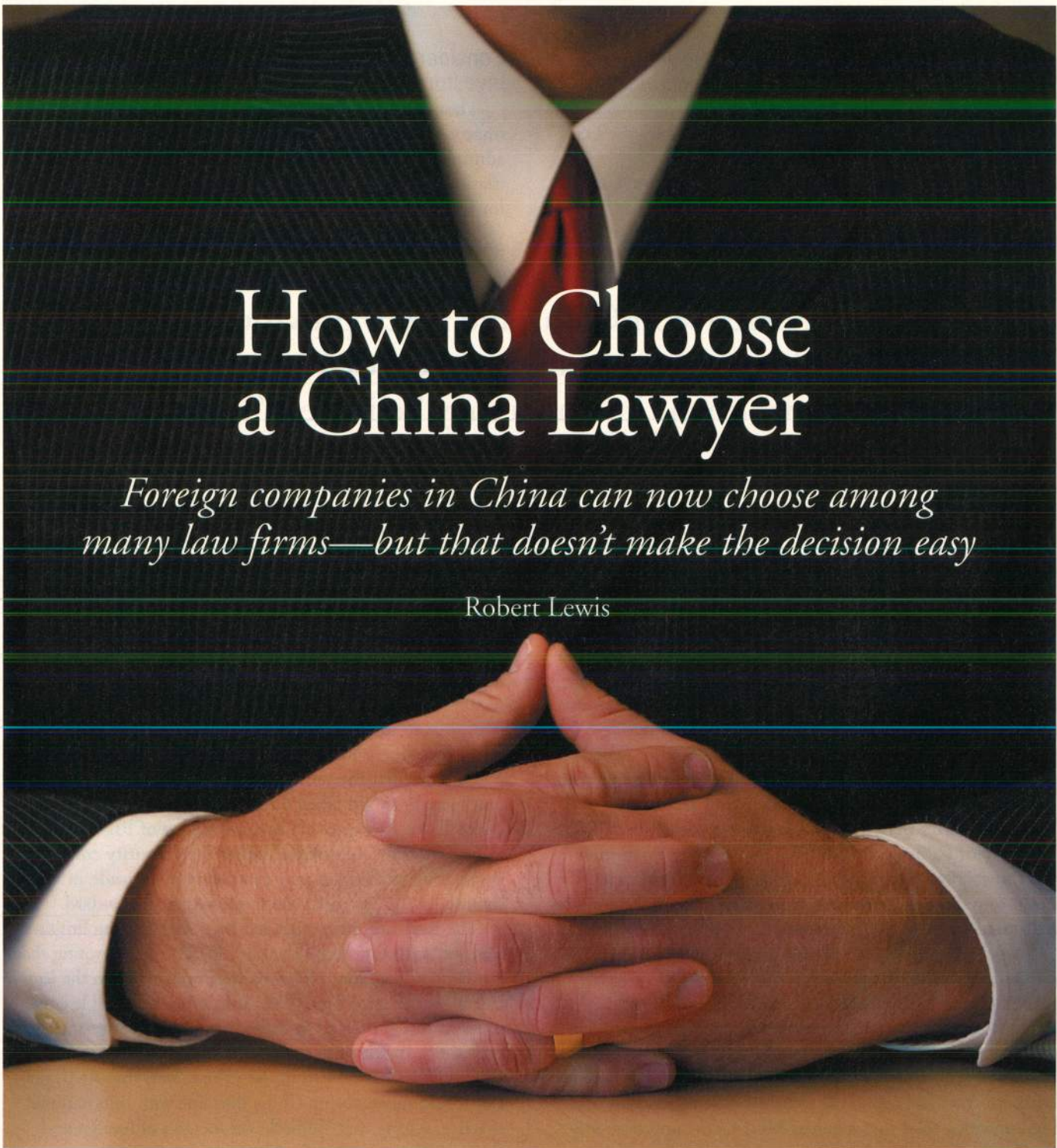
Of particular interest is how administration of the law in one country might affect administration of the law in the other. If, for example, US administration of FINSA appears to be driven by commercial rather than security considerations, PRC authorities may exercise more latitude in applying the AML's "national economic security" standard.

The Bush administration has been highlighting limitations on screening established in FINSA, rightly noting that a variety of troubling proposals were omitted from the legislation. At the same time, PRC authorities have made comparisons to US policies in defending AML security-screening provisions. In response to concerns about protectionism, PRC officials have stated in the *China Daily* that AML policies would merely bring China into line with international practice, stating that "[c]hecks on mergers of foreign and domestic firms are practiced by many countries."

In sum, administration of FINSA and the AML merit careful attention not only because of the effects that application of the laws can have on investment in the respective countries but also because of possibilities for reciprocal action by others. 完

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# How to Choose a China Lawyer

*Foreign companies in China can now choose among many law firms—but that doesn't make the decision easy*

Robert Lewis

Although China has been “open for business” for about 30 years, the country remains an enigma for many businesspeople. This is particularly true for most US and European in-house counsel when they need to identify outside Chinese legal counsel.

One reason choosing a lawyer can be difficult: There are more than 130,000 licensed Chinese lawyers in more than 12,500 law firms across China. In addition, more than 200 foreign law firms, nearly 70 of which are from

Hong Kong, have registered offices in mainland China. Though these numbers seem underwhelming when compared to the number of lawyers and law firms in the United States, only about 15 years have passed since private domestic law firms were established and foreign law firms were permitted to set up formal offices in China. Given the relatively short history of a modern legal services market in China, how does a company decide which counsel to use?



## What foreign law firms may do in China

For many foreign companies doing business in China, the threshold question is whether to use a foreign or a Chinese law firm for a particular legal issue. The answer depends in part on the scope of services required in each case because the scope of permitted activities for each type of firm varies. Regulations that govern foreign law firm activities in China are fairly straightforward and can be summarized as follows:

- Foreign law firms in China may not practice local law but may advise on all aspects of international law and practice in the context of the PRC legal environment;

- Foreign law firms may not employ Chinese lawyers, except as paralegals;

- A Chinese lawyer who is employed by a foreign law firm must suspend his or her practicing license certificate; and

- Foreign law firms may instruct practicing Chinese lawyers on behalf of foreign clients in the provision of Chinese legal services and are encouraged to enter into long-term cooperation arrangements with local firms but cannot enter into fee-sharing arrangements.

