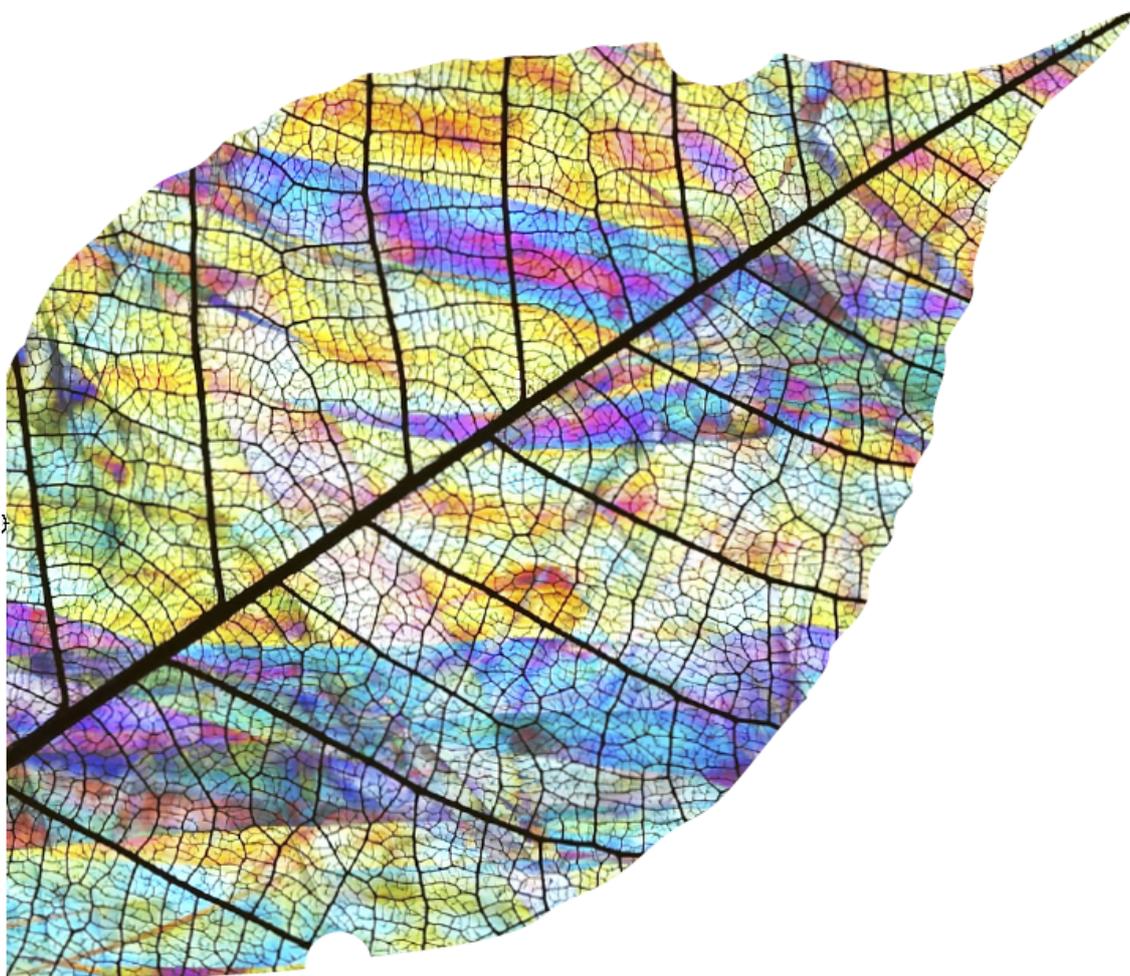


World Universities Comparative Law Project

Legal risk rating of China

carried out by students at Peking University

A production of the Allen & Overy Global Law Intelligence Unit



June 2013

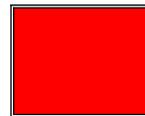
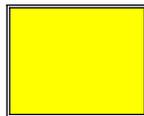
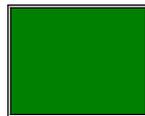
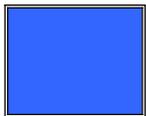
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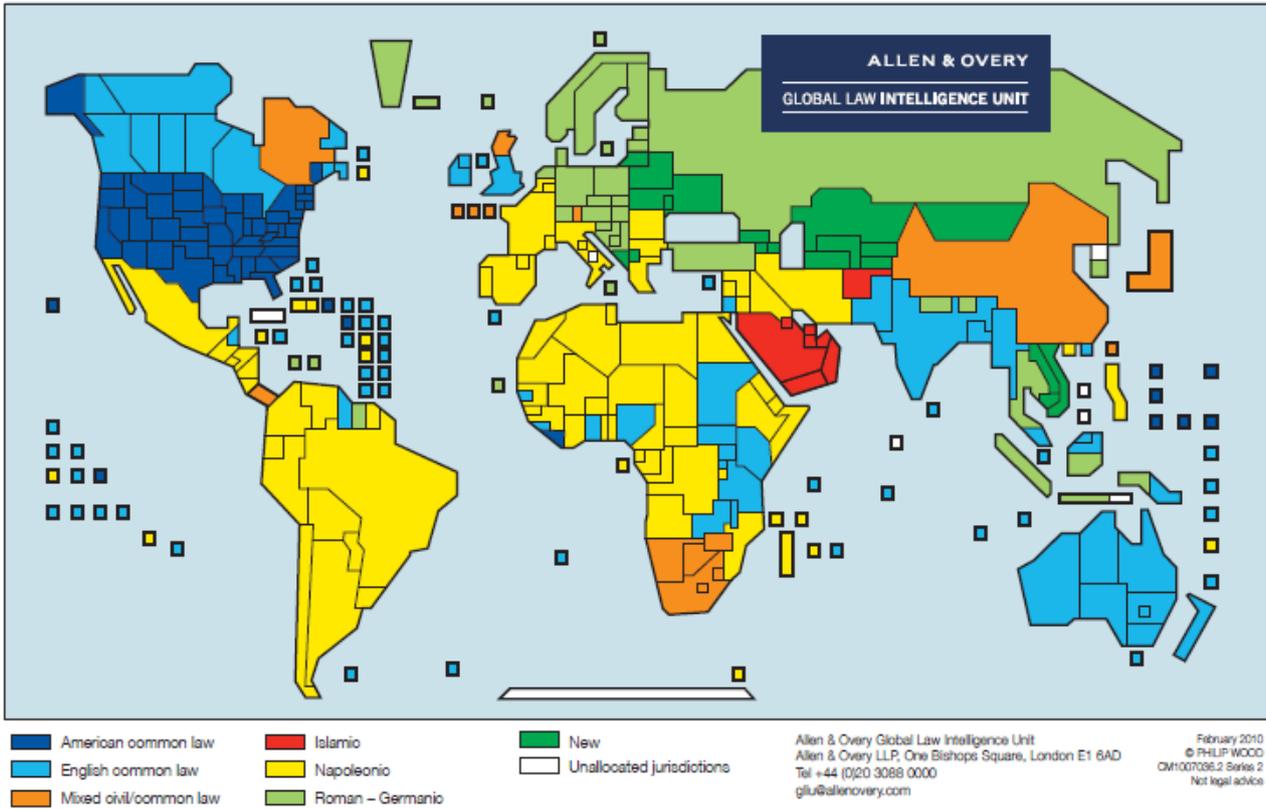
Peking University

