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CHINA LAW REPORTER
中国法律报道

REPORTING ON DEVELOPMENTS IN THE FOUR LEGAL SYSTEMS OF GREATER CHINA

Welcome to the May issue of the China Law Reporter. In this issue you will find articles on evidence in commercial arbitration in China; a summary of PRC labor law and regulation; a discussion of debt restructuring as a means to address difficult economic conditions; a summary of the changes in the new version of the Patent Law of China; and a variety of items of interest to our members.

Since the last issue of the reporter, Committee members have renewed old ties and made new friends at the largest Spring Meeting ever held by the Section in Washington, DC. Several programs at the Spring Meeting addressed developments in China's legal system with special attention paid to the merger review process under the new Anti-Monopoly Law. Following the rejection by MOFCOM of Coke's purchase of Huiyuan, the question of how the merger review process would proceed seemed to be one of the biggest questions on the minds of our fellow international lawyers.

Our Committee had members participating in and also sponsoring a number of programs. On Friday afternoon, Co-Chair Adam Bobrow and Vice Chair Adam Li participated in a panel with David Liu, partner at Jun He, and Yee Wah Chin, the Section's Program Officer, entitled "China: The Road Ahead." In that program, we addressed a continuing hypothetical involving the purchase of a formerly state-owned enterprise by a domestic enterprise, the increase in domestic market share for the combined company, attempts to resolve redundancy through lay-offs, and the attempt by the combined company to maintain its preferential tax status. All of these details and the resulting analysis provided the audience with a sense of what many of our members in China do every day.

Co-Chairs Message, continued

In lieu of our monthly steering group conference call, we took the opportunity to catch up at the Kennedy Center on Wednesday night of the meeting. At that time, we were able to discuss our thoughts about the Committee and share ideas with the members of many other committees, especially the Asia-Pacific and new India Committees. It was a great opportunity to connect with a larger group and see how our committee's work might fit in with that of other committees. We were able to continue that discussion on Friday at lunch where committees were seated according to their division. Our division, which spans most of the globe, has many active committees and both offers us examples to follow and a sense that the China Committee continues to be a leader.

During the first part of this year the Committee has remained active in a variety of ways, with representatives working on a variety of cooperative projects and putting on a breakfast teleconference with faculty in Washington and China. Co-Chair Adam Bobrow attended the ABA Rule of Law Initiative (ABA-ROLI) Conference in Washington. During the first quarter of 2009, the American Bar Association Rule of Law Initiative China Program (ABA ROLI) worked with local partners on programs to promote women's rights, increase fairness in the criminal justice system, enhance citizens' knowledge of legal rights, and facilitate direct communication between Chinese NGOs and the government. For additional information, please visit their website at http://www.abanet.org/rol/asia/china.html.

We have also worked with the International Antitrust Committee and the Section on interactions with some of the Chinese officials involved in implementing and enforcing the AML and its related regulations. The Chamber of Commerce hosted a session for the Section with Shang Min, the Ministry of Commerce's Director General for the Anti-Monopoly bureau, and his delegation. Presentations on the history of antitrust enforcement in the United States provided the delegation with a more complete understanding of the complexity of economic regulation of this type. Another delegation will be visiting Washington in May and the China Committee will again have representatives involved in the discussions.

In China, the Shanghai chapter of the committee hosted a very successful mixer for foreign and Chinese lawyers in March. Building on significant work by Co-Chair Elizabeth Cole and Vice Chairs Robin Kaptzan and Adam Li, the mixer provided an opportunity for Shanghai-based Committee members to see their local lawyer counterparts in a more informal setting. The mixer was oversubscribed so we're sure to repeat the event in the fall. If you were not able to attend the recent mixer, be sure to get your RSVP in early for the next one.

All members of the Committee should also know that we continue to hold monthly steering group conference calls. If you have a program that you would like to see become reality, please sign up for the steering group and get your program proposal discussed at the next call. How do you get on the steering group? Just send an email to either of the Co-Chairs and we'll be happy to add your email to the steering group list and put your program proposal on the agenda. Our next call with be the third Wednesday in May, May 20 (Thursday morning May 21 in China) at 8:30. Call-in details will be forthcoming to the steering group listserv the week before the event.

Elizabeth Cole, Co-Chair
Adam Bobrow, Co-Chair

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RECENT DEVELOPMENTS

China's Rules of Evidence in International Commercial Arbitration— from the perspective of CIETAC practice[Δ]

By LU Song[*] and GU Huaning[**]

I. Introduction

Rules of evidence are the crucial part of modern arbitration proceedings. In international commercial arbitration, disputes are resolved as a principle on the basis of facts that have been proven to have happened in a particular case, not on facts that actually happened, albeit in many occasions the two are quite close or at least consistent with each other.

Apart from the numbered provisions on evidence under the Arbitration Law of the People's Republic of China[1] ("PRC" or "China"), which are generally dutifully observed by arbitral tribunals conducting arbitration in China, there is no set of evidence rules for international commercial arbitration in the PRC like the IBA Rules on the Taking of Evidence in International Commercial Arbitration "(IBA Rules of Evidence"). The arbitration rules adopted by the arbitration institutions in the PRC, when agreed upon by the parties to be applicable, scarcely have provisions on evidence that are adequate for the use of the parties and the arbitral tribunals. The rules of evidence followed by the Chinese court of law are, arguably, inapplicable to international commercial arbitration conducted in China. This leads to a frequent situation in which an arbitral tribunal, facing a complicated case and absent the parties' choice, fills in the gap in evidence rules by its own decision, which will necessarily be influenced by the educational background and practical experience of each member of the panel.

China International Economic and Trade Arbitration Commission ("CIETAC") has established its practice concerning taking of evidence over 50 years of its development. This article aims at summarizing certain rules for taking of evidence in China's international commercial arbitration, based on the PRC Arbitration Law, CIETAC Arbitration Rules (CIETAC Rules[2]) and its practice, the PRC Civil Procedure Law[3], the Supreme People's Court Provisions on Evidence in Civil Procedures

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[Δ] This paper is based on a speech delivered by the authors at the CIETAC-IBA Conference held in Beijing November 24, 2008 on Evidence Procedure and Ethics in International Arbitration.

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[1] Effective September 1, 1995.

[2] Effective May 1, 2005.

[3] Effective April 9, 1991 and amended October 28, 2007.

("Provisions on Evidence"[4]), and the personal experience of the authors in CIETAC arbitration. The views expressed herein are those of the authors who are aware that some of these views are academically disputed and do not necessarily reflect the opinion of CIETAC.

II. Rules of Evidence Applicable in Chinese Arbitration

A. *Court evidence rules not binding in arbitration*

Arbitration proceedings can be categorized as a special civil procedure, and a statute entitled "arbitration law" will be commonly understood in the same way as a special piece of legislation taking priority over the Civil Procedure Law in case of any discrepancy[5]. Internationally, the code of civil procedure of a civil law country may contain a part specifically on arbitration[6]. While some fundamental principles and procedural rules followed in both arbitration and litigation are identical or at least similar, the code of civil procedure (except for the part on arbitration) which is binding on the courts of justice in a given jurisdiction is, in theory, inapplicable to commercial arbitration. Arbitration and litigation are alternative procedures in terms of deciding on the merits of a commercial dispute[7]. There are other apparent distinctions between the two, such as the display of judicial sovereignty of a country in a court litigation, while a private dispute resolution mechanism is demonstrated in arbitration.

The code of civil procedure, as *lex fori*, governs the procedure of the courts, which is also the case in China. Article 4 of PRC Civil Procedure Law provides: "Whoever engages *in civil litigation* [emphasis added] within the territory of the People's Republic of China must abide by this Law." The preamble of the SPC's Provisions on Evidence serves as another example, which make it clear that the purposes of the provisions are to ensure that *the courts* [emphasis added] correctly establish the facts of the case, try civil cases in an impartially and timely manner and safeguard and facilitate the exercise by the parties of their procedural rights. Consequently and technically speaking, these rules of evidence are not binding on the parties and the tribunals in international commercial arbitration conducted in China.

B. *Rules of evidence applicable in arbitration in China*

The statutory provisions that govern the taking of evidence in international commercial arbitration can be found in Articles 43-46 and Article 68 of the Chinese Arbitration Law. These provisions cover certain basic principles in rules of evidence like the burden of proof, tribunal's power to collect evidence, expert opinion on technological and professional issues, questioning and cross examination of evidence during arbitral hearing and the protection of perishable evidence. However, a salient question has been

[4] Effective April 1, 2002.
[5] Art. 83, PRC Legislation Law.
[6] See for instance, French Code of Civil Procedure, Book IV; Italian Code of Civil Procedure, Book IV, Title III; Switzerland's Federal Code on Private International Law, Chapter XII.
[7] See for instance, Art. 2(3) of the 1958 UN Convention on Recognition and Enforcement of Foreign Arbitral Awards and Art. 8(1) of 1985 UNCITRAL Model Law on International Commercial Arbitration.

left unanswered by that law: are these provisions or any of them mandatory or non-mandatory along the lines of the distinction made under the UK Arbitration Act 1996[8]? These provisions will be discussed below in more detail.

Under the UNCITRAL Model Law[9], the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings. Failing such agreement, the tribunal is empowered to conduct the arbitration in such manner as it considers appropriate, including the power to determine all the issues relating to evidence. The UNCITRAL Model Law itself does not provide much on evidence rules. The Chinese law also recognizes the principle of party autonomy in choosing arbitration rules[10], which allows for not only the arbitration rules of a permanent arbitration body or a set of rules such as the UNCITRAL Arbitration Rules (1976), but also other rules which may include rules of evidence selected by the parties and tailored rules of procedure for *ad hoc* arbitration. Consequently, the provisions on taking of evidence under the arbitration rules agreed upon by the parties will play a crucial role in the establishment of facts of the case. However, there are only a few provisions under CIETAC Rules[11] which will help the tribunals to try disputes under the auspices of CIETAC. A guideline in this respect not forming part of the arbitration rules is therefore considered necessary by the authors. The guideline may take into account the Chinese practice and replace the impact currently exerted by the court's evidence rules.

Under Chinese law, a distinction can be drawn between domestic arbitration and international arbitration. In the former case, "*the composition of the arbitral tribunal or the procedure for arbitration contradicts the procedure prescribed by the law*" is a ground for setting aside[12] or refusal of enforcement of domestic arbitral awards by the court[13], while in the latter case, the counterpart ground is stated as *"the composition of the arbitration tribunal or the procedure for arbitration was not in conformity with the rules of arbitration."* In addition, Chinese arbitration law contains a requirement of due process[14], which is considered so fundamental as a procedural right of the parties that it cannot be derogated from. A strict interpretation of this statutory provision of Chinese law will lead to the conclusion that, apart from the requirement of due process which is regarded as mandatory, arbitration proceedings in international commercial arbitration will be deemed lawful so long as they conform to the arbitration rules, which the parties (or the tribunals in the absence of agreement by the parties) have the right to choose. Unfortunately, this conclusion may not be universally accepted, for it is uncertain in the view of the Chinese courts whether other provisions contained in the PRC Arbitration Law regarding evidence must be followed by the tribunals.

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[8] § 4.
[9] Art. 19.
[10] Art. 257, PRC Civil Procedure Law.
[11] Articles 36-39 and 67.
[12] Art. 58, PRC Arbitration Law.
[13] Art. 213, PRC Civil Procedure Law.
[14] The requirement of due process is expressed in Article 257 of PRC Civil Procedure Law as "the party against whom the application for enforcement is made was not given notice for the appointment of an arbitrator or for the inception of the arbitration proceedings or was unable to present his case due to causes for which he is not responsible."