This scope still provides ample room for foreign law firms to operate legitimately in China. Under China's regulatory regime, foreign lawyers in international law firms can and should be well acquainted with the PRC legal environment and can lead, structure, document, negotiate, and manage deals in accordance with international norms and practices that are appropriately adapted to the PRC commercial and legal environment. When novel questions on the interpretation or application of PRC law arise, foreign lawyers should consult with Chinese lawyers and can (and should) add value to the process by framing the questions appropriately and testing the responses from a position of familiarity with the overall Chinese legal framework and regulatory environment. This practice ensures that the client receives the most reliable advice on PRC law.

## Foreign firms vs. local firms:

### Evaluating comparative advantages

When it comes to "plain vanilla" foreign direct investment (FDI) work, local PRC firms continue to gain market share. Local firms have significant competitive advantages: They can practice local law, and their rates are lower than those of foreign law firms. An increasing number of lawyers in Chinese firms have studied law overseas (US Master of Laws programs are the most popular), and some are dual qualified (New York bar qualifications are the most common). Many Chinese lawyers in leading local law firms in major cities are bilingual and have worked in foreign law firms, principally in the China offices of such firms.

Consequently, these local lawyers have become quite competitive vis-à-vis many foreign law firms in the market for FDI-related legal services for foreign clients in China.

Yet foreign law firms in China also have significant comparative advantages when it comes to cross-border transactions and many other categories of inbound investment, such as mergers and acquisitions, private equity, distressed assets, and privatization of state-owned enterprises. An increasing number of China inbound and outbound investment deals have significant onshore and offshore elements, and the clear market trend is for international and domestic firms to work side by side on the more complex matters. In almost all such cases, the allocation of roles complies with the PRC regulatory framework: The foreign firm leads the

structuring, documentation, negotiation, and management of the deal, while local counsel manages all aspects of PRC law. For example, in an acquisition project, an international law firm can take the lead on all aspects of the project. It can reduce the total project costs while maintaining overall service quality by cooperating with a local firm on due diligence, preparation of various local documentation, advice on PRC law issues, and management of the approval process. With respect to litigation matters, the role of the local lawyers must, of course, be more prominent. But the foreign firm still has wide scope to participate

in case preparation and strategy, particularly when the onshore legal action is part of a series of related actions in various jurisdictions.

In these more complex matters, the client corporation's in-house counsel always plays the key role in determining what work is to be done in-house, what is to be done by a foreign law firm, and what is to be given to local counsel. The goal is to avoid duplicating efforts while still achieving the desired results.

## Sifting through inadequate market data

Once a company decides whether to select a foreign or domestic law firm, the company must narrow its options further. The key criteria for selecting outside counsel in China—and anywhere in the world—typically include expertise, resources, and location. Finding reliable data points on these selection factors can be especially difficult in China, where directories of domestic law firms are incomplete, promotional materials of most firms are generally suspect, and word-of-mouth can be unreliable. This problem is particularly acute among local Chinese law firms—especially because of the common tendency to oversell claimed specialized expertise and experience. The problem, however, is also true of foreign law firms in China (after all, overzealous marketing is not confined to any one group or profession).

### Quick Glance

- When choosing a lawyer in China, companies should look beyond head count to management structure.

- In many cases, Chinese and foreign law firms that work together offer the best services.

- For matters outside of Beijing and Shanghai, a local regional firm may be best.



**Table 1: Regional Chinese Law Firms  
Selected to Join the Sino-Global Legal Alliance  
(head offices in alphabetical order)**

Firm	City
AllBright Law Offices	Shanghai
China Commercial Law Co.	Shenzhen, Guangdong
Deheng Law Firm	Qingdao, Shandong
Dewell & Partners	Wuhan, Hubei
Guangda Law Firm	Guangzhou, Guangdong
Join & High Law Office	Tianjin
Solton & Partners Law	Chongqing
T&C Law Firm	Hangzhou, Zhejiang
Wang, Wu, Yang & Ma Law Firm	Shenyang, Liaoning

Sources: Lovells LLP, Sino-Global Legal Alliance

In connection with the recent establishment of the Sino-Global Legal Alliance (SGLA), a non-exclusive cooperation among nine leading independent Chinese law firms and London-based international law firm Lovells LLP, Lovells conducted extensive market research and due diligence on more than 100 Chinese law firms in 15 major Chinese cities. This research involved more than 6,000 hours over nearly one year. Lacking a reliable independent guide in the form of professional directories or other sources, Lovells created its own framework for evaluating local firms and collected detailed, concrete information that delved deeper than self-promotional law firm brochures (see below).

As a result of this extensive market research, Lovells selected nine leading local law firms from nine different cities in China to join the SGLA (see Table 1). (In comparison, the 20 leading foreign law firms in China and the 10 leading Chinese law firms ranked in the 2007–08 edition of *Asia Pacific Legal 500* are all based in Beijing and

Shanghai [see Tables 2 and 3].) The establishment of the SGLA represents the first time that the top local firms in these key regional commercial centers have been identified through objective market analysis. The SGLA permits these firms to pool their resources on a shared platform through cross-firm virtual practice groups and related internal training and the coordinated provision of legal services on an alliance-wide basis.

### Counting noses in foreign law firms

Expertise is clearly the most important criterion in the selection of outside counsel. It is difficult, if not impossible, however, to develop expertise without critical mass. In general, the China offices of foreign law firms are quite small. Consequently, the level of practice-area-specific expertise is less developed than in other jurisdictions.

Fifteen years ago, so-called “China law practitioners” were based almost exclusively in Hong Kong. While foreign law firms have, over the last five to ten years, steadily shifted resources into Beijing and Shanghai, the relatively stronger Hong Kong offices of the UK firms provide a pool of cross-practice area expertise that can supplement the necessarily more general-practice skills of the Beijing- and Shanghai-based lawyers. This is helpful when clients require expertise in a wide range of disciplines, including capital markets, private equity, intellectual property, cross-border insolvency, bank finance, and litigation.

Based on independent rankings by two leading international legal directories, UK law firms seem to have a clear advantage over their US counterparts in China. Six of the top seven foreign law firms in mainland China are from the United Kingdom. Generally, the Hong Kong offices of UK firms are much larger than those of US firms. (Baker & McKenzie is the clear exception to this rule, as it has the largest office in Hong Kong of all US and UK firms.)