June 2013



Produced by the Allen & Overy Global Law Intelligence Unit

Families of law



Foreword

We are delighted to present this legal risk rating of China, which is one of a series of similar risk ratings carried out by students around the world.

The aim was to produce a survey of the wholesale financial and corporate law in China looking at how China fits in with the rest of the world.

We hope that you will find the colour-coded methodology and the technique of selecting symbolic and resonant legal indicators to be an expressive and creative way of signalling some of the main contours of wholesale financial, corporate and related law in China. We certainly find the result to be most fascinating and helpful and we hope that the reader will agree.

We are most grateful to the four students at Peking University for being willing to participate in this project. In particular I am warmly appreciative of the opportunity I have had discuss this legal risk rating with the students concerned. I would pay a special tribute to their intellectual flair and dedication.

Dr Wang Yunchuan (PhD, Peking) of the Export-Import Bank of China and Mr Zheng Hui (MJur, Oxon; LLB, Nanjing) of Allen & Overy LLP, who managed and guided this project, made a splendid contribution to the successful achievement of the survey.

Philip R Wood QC (Hon), BA (Cape Town), MA (Oxon), LLD (Lund, Hon)

Head, Allen & Overy Global Law Intelligence Unit

Special Global Counsel

Visiting Professor in International Financial Law, University of Oxford

Yorke Distinguished Visiting Fellow, University of Cambridge

Visiting Professor, Queen Mary College, University of London

Visiting Professor, London School of Economics & Political Science

Legal risk rating: China

Introduction

This paper assesses aspects of legal risk in China with a view to rating the legal risk. The survey is concerned primarily with wholesale financial and corporate law and transactions, not with retail law.

Legal risk has increased globally because of the enormous growth of law; because of its intensity; because many businesses are global but the law is national; because nearly all countries are now part of the world economy; and because the law is considered to play a very significant role in the fortunes of our societies. Liabilities can be very large and reputational losses severe.

The survey was carried out by students at Peking University. The survey was designed by the Allen & Overy Global Law Intelligence Unit in conjunction with the students concerned.

The views expressed in this survey are the views of the students, not necessarily those of the Global Law Intelligence Unit or the members of Allen & Overy. In accordance with the requirements of academic freedom, the students expressed their views freely and in their own way.

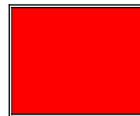
Methodology

The survey uses colour-coding as follows:

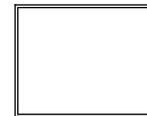
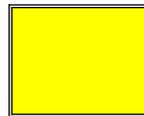
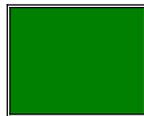
True



False



**Can't
say**



Blue generally means that the law does not intervene and the parties are free, ie the law is liberal and open.

Red generally means that there is intense legal intervention, usually in the form of a prohibition.

Green and **yellow** are in-between.

The purpose of this colour-coding is to synthesise and distil information in a dramatic way, rather than a legal treatise. The colours correspond to a rating of 1, 2, 3 or 4, or A, B, C or D.

The cross in the relevant box signifies the view of the students carrying out this assessment of the position of China. This may or may not be followed by a comment, eg pointing out qualifications or expanding the point. These comments were written by the students.

The colour-coding does not usually express a view about what is good or bad. Whether the law should intervene in a particular arena is a matter of opinion. But if the law does intervene, this creates a risk because the law has to be complied with. If it is not complied with, there is generally some sanction in the form of liability, a penalty or the invalidity of a transaction.

Black letter law and how it is applied

This survey measures two aspects of law. The first is black letter law, ie what the law says or the written law or law in the books.

The second measure is how the law is applied in practice, regardless of what it says. Thus, the law of Congo Kinshasa and Belgium has similar roots but its application is very different.

Although there is a continuum, these two measures have to be kept separate. Otherwise we may end up with just a blur or noise or some bland platitude, eg that the law depends upon GDP per capita.

Most of the ratings in this survey concern the written law and ignore how it is applied or whether it is enforced in practice.

Key indicators

The survey uses key indicators to carry out the assessment. It is not feasible to measure all the laws or even a tiny fraction of them. The law of most jurisdictions is vast and fills whole libraries.

The key indicators are intended to be symptomatic or symbolic of the general approach of the jurisdiction. To qualify as useful, the indicator must usually be (1) important in economic terms, (2) representative or symbolic and (3) measurable. In addition, the indicators usually measure topics where jurisdictions are in conflict. There is less need for measuring topics where everybody agrees.

The key indicators and the text explaining the indicators were produced by the Allen & Overy Global Law Intelligence Unit.

Legal families of the world

Most of the 320 jurisdictions in the world, spread around just under 200 sovereign states, can be grouped into legal families. The three most important of these are: (1) the common law group, originally championed by England; (2) the Napoleonic group, originally championed by France; and (3) the Roman-Germanic group, originally championed by Germany, with major contributions from other countries.

The balance of jurisdictions is made up of mixed, Islamic, new and unallocated jurisdictions.

Many aspects of private law are determined primarily by the family group, but this is not true of regulatory or economic law.

Excluded topics

This survey does not cover:

- transactions involving individuals
- personal law, such as family law or succession
- competition or antitrust law
- intellectual property
- auditing
- general taxation
- macroeconomic conditions, such as inflation, government debt, credit rating or savings rates
- human development, such as education, public health or life expectancy
- infrastructure, such as roads, ports, water supply, electricity supply
- personal security, such as crime rates, civil disorder or terrorism.

Banking and finance

Introduction

Banks and bondholders (typically also banks, but also insurance companies, pension funds and mutual funds) provide credit to enhance growth. Their main risk is the insolvency of the debtor and therefore the key indicators are whether the law supports creditors or debtors when it matters, ie on bankruptcy. This is when commercial law is at its most ruthless in deciding who survives and who drowns.