III. Impact of the Evidence Rules Followed by Chinese Courts

Although the evidence rules embodied in the PRC Civil Procedure Law and the Provisions on Evidence are not directly applicable to international commercial arbitration, they nevertheless have a profound impact on the taking of evidence in arbitration conducted in China. Many Chinese arbitrators subconsciously or consciously make reference to these rules of evidence as guidance in their arbitration practice. Some of them even cite the court rules of evidence in support of their decision on evidence. This is especially so when an arbitrator is a retired judge. Similar situations are also found in the pleadings prepared and filed by Chinese legal counsel in CIETAC arbitrations[15]. This is not the preferred practice in the view of the authors.

Many Chinese arbitrators believe that the rules of evidence followed by Chinese courts are much stricter than those employed by tribunals in international commercial arbitration in China. This is true not only in terms of the forms of evidence, admissibility, relevance and weight of evidence, but also on burden of proof and determination of the preponderance of evidence. The reality in current PRC arbitration is that the rules of evidence followed by each arbitral tribunal differ, sometimes noticeably. Some arbitrators will be concerned that the rules of evidence they use in deciding a dispute in arbitration vary too much from the rules of evidence followed by the Chinese courts. Due to our limited experience, the authors have not been personally involved in or known of any case decided under the auspices of CIETAC in which IBA Rules of Evidence have been ultimately made applicable by a tribunal. This is not attributable to the ignorance of these rules by Chinese arbitrators, but to the disparity between these unaccustomed rules and the usual practice they follow in arbitration in China. The lack of experience in using IBA Rules of Evidence makes them reluctant to take initiative in proposing the application of these rules. Nevertheless, they will follow these rules if the parties agree to adopt these rules in their case.

IV. Burden of Proof

The parties are free to submit to an arbitral tribunal evidence of their choice. There is no rule, even under Chinese judicial practice, that requires all parties to fully disclose evidence relevant to the dispute. There is no mechanism to compel the parties to submit all relevant evidence either[16].

Article 36 of the CIETAC Rules provides that each party shall have the burden of proof for supporting its claims or counterclaims while the tribunal may set a time limit for evidence submission. Article 37 empowers the tribunal to investigate and collect evidence when it deems necessary and appropriate. These two articles come from Article 43 of the PRC Arbitration Law which states:

> *The parties concerned shall provide evidence to support their respective claims. Whereas an arbitration tribunal deems it*

[15] Undoubtedly, these and many other conclusions of the authors are based on our long-time personal involvement in CIETAC arbitration.

[16] There is no contempt of court under current Chinese law and the courts are not empowered to put in prison a person not cooperative with the court in producing evidence.

> *necessary to collect evidence, it may collect it on its own initiative.*

For the parties, providing evidence is mandatory, while collecting evidence by tribunals is discretionary. This is exactly the situation in China and in the CIETAC practice. "Whoever makes a claim must prove his case" is an undisputed doctrine of procedure under Chinese law. It is also a fundamental principle of evidence rules shared by both Chinese courts[17] and Chinese arbitration tribunals. This principle currently equips a CIETAC tribunal with the most useful weapon in establishing the facts of a dispute. However, in international commercial arbitration conducted in China, purposeful selection of other rules of evidence seldom occurs and the tribunal in each case has to determine by itself other rules of evidence, such as how the burden of proof will be shifted among the parties.

Although Chinese law empowers a tribunal to collect evidence at its own initiative, CIETAC tribunals prefer to rely on evidence submitted by the parties, since the onus to prove the facts rests on the parties, and tribunals would only assist in the interest of justice. In this aspect, the reader's attention is drawn to two considerations. First, there are occasions in which it is necessary to appoint an expert to assist the tribunal to ascertain the facts or make site inspections, since the tribunal believes it is in the interest of justice that certain facts be determined with the independent effort of the tribunal rather than simply dismissing the claim/counterclaim of a party for failure of proof. Such discretionary powers of tribunals reflect the legal philosophy of China to try to seek the truth and protect the party injured. Secondly, there are some governmental agencies in China which would reject requests for evidence made by legal counsel of a party, even in the judicial process.[18] On the other hand, some of these agencies are more likely to cooperate and approve a request for evidence issued by an arbitration institution, e.g., CIETAC, since there is a nurtured cultural tendency in China to place more trust on an institution established under the law rather than on an individual. Consequently, when a party is unable to collect evidence and applies to a CIETAC tribunal to take initiative, and the collection of specifically identified evidence is crucial to the determination of the disputed facts, the tribunal may accept such petition and make its own effort with or without success. Most tribunals in practice are not enthusiastic about this type of assistance.

V. Classification of Evidence

There is no stipulation on evidence classification in either CIETAC Rules or the PRC Arbitration Law. PRC Civil Procedure Law classifies evidence into seven

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[17] Exceptions exist to this principle in special cases where the respondent shall have the burden of proof in the first place. See Art. 4, Provisions on Evidence.

[18] Article 35 (2) of PRC Law of Lawyers permits a lawyer to investigate and collect evidence relating to the matters he is handling. In case of refusal from the person or agency being asked to cooperate, the lawyer may only make a formal request to a competent court for help to collect the identified evidence, which may or may not approve such a request. Under Article 65 of Civil Procedure Law, a person or agency may not refuse to cooperate with a court when requested to produce evidence, while no similar duty is provided in law if the request is made by a lawyer. A court-sanctioned mechanism of investigation and collection of evidence by lawyers does not exist in China. A judge will collect the evidence himself rather than support a lawyer to collect them.

categories[19]: documentary evidence, physical evidence, audio and visual material, testimony of witnesses, statements of the parties, conclusions of expert witnesses and transcripts of inspection and examination. All of these types of evidence are admissible as well in international commercial arbitration in China, albeit some of them are used more frequently than others.

A. Documentary evidence

In CIETAC practice, documentary evidence is the most common evidence and heavily relied upon by the parties and tribunals in international commercial arbitration. Parties are directed to compile their documentary evidence in a bundle or bundles and clearly numbered for the convenience of arbitrators and the other party. Lawyers familiar with the formal requirements of submission of evidence to Chinese courts will usually follow the same requirements when submitting evidence to CIETAC tribunals, which are very much welcomed. However, there are several distinctions between judicial practice and CIETAC arbitration practice regarding documentary evidence:

(i) Evidence formed outside China shall be notarized and authenticated in order to be admissible in Chinese courts[20], while it is not necessarily the case in CIETAC international commercial arbitration. In fact, only those documents which prove the legal existence and continuance of an entity as a party to arbitration proceedings may be required to be notarized and authenticated, since the mere signature of a formal CEO or managing director or the corporate seal might be misleading. (There have been cases where a corporate party ceased to exist before or during the commencement of the arbitration proceedings and that fact had only been found out after the rendition of the award.) The delay of time as a result of such strict notarization/authentication requirements contradicts the principle of efficiency and economy inherently desirable by commercial arbitration; hence the non-application of the strict requirements to most evidence in international arbitration.

(ii) All documentary evidence that is in a foreign language shall be translated into Chinese to be admissible in Chinese courts[21], while in CIETAC arbitration such translation is required only by the parties' agreement or the tribunal's direction. Translation not only incurs additional financial cost to the parties but may be misleading as well. Translation sometimes entails technical and procedural problems difficult to resolve. The issue of language will be further discussed below.

(iii) In international commercial arbitration CIETAC is more liberal in the admissibility of forms of documentary evidence than Chinese courts in litigation are. Chinese courts are traditionally reluctant to accept facsimiles as documentary evidence. Fax, gradually replacing telex, was so commonly used in the past several decades (and at present as well) in international trade that it typically has commanded a good part of all the evidence submitted by a party in CIETAC arbitration of international trade disputes. Nowadays, telegram has vanished in China and e-mail

[19] Art. 63.
[20] Art. 11, Provisions on Evidence.
[21] Art. 12, Provisions on Evidence.

has become more and more popular among international traders and it is readily acceptable to CIETAC tribunals as evidence in writing[22].

(iv) Chinese courts emphasize more on the original of a document[23], while CIETAC has been traditionally more elastic towards the admissibility and weight of a photocopied document. The photocopy of a document may be relied on heavily by a tribunal if, taking into account its relationship to other evidence that establishes genuineness of the photocopy, it reasonably proves the fact of the case.

Pursuant to Chinese judicial practice, there is no regime of compulsory disclosure of all documents relevant to a court case as exists in common law countries, but a judge may order a party to produce identified documents upon the request of another party, similar to specific disclosure procedures existing in common law countries. However, a court will not compel disclosure or hold the party in contempt if it does not obey the order, nor will pecuniary sanctions be imposed. The drawing of adverse inference is mentioned as the only sanction for non-obedience of such court order[24]. Of course, persons committing perjury and destruction of material evidence related to a civil litigation may be subject to fine and detention in serious cases according to law[25], although reports of such cases are seldom heard. Although CIETAC Rules are silent in providing for full disclosure or specific disclosure of documentary evidence, in CIETAC arbitration the parties may petition a tribunal to direct the other party to disclose specific documents. Such petition might be granted subject to the tribunal's determination of the materiality of the identified document[26]. In case the party in whose custody the document rests refuses to obey the order of the tribunal, an adverse inference may be drawn against that party by the tribunal. Hiding evidence in arbitration is not subject to any other sanction but can be a ground to set aside a domestic award[27].

The rules regarding legal privileges on the production of documents that exist in the common law system do not exist under Chinese Civil Procedure Law or judicial practice[28], nor do they in CIETAC Rules and practice. Most CIETAC arbitrators would accept into evidence a document which, under common law, is classified as a document of "without prejudice privilege". A CIETAC tribunal is pursuant to CIETAC Rules required to decide the dispute in accordance with the proven facts[29] – what actually happened during the performance of the contract, irrespective of the fact that a party

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[22] This can be inferred from Art. 5(3) of CIETAC Rules, though it only refers to the arbitration agreement.
[23] Art. 49 and Art. 69(4), Provisions on Evidence.
[24] Art. 75, Provisions on Evidence.
[25] Art. 102, Civil Procedure Law.
[26] Such power may be inferred from art. 29 (5) of CIETAC Rules.
[27] Art. 58, Arbitration Law.
[28] As a possible exception, Art. 67 of Provisions on Evidence stipulates that recognition of facts by a party during the process of negotiation of settlement or mediation should not be taken as evidence against that party. This is similar to the "without prejudice" evidence rule. However, there is no prohibition for the production of such evidence.
[29] Although it is not clearly stipulated in CIETAC Rules, in case the parties authorize the tribunal to act as *amiable compositeur* or to decide *ex aequo et bono*, a CIETAC tribunal will act accordingly, since a tribunal in China is bound by the parties' agreement that does not contradict the compulsory provisions of law.

made certain concessions during the process of negotiation of a settlement with the other party[30], on the privileged basis of "without prejudice".

The authors can not help from asking the following question: is it really true from a pragmatic perspective that an arbitrator exposed to such a privileged document will not be influenced and that his or her neutrality will not be improperly affected? What is the estimated percentage of arbitrators being improperly influenced in making his or her award after seeing such "without prejudice" documents? However, CIETAC arbitrators are experienced and are accustomed to addressing issues of neutrality in many situations, not only in relation to exposure to a "without prejudice" document.

Under Chinese law, conciliation/mediation is combined with arbitration. It combines with litigation as well. China has a long history of using conciliation/mediation as part of its judicial and arbitral processes, a practice fairly successful in Chinese legal culture. This is not equally true in other countries[31]. "Privileged" information is disclosed to the tribunal while arbitrators serve as mediators under CIETAC Rules. Those legal professionals not personally involved in a CIETAC arbitration may be intrigued when they realize that most foreign lawyers representing clients in CIETAC arbitration, while understanding that their clients had the perfect right to decline such a process, accepted conciliation/mediation by arbitrators, clearly knowing that the panel members will resume their role as arbitrators should mediation fail in the end. An impressive percentage of CIETAC cases have been resolved in this combined way[32]. In fact, according to the experience of the authors, more than half of all CIETAC cases have gone through the mediation process. There is no evidence that CIETAC panel members, shifting their role as arbitrator-mediator-arbitrator pursuant to CIETAC Rules in the same cases, rendered awards which are less fair and just than in those cases where mediation did not occur.