### Framework for Evaluating Local Law Firms

To identify the leading local law firms in key Chinese cities, Lovells LLP studied local firms’ market profiles, representative clients and matters, specialized practice area capabilities, and management structures and systems. The evaluation process was divided into three progressive stages: market surveys, preliminary due diligence on top-tier firms in each jurisdiction as identified in market surveys, and in-depth due diligence on the final shortlist of candidate firms based on the preliminary due diligence results.

The two key criteria in the initial market survey stage were the profile of the firms

among their peers in the local market and whether the firm had qualified to receive the “National Outstanding Law Firm” qualification issued by the PRC Ministry of Justice (MOJ). In almost all surveyed cities, there was a clear consensus, with only one or two firms consistently rated at the top end of the scale. In nearly every case, the leading law firms identified in the market surveys in each city had obtained MOJ’s National Outstanding Law Firm certification (or satisfied the same evaluation criteria). This certification is based on a comprehensive set of evaluation criteria that focus primarily on

structure, business and business development, general infrastructure and management systems, and regulatory compliance.

In the subsequent due diligence stages, Lovells delved more deeply into the management structures and systems employed by each firm. The management structures and systems form the foundation on which firms can develop practice area specialization and foster quality of service.

—Robert Lewis



The UK firms' size advantage in Hong Kong likely reflects Hong Kong's colonial past and the continuing high entry barriers to the top of Hong Kong's legal services market for US and other foreign law firms. For example, because Hong Kong law is based on English law, UK firms more readily possess local law expertise. In addition, many UK law firms have long-standing relationships with key Hong Kong-based clients.

Precise figures are generally unavailable, but it appears that the correlation between scale of resources and market ranking also applies to the Beijing and Shanghai offices of the top 20 foreign law firms. Based on publicly available information, four of the top five foreign law firms in China

lawyers who, as noted above, can only be hired as paralegals and cannot provide advice on PRC legal matters. These foreign law offices in China are comprised principally of local Chinese lawyers with no foreign legal education, qualification, or experience, but notwithstanding the practice restrictions noted above, they typically are still billed out at international law firm rates. Consequently, in China, even more so than in other countries, one has to look beyond staff numbers to select a law firm.

### Chinese firms: Size is only one factor

Scale is an even less reliable indicator of quality when it comes to Chinese law firms. Perhaps because China is a

## The primary indicator of expertise in Chinese firms is the sophistication and stability of management structures.

have more than 40 lawyers in their mainland offices combined, while none of the second five has achieved this scale.

Of course, size does not automatically equal quality, and in a market thin on highly qualified practitioners, new market entrants in mainland China that aim to grow quickly will often hire second- or third-tier talent. Many foreign law firms also pad their numbers by counting local Chinese

vast country with an enormous population, the country's prevailing business culture reveres grand scale; it follows that in many Chinese law firms, size is admired for its own sake.

With more than 600 lawyers, Beijing-based King & Wood PRC Lawyers is the largest Chinese law firm. The Beijing-based Jun He Law Offices and Shanghai-based AllBright Law Offices, which join King & Wood in the list of top three local Chinese law firms, each have roughly 250 lawyers. About one-quarter of the lawyers in these top firms have had some foreign legal education.

The vast majority of local Chinese law firms are composed of a loose collection of sole practitioners operating under a shared name. Offices of the same firm are, more often than not, completely independent profit centers. Not surprisingly, cross-selling is uncommon, quality control measures are weak, and staffing and coordination of larger transactions can be problematic in the absence of cohesive teams within the local law firms. Even though

**Table 2: Top 20 Foreign Law Firms in China (ranked in order of overall best law firm)**

Rank	Firm	Country/Region
1	Baker & McKenzie LLP	United States
2	Freshfields Bruckhaus Deringer	United Kingdom
3	Clifford Chance LLP	United Kingdom
4	Lovells LLP	United Kingdom
5	Linklaters LLP	United Kingdom
6	Allen & Overy LLP	United Kingdom
7	Herbert Smith LLP	United Kingdom
8	Jones Day	United States
9	O'Melveny & Myers LLP	United States
10	White & Case LLP	United States
11	Simmons & Simmons	United Kingdom
12	Johnson Stokes & Masters	Hong Kong
13	Morrison & Foerster LLP	United States
14	Sherman & Sterling LLP	United States
15	Deacons Hong Kong	Hong Kong
16	Paul, Hastings, Janofsky & Walker LLP	United States
17	DLA Piper UK LLP	United Kingdom
18	Sidley Austin LLP	United States
19	Skadden, Arps, Slate, Meagher & Flom LLP	United States
20	Latham & Watkins LLP	United States

Sources: Adapted from *Asia Pacific Legal 500*, 2007–08 edition; and *PLC Which Lawyer? Recommended Firms in China*, 2007

**Table 3: Top 10 Chinese Law Firms (head offices ranked in order of overall best law firm)**

Rank	Firm	City
1	King & Wood PRC Lawyers	Beijing
2	Jun He Law Offices	Beijing
3	Global Law Office LLC	Beijing
4	AllBright Law Offices	Shanghai
5	Jingtian & Gongcheng	Beijing
6	Llinks Law Offices	Shanghai
7	Fangda Partners	Shanghai
8	Commerce & Finance Law Offices	Beijing
9	Boss & Young Law Firm	Shanghai
10	Haiwen & Partners	Beijing

Source: Adapted from *Asia Pacific Legal 500*, 2007–08 edition



the top three local firms listed above have advanced management systems by local standards, their management structures have not yet fully matured to international standards. The market consensus is that they still suffer from many of the above problems to one degree or another, although they are making important strides in this regard.

will be able to deepen their specialized areas of expertise only after such reforms have been properly implemented and have matured.

When Lovells commenced its market survey to identify leading local law firms in key second-tier cities across China, it expected to find that these firms lagged even further behind most Beijing and Shanghai firms. But to

## The day of the “one size fits all” China lawyer is gone.

Clients must be careful not to hire either a “dinosaur” or a partially retooled specialist outside his or her narrow area of expertise.