This debtor or creditor decision is implemented mainly through the bankruptcy ladder of priorities. A notable feature of common law systems is the presence of super-priority creditors who are paid before anyone else - creditors with a set-off or a security interest and beneficiaries under a trust. For example, if a bank has universal security over all the assets of a company, the bank is paid before all other creditors, including employees and trade creditors. This regime therefore protects the largest creditors who are typically banks (who in turn represent depositors, ie the citizen) and the law is creditor-protective. Their legal risk is reduced and hence the risks of depositors with banks is reduced.

If the jurisdiction prioritises these three super-priority claimants, then the legal system of that jurisdiction is likely to be based on the English common law model, meaning that the indicators are highly accurate in informing us about the rest of the legal system. If these super-priority risk mitigants are debased, this may also tell us whether the legal system is generally pro-debtor or pro-creditor in its bankruptcy law. For example, one might be able to conjecture whether or not there is a tough rescue law and whether wholesale creditors are or are not favoured in the bankruptcy ladder of priorities. The result is that it would be much quicker to check the key points.

Traditional Napoleonic jurisdictions typically do not allow insolvency set-off, have narrower security interests and do not recognise the trust. They are therefore debtor-protective. Most traditional Roman-Germanic jurisdictions are in-between. They allow insolvency set-off and have quite wide security but most do not recognise the trust.

Insolvency set-off

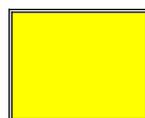
Generally If set-off of mutual debts is allowed on the insolvency of a debtor, the creditor is paid. If it is not allowed, then effectively the creditor is not paid. Hence insolvency set-off is creditor-protective. A prohibition is debtor-protective. Very large amounts are involved in markets for foreign exchange, securities, derivatives, commodities and the like, so that the question of whether exposures should be gross or net is a major aspect of legal risk.

Q1 In China, creditors can set off mutual debts on the insolvency of a debtor if they are incurred before notice of the insolvency.

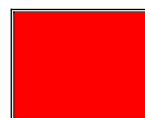
True



False



**Can't
say**



Comment: We consider three different subjects.

Firstly, for enterprise legal persons (in the legal system of China, enterprise legal persons are those enterprises whose shareholders are granted the protection of limited liability rather than all different kinds of business organizations), according to Article 40 of the Enterprise Bankruptcy Law of 2007, where a creditor

is indebted to its debtor before an application for bankruptcy is accepted, it may claim a set-off against the bankruptcy administrator.

There are the usual exclusions for debts incurred after the commencement of the bankruptcy and to prevent the build-up of set-offs by the creditor as signing a debt after a notice of actual insolvency. Thus after the people's court accepts the application for bankruptcy and before the debtor is announced bankrupt, where a debtor of the debtor obtains the creditor's right of any other party against the debtor, the relevant debts shall not be set-off (Article 40 of the Enterprise Bankruptcy Law of 2007).

In addition, set-off is not allowed in certain cases: (I) where a creditor learns that a debtor is incapable of paying off its due debts or is in the process of applying for bankruptcy and it is indebted to the debtor (exception: that the creditor assumes its liabilities according to the provisions of law or for any reason incurred one year before the application for bankruptcy is filed), it may claim a set-off against the bankruptcy administrator; (II) where a debtor of the debtor learns that the debtor is incapable of paying off its debts or is in the process of applying for bankruptcy, and therefore obtains the creditor's right from the debtor (exception: the debtor's debtor obtains the creditor's right according to law or for any reason incurred one year before the application for bankruptcy), it may claim a set-off against the bankruptcy administrator.

Secondly, for individuals and other non-corporate business organizations, in China there is no specific rule concerning the insolvency state of these subjects. But according to the general rule provided by Article 99 of the Contract Law of 1999, the set-off of mutual debts is allowed when individuals and other non-corporate business organizations are in the state of insolvency.

Thirdly, certain entities in China (such as commercial banks, securities companies or insurance companies) may be required to follow somewhat different proceedings from that provided in the Enterprise Bankruptcy Law of 2007, but the set-off available under the general Contract Law of 1999 and the Enterprise Bankruptcy Law of 2007 may continue to be in effect in those special proceedings.

Security interests

Generally Security interests give priority to the creditor with security - typically banks - who are the main providers of credit in most countries.

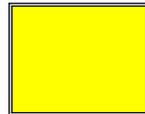
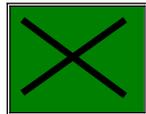
In traditional common law jurisdictions, a company can create universal security over all its present and future assets to secure all present and future debt owed to a bank. Once registered, the security is valid against all creditors, except that the floating collateral ranks after preferred creditors - typically wages and taxes. The security can be granted to a trustee for creditors. On a default there are no mandatory grace periods and the creditor can enforce out-of-court by appointing a receiver (a type of possessory manager) or by private sale. But in some jurisdictions there are freezes on enforcement in the event of a judicial rescue of the debtor. Also, in some jurisdictions there are stamp duties.

On the other hand, in many traditional Napoleonic jurisdictions, universal security is not possible, neither is security for all future debt. There is no trustee to hold the security. On enforcement, there are grace periods and no receiver. Sale is through the court and a public auction. Preferential creditors rank ahead. Some countries have a strict freeze under a judicial rescue statute.

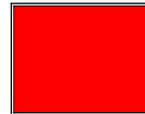
The main tests are therefore (1) scope, (2) debt secured, (3) trustee, (4) priority over preferred creditors, (5) private enforcement and receiver, (6) no rescue freezes and (7) low costs. Security interests reduce the legal risk suffered by banks and hence strengthen the position of depositors with banks.

Q2 In China, the law offers a security interest which is highly protective of the secured creditor.

True



False



**Can't
say**



Comment: In China, generally speaking, the protection of security interest is moderate. Assets other than those that shall not be mortgaged according to any law or administrative regulation can secure present and future debts (Article 180 of the Property Law of 2007). Movable Properties and qualified rights such as money orders, checks, and cashier's checks can be pledged for present and future debts (Article 223 of the Property Law of 2007) The difference between mortgage and pledge in China is that in the latter circumstance, the obligator should pledge his (its) properties to the obligee for possession. Existing manufacturing facilities, raw materials, semi-manufactured goods and finished products or those to be owned in future in an enterprise, individual industrial and commercial household or agricultural production operator can be mortgaged (Article 181 of the Real Right Law of 2007). And in the transaction of factoring, receivables are often the subject of security.