B. Expert witnesses

Article 38 of CIETAC Rules refers to tribunals' experts. While there is no mention of parties' experts in CIETAC Rules, the opinions of party-appointed experts are common and are acceptable in practice. Possibility of an expert jointly appointed by the parties is not excluded but infrequent in CIETAC practice. Generally speaking, ex-parte expert testimony may have less weight than that of tribunal-appointed experts or the experts jointly appointed by the parties.

The experts appointed by a tribunal can be an organization or an individual. The qualification requirements of an expert who is eligible to submit an expert opinion to a CIETAC tribunal are less rigid than those required by a Chinese court. An

[30] In the view of authors, this is the correct understanding of Art. 43(1) of CIETAC Rules.

[31] See UNCITRAL Model Law on International Commercial Conciliation with Guide to Enactment and Use (2002), particularly Article 12 and its explanations, at www.uncitral.org.

[32] For instance, in 2004, around 10% of all the cases where an award had been made were awards by consent after successful mediation by the tribunals. The figure is disclosed in a report (in Chinese) by CIETAC at the conclusion of its 15th plenary session summarizing its work in 2004 to be found in CIETAC website: http://www.cietac.org.

arbitral tribunal will be assisted by CIETAC Secretariat in selecting a qualified expert. Consultation with parties is often made for advice of competent organizations or individuals. CIETAC Secretariat may reserve a list of experts in a number of fields where expert opinions are frequently sought. The tribunals will give direction to the expert appointed as to what questions need to be answered. A formal written report from the expert is always expected.

The parties have a duty to cooperate in furnishing the documents and allowing inspection of the contract goods, etc., required by such experts in order for them to form an opinion. Any tribunal-appointed expert who submits a written opinion shall, at the request of a party and with the approval of the tribunal, be heard at an oral hearing and, if considered necessary and appropriate by the tribunal, give explanations on his or her report, which occur frequently. This ordinarily means that any such expert may be requested to answer questions put forward by the parties or the tribunal.

C. Other types of evidence

Witness testimony is acceptable, but many arbitrators in China are generally skeptical about the credibility of witnesses[33], since no sanction will be applied against fabrication in arbitration. A written statement will usually be required in advance and the witnesses will be subject to cross-examination of the legal counsel of the other party and questioned by the arbitrators. Submission of physical evidence such as a sample product or a sample from the contract goods is allowed in CIETAC practice, but it does not take place very often, nor does the submission of audio and visual materials. A party may wish to call its witnesses of fact during an oral hearing. However, a prudent CIETAC tribunal will require that the party submit a written statement of such witnesses of fact in advance in order for the other party to prepare questions for such witnesses. On many occasions, a statement of a party, which usually forms part of the arbitration application or statement of defense, will not be treated in CIETAC arbitration as evidence but mere allegations of that party, which needs to be substantiated by other evidence.

On-site inspections conducted by tribunals occur in CIETAC arbitration. The parties are always notified to attend. A record of inspection will be made and forwarded to the parties for their comments. Many such inspections are conducted by the experts appointed by the tribunals. However, it is customary that members of the tribunals or at least one arbitrator entrusted by the tribunal will also participate in such inspections and make on-site decisions as to any objections put forward by a party during such inspections.

VI. Language of Evidence

Should the language of evidence be the same as the language of arbitration? There is no answer in the CIETAC Rules or in relevant laws. Article 67 of the CIETAC Rules provides:

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[33] Similar attitude can be found in other countries. See for instance, Fouchard, Gaillard, Goldman On International Commercial Arbitration, CITIC Publishing House, 2004, pp. 698-699, para. 1278.

> *Where the parties have agreed on the arbitration language, their agreement shall prevail. Absent such agreement, Chinese language shall be the official language to be used in the arbitration proceedings.*

The common understanding of this provision is that it applies also to the language of evidence save for any other agreement by the parties. However, CIETAC tribunals may be quite flexible on this issue. With the parties' consent, which is common, the language of evidence may be the same as the language of arbitration or different according to the relevant circumstances. The preferred practice in CIETAC is that the language of evidence is determined soon after the initiation of an arbitration case. If there is a preliminary hearing or a pre-hearing meeting, the tribunal may settle this issue during that hearing or meeting and issue a written direction thereafter. Although the tribunal's power to select the applicable language might be inferred from CIETAC Rules[34], the tribunals prefer to obtain the parties' agreement on the applicable language.

In CIETAC arbitration cases the tribunal will usually, in consultation with the parties, try to procure an agreement that documentary evidence either in Chinese or English be submitted in its original form without the need of translation into another language. Chinese and English are the most commonly used languages in CIETAC arbitration. In order to cut costs for the parties and avoid any undesirable impact of incorrect translation of documentary evidence, many tribunals prefer the documents be produced without translation. It is problematic for a tribunal when the official (translated) version of a document departs from the meaning of the original language version, while at the same time the tribunal understands what the document actually indicates but is somehow bound by the incorrectly translated version.

VII. Preservation of Evidence

Under current Chinese law, the power to preserve evidence for an arbitral proceeding that is perishable or may be destroyed is vested exclusively in courts of law, not in arbitral tribunals or arbitration institutions. Article 68 of the Arbitration Law provides:

> *If the parties to a foreign-related arbitration apply for evidence preservation, the foreign arbitration commission shall submit their applications to the intermediate people's court in the place where the evidence is located.*

Parties usually submit their petitions for preservation of evidence along with the application for arbitration. CIETAC then transfers such petition to a competent court along with an official notice issued by CIETAC to the effect that the addressed court of law is requested, under Chinese law, to exercise its sole discretion on whether or not to grant such petition by the party. A copy of the party's application for arbitration is attached thereto.

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[34] Art 29 (1), CIETAC Rules.

Opinions have been voiced[35] that CIETAC should examine these petitions in the first place in order to preliminarily determine the relevance and materiality of the evidence the preservation of which has been requested, and submit a written opinion to the competent court for its consideration, because the court does not determine the merits of the dispute and is not in the best position to make such a decision. However, it is the authors' view that it is inappropriate for an arbitration institution to decide any issue on the merits related to the relevance and materiality of evidence, since the arbitral tribunal has yet to hear the case and decide the dispute. The arbitration institution is in no better position than a court in respect of the decision on the relevance and materiality of the evidence. The experience of the authors shows that most applications for the preservation of evidence have been filed together with the request of arbitration at the commencement of arbitration proceedings. There will not be any opinion of the tribunal on such application since it is not constituted yet. A natural question would be: if the decision on the preservation of evidence shall be made by a court of law anyway, why bother the arbitration body in the first place and not permit a party to file a preservation application directly to the court? One ground, and indeed the presumed legal requirement, is that the court must be convinced and certain that arbitration proceedings have been commenced by an arbitration institution established and registered under Chinese law, as a prerequisite for the procedure of preservation of evidence in arbitration. Otherwise, the court has to communicate with the arbitration institution to verify the fact.

VIII. Time of Submission

Time limit for submission of evidence now becomes a fairly important element in Chinese arbitration owing to the statutory requirement. The PRC Arbitration Law requires[36] that all evidence submitted by the parties be exhibited during the oral hearing of arbitration[37] and the parties have the right to examine and challenge the evidence. Notwithstanding the fact that this legal requirement can be waived by the parties' agreement[38], it necessitates and results in the practice of many tribunals to set deadlines or timetables for the submission of evidence.

As to setting time limits for submitting evidence[39], different tribunals employ different methods. More and more tribunals set a time limit for the parties to submit evidence before the first oral hearing and only allow further submission of evidence which can not be reasonably obtained before the time limit. Some tribunals only set a time limit after the first oral hearing, a practice often entailing a second hearing, which is not deemed preferable. For a complicated case, the tribunal may hold a pre-hearing meeting, after consulting with both parties, to set a timetable for the whole arbitration process, including how the evidence from each party will be exchanged. CIETAC

[35] See http://china.findlaw.cn/info/zhongcai/fa/39869.html for an analysis of a preservation of evidence case (in Chinese).

[36] Art. 45.

[37] A number of arbitral awards have been set aside owing to the fact that some evidence has been submitted after the hearing and a second hearing has not been held. Consequently, the supplemental evidence has not been exhibited during the hearing.

[38] Art. 29 (2) of CIETAC Rules provides for documents-only arbitration which Chinese judicial practice approves. See also art. 258 of PRC Civil Procedure Law.

[39] Art. 36 (2), CIETAC Rules.

practice shows that efforts have been made by most tribunals to eliminate the possibility of a party's ambushing to the other party by unexpected production of evidence during the oral hearing and to require that all cards be placed on the table face up.

VIIII. Admissibility and Assessment of Evidence

The principle that an arbitral tribunal shall determine the admissibility, relevance, materiality and weight of evidence is equally applicable in CIETAC arbitration. In the previous version of CIETAC Rules (2000), Article 41 provides that evidence submitted by the parties shall be examined and evaluated by the tribunal which shall also decide on whether to admit expert reports and appraiser's reports. This article has been deleted in the current version of the CIETAC Rules (2005), but the principle has been retained in practice.

With respect to the admissibility of evidence in Chinese arbitration, CIETAC tribunals are fairly elastic in admitting any document that is relevant to the dispute principally because of the reasons discussed above in the section of documentary evidence:

(i) There is no compulsory disclosure of all evidence, so the parties are not required to produce any evidence against their interest;

(ii) The assistance by the courts with respect to evidence used in arbitration is limited to the preservation of evidence; and

(iii) The concept of legal impediment and privilege in common law countries does not exist in China.

However, in CIETAC practice, commercial and technical confidentiality that the tribunal determines as compelling as well as government secrecy are justified grounds for non-production of evidence. The tribunal will not draw adverse inference against the party concerned by reason of such non-production.

A party's right to challenge any evidence submitted or question any witness produced by the other party or otherwise possibly relied on by the tribunal is safeguarded by Chinese law[40], which provides that all evidence shall be exhibited during the oral hearing and the parties have the right to challenge the evidence[41]. The practical implication of this legal requirement is that the tribunal will require that all evidence submitted to it be brought to the hearing room and shown to the parties. And the tribunal will inform the parties that they have the right to challenge any evidence. The legal counsel for each party, during the hearing, usually voices his challenge to any evidence he deems inadmissible and cross-examines any witness. However, with both parties'

[40] Art. 70 and Art. 71 of Arbitration Law provide that vacation and non-enforcement of awards can be made according to Art. 260 (currently Art. 258 after the amendment) of Civil Procedure Law, which stipulates, *inter alia*, that the party against whom the award was made has been deprived of opportunity to present his case. This due process requirement covers the right of the party to present his opinion on any evidence relied upon by the tribunal.
[41] Art. 45, Arbitration Law.

consent, a tribunal may allow the parties to challenge evidence in writing instead of during oral hearings.

In CIETAC practice, evidence produced after the time limit agreed by the parties or fixed by the tribunal will normally be inadmissible, unless a justifiable ground has been demonstrated by the party failing to observe the deadline, in which case an extension can be granted but the principle of equality will be complied with. Another phenomenon not uncommon in CIETAC arbitration is that some parties have unilaterally made disclosure of certain documents to tribunals with express notice that the same should not be communicated to the opposing party. Some of these documents may be earmarked as confidential government documents. Other "internal documents" are actually disclosable evidence without any legal impediment. It is the party's sole decision whether the documents will be disclosed to the other party. In any case, a document not disclosed and communicated to the other party cannot be relied upon by a CIETAC tribunal in its award even if it is relevant and material and its existence is known to the tribunal.