### Seeking concrete indications of expertise in Chinese firms

Consequently, the primary indicator of expertise in Chinese firms is not scale alone but the sophistication and stability of management structures. Management structure is also one of the more difficult factors to assess, since firms are rarely candid about their management systems in the context of a pitch to a potential client. The key elements of law firm management that directly affect specialization and service quality are profit-sharing systems among partners and compensation systems for associate lawyers. While systems differ from firm to firm even in developed jurisdictions, the goal of management systems in leading law firms is to strike the appropriate balance between individual incentives, collective investment, and shared rewards. Finding this balance has proven to be the most significant challenge facing local Chinese law firms today.

The majority of local law firms in Beijing and Shanghai, including many top-rated firms, have either initiated partial management reforms in the last two years or have yet to do so. The delay reflects the long-standing market advantages of these Beijing and Shanghai firms with respect to work for foreign clients or on matters acting opposite foreign clients. Business was so good that the firms had little incentive to undertake management reforms.

More recently, however, local firms have realized that they cannot achieve the levels of specialization and service quality that the market increasingly demands with their current management structures. Law firm management structures are now correctly viewed as the key advantage in a competitive market, but law firm management concepts are not well developed in China and change can be painful. To date, only a small leading group of local firms in Beijing and Shanghai have started to reform their management structures, typically by taking incremental steps toward the goal of collective investment and shared rewards. It will take several more years for these management systems to mature and stabilize, and Chinese lawyers

its surprise, Lovells discovered that the best firms in second-tier cities had identified the importance of solid law firm management structures much earlier than most of their counterparts in Beijing and Shanghai. In most cases, the core partnership of the firms invited to join the SGLA had remained stable for 12 to 15 years, and these firms commenced serious management system reforms in the early part of this decade, well before most Beijing and Shanghai firms. This remarkable result likely reflects the differing demands of the first- and second-tier marketplaces. Local law firms in Beijing and Shanghai often benefit from the superior market conditions in those cities. Local firms in second-tier cities, however, needed stable management and a strong and sustainable vision to build a robust regional practice.

The management reforms of the law firms in second-tier cities have, to a surprising degree, struck the right balance between individual incentives and collective interests. This balance gives them a more stable basis for developing specialized practice groups and a framework for sustainable growth in the scale of, and improvements in quality of, service. None of these regional firms, and in fact no Beijing- or Shanghai-based Chinese firm, is yet close to international standards, but the establishment of proper management systems sets a foundation for further progress.

### Seeking on-the-ground expertise in foreign firms

For most of the last 20 years, FDI was the main game for law firms in China, and China specialists had to be able to run investment projects in a range of industries. It was a fairly simple game, and any reasonably competent bilingual lawyer could make a decent living. Specialization was irrelevant because most deals were variations on the same simple theme. Virtually everyone was a China “corporate” lawyer.

In the last five years, however, the game has started to change dramatically. China deals are more sophisticated and complex, and as the economy flourishes and the regu-



latory environment develops, legal issues are growing more complex. In today's market it is no longer adequate to dress up equity transfers in a Sino-foreign joint venture as merger and acquisition experience applicable to public company takeovers or pretend that handling a couple of manufacturing license negotiations makes one an intellectual property rights expert.

But, just as the balance of resources in China's legal services market shifted from Hong Kong to Beijing and Shanghai in the first part of this decade, the legal services market began to shift from its Beijing and Shanghai focus to a national and international focus in the last two to three years. In the next five years, regional firms in cities such as Chongqing; Guangzhou, Guangdong (which will

## In the next five years, regional firms in cities such as Chongqing, Guangzhou, Hangzhou, Tianjin, and Wuhan will continue to gain prominence.

At the same time, there is not always enough work in a particular category to be a single-practice specialist. This can cause banking specialists, moved from Hong Kong into mainland offices, to work on corporate deals for which their specialized experience is ill-suited. The day of the "one size fits all" China lawyer is gone. Clients must now ensure that they do not hire either a "dinosaur" or a partially retooled specialist outside his or her narrow area of expertise.

### Location, location, location

PRC regulations originally permitted foreign law firms to establish only one law office in mainland China. In 2003, just over one year after China's World Trade Organization entry, China allowed foreign firms to open a second office. To date, virtually all of the leading foreign law firms have opened offices in Beijing and Shanghai. Though PRC regulations permit foreign law firms to open a third office three years after opening the second, no foreign law firm has done so. Since small offices are generally unprofitable, no firm is expected to open a third office in the near future.

A handful of Chinese firms, almost all based in Beijing, have attempted to create a national footprint by establishing multiple offices. Beyond their home market of Beijing, these firms have achieved the most success in Shanghai and Shenzhen. In Lovells' market surveys, no office of a Beijing or Shanghai firm ranked in the top five firms in any other regional market outside of these three cities.

continue to emerge from the shadow of Hong Kong); Hangzhou, Zhejiang; Qingdao, Shandong; Shenyang, Liaoning; Tianjin; and Wuhan, Hubei, will continue to gain prominence.

This market trend follows the flow of foreign investment across all parts of China. Certain categories of legal services are local by nature, however. For example, although China has a single, unified national bar, a lawyer from Beijing or Shanghai can no longer effectively litigate cases in second-tier cities because the local content and *guanxi*, or connections, requirements are too high. Similarly, labor law matters, environmental and other regulatory issues, real estate projects, and virtually any other matter that requires local approvals can be handled best by lawyers in the local jurisdiction.

Almost unnoticed by the foreign legal community in China, leading domestic firms in many of these regional cities are preparing to rise to the next level. The opportunity and challenge for foreign companies in China is to find these firms and include them as part of their overall team of in-house and external legal professionals in a balanced and complementary manner. The establishment of the SGLA represents an important first step in this critical process of creating a new model for legal services delivery in China. 完

*Robert Lewis is managing partner, Lovells LLP, Beijing. Before joining Lovells, he was the Asia general counsel for Nortel Networks. Lewis qualified to practice law in California in 1985 and has worked in China since 1993.*



The following listings contain information from recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*. Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor.

*Compiled by Yoko Uchida*

### Advertising, Marketing & Public Relations

#### INVESTMENTS IN CHINA

**BatesAsia**, a wholly owned subsidiary of WPP Group plc (UK)

Acquired Shanghai-based marketing services company, MeThinks. \$4.95 million. 10/07.