In China, there are several ways for corporations to issue bonds, but generally speaking, issuing bonds are not that popular in China. The present legal system has already established the institution of “trustee for creditors” who is required to “obtain the certificate of the security right or other relevant documents before the issuance of bonds and keep them appropriately”(Article 23 of the Pilot Rules on the Issuance of Corporate Bonds issued by China Securities Regulatory Commission in 2007). According to Article 109 of the Enterprise Bankruptcy Law of 2007, an owner of a security interest on the particular assets of the bankrupt may enjoy the priority right to be repaid by means of the particular assets. There are no preferential creditors ranking ahead, even in the proceedings concern the financial entities mentioned in Q1. But exceptions exist: as to the defaulted wages and subsidies for medical treatment and disability, compassionate and compensatory payments, the basic old-age insurance premiums and basic medical insurance premiums that shall have been transferred into the individual accounts of employees as well as the compensation for the employees as prescribed by the relevant laws and administrative regulations incurred before the date of August 27, 2006, rank prior, that is where the assets are not enough for payment of these claims upon liquidation other than with the security assets, the particular assets charged to the creditors shall be liquidated prior to the repayment of the owner of the security interest on the particular assets (Article 132 of the Enterprise Bankruptcy Law of 2007). They can require the bankruptcy administrator to sell the secured assets to satisfy their claim before the distribution plan is confirmed by the court and is executed by the bankruptcy administrator. Or they can sell the collateral through a private sale without court approval. But during the rescue proceedings, the security interest on the particular assets of a debtor shall be suspended (Article 75 of the Enterprise Bankruptcy Law of 2007). Indispensably to realising security interests will involve necessary expenses for management (considering that before the requirement imposed on the bankruptcy administrator to sell the security, the management of the security will bring about expenses) and selling off the security.

Universal trusts

Under a trust, one person, called the trustee, holds title to the assets of another person, called the beneficiary, on terms that, if the trustee becomes insolvent, the assets go to the beneficiary and are not used to pay the

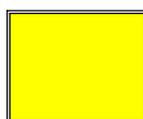
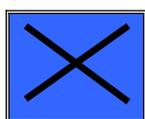
trustee's private creditors. The assets are immune and therefore taken away from the debtor-trustee's bankrupt estate.

The main examples of trusts are custodianship of securities, pension funds, securities settlement systems and trustees of security for bondholders and syndicate banks. The availability of the trust mitigates the legal risk of, for example, those who place their securities in the custodianship of banks and the users of securities settlement systems. The amounts involved are enormous.

All jurisdictions have an effective trust of goods (called bailment or deposit), but only the common law group has a universal trust for all other assets (land and intangible property). Most members of the civil code group do not have a universal trust, subject to wide exceptions, especially for custodianship of securities.

Q3 China has a universal trust for all assets.

True



False



**Can't
say**



Comment: In China, trusts are possible in respect of both movable and immovable property, both tangible property and intangible property. Negative requirements are: properties forbidden to circulate by laws or regulations shall not be used as trust property, and properties limited in circulation by laws and regulations may be used as trust property with the approval of relevant departments in charge according to law (Article 14 of the Trust Law of 2001). Specifically, trust companies may apply to conduct some or all of the following domestic or foreign currency businesses: (1) capital trust; (2) trust of movable property; (3) real estate trust; (4) trust of negotiable instruments; (5) trust of any other property or property rights (Article 16 of the Measures for the Administration of Trust Companies issued by China Banking Regulatory Commission in 2007). Besides, banking financial institutions, as the promoter institution, can entrust the credit assets to a trustee institution for the purpose of issuing asset-backed securities (Article 3 of the Measures for Supervising and Administrating the Pilot Securitization of Credit Assets by Financial Institutions issued by China Banking Regulatory Commission in 2005).

Other indicators

Other bankruptcy indicators not measured here include freezes on the termination of contracts, fraudulent preferences, the priority of rescue new money, the presence and intensity of rescue proceedings and recognition of foreign insolvencies. Director liability for deepening the insolvency is dealt with below.

Other financial law topics not covered in this survey include the regulatory regime, especially capital, liquidity, authorisation of financial business, conduct of business, control of prospectuses, control of market abuse and frauds, such as insider dealing, and the insolvency regime for banks. Financial regulation is a very large field.

Corporations

Introduction

Financial law involves competition between debtors and creditors so that jurisdictions can be positioned on a straight line. Corporate law however involves three main competitors: (1) shareholders, (2) creditors and (3) managers - a triangle. If the key indicators show that a jurisdiction strongly favours one or other of the parties at the points of the triangle, whether creditors, shareholders or management, then one can begin to build up a picture of the choices which the jurisdiction habitually makes in resolving the conflicting interests of the parties.

For example, a very tough prohibition on financial assistance by a company to buy its own shares (which is protective of creditors against shareholders) tends also to support an attitude to other principles of the maintenance of capital or to support the proposition that mergers by fusion are difficult (because they can prejudice creditors). This would be true of the English regime in 1948. Similarly, a view which easily imposes personal liability on directors for deepening an insolvency might also show a legal approach which is not supportive of the veil of incorporation in other areas, eg shareholder liability and substantive consolidation on insolvency.

The two extreme corporate law models are the Delaware model and the traditional English model, exemplified by the English Companies Act 1948 (now superseded in the UK). Napoleonic and Roman-Germanic models are in-between to varying degrees.

The Delaware regime is highly protective of management in the key areas. The English regime favours creditors in most of the key contests and, where creditor interests are not involved, it tends to favour shareholders as opposed to managers.

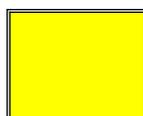
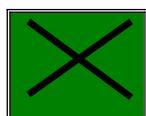
Director liability for deepening an insolvency

Generally If the law imposes personal liability on directors for deepening an insolvency, eg carrying on business and incurring debts where there is no reasonable prospect of paying them, then the regime is hostile to the interests of management. The legal risks of management are increased.

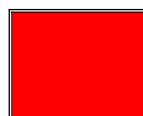
There are basically four regimes internationally: (1) directors are hardly ever liable for deepening the insolvency, eg Delaware and most U.S. jurisdictions, plus some traditional English jurisdictions which only punish fraudulent trading; (2) directors are liable for serious negligence (England, Singapore, Australia, Ireland); (3) directors are liable for mere business misjudgements deepening the insolvency (France); and (4) directors are liable if they fail to file for an insolvency proceeding after the company becomes insolvent (France, Germany and others).

Q4 China The law rarely imposes personal liability on directors for deepening the insolvency and there is no rule that the directors must file for insolvency when the company is insolvent.