Most Chinese lawyers in CIETAC arbitration, when examining documentary evidence, will focus on the genuineness, relevance, lawfulness and weight of the evidence. While examining witnesses, CIETAC tribunals have adopted either an inquisitorial or adversarial approach[42] while at the same time ensuring that the parties are given a fair opportunity to question the witnesses. In most cases, arbitrators themselves have been active in questioning the witnesses, whether they are witnesses of fact or witnesses of opinion. This is especially so when the arbitrators consider the legal counsel less competent in getting to the crucial fact or opinion from the witnesses.

The assessment of evidence belongs exclusively to the discretionary realm of the tribunal. Some of the rules more frequently used by tribunals in CIETAC arbitration in assessing evidence are:

- More emphasis is placed on documentary evidence than witness testimony.
- Contemporaneous evidence usually has more weight than evidence that formed after the event;
- Among all evidence produced by a party, those against the interest of that party are more readily relied upon than those favoring the same party;
- More weight will be attached to the opinion of an expert who has been appointed by the tribunal than one appointed by a party alone; and
- Evidence needs not be produced or can be disregarded if the fact such evidence intends to prove is admitted by the opposing side.

[42] Art. 29(3), CIETAC Rules.

X. Conclusion

The statutory evidence rules to be found in Chinese law applicable in international commercial arbitration conducted in China are few, while the evidence rules followed by Chinese courts of law, particularly those in the Provisions on Evidence and the rules embodied in PRC Civil Procedure Law, are technically inapplicable in arbitration. The latter rules nonetheless have exerted a profound impact on Chinese arbitration, reference to which has been made by arbitral tribunals. Apart from those numbered rules of evidence provided in the PRC Arbitration Law and CIETAC Rules, the detailed rules of evidence applied vary from tribunal to tribunal in CIETAC practice depending on the education and experience of different arbitrators. There may be a need for CIETAC to adopt a set of evidence rules as guidelines for tribunals conducting international commercial arbitration at CIETAC.

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A Summary of PRC Labor Laws

This article was contributed by LegalStudio with the assistance of RSM Hong Kong

In this article, we summarise the provisions of the PRC Labour Contract Law and relevant provisions of the PRC Labour Contract Law Implementing Regulations (IRs). Regional regulations will be discussed in follow-on articles.

1. **Scope of Application of Labour Contract Law**
    - "Employer" includes enterprises, individual economic organizations, non-enterprise private entity and other entities, such as foundations, company branches/offices with business licenses or registration certificates, partnerships including accounting and legal firms. (Art. 2 of Law) (Art. 3 and 4 of IRs)

2. **Employment Relationship and Employee Register**
    - An employment relationship is established on an employee's first working day. (Art. 7 of Law) (Art 8 and 33 of IRs)
    - An employer must keep an employees' register which includes each employee's personal details and terms of employment. Fines of RMB2,000 - RMB20,000 apply.

3. **Staff Manual**
    - A draft of a company's staff manual (covering matters such as remuneration, working hours, leave, work safety, training, discipline and issues directly affecting employees' personal interests etc.) should be presented to labour unions / all employees for discussion and feedback. (Art. 4 of Law)
    - The finalised staff manual should be issued to all employees.

4. **ID/Guarantee Deposit**
    - An employer should not retain/hold an employee's identity card or other certificates, nor ask for a guarantee or collect property from an employee. (Art. 9 and 84 of Law)
    - If an employer collects property from an employee in the form of guarantee or for any other reason, the employer may be fined RMB500 – RMB2,000 per employee.

5. Labour Contract

- A written labour contract must be concluded within one month of employment. (Art. 10, 12, 82 and 14 of Law)
- There are three types of contracts: fixed-period, open-ended and project based. (Art. 5 and 6 of IRs)

Failure to sign a written contract within one month:

- An employer is liable to pay an employee twice his salary for the period without a written contract starting from the 1st day after one month of the employment until such time that the written contract is concluded.

Failure to sign a written contract within one year:

- An employer is deemed to have concluded an open-ended contract (starting from the 1st day after one year) and the employer is liable to pay twice his salary during the period without a written contract.

Where an employee is unwilling to conclude a written labour contract with his employer, within one month of the employment his employer should:

- Serve written notice notifying the employee of the requirement for a written contract.
- Terminate the employment by a written notice if the employee is still unwilling to conclude a written labour contract.
- Pay the employee his salary for the period of work.

If the above is done, the employer will not be liable for any economic compensation (please refer to point 13 below).

An Open-ended Labour Contract should be concluded if: (Art. 14 of Law) (Art. 9 of IRs)

- Employers and employees mutually agree.
- An employee has worked for an uninterrupted term of 10 years with the same employer.
- When an employer implements the labour contract system for the first time, or a state-owned enterprise rehires workers following restructuring, and the employee has worked for an uninterrupted term of 10 years with his employer and is less than 10 years from his statutory retirement age (male: 60; female:50).
- When a labour contract is renewed after an uninterrupted completion of 2 fixed-period contracts.

The 10-year period is counted from the date an employee started working for his employer which includes the working period prior to the implementation of the Law.

5.1. Transition of Existing Contract

Any labour contracts that have been lawfully entered into and existing before the effective date of the Law (i.e. 1 January 2008) will continue to be valid. (Art. 97 of Law)

5.2. Contents of a Labour Contract

(Art. 17 of the Law)

- Employer's details (e.g. name, residence, legal representative or general manager).
- Employee's details (e.g. name, residence, identity card number or other valid identity certificate).
- Period of the labour contract.
- Scope of duties and working location.
- Working hours, break times and holiday arrangements.
- Remuneration
- Social security insurance arrangements.
- Terms of labour protection, working conditions, and protection against and prevention of occupational harm and hazards.
- Other matters that should be incorporated in the labour contract according to local laws and regulations include probation, special training, confidentiality, supplementary insurance, welfare and other treatment, as well as other items that may also be stipulated.

Apart from the these standard terms, employers and employees may further negotiate and agree on employment contract terms, such as probation period, trade secret, supplementary insurance and other fringe benefits under Article 17.

5.3. Invalid Labour Contracts

A labour contract will be wholly or partially invalid if: (Art. 26, 86, 33 and 34 of Law)

- The contract is concluded/amended by way of deception or coercion, or takes advantage of the other party's difficulties [ambiguity: no guidance as what qualifies as "difficulties"].
- There is a waiver of employee's statutory rights.
- The contract contains terms contrary to the statutory provisions of the laws and regulations.

Mergers, acquisitions, disposals, or changes in company name, legal representative, general manager, investors etc will not affect the validity of the labour contract.

Where the employment contract is deemed to be void while the employee has already provided his / her employment services, the employer shall pay for the employment services. The amount payable for such services shall be determined with reference to the same or similar position within the company. (Art. 28 of Law)

5.4 Terms of Employment

Working hours: (Art. 36 of Law)

- Daily working hours shall not exceed 8 hours; average working hours per week shall not be over 44 hours

Annual leave / holidays:

- 1 to 9 years of service: 5 days annual leave
- 10 to 19 years of service: 10 days annual leave
- Over 20 years of service: 15 days annual leave

Remuneration shall specify: (common terms may be included in a company manual):

- Salary level, salary distribution system, standard for salaries and forms of distribution of salaries;
- Method for payments of salaries;
- Basis and distribution methods for over-time payments, subsidies and bonus;
- Methods for adjusting salaries;
- Wages during probation period, sick or personal leave;
- Methods for paying wages (living expenses) to employees in special circumstances; and
- Other distribution methods for wages.

Terms in an employment contract concerning wages must satisfy relevant minimum wage standards of the State.

7. Probation

Length of probation period: (Art. 19 of Law)

- Contract term less than 3 months or a project based contract: No probation.
- Contract term between 3 months and 1 year: Maximum probation period 1 month.
- Contract term between 1 year and 3 years: Maximum probation period 2 months.
- Contract term longer than 3 years (including open-ended contract): Maximum probation period 6 months.

Wages during probation should not be less than: (Art. 20 of Law) (Art. 15 of IRs)

- The minimum wage offered by the same employer for the same position or 80% of the post-probation wage; or
- Local statutory minimum monthly wage.

Dismissal during probation is allowed if an employee: (Art. 21 of Law)

- Did not meet the recruitment requirements.
- Commits a serious violation of the company's staff manuals.

- Suffers illness, or is injured by a non-work-related accident, and so is unable to take up the original post or other position as arranged by his employer after medical treatment period.
- Performed unsatisfactorily after training or assuming other position as arranged by his employer.
- Objective circumstances have altered significantly so that the original labour contract is unable to be performed

Employee may terminated contract during probation by giving the Employer 3 days' prior notice (Art. 37 of Law)

8. Breach of Contract – Employee

Only the following can be stipulated as possible breaches in a labour contract: (Art. 25 of Law)

- Minimum service period obligations (please refer to point 8.1 below).
- Confidentiality and non-competition obligations.

Penalty payable to the Employer: (Art. 26 of Law)
In case an employer terminates the labour contract due to the fault of an employee, the employee will be required to pay a penalty to the employer if:

- An employee commits a serious violation of the company's staff manual.
- An employee causes severe damage to his employer due to his/her grave negligence to his/her duties, or attempts to obtain additional personal benefits outside the scope of the labour contract.
- An employee maintains a labour relationship with other employers which seriously influences his/her performance.
- The employment contract is concluded/amended by the way of employee's deception or coercion, or by taking advantage of the employer's difficulties [again, no guidance as what qualifies as "difficulties"].
- An employee is pursued for criminal liability.

8.1 Special Training

- An employer may request an employee to sign a supplementary minimum service period agreement if "special training" is provided. (Art. 22 of Law) (Art. 16 and 17 of IRs)
- If the minimum employment service period agreement is breached by an employee, a penalty not exceeding the duly pro-rated training expenses can be charged by the employer.

- Training expenses include the expenses incurred by an employer in the provision of training plus the travel expenses and other direct expenses incurred by an employee reimbursed by the employer.

- If a labour contract expires prior to the minimum employment service period, the labour contract should be extended accordingly.

8.2 Non-Compete Covenant

(Art. 23, 24 and 90 of Law)

- Senior management, senior technical personnel and those bound to keep confidential information of the employer may be subject to non-competition requirements.
- Maximum period of a non-compete covenant: 2 years.
- If non-compete covenant is entered, an employer has to pay monthly compensation to an employee during the non-compete period.
- Terms of the non-compete, its geographic limits, and the cap on the penalty paid by an employee to the employer in the event of breach are subject to mutual agreement between the employer and the employee.
- The minimum compensation payable to an employee varies according to regional regulations.

9. Discharge of Labour Contract by Employee

An employee may discharge the labour contract if an employer:

(Art. 38 of Law)
(Art. 18 of IRs)

- Fails to provide labour protection or work conditions as stipulated in the labour contract.
- Fails to pay the full amount of remuneration in a timely manner.
- Fails to pay social security premiums according to law.
- The company's staff manual is inconsistent with the prevailing laws and regulations which impair the rights and interests of the employee.
- The circumstances under Article 26 of the Law (please refer to point 6 above).
- Any other circumstance as prescribed by prevailing laws and regulations.

To discharge a labour contract, an employee should inform the employer (in written form) 30 days in advance (3 days in advance during the probation).

If the employee is forced to work by violence, by threat or by illegally limiting his/her personal freedom, or is forced to perform dangerous operations which may endanger his/her personal safety he may immediately discharge the labour contract without informing the employer in advance.

10. Discharge of Labour Contract by Employer

An employer may discharge the labour contract if an employee: (Art. 39 of Law) (Art. 19 of IRs)

- Does not meet the recruitment requirements.
- Commits a serious violation of the company's staff manual.
- Causes severe damage to his employer due to his/her grave negligence to his/her duties, or attempts to obtain additional personal benefits outside the scope of the labour contract.
- Maintains labour relationship with other employers which seriously influences his/her performance.
- The employment contract is concluded/amended by the way of employee's deception or coercion, or by taking advantage of the employer's difficulties
- Is pursued for criminal liability.