### Architecture, Construction & Engineering

#### CHINA'S EXPORTS

**China CAMC Engineering Co., Ltd.** (Beijing)

Signed contract to design and construct Bekabad Cement Chamotte Production Line Project in Uzbekistan and supply and install equipment and train staff. \$58.73 million. 11/07.

**China CAMC Engineering Co., Ltd.** (Beijing)

Signed contract to initiate Yakuriel Cement Grinding Station Project in Uzbekistan and supply and install equipment and train staff. \$33.18 million. 11/07.

#### CHINA'S IMPORTS

**Goettsch Partners Inc.** (US)

Will design a 1,000-foot-tall mixed-use building in Guangzhou, Guangdong, for Guangzhou R&F Properties Co., Ltd. 09/07.

#### CHINA'S INVESTMENTS ABROAD

**China Architectural Engineering, Inc.** (Guangdong)

Acquired Hong Kong-based Techwell Engineering Ltd. and its subsidiaries. \$11.7 million. 11/07.

### Automotive

#### CHINA'S EXPORTS

**Zhengzhou Yutong Group Co., Ltd.** (Henan)

Will supply 5,348 buses to Cuba by 2009. \$370 million. 09/07.

#### CHINA'S IMPORTS

**Oshkosh Truck Corp.** (US)

Will provide six Striker aircraft rescue and firefighting vehicles and two snow removal vehicles to Beijing Capital International Airport. \$6 million. 09/07.

#### INVESTMENTS IN CHINA

**Nippon Steel Corp.** (Japan), **ArcelorMittal** (Luxembourg)/**Baosteel Group Corp. Ltd.** (Shanghai)

Will build an automotive sheet line in Shanghai by 2010. 11/07.

**Continental AG** (Germany)

Will build a new tire plant in Hefei, Anhui. \$222.89 million. 10/07.

**Dunlop Aircraft Tyres Ltd.** (UK), **Hong Kong Aircraft Engineering Co. Ltd.** (HAECO), and **Taikoo** (Xiamen) Aircraft Engineering Co. Ltd., a subsidiary of HAECO

Signed MOU to build a tire retreading facility in Jinjiang, Fujian. 10/07.

**Antonov plc** (UK)/**Chongqing Loncin General-Purpose Engine Co., Ltd.**, a subsidiary of **Loncin Holdings Co., Ltd.**

Will jointly develop, manufacture, and market a small six-speed automatic transmission. 09/07.

**ZAP** (US)/**Youngman Automotive Group Co., Ltd.** (Zhejiang)

Formed JV to manufacture, market, and distribute electric and hybrid vehicles and to develop and manufacture electric charging infrastructure. 09/07.

### OTHER

**Intel Capital Corp.**, a subsidiary of **Intel Corp.** (US)

Opened the Intel Zhejiang Software Technology Innovation Support Center. 10/07.

**Sixt GmbH & Co.**

**Autovermietung KG** (Germany) Will lease cars and provide limousine services in China. 10/07.

### Aviation/Aerospace

#### CHINA'S EXPORTS

**BOC Aviation** (Singapore), wholly owned subsidiary of **BOC** (Beijing)

Signed contract to supply V2500 engines to power 10 A320 family aircraft to US-based International Aero Engines AG. 09/07.

#### CHINA'S IMPORTS

**Piaggio Aero Industries SpA** (Italy)

Will deliver three P180 Avanti II aircraft to Beijing-based Sino Europe Aircraft Ltd. 09/07.

#### INVESTMENTS IN CHINA

**Singapore Airlines Ltd.**, a subsidiary of **Temasek Holdings Pte. Ltd.** (Singapore)

Acquired 24% stake in Shanghai-based China Eastern Airlines Corp. Ltd. \$927 million. 11/07.

### OTHER

**Antonov ASTC** (Ukraine)/**Shaanxi Aircraft Industry Co., Ltd.**

Signed MOU to establish joint aviation-engineering center in Beijing. 09/07.

### Banking & Finance

#### CHINA'S INVESTMENTS ABROAD

**Bear Stearns Companies, Inc.** (US)/**CITIC Securities** (Beijing)

Signed strategic collaboration agreement to form JV in Hong Kong. (US:50%-PRC:50%). 11/07.

**CITIC Securities Co. Ltd.** (Beijing)

Will acquire 6% stake in US-based Bear Stearns Companies, Inc. 11/07.

**ICBC** (Beijing)

Opened ICBC Moscow Joint-Stock Co. \$40 million. 11/07.

**China Minsheng Banking Corp., Ltd.** (Beijing)

Acquired 9.9% stake in US-based UCBH Holdings, Inc. 10/07.

**ICBC** (Beijing)

Acquired 20% stake in South Africa-based Standard Bank Group Ltd. \$5.46 billion. 10/07.

#### INVESTMENTS IN CHINA

**Cisco Systems Inc.** (US)

Will fund Cisco Systems Capital China, which will provide financing facilities to Cisco customers over the next three to five years. \$400 million. 11/07.

**Morley Fund Management Ltd.**, a subsidiary of **Aviva plc** (UK)/**COFCO** (Beijing)

Signed MOU to form a fund management JV. 11/07.

**Motorola Inc.** (US)

Will establish a WFOE, Motorola (China) Finance Ltd., in Binhai Tianjin New Area. \$13.5 million. 11/07.

**Hong Leong Bank Bhd**, a subsidiary of **Hong Leong Group Malaysia**

Acquired 19.99% stake in Sichuan-based Chengdu City Commercial Bank Co. Ltd. 10/07.



**JPMorgan Chase & Co. (US)**  
Opened its locally incorporated bank in Beijing. 10/07.

**JPMorgan Chase & Co. (US)/Zhongshan Future Electronics Manufacturing Co., Ltd. (Guangdong)**  
Will form JV to provide futures execution and clearing services in China. 09/07.

## OTHER

**Cisco Systems Inc. (US)**  
Will form strategic initiative with CDB to invest in innovative PRC companies. 11/07.

**AB Bankas SNORAS (Lithuania)**  
Opened representative office in Shanghai. 10/07.

**Barclays Bank plc (UK)/CDB (Beijing)**  
Formed a commodities strategic alliance to strengthen CDB's commodities capabilities and expand Barclay's market presence in China. 10/07.