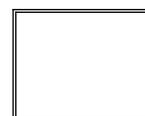
True



False



**Can't
say**



Comment: In China, where a director violates his obligations of being honest and diligent and thus leads to enterprise bankruptcy, he shall be subject to the relevant civil liabilities according to law (Article 125 of the Enterprise Bankruptcy Law of 2007). But there is no positive requirement for filing for insolvency in China. From the academic perspective, it is unclear whether the obligations of fidelity and diligence in the Company Law of 2005 (Article 148) or the tort claim (Article 6 of the Tort Law or Article 106 of the General Principles of the Civil Law) can impose civil liability on the directors when they deepen the insolvency. But there are few cases indicating that directors are subjected to this liability.

Financial assistance to buy own shares

Generally Many jurisdictions prohibit a company from giving financial assistance to buy its own shares. The typical example would be where a bidder finances the acquisition of a target company by a loan and after the takeover arranges for the target to guarantee the loan and charge its assets to secure the guarantee. The commercial effect is similar to the repayment of the share capital of the target before its creditors are paid. Shareholders should be subordinated to creditors.

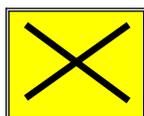
The prohibition therefore favours creditors against shareholders of the target.

The Delaware regime does not prohibit financial assistance. The traditional English regime has a wide prohibition (not England any more). Most Roman-Germanic regimes are against it, with Napoleonic regimes hesitant. The EU has a prohibition against financial assistance by public companies. Some countries allow financial assistance by private companies if solvency is established.

A contravening transaction is usually a criminal offence and void, thereby exacerbating legal risk.

Q5 China permits a company to grant financial assistance for the purchase of its own shares.

True



False



Can't
say



Comment: Target listed companies are forbidden to provide any means of financial aid to the purchaser by making use of the sources of the target company (Article 8 of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006).

As for private companies, general rules of the Company Law will present some certain restrictions: firstly, if a company intends to provide a guarantee to a shareholder or actual controller of the company, it must obtain a resolution through the shareholder's meeting or shareholders' assembly (Article 16 of the Company Law); secondly, if the target company is a joint stock limited company, it may not, directly or via its subsidiary, lend money to any of its directors, supervisors, or senior managers (Article 116 of the Company Law). So if the restrictions mentioned above are not triggered, the target company may via legitimate ways provide financial support to the bidders to acquire its stocks. But if the financial support cannot follow the mechanism of company decision-making or involves an improper conveyance from the company to its stockholders, it may be challenged by certain parties, and the stockholder may even be accused of crime of official embezzlement (Article 271 of the Criminal Law) or crime of misappropriation of funds (Article 272 of the Criminal Law) – see the case of Zhanghai who acquired the stocks of the company of Jianlibao and somehow made use of the capital of Jianlibao to pay the consideration in 2002. But if the bidder company

after acquiring enough stocks to control the target company manages to merge the target company, the assets of the former target company will be used to pay back the acquiring company's debts including those incurred for the purpose of acquisition (Article 175 of the Company Law of 2005).

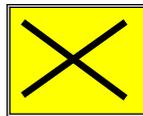
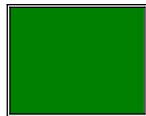
Public takeover regime

Generally A public takeover regime which is free and open tends to favour managers who can guard against takeovers by poison pills and the like and who have relative freedom to acquire other companies. An example is the Delaware regime. A restrictive regime on the lines of the British system tends to favour shareholders.

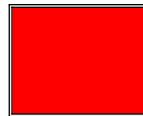
The chief features of a restrictive regime are: (1) the bidder must make a mandatory bid in cash when a threshold of shares in the target is reached, eg 30%; (2) the bidder must pay the same price to all shareholders (sharing the control premium); (3) no partial bids (getting control on the cheap); (4) proof of certain funds to implement the offer; (5) compulsory acquisition of dissenting minorities (squeeze-out); (6) fixed timetable; (7) no ability of the managers to frustrate a bid by poison pills without shareholder approval; and (8) control of the content of circulars, especially forecasts.

Q6 Apart from exchange controls and restrictions on foreign direct investments, the public takeover regime in China is open and has few restrictions.

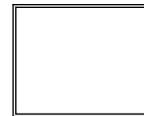
True



False



Can't say



Comment: In China, there are a series of procedural and substantive requirements covering public takeovers. In practice, the frequency of public takeovers is low, which may be caused by the concentrated equity structure of listed corporations in China. The exact institutional effect on the frequency of public takeovers cannot be measured.

Where an investor holds individually or with any other person 30% of the stocks as issued by a listed company by means of agreement or any other arrangement through securities trading at the stock exchange and continues the purchase, he shall issue a tender offer to all the shareholders of the said listed company to purchase all of or part of the shares of the listed company (Article 88 of the Securities Law of 2005). As for the consideration of the offer, cash or securities or both are allowed.

The price for listed shares of the same class that are the subject of the takeover offer shall not be less than the highest price that the purchaser paid for the target company's listed shares of that class during the six months prior to the date of publication of the notice of takeover (Article 35 of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006). Whether the bidder must pay the same price to all shareholders of the same class is still unclear according to the written words of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006 which requires that all the stockholders should be treated equally (Article 26). But creeping tender offers are not explicitly forbidden, although there is no such real case up to now in practice.

A partial bid is allowed in China and in practice it is the more common one.

If the purchaser is to make payments in cash, it shall, at the same time as publishing the notice of the tender offer, deposit and cause to be frozen a performance bond of not less than 20% of the total takeover amount into a bank account designated by the securities registration and clearing institution. If the purchaser is to make payments by means of legally negotiable securities, it shall, at the same time as publishing the notice of the tender offer, deliver all the securities to be used for payment into the custody of the securities registration and clearing institution (Article 36 of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006).

Compulsory acquisition of dissenting minorities is not required in China. And it is also impossible to acquire the minorities compulsorily. But practically, majority shareholders can vote for a merger which may drive the minorities out with cash.

The time limit within which the stockholders can accept the tender offer should be designated by the bidder beforehand (Article 29 of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006). The term of the takeover offer shall be no less than 30 days and may not exceed 60 days, unless a competing offer is made (Article 37 of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006).

Unless the target company continuously engages in normal business operations or implements the resolutions made by the general assembly of shareholders, the board of directors of the target company shall not, after the purchaser makes a suggestive announcement and before the tender offer is completed, produce significant effects on the assets, liabilities, entitlements or business performances of the company by disposing of the assets or external investments of the company or adjusting main businesses, guarantees or loans of the company, etc (Article 33 of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006). So most antitakeover defences should be approved by the shareholders. Indeed, poison pills are infeasible in China due to the strict supervisory requirements concerning the issuance of new stocks.