Penalty compensation: (Art. 48 and 87 of Law)

- If an employer discharges or terminates a labour contract which violates the Law, an employee may request to be re-employed under the terms of the original contract, pending which the employer would pay penalty compensation to the employee at the rate of twice the amount of the economic compensation
- If an employer pays a penalty compensation to an employee, no further economic compensation is required.

10.1 Discharge Notification – 30 days in advance

An employer needs to notify an employee in writing 30 days in advance or pay an extra month's salary in lieu of discharge notice if: (Art 40 of Law) (Art. 20 of IRs)

- An employee suffers illness or is injured by a non-work-related accident and so is unable to take up the original post or other position as arranged by his employer after medical treatment period.
- Performance of the employee is unsatisfactory after training or assuming other position as arranged by the employer.
- Objective circumstances have altered significantly so that the original labour contract is unable to be performed.

If an employer pays an extra month's salary in lieu of discharge notice, the extra month's salary should be calculated based on the salary paid in the preceding month.

10.2 Lay-offs

Lay-offs may take place under the following circumstances: (Art. 41 of Law)

- Bankruptcy-related reorganization.
- Serious difficulties in business operations.
- Change in the business, e.g. major technical innovation or change in operational models.
- Change in the company's objective circumstances.

Where an employer intends to lay-off more than 20 employees or more than 10% of total employees, the employer must consult the local labour authorities and announce the layoff to all employees or the labor union, providing:

- information regarding the enterprise's operational status;
- all employees or the union with the layoff proposal, including a list of the employees to be laid off, the time when employment will be terminated, and the laid-off employees' severance package;
- seek opinions from all employees or the union for the layoff proposal, and adjust the proposal according to reasonable suggestions from employees or the union;
- report the layoff proposal to the local labor bureau;[2] and
- formally announce the layoff proposal, process the layoff formalities, and pay severance compensation to the laid-off employees.

An employer should give priority to retaining the following employees:

- Those with long fixed term contracts.
- Those with open-ended contracts.
- Those who are the only income earners, and those with young or elderly families.

10.3 Conditions where Labour Contracts cannot be discharged under Articles 40 and 41 (i.e. point 10.1 and 10.2 above)

A labour contract cannot be discharged if: (Art. 42 of Law)

- An employee has been exposed to occupational disease hazards and has not completed occupational health check, or is suspected of having an occupational disease and is under diagnoses or medical observation.
- An employee has an occupational disease or has lost, or partially lost the capacity to work due to an injury relating to the employment.
- An employee suffers an illness or is injured (not related to his job), and the period of medical treatment has not expired.
- A female employee is in her pregnancy, confinement or nursing

period.
- An employee has worked continuously for the employer for more than 15 years and is less than 5 years from his legal retirement age (male: 60; female: 50).

Other circumstances as prescribed by laws and regulations.

11. Termination of Contract

A labour contract shall be terminated only if: (Art. 44 of Law) (Art. 13 of IRs)

- The term of the labour contract has expired.
- An employee has reached his legal retirement age.
- Employee is presumed dead or missing as announced by the court.
- An employer becomes bankrupt according to law.
- An employer ceases business, goes bankrupt, loses its business licence or is ordered to close.
- Other circumstances as prescribed by prevailing laws and regulations.

11.1 Notification of Contract Discharge / Termination

(Art 50 of Law) (Art. 24 of IRs)

- An employer should issue a discharge/termination certification detailing the nature and terms of the employment (e.g. position held and years of service) and confirmation of termination.
- A copy should be kept by the employer for at least 2 years for record purposes.

12. Economic Compensation / Severance Pay

Economic compensation payments should be made under the following circumstances: (Art 46 of Law) (Art. 23 of IRs)

- Circumstances under Article 38 of the Law (Discharge by employee above).
- An employer and employee unanimously agree to discharge the contract.
- Circumstance under Article 40 of the Law (Discharge by employer, Art. 40).
- Lay offs.
- a fixed-term labour contract expires (this does not apply if the employer agrees to raise or maintain the benefits for the employee and the employee refuses to renew the labour contract).
- An employer ceases business, goes bankrupt, loses its business license or is ordered to close.
- Other situations as may be prescribed by prevailing laws and regulations.

In case an employment relationship is terminated due to an employee's occupational injury, an employer must pay economic

compensation, medical treatment subsidies and employment subsidies according to the occupational injury insurance program.

12.1 Economic Compensation - Basis of Calculation

- One month's salary for each year of employment up to 12 years. (Art 47 of Law) (Art. 27 of IRs)
- Employment which lasts less than one year but more than six months shall be rounded up to one year.
- Employment which lasts less than six months shall be calculated as one-half of the employee's monthly salary.

"Monthly salary" will be the higher of:

- the average monthly total compensation (including standard wages, bonuses, allowances and subsidies) over the twelve months immediately preceding termination; or
- the local statutory minimum monthly wage.

The cap for the monthly salary is three times the average salary in the preceding twelve months of the municipality where the employer is located.

Taxation of economic compensation / severance pay:

- Compensation is not subject to individual income tax (IIT) if it is less than 3 times the average local salary
- For salaries above 3 times the average, IIT applies but at special lower tax rates.

12.2 Employment Transferred to another Group Company (for reasons not attributable to employee)

The period of service with the transferring employee is combined with that of the new employer for the purposes of calculating economic compensation for any subsequent dismissal, except where the transferring employer has already paid compensation upon the transfer. (Art. 10 of IRs)

13. Collective Labour Contract

- Upon consultation, collective labour contracts may be concluded by labour unions or employees' representatives with an employer covering terms of remuneration, working hours, rest and vacation, work safety and health care, social insurance and welfare, etc. (Art. 51 – 56 of Law)
- The draft of the collective contract shall be presented to the labour union and all employees for discussion and approval.

If an employer acts in a harmful way to workers' interests, the labour union can seek recourse through the local labour arbitration commission.

14. Employee Secondment with Staffing Agencies

(Art 57-67 of Law)
(Art. 28 – 32 and 35 of IRs)

- The labour contract between a staffing agency (incorporated under the PRC Company Law with minimum registered capital of RMB 500,000) and the employee should be at least a 2-year fixed-period contract.
- During the non-seconded period, the staffing agency should pay the employee at least the local minimum wages plus social security and housing fund contributions.
- A secondment agreement (covering the posts for seconded employees, the number of seconded employees, the term of secondment, remuneration and social security premiums, and the liability for breach of agreement etc.) should be concluded between the staffing agency and the entity that accepts the workers ("accepting entity").
- The accepting entity may return the seconded employee to the staffing agency and the staffing agency may discharge the labour contract with the seconded employee if the seconded employee is:
  - Under any of the circumstances as mentioned in Article 39 of the Law (please refer to point 10 above).
  - Suffers illness or is injured by a non-work-related accident and so is unable to take up the original post or other position as arranged by the accepting entity after medical treatment period.
  - Performance is unsatisfactory after training or assuming other position as arranged by the accepting entity.
- If a seconded employee suffers harm, the staffing agency and the accepting entity will be held jointly and severally liable for the damages.
- Accepting entity is jointly and severally liable with the staffing agency for any loss sustained by the seconded employee arising from any violation of the Law by the staffing agency.
- If the employee secondment arrangement violates the Law, the accepting entity may be fined between RMB 1,000 to RMB 5,000 for each seconded employee.

15. Part Time Employees

(Art. 68 – 72 of Law)

- Remuneration is calculated on an hourly basis (no less than the minimum hourly rates as prescribed by the local government).
- Average working hours per day should not be more than 4 hours and cumulative working hours per week (for the same employer) should not be more than 24 hours.
- No probation period.
- May terminate the employment relationship at any time.
- No economic compensation is required.

16. Legal Liabilities

An extra 50% - 100% of the payable amounts should be made to employees if the employer discharges / terminates a labour contract without paying economic compensation in accordance with the Law, or if the following payments are not made within stipulated time limits: (Art. 85 and 88 of Law)

Employee's full remuneration as stipulated in the labour contract.

- Employee's salary is lower than the local minimum salary.
- Overtime pay.

In the case of any of the following circumstances, an employer may be subject to administrative punishment or even criminal offence:

- Forcing the employee to work by way of violence, threat or illegal limitation of personal liberty.
- Illegally directing or ordering any employee to conduct dangerous operations that may imperil the employee's personal safety.
- Affronting, physically punishing, beating, illegally searching or detaining any employee.
- Providing bad working conditions or a seriously polluted environment, leading to severe damages to the physical or mental health of any employee.

If the worker suffers any damage, the employer should bear the liability for compensation.

17. Disputes on Labour Contract Matters

Follows the "PRC Labour Disputes Arbitrage Regulations" (Art. 37 of IRs)

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Facing Downsizing in China: Avoiding Legal Risks in Reductions in Force

By Jing Wu, Esq.

Understanding Labor Disputes in China

With the promulgation of *PRC Employment Contract Law* (effective Jan. 1, 2008) and *PRC Conciliation and Arbitration Law on Labor Disputes* (effective May 1, 2008), employees in China are now enjoying greater advantages to resolve their labor disputes at relatively low costs.[1] In this process, labor arbitration is still the mandatory first step. Within the prescribed timeframe, the labor arbitration commission has to complete formal hearings and render written decisions.[2] Except for certain small claims, employees can further appeal the labor arbitration decision *de novo* to the People's Court, in conjunction with further evidences and additional claims.[3]

Encouraged by the pro-employee labor dispute resolution mechanism, Chinese employees (and their lawyers) have demonstrated their willingness and abilities to invoke formal legal proceedings. For example, during the first six months of 2008, the labor arbitration cases in Shanghai increased by 113.2%.[4] In Guangzhou city, there were over 60,000 new labor arbitration cases filed during the period of January 2008 to November 2008, doubling the combined total amount of filings in the previous two years.[5]

Legal Challenges to Reductions in Force

In this context, planning reductions in force ("RIFs") in China necessarily includes planning to minimize the risks of labor arbitration and litigation. The most common legal challenges to RIFs in China are those alleging termination without statutory grounds or statutory procedures. Other types of legal challenges to RIFs in China are often based on protected status, such as pregnancy, maternity or illness. Once a terminee establishes a *prima facie* wrongful termination case, the burden of production and burden of

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[1] For example, the statute of limitation is now extended to 1 year, pursuant to Article 17 of *PRC Conciliation and Arbitration Law on Labor Disputes*. The labor arbitration proceeding is free of charge, see also *Id.*, Article 52,
[2] *Id.*, Article 43.
[3] *Id.*, Article 48, 49.
[4] *Labor Disputes Cases Increased by 113%* [上半年劳动争议增113%劳动报酬争议数量居首位]，http://vic.sina.com.cn/20080815/09246157.shtml (last visited Feb. 15, 2009).
[5] *Explosion of Labor Disputes Cases* [穗莞劳资纠纷案激增], http://forex.stockstar.com/info/Darticle.aspx?id=JL,20081208,00001206&columnid=947 (last visited Feb. 15, 2009).

persuasion then shifts back to the employer.[6] Losing the wrongful termination case means that the employer pays double amount of severance.[7] Sometimes, the prevailing terminee may also elect to seek the remedy of re-instatement, further complicating the RIFs plan.[8]

As a plaintiff strategy, a terminee often alleges back pay and/or overtime in connection with any RIFs challenges. If any of the alleged back pay or overtime occurred within the past two years, then the burden of production and burden of persuasion shifts back to the employer.[9] In trial practice, unless a terminee's job post implements a flexible working hours system, the employer has no choice but to present detailed payroll records and attendance records to the labor arbitrators and judges.[10]

With the above legal challenges in mind, it is apparently important for an employer to take extra caution in planning RIFs in China. The following sections discuss current legal requirements and suggest practicing tips for considering ameliorating unwarranted risks.