## Chemicals, Petrochemicals & Related Equipment

### INVESTMENTS IN CHINA

**Sinochem Fertilizer Co., Ltd., a wholly owned subsidiary of Sinofer Holdings Ltd. (Hong Kong)**  
Signed agreement to acquire 30% stake in Gansu Wengfu Chemical Co., Ltd. 11/07.

**China BlueChemical Ltd. (Hong Kong)/Jincheng Municipal State Assets Supervision and Administration Committee (Shanxi)**  
Will form chemical fertilizer JV, China BlueChem Jincheng Chemical Ltd. \$214.6 million.

(HK:75%-PRC:25%). 09/07.

**E.I. DuPont de Nemours & Co. (US)/Sinopec (Beijing)**  
Formed JV to produce ethylene vinyl acetate resins. (US:45%-PRC:55%). 09/07.

**Radici Novacips SpA, a subsidiary of Radici Partecipazioni SpA, Lati Industria Termoplastici SpA (Italy)**  
Will form JV, RadiciPlastics Suzhou Co., Ltd., to develop the Chinese engineering plastics market. 09/07.

## Distribution, Logistics & Related Services

### CHINA'S IMPORTS

**Sigma Kudos AB, a subsidiary of Sigma AB (Sweden)**  
Will provide Internet protocol multimedia subsystems and information logistics services in Shanghai. 11/07.

## OTHER

**Staples UPS Express, a JV between Staples, Inc. and United Parcel Service, Inc. (US)**  
Opened its first two stores in Beijing. 10/07.

## Electronics, Hardware & Software

## OTHER

**Oracle Corp. (US)/China TransInfo Technology Corp. (Beijing)**  
Formed a partnership to work in China's transportation sector. 10/07.

**Dell Inc. (US)**  
Will sell products at 50 major metropolitan stores through

Beijing-based electronics retailer Gome Electrical Appliances Holdings Ltd. 09/07.

## Energy & Electric Power

### CHINA'S IMPORTS

**Wikov MGI (Czech Republic)**  
Will supply 50 3-megawatt gearboxes for wind power stations in China. \$24.17 million. 11/07.

**Alstom Power Hydro, a JV between Alstom SA and Bouygues SA (France)**  
Will supply hydropower generators to Sichuan-based Ertan Hydropower Development Co. 10/07.

**Alstom Power Hydro, a JV between Alstom SA and Bouygues SA (France)**  
Will supply hydropower generators to Yunnan Lancangjiang Hydro Development Co. Ltd. 10/07.

**Alstom Power Hydro, a JV between Alstom SA and Bouygues SA (France)**  
Will supply hydropower generators to Guizhou-based Wujiang Hydroelectric Development Corp. 10/07.

**Alstom Power Hydro, a JV between Alstom SA and Bouygues SA (France)**  
Will supply hydropower turbine and generator units to Yunnan Longjiang Water Conservancy Development. 10/07.

**Curtiss-Wright Corp., Westinghouse Electric Co. LLC (US)**  
Will provide reactor coolant pumps for four commercial nuclear power plants to be built in China. 09/07.

## OTHER

**Shell Hydrogen, a division of Shell Group (the Netherlands)**  
Opened its first hydrogen refueling station in Shanghai. 11/07.

**Techsnabexport (Russia)/Chinese Atomic Energy Industry Co. (Beijing)**  
Signed framework agreement on construction of a gaseous centrifuge facility in Hanzhun, Shaanxi. 11/07.

**Kazatomprom (Kazakhstan)/China Guangdong Nuclear Power Holding Co., Ltd.**  
Signed MOU for Kazatomprom to invest in China's nuclear power industry. 10/07.

## Environmental Equipment & Technology

### INVESTMENTS IN CHINA

**Cisco Systems Inc. (US)**  
Will establish "green" technology center to support sustainable development, energy efficiency, reduction of electronic waste, and emission reductions inside and outside of China. 11/07.

## Food & Food Processing

### CHINA IMPORTS

**E.I. DuPont de Nemours & Co. (US)**  
Will provide BAX detection system to help the Beijing Food Safety Administration monitor and ensure food safety in 2008. 10/07.

### INVESTMENTS IN CHINA

**Coffee Pacifica, Inc. (US), China Capital Partners Inc. (Canada)**  
Opened Shanghai café, Uncommon Grounds Coffee. 11/07.

Abbreviations used throughout text: **ABC:** Agricultural Bank of China; **ADB:** Asian Development Bank; **ASEAN:** Association of Southeast Asian Nations; **ATM:** automated teller machine; **AVIC I and II:** China Aviation Industry Corp. I and II; **BOC:** Bank of China; **CAAC:** General Administration of Civil Aviation of China; **CATV:** cable television; **CBRC:** China Banking Regulatory Commission; **CCB:** China Construction Bank; **CCTV:** China Central Television; **CDB:** China Development Bank; **CDMA:** code division multiple access; **CEIEC:** China National Electronics Import and Export Corp.; **China Mobile:** China Mobile Communications Corp.; **China Netcom:** China Netcom Corp. Ltd.; **China Railcom:** China Railway Communications Co., Ltd.; **China Telecom:** China Telecommunications Group Corp.; **China Unicom:** China United Telecommunications Corp.; **CIRC:** China Insurance Regulatory Commission; **CITIC:** China International Trust and Investment Corp.; **CITS:** China International Travel Service; **CNOOC:** China National Offshore Oil Corp.; **CNPC:** China National Petroleum Corp.; **COFCO:** China National Cereals, Oils, and Foodstuffs Import and Export Corp.; **COSCO:** China Ocean Shipping Co.; **CSRC:** China Securities Regulatory Commission; **DSL:** digital subscriber line; **ETDZ:** economic and technological development zone; **GSM:** global system for mobile communication; **GPS:** global positioning system; **ICBC:** Industrial and Commercial Bank of China; **IP:** Internet protocol; **IT:** information technology; **JV:** joint venture; **LNG:** liquefied natural gas; **MII:** Ministry of Information Industry; **MOFCOM:** Ministry of Commerce; **MOU:** memorandum of understanding; **NA:** not available; **NDRC:** National Development and Reform Commission; **NORINCO:** China North Industries Corp.; **PAS:** personal access system; **PBOC:** People's Bank of China; **PetroChina:** PetroChina Co., Ltd.; **RMB:** renminbi; **R&D:** research and development; **SARFT:** State Administration of Radio, Film, and Television; **SASAC:** State Assets Supervision and Administration Commission; **SEZ:** special economic zone; **SINOPEC:** China Petroleum & Chemical Corp.; **SINOTRANS:** China National Foreign Trade Transportation Corp.; **UNDP:** United Nations Development Program; **SME:** small and medium-sized enterprise; **Wi-Fi:** wireless fidelity; **WFOE:** wholly foreign-owned enterprise



## Forestry, Timber & Paper

### INVESTMENTS IN CHINA

#### Voith AG (Germany)

Opened third paper machine plant in Jiangsu. \$74 million. 10/07.