Lastly, a tender offer report shall state matters such as the purposes of the takeover, an analysis of effects of this takeover on the listed company (such as whether there is intra-industry competition or potential intra-industry competition between the business engaged in by the purchaser or any affiliated party thereof and the business of the listed company; whether there is any continuous affiliated transaction), follow-up plans for adjusting the assets, businesses, personnel, organizational structure or articles of association of the listed company for the future 12 months and so on (Article 29 of the Measures for the Administration of the Takeover of Listed Companies issued by China Securities Regulatory Commission in 2006). A forecast of the future business prospect is not mentioned by the Measures.

Other indicators

Other important indicators are corporate governance (difficult to measure), free ability to merge companies by fusion, the one-share-one-vote rule, and, to a lesser extent, minority protections. Other indicators relate to quick and cheap incorporation, the *ultra vires* rule, maintenance of capital, no par value shares, shareholder liability, substantive consolidation on insolvency and disclosure. These are not measured here.

Commercial contracts

Introduction

Contract is at the heart of commercial life and is everywhere. In fact, the main tenets of contract law across the main families of jurisdictions are consistent - it is in the fields of insolvency and real rights law where the main differences emerge. It is true that there are contract differences, for example, between writing

requirements, open offers, the letterbox rule and specific performance, but often these differences are of lesser significance in practice in the business field.

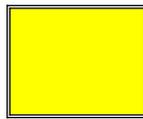
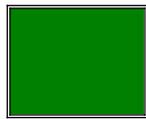
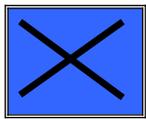
The key indicators the survey chooses all tend to symbolise whether the approach of the jurisdiction to contract is hard or soft. If the approach is hard, then the jurisdiction tends to support predictability in business contracts so that certainty and freedom of contract are valued more than mitigating the risk of occasionally abusive behaviour and unfair results, especially for weaker parties.

Exclusion of contract formation

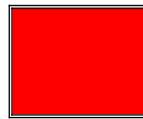
Generally Commercial parties often wish to be able to negotiate heads of terms commercially without being bound by a contract. In some jurisdictions, the courts are ready to infer that the parties are bound if the terms are sufficiently clear, even if they have said expressly that they do not intend to be bound. Legal risk is increased if parties are committed when they did not intend to be.

Q7 In China, parties are not bound to heads of terms if they expressly state that the terms are "subject to contract" or some such clear phrase.

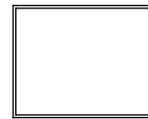
True



False



Can't
say



Comment: The conclusion of contracts and the validity of contracts are different in Chinese contract law. A contract will be concluded if there exists a valid offer and acceptance; except that people might want their contracts to be concluded only in written form or by a letter of confirmation, etc., under these circumstances, special rules apply: see Art.32-38 of Contract Law of China. Parties are bound only by valid contracts. In general, contracts are valid when parties conclude the contracts: see Art.44. The parties may agree that the effectiveness of a contract will be subject to certain conditions or period and such contract shall become effective when such conditions are accomplished or such period expires (see Art. 45-46). According to these rules, if the parties expressly state that the terms are "subject to contract" or use similar language, the terms are not valid contracts and the parties are not bound; however, these rules should not be abused, otherwise the party shall be liable for the damage according to Art.42 of Contract Law.

Termination clauses

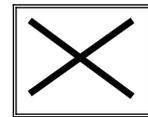
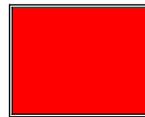
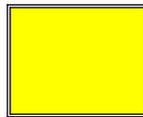
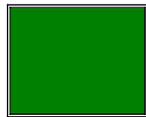
Generally Many contracts, especially loan contracts, leases of goods and long-term sales contracts, contain events of default on the occurrence of which one party can terminate the contract. Jurisdictions which uphold freedom of contract and the literal interpretation of contract give effect to these clauses and do not rewrite the contract according to the court's notions of what is fair. We ignore consumer contracts - where there may be consumer protections.

Q8 In China, a termination clause in a loan or sale of goods contract between sophisticated companies (not individuals) providing for the termination of the contract immediately on certain events is usually upheld, even if the event concerned is relatively trivial.

True

False

**Can't
say**



Comment: Contracts can be terminated either by consensus or by law. The former way of termination includes: (1) separate agreements besides the contract and (2) termination clause in the contract. The situation in question belongs to (2). In this case, the termination clause in the contract will be upheld if certain events occur, even if they are relatively trivial (see Art. 93 of Contract Law). Therefore, sophisticated companies can terminate the contract if the termination clause is met. However, we do not think it is a problem in reality, because sophisticated companies usually put limitations on the use of a termination clause in order to keep the contract in valid.

However, the termination clause will be upheld only when: (1) the termination clause should be within the time period of suing, so it should be used immediately, otherwise it will not be upheld as well. (2) the termination clause itself should be valid because it is part of the contract (see Chapter 3 of Contract Law). However, loans between companies are forbidden in the Chinese legal system, although in reality companies do lend and pay interest; and Chinese regulators are establishing new rules in this area. But according to our knowledge at the moment, a loan contract between companies is not valid, including its termination clause. So in the case of loan contract, the court will stop the contract because it is invalid, but the court may also consider the principle of fairness and ask the lender to pay some interest back to the lender, which results in the same effect of continuing the contract. So it is difficult to say whether the court will uphold the termination clause or not in loan contracts in China.

Exclusion clauses

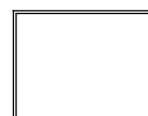
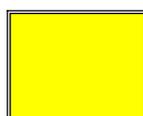
Generally Contracting parties often seek to exclude their liability for defective performance of the contract. So the issue is whether these exclusion clauses are generally upheld if they are clear and whether freedom of contract is allowed in this area. An ineffective clause increases legal risk.

Q9 In China, exclusions of liability in most commercial contracts between sophisticated companies, such as a sale of goods contract, are generally upheld if they are clear.

True

False

**Can't
say**



Comment: If the exclusions of liability between sophisticated companies are clear in commercial contracts, most of them will be upheld in China, except: (1) such exclusions of liability fall into the categories of Art. 52 of null and void contracts, including damaging the public interests or violating the compulsory provisions of laws and administrative regulations, etc.; (2) those that cause property damages to the other party as a result of deliberate intent or gross negligence, see Art. 53; (3) the exclusions of liability were significantly misunderstood, or are obviously unfair when concluding the contract, or there exist the use of fraud, coercion, exploitation of unfavourable position and therefore contradict the other party's true intention: see Art. 54; (4) the party which supplies the standard terms exempts itself from its liabilities. So being clear is not enough for the exclusions of liability in most commercial contracts to be upheld.