"Economic Downsizing" Rules

Under *PRC Employment Contract Law*, termination must fall within one of the specified statutory grounds. If the RIFs involve a small number (usually less than 20) of workers, the employer has to structure it as individual terminations. In that case, business judgment, such as redundancy, does not satisfy the statutory termination grounds.[11] In practice, unless the employer can justify the termination decision on statutory grounds such as incompetence or misconduct, the employees will be presented with incentive severance packages in exchange for entering into a voluntary termination agreement.

However, special procedures will be triggered if the employer plans to downsize its workforce by either 20 or more persons or less than 20 persons but it accounts for 10% or more of the workforce of the enterprise.[12] Under such circumstances, this is commonly referred as "economic downsizing," which stipulates that the downsizing has to be based on (1) re-structuring pursuant to relevant bankruptcy laws, (2) "*serious economic troubles,*" (3) technological changes or changes of mode of operation, and upon amendment of employment contract there is still need for downsizing, or (4) "*material changes of objective economic circumstances which the employment contract is based on,*" and as a result of changes the employment contract can no longer be performed.[13] There is consensus among Chinese practitioners that the above four grounds of

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[6] Article 13, *Interpretation by PRC Supreme People's Court On Labor Disputes* (2001).
[7] Article 87, *PRC Employment Contract Law*.
[8] Article 20, *Interpretation by PRC Supreme People's Court On Labor Disputes*.
[9] *Id.*, Article 13.
[10] Article 6, *PRC Conciliation and Arbitration Law on Labor Disputes*.
[11] For statutory termination grounds, please see Article 19, *Implementation Rules of PRC Employment Contract Law*.
[12] Article 41, *PRC Employment Contract Law*.
[13] *Id.*

"economic downsizing" are not available to any downsizing involving less than 20 workers.[14]

Furthermore, to proceed with "economic downsizing," the law requires the employer to follow a selection methodology. It gives priority to retain certain personnel, who (1) have entered into a fixed-term employment contract of a longer period with the company, (2) have entered into an open-ended employment contract with the company, or (3) have unemployed family members and need to support elderly or minors.[15]

To complete the planned "economic downsizing" on any of the above four statutory grounds, the law imposes on the employer a duty of consultation within a prescribed period. Particularly, the employer has to (1) explain the situation to the labor union *or* all employees 30 days in advance, (2) seek feedback from the labor union or the employees, and (3) report the downsizing scheme to the local labor bureaus.[16]

Employees with Protected Status

In RIFs, "economic downsizing" rules may not apply to employees with protected status. They generally include (1) female workers during pregnancy, maternity leave or breastfeeding period, (2) workers who have worked for 15 years consecutively with the company and will attain statutory retirement age in less than 5 years, (3) workers who have been diagnosed with an occupational disease or work-related injury and are confirmed to have partially or wholly lost labor capacity, (4) workers suffering from illness or a non-work-related injury, and are still within the statutory medical treatment period, (5) and certain workers exposed to occupational disease hazards and who have not completed a required medical checkup.[17]

Nevertheless, the law recognizes a few "safe harbors" for the purpose of terminating employees with protected status. Voluntary mutual agreement is the commonly recognized one, as well as "serious misconduct."[18] On the other hand, certain otherwise available termination grounds, such as incompetence, do not fall into those "safe harbors."[19]

Different from other legal systems, the permissible recovery of protected status challenges in China is generally the same as other wrongful termination cases. Punitive damages are not authorized. Damages for "pain and suffering" are also not actionable in labor arbitration and litigation. Attorney's fees are rarely ordered, despite the fact that terminees frequently request so.

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[14] Please see Annotated PRC Employment Contract Law [中华人民共和国劳动合同法注释本] at 33-36, Law Press China [法律出版社] (2007).
[15] Article 41, *PRC Employment Contract Law*.
[16] *Id.*
[17] *Id.*, Article 42.
[18] Annotated PRC Employment Contract Law [中华人民共和国劳动合同法注释本] at 32-37, Law Press China [法律出版社] (2007).
[19] *Id.*

Local RIFs Reporting Systems

Although the "economic downsizing" rules are purportedly to enable the employer to deal with difficult times, the long-standing policy of favoring social stability actually restricts further implementation by the central government. For example, neither *Implementation Rules of PRC Employment Contract Law* (effective Sep. 18, 2009) nor its published legislative drafts provide any definition of "*serious economic troubles*" or "*material changes of objective economic circumstances which the employment contract is based on*" of the "economic downsizing" rules. Although there are some liberal views to interpret it with plain meaning, legal experts and labor authorities tend to construe it conservatively.[20] In Beijing, as of January 2009, the local labor bureau is still citing a regulation published in 1995, under which an employer has to establish continuous losses of net income in three years before invoking any "economic downsizing" rules.[21]

Facing a global financial crisis, export-oriented southern provinces appear to adopt more liberal views on "economic downsizing" in terms of local implementation procedures. For example, under the *Notice of Reporting Method of Lawful Downsizing in Shanghai* (2009) ("*Notice*"), Shanghai labor bureaus streamline the statutory reporting obligation.[22] It is implemented as a formal RIFs reporting system, pursuant to which the employer shall submit (1) proof of labor union registration or appointment of an authorized employee representative by all employees in case a union has not been formed, (2) qualification and background information of the union representative or authorized employee representative, (3) RIFs scheme showing pertinent statistics, personnel records, severance packages, the company's financial ability and preparation of the severance payment, and other remedial measures, and (4) written feedback from union or employee representatives regarding the planned downsizing scheme and any remedial measures.[23]

In addition, the Notice stipulates that the report may not be filed unless the prescribed 30-day notice period has lapsed.[24] A formal receipt notice will be issued if the local labor bureau determines that the employer's planned RIFs establish its *prima facie* eligibility pursuant to "economic downsizing" rules.[25] As reflected in the Notice, Shanghai local labor bureaus focus on the compliance of procedural matters, such as the mandatory 30-day prescribed notice period, consultation and remedial measures. In addition, the local labor bureau will also focus on the severance package calculation method as well as the employer's financial ability to pay proffered severance.

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[20] See Comments on PRC Employment Contract Law [中华人民共和国劳动合同法释义] at 146-149, Law Press China [法律出版社] (2007).

[21] Please see *Beijing Local Rule on Enterprise Economic Downsizing* [北京市企业经济性裁减人员规定] (1995)

[22] See, *Notice of Reporting Method of Lawful Downsizing in Shanghai* [上海市人力资源和社会保障局关于用人单位依法实施裁减人员报告的通知] (2009)

[23] *Id.*, Article 2(1)-(4).

[24] *Id.*, Article 3.

[25] *Id.*

In the above RIFs reporting system, an administrative order will be issued for cases of violations or non-compliance.[26] However, such reporting system shall not be confused as a system of "certification" or "approval." On the contrary, an employer in Shanghai may start the downsizing exercise, when (1) a report has been filed with the local labor bureau, and (2) such report establishes a *prima facie* case of lawful "economic downsizing" at the time of filing.[27] Although a receipt notice itself does not make final determination on substantive issues, it does establish primary evidence of the employer's compliance with the required procedural matters, such as notice, consultation and reporting.[28] Thus, compliance with the RIFs reporting system is essential as it eventually preserves documentation with good probative value to fend off labor disputes in the future.

Remedial Measures through Tri-partite Consultation

Despite local implementations, the Chinese government at a central level is cautiously dealing with the "economic downsizing" rules to balance against the longstanding policy favoring social stability. There is great emphasis, to the extent within the current legal framework of "economic downsizing" rules, on the mandatory 30-day advance notice procedure and employee consultation. According to the tri-partite *Guiding Opinion on Stabilizing Labor Relationships* jointly published by Ministry of Human Resources and Social Security, All-China Federation of Trade Unions ("ACFTU") and China Enterprise Confederation/China Enterprise Directors Association, the employers are encouraged, as alternatives to RIFs, to take remedial measures through collective consultation with unions or employees.[29] Alternative remedial measures may include a rotational production cycle, on-site training, salary (freeze or reduction) negotiation or other alternative approaches to preserve job opportunities while reducing operational costs.[30] Similarly, the State Council's most recent notice on February 3, 2009 cites the prescribed 30-day notice procedures of "economic downsizing" rules, and calls for corporate social responsibility and employment promotion through ACFTU and local government.[31]

Employers, on the other hand, have also started to utilize alternative remedial measures to control legal risks associated with the RIFs. For example, as part of the strategic alignment of its global operations, Intel will reshuffle its production sites and eliminate about 2,000 jobs in Shanghai over the next 12 months.[32] It has been reported that Intel is collaborating with ACFTU's local federations of trade unions to jointly work out

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[26] *Id.*
[27] This is confirmed per author's anonymous consultation with Shanghai Labor Bureau on Feb. 6, 2009.
[28] *Id.*
[29] *Guiding Opinion on Stabilizing Labor Relationships*
[关于应对当前经济形势稳定劳动关系的指导意见] (effective Jan. 23, 2009).
[30] *Id.*
[31] *PRC State Council's Notice on Promoting Employment at Current Economic Situation*
[国务院关于做好当前经济形势下就业工作的通知] (effective Feb. 3, 2009).
[32] *Trade Union to Participate Intel's Downsizing Excise in Shanghai*
[上海浦东工会称将全程参与英特尔上海关厂], available at http://it.people.com.cn/GB/8766109.html (last visited Feb. 15, 2009).

employee transfer plans.[33] In another recent report, employers at Shanghai Fengpu Industrial Park are coordinating with local authorities to shorten employees' weekly working days in order to cut salary expenses.[34] Remedial measures taken at Shanghai Fengpu Industrial Park also include preserving more job opportunities for regular employees by eliminating unnecessary outsourced services.[35]

Conclusion

With careful planning, employers in China can implement the RIFs, while managing the risks of labor arbitration and litigation. When there are less than 20 employees involved, it is advisable to structure the RIFs as individual terminations on permitted statutory grounds. When there are 20 or more employees involved, the employer can utilize the "economic downsizing" rules, while complying with the notice, consultation and reporting procedures. In any case, RIFs in China require substantial time for both planning and implementation. If local labor bureaus implement a RIFs reporting system, compliance is critical to establish a *prima facie* case of lawful "economic downsizing." The legal risks may be reduced even further if the employer is able to document its good faith efforts of tri-partite consultation and alternative remedial measures.

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[33] *Id.*
[34] *Enterprises in Shanghai Implements 4-day Working System* [上海奉贤区部分企业推出四天工作制], http://sh.people.com.cn/GB/138654/8758155.html (last visited Feb. 15, 2009).
[35] *Id.*

Debt Restructuring — Second Life for a Distressed Company

By Liu Yanling

Stellar Megaunion Corporation ("SMC") was in a debt crisis, as its assets could barely repay its liabilities. New World China Land ("NWCL"), which was seeking an opportunity to go public, proposed to acquire SMC as a shell company via its subsidiary. To achieve this goal, NWCL conducted several rounds of negotiations with SMC's creditors to settle SMC's debts and clear the roadblocks for the acquisition. However, the parties were unable to make much progress in the negotiations due to the large number of SMC's creditors involved and their complicated creditor-debtor relationships with the company. As SMC needed to solve its debt crisis as soon as possible and its negotiations with NWCL were in deadlock, the company decided to reorganize to completely release itself from the heavy debt burdens in a short period of time.

I. Background of SMP's Reorganization

SMC was established on November 16, 1997 by merging the Sichuan Sanai Industrial Co. Ltd. and Sichuan Hailing Industrial Co. Ltd. upon the approval of the municipal government of Chongqing (Yufu [1997] No.2). On October 19, 1998, SMC issued 50,000,000 ordinary shares and these shares were listed on Shenzhen Stock Exchange with the approval of China Securities Regulatory Commission ("CSRC") (Zhengjianfazi [1998] No. 268 and Zhengjianfazi [1998] No. 269). After the conversion of capital reserve to paid-in capital and dividends issuance, SMC's total equity shares reached 413,876,880 shares, among which 293,876,880 were non-tradable shares (71.01%) and 120,000,000 were tradable shares (28.99%).