## Human Resources & Labor

### OTHER

E.I. DuPont de Nemours & Co. (US)/China Academy of Safety Science & Technology (Beijing) Signed MOU to improve industrial workplace safety in China. 09/07.

## Insurance

### INVESTMENTS IN CHINA

Pacific Antai Life Insurance Co., a JV between ING Group (the Netherlands) and China Pacific Insurance (Group) Co., Ltd. (Shanghai)

Will open a Jiangsu branch in the first half of 2008. 11/07.

Shin Kong Life Insurance Co., Ltd. (Taiwan)/Hainan Airlines Group

Will form a JV to establish sales channel. (Taiwan:50%-PRC:50%). \$67 million. 11/07.

## Internet/E-Commerce

### OTHER

Cisco Systems Inc. (US)

Signed MOU with Zhejiang-based Alibaba Group to explore collaboration in providing business management solutions to small and medium-sized enterprises. 11/07.

## Light Industry/Manufacturing

### CHINA'S IMPORTS

Meyer Burger Technology AG (Switzerland)

Will deliver cutting and slicing machines to Jiangsu-based Trina Solar Ltd., a subsidiary of Changzhou Trina Solar Energy Co. Ltd. \$153 million. 10/07.

### INVESTMENTS IN CHINA

Goldman Sachs Group, Inc. (US) Will acquire 12.08% stake in toolmaker Sichuan-based Chengdu Yangzhiguang Industrial. 11/07.

Cooper Industries, Ltd. (US)/Nature Science & Technology Co. Ltd. (Zhejiang)

Will form JV to develop indoor switchgear products. 10/07.

CVC Asia Pacific Ltd., a subsidiary of CVC Capital Partners (UK)

Acquired 29% stake in Zhuhai Zhongfu Enterprise Co., Ltd., China's largest polyethylene terephthalate bottle manufacturer. \$223 million. 10/07.

Resinoplast SA, a subsidiary of the Arkema Group (France)

Opened plant to produce synthetic leather for auto interiors in Changshu, Jiangsu. 10/07.

Ahlstrom Corp. (Finland)/Zhejiang Kan Specialty Material Co. Ltd.

Will form JV to produce crepe paper. (Finland:70%-PRC30%). \$14.48 million. 09/07.

Arkema Group (France)

Will build facility to produce polyvinylidene fluoride in Changshu, Jiangsu. 09/07.

### OTHER

Intel Capital Corp., a subsidiary of Intel Corp. (US)/Supcon Group Co., Ltd. (Zhejiang)

Will cooperate to develop and promote industrial automation solution in China. \$10.5 million. 11/07.

## Media, Publishing & Entertainment

### CHINA'S IMPORTS

VODone Ltd. (Hong Kong)

Will provide equipment, staff, and other support to the Beijing International (non-registered reporter) Media Center 2008 for the Olympics. 10/07.

### OTHER

International Telecommunication Union (Switzerland)/Huawei Technologies Co., Ltd. (Guangdong)

Signed MOU to jointly promote information and communication technology development in developing countries. 10/07.

## Metals, Minerals & Mining

### CHINA'S EXPORTS

China Nonferrous Metal Industry's Foreign Engineering and Construction Co., Ltd. (Beijing)

Signed contract with Mines and Industries Ministry of Iran and Iranian Mines and Mining Industries Development and Renovation Organization to design, construct, supply equipment to, and provide technical assistance and training to, the Alumina Production from Nepheline Project in Iran. \$107.76 million. 10/07.

Yukon-Nevada Gold Corp. (Canada)/Northwest Mining and Geological Exploration Bureau for Nonferrous Metals (Shaanxi) Will form JV, Yukon-Shaanxi Gold Co. Inc., to acquire, explore, and develop mineral resources in Yukon. 10/07.

### CHINA'S IMPORTS

Vietnam National Coal Mineral Industries Group

Will supply 1 million metric tons of thermal coal per year to Guangxi-based Chongzuo Power Plant, a subsidiary of China Guodian Corp., from 2008 to 2010. 10/07.

Komatsu America Corp., a subsidiary of Komatsu Ltd. (Japan)

Will supply mining trucks and support equipment to the Beijing-based China National Coal Development Corp. \$200 million. 09/07.

### CHINA'S INVESTMENTS ABROAD

Kazatomprom (Kazakhstan)/China Guangdong Nuclear Power Holding Co., Ltd. (Guangdong), China National Nuclear Corp. (Beijing) Agreed to establish JV to jointly develop uranium resources in Kazakhstan. 10/07.

Sinosteel Corp. (Beijing) Acquired Zimbabwe-based Zimasco Consolidated Enterprises Ltd. 09/07.

### INVESTMENTS IN CHINA

Minmetals Resources Ltd., a subsidiary of China Metals Corp. (Hong Kong)

Will acquire 33% stake in Guangxi Huayin Aluminum Co. Ltd. \$115.27 million. 11/07.

MultiServ (UK), a division of Harsco Corp. (US)

Signed agreement to provide mill services to Zhejiang-based Ningbo Jianlong Iron and Steel Co., Ltd. for 12 years. \$50 million. 11/07.

Novolipetskiy Metallurgicheskiy Kombinat OAO (Russia)/Xinjiang Tebian Electric Apparatus Stock Co. Ltd.

Will form metals service center to process transformer steel in Shenyang, Liaoning. \$12 million. 11/07.

### OTHER

MMC Corp. Bhd (Malaysia), Saudi Binladin Group (Saudi Arabia)/Aluminum Corp. of China Ltd. (Beijing)

Will jointly build an aluminum smelter plant in Saudi Arabia. \$3 billion. 10/07.