Other indicators

Other contract indicators not assessed here include writing formalities, open offers, mistake, frustration, damages, specific performance and whether notice of assignment of the contract to the debtor is mandatory if the assignment is to be valid on the insolvency of the assignor.

Litigation

Introduction

The first three key indicators of governing law, jurisdiction and arbitration tend to show whether the jurisdiction does or does not place a high value on international comity and freedom of contract as opposed to an insistence on national primacy.

The indicator on class actions tends to show whether or not the jurisdiction's litigation system is orientated towards plaintiffs, especially mass plaintiffs in product liability cases. This indicator may also show the attitude of the jurisdiction to the protection of individual parties as against business parties, both in terms of the incidence of costs and enforcement.

Governing law clauses

Generally Most countries apply a foreign governing law of a contract even if there is no connection between the contract and the jurisdiction. If the courts do not uphold the governing law, the effect is that legal risks are unexpectedly different.

Q10 The Chinese courts will apply an express choice of a foreign law in a loan or sale of goods contract between sophisticated companies, even though the contract has no connection with the foreign jurisdiction, but subject to Chinese public policy and mandatory statutes.

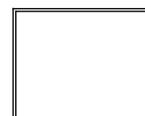
True



False



Can't
say



Comment: Art. 41 of Law of the People's Republic of China on Choice of Law for Foreign-related Civil Relationships clearly states that "Parties concerned may choose the laws applicable to a contract by agreement. Where the parties have made no such choice, laws of the habitual residence of the party whose performance of obligations best reflects the characteristics of the contract or other laws having the most

significant relationship with the contract shall apply.” According to this rule, if the parties expressly choose a law, that law shall apply first; otherwise, the law best-related to the contract shall apply. However, such application of laws can not apply if: (1) there are mandatory provisions on foreign-related civil relations prescribed in laws which shall apply directly: see Art. 4 of the above law. In the case of loan contracts, the situation is complex and needs further explanation: a) if the lender and the payer of a loan contract are both Chinese companies, the law clearly forbids such interactions so the Chinese law will apply directly even the parties chose a foreign law; b) if one of the parties is a domestic company and another is a foreign one, such loan contract is still under Chinese law, considering the effectiveness of regulation on capital market, stated by Article 10 of No.24 explanatory rule by Chinese Supreme Court on 28th December, 2012. Thus, the mandatory rules shall apply instead of the choice of law under both situations; (2) the application of foreign laws will undermine the social and public interests of the People's Republic of China in which situation the Chinese law will apply: see Art. 5. The question is consistent with PRC’s choice of law for Foreign-related Civil Relationships.

Foreign jurisdiction clauses

Generally Many contracts confer jurisdiction, sometimes exclusive, on the courts of a foreign jurisdiction, usually accompanied by a choice of foreign governing law.

Q11 The Chinese courts will generally uphold a clear submission in a loan or sale of goods contract between sophisticated companies to the exclusive jurisdiction of the courts of a foreign country, even if there is no connection between that country and the contract.

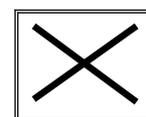
True



False



Can't say



Comment: The situation in the question needs further classification: (1) if the case is brought in Chinese territory and has no foreign-related relationship, Chapter II of PRC’s civil procedure law shall apply directly, which means parties cannot choose an exclusive jurisdiction for the contract: see Art. 4 and Chapter II; (2) if the case has a foreign-related relationship, Chapter XXIV shall apply instead. However, the National People's Congress amended this chapter on August 31, 2012, and the situation in the question remains unclear according to new rules.

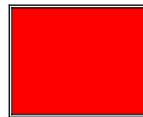
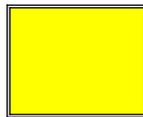
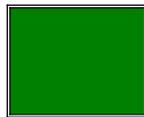
Before the amendment, Chinese Civil Procedure Law stated in Art. 242 Chapter XXIV that “The parties to a disputed contract involving foreign elements or the parties having disputes over property rights and interests involving foreign elements may reach a written agreement to choose a court located in the place that has actual connections with their disputes as the court to adjudicate their disputes.” So literally speaking, parties can choose foreign courts as the exclusive jurisdiction, provided that such jurisdiction has actual connections with the contractual disputes. But the new version of PRC’s Civil Procedure Law deleted this article, and according to Art. 259 of the new rules, if there is no rule governing the matter, Chapter II shall apply, which allow parties to choose only the People’s Courts as the exclusive jurisdiction: see Art. 34 of 2012’s rule). Therefore, the present rule considers only one situation--the contract parties choose Chinese courts-- and ignore another possible situation-- the contract parties choose foreign courts, so the new rule does not give a clear answer to the above question.

Arbitration recognition

Generally Contracting parties, especially in trading and construction contracts, but less so in loan contracts, often wish to submit disputes to arbitration, sometimes in a foreign country. The resulting award is often enforceable locally under the New York Arbitration Convention of 1958, to which most countries have adhered.

Q12 In China, the courts allow sophisticated contracting parties to submit contract disputes to a foreign arbitral tribunal to the exclusion of the Chinese courts.

True



False

Can't
say

Comment: Contract parties are allowed to submit disputes to a foreign arbitral tribunal by arbitration agreements, which should accord with Art.17 of PRC's Arbitration Law. According to this, an arbitration agreement under any of the following circumstances shall be invalid: (1) matters agreed upon for arbitration are beyond the scope of arbitration prescribed by law; (2) an arbitration agreement concluded by persons without or with limited capacity for civil acts; and (3) one party forces the other party to sign an arbitration agreement by means of duress. But generally, Chinese courts allow sophisticated contracting parties to submit contract disputes to a foreign arbitral tribunal to the exclusion of the Chinese courts.

Class actions

Generally In some countries, such as the United States, a plaintiff can be authorised by the court to sue on behalf of all claimants who are similarly situated. Claimants have to opt out or they are bound. The result can be enormous liabilities.

Q13 In China, class actions where the class is bound if they do not opt out are generally not allowed.