The business scope of SMC covers investments in the telecom and machinery industries, manufacturing of telecom equipment and machines, telecom engineering and technology consultancy, value-added telecom services and export. Since its incorporation, SMC had operated on loans from several commercial banks. SMC, which was overburdened with debts, also provided large amounts of guarantee for other enterprises on their borrowings. And the company suffered huge losses due to its poor business operation and was unable to repay their debts due. Even worse, all assets of SMC had been mortgaged, seized or frozen and its manufacturing had been interrupted. The company's death was imminent. In addition, the Shenzhen Stock Exchange imposed special measures of delisting warnings on SMC on May 8, 2007 as the company suffered losses both in 2005 and 2006.

By December 31, 2007, the owner's equity of SMC's balance sheet was negative RMB 1,185,511,232.70, indicating that the company had become insolvent.[1]

Before SMC entered into reorganization proceedings, NWCL had initiated a number of rounds of negotiation with SMC's creditors and proposed to repay up to 30% of their claims with the real property of NWCL and a portion of the SMC's shares NWCL would obtain in the future. Nonetheless, the creditors had different ideas regarding NWCL's repayment proposal and failed to agree on the proportion of cash repayment and repayment by equity shares. Also such proposal was not legally binding as it was not rendered by the court. Therefore, the negotiations were unable to produce satisfying results and the reorganization of SMC was pending.

II. SMC's Reorganization

A. Reorganization initiated by SMC's creditors

As SMC failed to repay its debts due, Chongqing Chaoyang Technology Development Co. Ltd., one of SMC's creditors, petitioned at Chongqing No.3 Intermediate People's Court (the "Court") for reorganizing SMC. The Court accepted the said petition on March 11, 2008 ([2008] Yusanzhongbozi No.1).

B. Confirmation of Creditors' Rights

According to the proposed reorganization plan the administrator of SMC (the "Administrator") submitted to the Court and the first SMC creditors' meeting, 70 creditors filed claims and the total value of confirmed claims was RMB 2,499,031,279.14.[2] The confirmed claims consisted of secured claims of RMB 1,241,974,486.89, employees' claims of RMB 1,921,449.70, tax claims of RMB 18,000,000 and unsecured claims of RMB 1,237,135,342.55.[3]

[1] According to the Listing Rules of Shenzhen Stock Exchange (2006 amendments), special measures shall be imposed to warn companies which experience a financial problem or other type of problem and such problem will result in the risk of delisting. Such special measures shall also apply where the investors are unable to judge the future of a company or their investment interests may be impaired. Such special measures of delisting warning include: 1) differentiating the shares of the company from those of other company by adding "ST" before the shortened form of the company name; and 2) restricting the daily limit up and limit down to 5%. The said special measures shall also be triggered where a company has suffered losses for the past two years, may become dissolved, or the court accepts the bankruptcy petition of the company or may rule for the bankruptcy of the company.

[2] Upon accepting the reorganization petition of SMC's creditor, the Court appointed the liquidator of SMC as the administrator. The parties acting as the administrator included the relevant officials of Chongqing Fuling District government, King & Wood and Haichuan Liquidation Service Co. Ltd.

[3] The employees' claims included unpaid salaries, medical claims, work injury claims, dependent claims, pension claims, medical insurance claims and other claims the employees of SMC were entitled to according to laws and administrative regulations.

C. The Reorganization Plan

The Administrator proposed the following reorganization based on SMC's financial status and characteristics:

a. SMC should repay the secured creditors with the asset(s) over which the security was created. Where the asset(s) is converted into cash, the corresponding secured creditor shall enjoy priority of repayment and a cash payment equivalent of 30% of the principal of the secured claim should be paid to the secured creditor as a compensation for repayment deferral. Once the creditor receives the said compensations, SMC is no longer liable for any further claims by such party.

b. The employees' claims and tax claims should be paid in full.

c. The unsecured creditors should be repaid 30% of the principal of the unsecured claims. Additionally, SMC would no longer be liable for any further claims by the unsecured creditors once such parties are repaid as above.

d. The shareholders of non-tradable shares of SMC ("Non-tradable Shareholders") transferred 50% of the equity shares they held to Shanghai Xinyi Industrial Co. Ltd. ("SXI") as the consideration for SXI to fund SMC's cash repayment to the creditors.[4] Up to 40 million of shares the Non-tradable Shareholders transferred to SXI should be converted into cash at 5 RMB/share and used to repay the creditors. The secured and unsecured creditors may apply in writing for shares repayment from SMC on a voluntary basis.

e. SMC should transfer all its existing assets (excluding those over which secured claims were created) to Chongqing Cheng'ao Corporate Management and Consultancy Co. Ltd. ("CCCMC") as consideration for CCCMC to repay the claims remaining outstanding upon the cash repayment by SXI and the stock repayment by the Non-tradable Shareholders.

On April 18, 2008, SMC convened the first creditors' meeting and the Administrator submitted the proposed reorganization plan to the Court and to the creditors meeting for the creditors voting group and for the equity investors voting group to vote. The plan was passed by both groups and approved by the Court.[5]

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[4] The said transfer of Non-tradable Shares does not necessarily require the consent of all Non-tradable Shareholders. Such transfer becomes mandatory to all Non-tradable Shareholders once the majority of Non-tradable Shareholders in the equity investors voting group vote for it or the court rules for a mandatory transfer. For the minority of Non-tradable Shareholders that do not agree to the transfer, such transfer is not on a voluntary basis.

[5] As SMC's reorganization plan involved the interests of all non-tradable shareholders, the creditors' meeting included an equity investor voting group consisting of all non-tradable shareholders.

III. The Reorganized SMC

Upon the completion of reorganization, SMC repaid claims of RMB 563,634,696.77 and the creditors discharged claims of RMB 1,935,396,782.37 in total. All the assets and the outstanding portion of the creditors' claims of SMC were transferred to CCCMC. SMC was released from that portion of liabilities and became a shell company without any assets or liabilities.

Compared with the reorganization of other listed companies, the reorganization of SMC has its own features. First, SMC's reorganization timing was shorter — the proceeding was concluded within 41 days from the day the Court accepted the reorganization petition. Second, SMC utilized shares, a fictitious currency, to fund a portion of cash repayment under the reorganization plan. This approach not only lowered the cost of SXI but also provided reasonable compensation for SMC's creditors with the revaluation of the company shares upon further asset restructuring.

IV. The Importance of Reorganization for Listed Companies

By April 30, 2008, more than 10 listed companies in China had completed their reorganization. Reorganization offers those companies that face a debt crisis due to their poor operation an opportunity of survival. To distressed public companies, reorganization is not only a means to gain a second life but also a tool to better protect their creditors and shareholders, alleviate the unemployment pressure of their employees and stabilize the local economy.

As the most efficient method to solve debt crisis, reorganization has been increasingly used in the debt restructuring of listed companies. It is also the most popular approach for the parties to release the debt burden of the target company in merger and acquisition transactions in China.

Compared with other conciliation proceedings, reorganization has some advantages. First, reorganization is time efficient. The company under reorganization does not need to negotiate with each of its creditors. The reorganization can be adopted with the consent of the majority of the creditors.[6] Even if the creditors in a certain voting group reject a proposed plan, the court may rule to approve it if certain requirements are met. Second, reorganization has a better chance of success.[7] So far, no company has entered bankruptcy proceedings following an unsuccessful reorganization. Third, as the number of companies qualified for shell companies is small, more and more investors with substantial financial strength prefer to acquire shell companies via reorganization. Reorganization can lower the investment costs by alleviating the debt burden of the

[6] Paragraph 2 Article 81 of the PRC Enterprise Bankruptcy Law provides that a proposed reorganization plan is deemed as passed where more than half of the creditors in a certain voting group present at the creditors' meeting agree with the plan and the creditors agree with the plan represent more than two thirds of the claims all creditors in that group represent. Article 86 of the law sets forth that a reorganization plan can be adopted where the creditors in all voting groups vote for the plan.

[7] See Paragraph 2 Article 87 of the PRC Enterprise Bankruptcy Law.

distressed company and repaying a portion of the creditors' claims with the stocks of the company and leave the investors with more funds for further asset restructuring. Fourth, once the reorganization plan is approved by the court, the plan is binding on all creditors. This ensures that the distressed company is completely free from further claims by the creditors and becomes a shell company.

As an effective means of saving distressed companies and conducting debt restructuring in M&A transactions, reorganization creates a new mechanism that benefits all stakeholders of distressed companies.

(This article was originally written in Chinese, the English version is a translation.)

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Identifying the Variations in the PRC Patent Law in 2009

Contributed by ZY Partners
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By Ai Hong and Zhang Hui

There has been an enormous amount of proposals and commentaries weighing in on the amendments to the present PRC Patent Law. This article intends covers the differences between the present rules and the new rules that take effect on October 1, 2009.

The Patent Law of the People's Republic of China ("Patent Law") was first adopted in 1984 and came into effect on the April 1, 1985. Thereafter, the Patent Law was amended twice in 1992 and in 2000. On December 27, 2008, the most recent amendment ("Third Amendment") to the Patent Law was adopted by the National People's Congress and will take effect on October 1, 2009.

Despite that during the past three years discussion on these amendments has at times been controversial, the final version of the Third Amendment has affected only a few existing rules of the 2000 Patent Law. The final version of the Third Amendment indicates that the Standing Committee of the National People's Congress (the "Legislature") took a less controversial approach in revamping the law. It avoided making structural changes to the existing Patent Law. For example, the Legislature declined to end the bifurcated approaches for judicial review of invalidation cases by administrative and civil tribunals; rather it declared the civil procedural nature of judicial review of invalidation cases. The Legislature also disregarded the quest to simplify the jurisdictional tiers concerning judicial review of the Patent Reexamination and Adjudication Board invalidation decisions. The Legislature further avoided pressure from domestic industries to create new rules against "abusive use of patents;" the Legislature declared that issues of "abusive use" should be dealt with by principles of the Anti-Monopoly Law and its future implementing rules.

The legislative purpose of the Third Amendment is to shift the focus of the Patent Law. The prior focus of the Patent Law was to encourage introduction of foreign technology as well as to live up to China's commitment at enforcing international standards to protect the patent rights of foreign investors. The present focus is on independent creativity- "enhancing independent creativity to build a country of innovation" through equal protection of Chinese and foreign patentees as well as striking a proper balance with public interest. The legislative goals are recognized as twofold: (i) encouragement of creativity and application of new technologies, and (ii) enhancement of enforcement. Accordingly, the Third Amendment is summarized is as follows:

1. Encouragement of Creativity and Application of New Technologies

1.1 Setting Up Higher Threshold For Patentability By Adopting The "Absolute Novelty Standard"

The current 2000 Patent Law still in effect bases patentability on a "relative novelty standard" which allows grant of patents for technologies yet to be published but already used in public or applied in products in foreign countries. The Third Amendment has established a higher threshold for patentability by adopting the "absolute novelty standard." The current relative novelty standard has resulted in low quality patents because novelty is established in China for the subject matter technologies, notwithstanding that there exists prior public use outside of China—so long as these are not being publicly used in China. By shifting to the absolute novelty standard, the 2008 Patent Law requires that in order to establish absolute novelty, the subject matter technology must not be known to the public in and outside of China.

1.2 Easing Conditions For Implementation Of "Joint Patent"

To ease application of technologies covered by patents jointly owned by more than one patentees, the 2008 Patent Law stipulates that in the absence of an agreement, any of the co-patentees may exploit the patent or implement the patent by licensing the same to third parties under non-exclusive conditions and sharing the royalties among the co-patentees.