Ulba Metallurgical Plant (Kazakhstan)/Ningbo Xingye Electronic Copper Strip Co., Ltd. (Zhejiang)

Will form JV, Yingtian Ulba Shine Metal Materials Co. Ltd., to increase sales of beryllium-related products. 10/07.

West Hawk Development Corp. (Canada)/Luan Mining Industries Group (Shaanxi)



Signed cooperation agreement to develop chemical bases in Shanxi, Xinjiang, and North America. (Canada:50%-PRC:50%). 09/07.

## Petroleum, Natural Gas & Related Equipment

### CHINA'S IMPORTS

Taiyo Nippon Sanso Corp. (Japan)

Will supply industrial gases to Dalian Changxing Island Harbor Industrial Zone in Liaoning. 09/07.

### CHINA'S INVESTMENTS ABROAD

Government of Chad/CNPC (Beijing)

Signed agreement to form a JV refinery in Chad. 09/07.

### INVESTMENTS IN CHINA

Glitnir Banki hf (Iceland)/Sinopec (Beijing)

Will jointly develop a geothermal energy project in Shaanxi. 10/07.

### OTHER

Kingworld Resources Ltd., a subsidiary of Rimbunan Hijau Group (Malaysia)/CNPC (Beijing)  
Signed contract to develop oil reserves in Jilin. 11/07.

MEC Resources Ltd. (Australia)/China National Logging Corp., a subsidiary of CNPC (Beijing)  
Signed MOU to form JV to provide oil and gas production and exploration services to MEC Resources. 10/07.

## Ports & Shipping

### CHINA'S EXPORTS

Hudong-Zhonghua Shipbuilding (Group) Co., Ltd. (Shanghai)  
Will provide four vessels to Hong Kong-based Orient Overseas (International) Ltd. \$482.8 million. 10/07.

Shanghai Shipyard & Chengxi Shipyard Co., Ltd., a subsidiary of China State Shipbuilding Corp. (Beijing)

Will build one ship for Hong Kong-based Oak Maritime (HK) Inc. Ltd. and two for Wah Kwong Shipping Holdings Ltd. \$133 million. 10/07.

### CHINA'S IMPORTS

Golden Ocean Group Ltd. (Bermuda)

Will supply eight vessels to Zhoushan Jinhaiwan Shipyard. \$410 million. 10/07.

MacGregor Group AB (Sweden), a subsidiary of Cargotec Corp. (Finland)

Will provide ship cranes and hatch covers for 10 general cargo ships. \$28.9 million. 09/07.

### INVESTMENTS IN CHINA

COSCO Pacific Ltd., a subsidiary of COSCO Group Ltd. (Hong Kong)/Jinjiang Port Investment and Development (Guangdong)  
Will form JV, Jinjiang Pacific Ports Development to manage terminals at Weituo and Shenhui Ports and related transportation and freight forwarding businesses. (HK:80%-PRC:20%). \$99.8 million. 10/07.

## Rail

### CHINA'S IMPORTS

Bombardier Sifang Power (Qingdao) Transportation Ltd., a JV of Bombardier Transportation (Germany), Power Corp. of Canada, and China South Locomotive and Rolling Stock Industry (Group) Corp. (Beijing)  
Will deliver 40, 16-car, high-speed trains to the PRC Ministry of Railways. \$1.5 billion. 10/07.

## Real Estate & Land

### INVESTMENTS IN CHINA

Hutchison Whampoa Properties Ltd., a division of Hutchison Whampoa Ltd., Agile Property Holdings Ltd. (Hong Kong)  
Acquired land in Shenzhen, Guangdong, and Nanjing, Jiangsu. \$228.94 million. 11/07.

## Retail/Wholesale

### CHINA'S INVESTMENTS ABROAD

Youngor Group Co. Ltd. (Zhejiang)  
Acquired Smart Shirts, a division of US-based Kellwood Co. \$120 million. 11/07.

### INVESTMENTS IN CHINA

Marks and Spencer plc (UK)  
Will open shop in China. 11/07.

## Telecommunications

### CHINA'S EXPORTS

Huawei Technologies Co., Ltd. (Guangdong)  
Will supply kit for developing the southern Italian network for Telecom Italia SpA. 11/07.

### CHINA'S IMPORTS

Nokia Siemens Networks (Finland), a JV between Nokia Oyj and Siemens AG  
Will provide GSM-R railway communication system for the Hefei-Nanjing line. 10/07.  
Nokia Siemens Networks (Finland), a JV between Nokia Oyj and Siemens AG  
Will provide a mobile charging service for Guangdong Telecom, a subsidiary of China Telecom. 10/07.

### INVESTMENTS IN CHINA

ADC Telecommunications, Inc. (US)  
Will acquire Guangdong-based Century Man Communication Equipment Co., Ltd. \$55 million. 11/07.

## OTHER

### Qualcomm Inc. (US)

Signed license agreement with TechFaith Wireless Technology Group Ltd. to manufacture and sell 3G worldwide subscriber units and modem cards. 10/07.

### TransTelecom Co. (Russia)

Will open office in Beijing to develop its presence in the Asia-Pacific region. 09/07.

Huawei Tech Investment Co., Ltd. (Hong Kong), a wholly owned subsidiary of Huawei Technologies Co., Ltd. (Guangdong)

Acquired a minority stake in US-based 3Com Corp. as part of a deal with Bain Capital, LLC. 09/07.

## Tourism & Hotels

### INVESTMENTS IN CHINA

Accor SA (France)  
Will open three new hotels in Beijing by the 2008 Olympics as part of a plan to build 62 new hotels in China by 2010. 09/07.

Great Eagle Holdings Ltd. (Hong Kong)/Beijing Capital Airport Hotel

Signed contract to open at least 30 hotels throughout China in 5 to 10 years. 09/07.

Jones Lang LaSalle Hotels (US)/Langham Hotels (Hong Kong)

Signed agreement to open a hotel at the Beijing Capital International Airport's new terminal 3 by July 2008. 09/07.

## OTHER

Triton Distribution Systems, Inc. (US)

Signed partnership agreement with Beijing-based Destination Travel International Co., Ltd. to provide tour booking services. 9/07.



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