1.3 Adoption Of The "Bolar Exemption" To Stall Early Stage Infringement Actions

The 2000 Patent Law does not carve out an exemption in the use of patented technologies during the process of applying for regulatory approvals with respect of pharmaceutical and medical appliance products. Now with the Bolar Exemption being adopted in the 2008 Patent Law, activities in relation to manufacturing, use and import of drugs or medical appliances for purpose of applying for regulatory approvals, and manufacturing and importation of pharmaceutical products or medical appliances solely for the purpose of regulatory approvals will not be regarded as an act of infringement.

1.4 Recognizing Prior Art As An Affirmative Defense In Infringement Actions

Under the current 2000 Patent Law, where there is a patent infringement action before the court, the defendant was required to file a patent invalidation petition with the State Intellectual Property Office ("SIPO") in a parallel proceeding. With split proceedings, the disadvantage was that while SIPO heard the validity of a patent, the court handling the infringement case was often reluctant to rely on the prior art defense as such defense - was more relevant to the issue of patentability in the SIPO proceeding. However, the court*s* handling the infringement cases could not neglect jurisprudence allowing the prior art defense, and in practice have allowed this defense. The 2008 Patent Law now codifies this judicial practice.

1.5 Expending Rules For Compulsory Licensing

The 2008 Patent Law prescribes rules for compulsory licensing regarding pharmaceutical and semiconductor technologies that closely related to public interests. The law also lays out procedural rules, conditions, and market domains

arising from compulsory licensing. Despite the expanded rules to make compulsory licensing operable, the implementation of these rules still requires promulgation of corresponding technical rules.

1.6 Deregulating Overseas Patent Applications

The 2008 Patent Law repealed the restrictions ~~for~~ requiring Chinese applicants for inventions made in China to first file their applications in China before any foreign filing. The 2008 Patent Law now allows applicants for inventions made in China to file their patent applications outside of China, but first requires the applicants to file for *a* pre-filing confidentiality review with SIPO. To implement the pre-filing confidentiality review, SIPO will have to promulgate implementing rules to address the procedural and substantive review requirements.

1.7 Repealing Restrictions For Foreign Persons' Access To Chinese Patent Agencies

Recognizing the overall improvement of services of Chinese patent agencies, the 2008 Patent Law removed the restrictions for foreign persons' access to patent agencies with SIPO certifications for provide services to foreign individuals or companies. This deregulation embodies the principle of national treatment of WTO and will allow foreign entities to have broader scope of agency selection in China.

2. Protection Enhancement

2.1 Increased Penalties for Infringement – Statutory Damages

The current 2002 Patent Law does not have language regarding statutory damages. In trial practice, courts rely on Supreme Court interpretations to award statutory damage which can range anywhere from 5,000 RMB to 500,000 RMB for infringement of patent. The 2008 Patent Law prescribes statutory damages ranging from 10,000 RMB to 1 million RMB. Under the 2008 Patent Law, the amount of pecuniary penalties for patent counterfeiting has increased from three times to four times of the illegal proceeds, and where there are no proceeds from such counterfeiting, damages range from 50,000 RMB to 200,000 RMB.

2.2. Recognizing The Right Of Offer For Sale For Patentees Of Design Patents

The current 2000 Patent Law only recognizes the right for offer for sale for invention and utility patents. Taking into account of China's advantages in design patents, the 2008 Patent Law extends the protection for design patents to the right of offer for sale for design patents. The law's recognition of such right will entitle patentees of design patents to proscribe unauthorized advertisement, display and exhibition of the patent products. Unlike before, offering for sale of a product protected by a design patent will be regarded as infringement

2.3 Incorporation Of Rules Concerning Preliminary Injunction And Pre-Action Evidence Preservation

The 2008 Patent Law incorporated the preliminary measures for preliminary injunction and pre-action evidence preservation already existed in Supreme Court judicial interpretations.

2.4 Protection Of Genetic Resources

The 2008 Patent Law was amended to prevent patent applications based on research and development of illegally obtained genetic resources from China. According to the 2008 Patent Law, where an invention is accomplished based on genetic resources, the applicant - must disclose in the patent application document the direct and indirect origins of the genetic sources. Patent applications will be denied where the genetic resources are illegally obtained or exploited.

3. Regulations To Be Made For Implementing The 2008 Patent Law

The 2008 Patent Law will become effective on October 1, 2009 with implementing rules and regulations anticipated to also come into effect on the same date. SIPO is currently working on the implementing regulations for the 2008 Patent Law for detailed rules on the following:

3.1. Application examination, grant of patents and fees;

3.2 Application re-examination and invalidation declaration;

3.3 Compulsory licensing and protection of the patents;

3.4 Compensation and award for work for hire patentees;

3.5 Patent registration and patent gazette; and

3.6 International applications

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ITEMS OF INTEREST

Selected Recent English Language Books on Chinese Law

Best Practices for Mergers & Acquisitions in China: Leading Lawyers on Understanding Changing Laws and Trends, Navigating the Review and Approval Process, and Identifying the Key Steps in a Successful M&A Transaction (Inside the Minds), Thomson West, 2008, ISBN-13: 9780314199966

http://west.thomson.com/productdetail/149736/40778861/productdetail.aspx

From the publisher: "This product provides an authoritative, insider's perspective on key strategies for representing and advising companies involved in mergers and acquisitions transactions in China. Featuring partners from some of China's leading law firms, it guides the reader through the changing landscape of mergers and acquisitions law in China, discussing the key features of new provisions and explaining the factors driving change. It offers key strategies for completing a successful transaction, from signing the letter of intent and conducting due diligence to overcoming challenges and closing the deal."

China and International Environmental Liability: Legal Remedies for Transboundary Pollution, edited by Michael Faure & Song Ying, Edward Elgar, 2008, 360 p. ISBN: 1847207529

http://www.e-elgar.co.uk/Bookentry_Main.lasso?id=13029

From the website: "Few countries are likely to have a more important global environmental role in coming years than the People's Republic of China. Professors Faure and Song have prepared a remarkable collection of essays that provide valuable insight on one key aspect: China's engagement with issues of liability for environmental damage at the domestic and international levels. There is much to be learnt from the pages of this commendable, rich and accessible work."

Chinese Company and Securities Law: Investment Vehicles, Mergers and Acquisitions, and Corporate Finance in China, by Liu Chengwei, Wolters Kluwer Law and Business 2008, 454 p. ISBN-13: 9789041126191

http://www.aspenpublishers.com/Product.asp?catalog_name=Aspen&product_id=9041126198

From the publisher: "This detailed, systematic explanation—by a practising lawyer at one of the biggest law firms in China—provides thorough and up-to-date guidance on the rules and procedures affecting investments, mergers and acquisitions, and listings in China today. Focusing on such practical matters as applications, regulatory requirements, and transactional procedures, the author leads the practitioner through the maze of interconnected national and local authorities, with lucid explanation of the lines drawn as to total investment amount, sector or category of business, industrial compliance, geographic location, and various imposed restrictions, with expert knowledge of when and under what circumstances various rules apply and when they do not."

Legal Reform versus the Power of the Party and State in the People's Republic of China: Rule of Law or Rule by Law?, by Li Jiefen, Edwin Mellen Press, 2008, 280 p. ISBN: 0773448942

http://www.mellenpress.com/mellenpress.cfm?bookid=7573&pc=9

From the publisher: "This is a case-based approach to the construction of a rule-of-law society with Chinese characteristics by the Chinese Communist Party (CCP) in an attempt to build up its political legitimacy and to fulfill its nationalistic goal to develop China into a modern state. Based on a careful analysis of policy documents, jurisprudence and interview data on legal developments in contemporary China, the study reveals the distinctive place of 'law' and its close relationship to ideology in CCP led system, and concludes that the current legal construction, albeit not fully in compliance with Western conception of rule of law, is a legal-rational process aimed to modernise the Party-state and society."

Selected English Language Legal Articles

Thomas Howell, Alan Wolff, Rachel Howe, Diane Oh, *China's New Anti-Monopoly Law: A Perspective from the United States*, 18 PACIFIC RIM LAW AND POLICY JOURNAL 53 (2009). From the authors: "This article provides an overview of China's AntiMonopoly Law (AML) emphasizing key areas of significant apparent divergence from U.S. antitrust policy. The article addresses the evolution of anti-monopoly policy in China and the United States, observing that, where differences exist, China's AML frequently reflects principles similar to those once embedded in U.S. antitrust policy, but which have been abandoned or modified by U.S. policymakers and courts in a sustained process of policymaking through trial and error. This article also examines specific areas of divergence between the AML and U.S. antitrust policy, describing how past U.S. policies, which find parallels in the AML, were modified or abandoned over time. Finally, the article concludes that in enacting the AML, Chinese policymakers aim to promote economic growth and innovation."

Joshua Klein, *Recent Legal Changes that Affect Secured Financing in the People's Republic of China*, 27 AMERICAN BANKRUPTCY INSTITUTE JOURNAL 38 (2009). From the author: "This article focuses on the Property Law in the commercial context and its effect

on establishing security interests in movable assets, such as account receivables and inventory."

The Comparative Labor Law and Policy Journal has published a symposium issue (v. 30, issue 2, 2009) on labor law developments in China. Articles include:

- Measuring Progress Under China's Labor Law: Goals, Processes, Outcomes
  Hilary K. Josephs
- The New Chinese Employment Law
  Wolfgang Däubler and Qian Wang
- China's New Labor Dispute Resolution Law: A Catalyst for the Establishment of a Harmonious Labor Relationship?
  Yun Zhao
- The Emergence of Temporary Staffing Agencies in China
  Feng Xu

Submitted by Kara Phillips, Collection Development Librarian/Associate Director, Seattle University Law Library. Kara Phillips can be reached at: phillips@seattleu.edu.

Special 301 Considers China's IPR Conditions

Two of the major intellectual property rigths (IPR) trade associations released reports that focused either exclusively or extensively on China in response to a call for comments in conjunction with the U.S. Trade Representative's (USTR) Congressionally mandated, annual review of IPR legal regimes around the world. The conclusions of these two associations, the International Anti-Counterfeiting Coalition (IACC) and the International Intellectual Property Association (IIPA), representing the largest companies whose revenues largely come from their trademark and copyright ownership interests, respectively, stand out as some of the most meaningful contributions USTR receives in response to its call for comments. We commend the treatment of China on pages 7-27 of the IACC report and the entire IIPA report, to the attention of our members.

http://www.iacc.org/resources/IACC_2009_SPECIAL_301_Recommendations.pdf
http://www.iipa.com/rbc/2009/2009SPEC301PRC.pdf

USTR released its conclusions on completing the Special 301 review on April 30, 2009. A significant portion of the report covers conditions for IPR protection in China. The full report can be found at the link below.

http://ustr.gov/Document_Library/Reports_Publications/2009/2009_Special_301_Report/Section_Index.html

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The *China Law Reporter* is a publication of the China Committee of the Section of International Law of the American Bar Association. Editors are Russell K.L. Leu, Esq., Counsel to the law firm Taft, Stettinius & Hollister LLP and Vice Chair of the China Committee (leu@taftlaw.com), Paul B. Edelberg, Esq., Counsel to Murtha Cullina LLP in its Stamford, Connecticut office (pedelberg@murthalaw.com), and Cameron J. Smith, Esq. Consultant for the UN Office for Project Services in its Copenhagen, Denmark office (camerons@unops.org). Contributions of articles and other items for the *China Law Reporter* are welcome. Please submit to all of the editors simultaneously. All articles are subject to editing by the editors. Guidelines for authors of articles for this Reporter can be obtained by contacting any of the editors or found at http://www.abanet.org/dch/committee.cfm?com=IC860000.

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