True



False

Can't
say

Comment: In China, “class action” refers to a kind of litigation where one of the parties has numerous litigants but the exact number of the litigants is uncertain when the lawsuit is filed. According to Art.54 of PRC’s Civil Procedure Law, the people’s court may issue a public notice to explain the nature of the case and the claims in the litigation and informing those interested persons who are entitled to the claim to register their rights with the people’s court within a fixed period of time. Those who have registered their rights with the people’s court may elect representatives from among themselves to proceed with the litigation; if the election fails its purpose, such representatives may be determined by the people’s court through consultation with those who have registered their rights with the court. The acts of litigation taken by these representatives shall bind all litigants of the party whom they represent. However, any substitution of representatives, relinquishing claims, acceptance of claims of the opposing party, or negotiating settlement shall be approved by the litigants of the party. The judgments or written orders rendered by the people’s court shall bind all those interested persons who have registered their rights with the court. Such judgments or written orders shall apply to those who have not registered their rights but have instituted legal proceedings during the time of the statute of limitation. So the statement is not true in China.

Other indicators

Other indicators not covered by this survey include contingent costs, loser pays the costs of the winner, prejudgment freezes or arrests, appeals, disclosure (discovery of documents), efficacy of waivers of sovereign immunity and the enforceability of foreign judgments.

Real property

Security of land title and land registers

Generally Many jurisdictions improve the security of title to land by a registration system which, although not necessarily state-guaranteed, has high reliability. An example is the Torrens system developed in Australia and used in many other countries, eg Canada and England.

Most countries in the civil code groups do not have a title register but instead require documents concerning land to be notarised and filed at the registry so that they can be searched. The United States does not generally have title registers for land although there may be mortgage registers. They rely on title registration companies which provide title insurance.

The risk of losses is increased if title to land is unstable.

Q14 Most land in China is registered in a land register which records most major interests in land, eg ownership, mortgages and longer-term leases.

True



False



Can't say



Comment: China has a land registration system. Article 9 of the Real Right Law provides that creation, change, transfer or elimination of the real right of a real property shall become effective after it is registered according to law. After the promulgation of the Real Right Law, the Ministry of Land and Resources issued the Measures for Land Registration (“the Measures”) to regulate land property management, which further defined the content of land registration. Article 2 of the Measures defines “Land Registration” as the act of

registering state-owned land use rights, collective land ownership, collective land use rights, land mortgage rights, easement and other land rights that need to be registered according to any laws and regulations on the land registers for the purpose of announcement.

While the Measures clearly define land rights management and publicity, the Land Administration Law, the Urban Real Estate Administration Law and Regulation on the Implementation of the Land Administration provide fundamental regulations on the management of land ownership, mortgage and other rights.

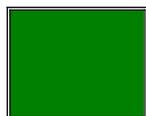
Article 10 of PRC's Constitution states that land is owned collectively or by state. Thus there is no private-owned land in China. Thus, China's land registration system does not include the registration of ownership. Would this issue cause problems of violation of land rights? The Urban Real Estate Administration Law protects 70 years use right of residential land. Although the expiry of the period of 70 years have not occurred since 1949, yet it can be estimated that large-scale nationalization of land is not going to happen, considering social stability is the Chinese Government's important concern.

Land development restrictions

Generally Many countries restrict development and the change of use of land and require permits to be obtained for any development or change of use.

Q15 In China, apart from environmental controls (dealt with later), the control of commercial development and the change of use of land is very light and, where required, permits are quick and cheap to obtain.

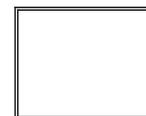
True



False



Can't
say



Comment: China has strict rules on the use of the land, especially cultivated land. For example, Chapter 4 of Land Management Law sets out special provisions for the protection of cultivated land. In addition, use of land also needs to be registered. Both Article 48 of the Measures for Land Registration and Article 12 of the Land Administration Law stipulate that parties shall proceed through relevant profiles and registration when changing the use of land.

Article 140 of the Real Right Law further states the holder of the right to use land for construction shall reasonably utilize the land, shall not change the purpose of land use, and shall be subject to the approval of the relevant administrative department if the purpose of land use needs to be changed. It is not difficult to find China has a strict review system for changing the use of land.

Other indicators

Other indicators not surveyed include transfer costs, stamp duties and lessee protections.

Employment law

Generally The indicator here is whether it is easy or hard to hire and fire employees. The measures include high minimum wages, maximum hours, minimum holidays, maternity rights, equal pay for equal work (non-discrimination) and severance costs.

Violation may lead to large liabilities. The legal risks increase costs.

Q16 In China, there are few controls on hiring and firing employees or on the terms of employment.

True



False



Can't
say



Comment: The main laws regulate the relationship between employers and employees include the Labor Law, Labor Contract Law, Labor Dispute Mediation and Arbitration Law. The Labor Law has detailed provisions for the protection of labor rights, covering right of wages, right of rests, right of labor safety and sanitation, protection for female and juvenile workers, professional training, social welfare, etc.

The Labor Contract Law focuses on the employment contract, including its fulfilment, formation, change, dissolution, termination and various special types of employment.

The Labor Dispute Mediation and Arbitration Law set out comprehensive rules for the settlement of employment disputes with a detailed explanation and description of the procedure.

Overall, the relationship between employers and employees in China is mainly set through the employment contract. Taking Article 14 of Labor Contract Law as an example, employer and employee can conclude an employment contract without a fixed term. And an employment contract without a fixed term shall be concluded unless the employee proposes to conclude a fixed-term employment contract in the following circumstance: (1) the employee has already worked for the employer for 10 full years consecutively; (2) when the employer initially adopts the employment contract system or when a state-owned enterprise re-concludes the employment contract due to restructuring, the employee has already worked for this employer for 10 full years consecutively and he attains the age which is less than 10 years up to the statutory retirement age; or; (3) the employment contract is to be renewed after two fixed-term employment contracts have been concluded consecutively, and the employee is not within any of the circumstances as mentioned in Article 39 and Paragraphs (1) and (2) of Article 40 of this Law. Such provision is obviously intended to protect the rights and interests of the employees. Nonetheless, this provision can also be altered by the agreement of both parties.

Although the parties have the freedom to negotiate, the boundary of their autonomy is set by law.

Moreover, China has enacted a series of policy documents in the area of labor right protection. Most often the Chinese government prefers to make policy and administrative orders instead of legislation. Taking minimum wage for instance, the local government would promulgate different standards of minimum wage according to local conditions. For example, Order 349[2012] of Beijing Labor and Social Security Bureau provides that “minimum wage not lower than 8.05yuan\hour, 1400yuan\month.”

And there two groups of conflict need attention. The first conflict is between the legislation and law enforcement. In fact, China has established a labour protection system, but problems mainly happen in the process of enforcement. The second conflict is between the legislation and ‘soft law’. In China, many effective rules play their role as ‘soft law’. Taking payment problem of farmer workers in China as an example, the instruction of government leaders is more useful than the words of the law.

In conclusion, literally speaking, China has established well-developed labour law institutions.

Environmental restrictions

Q17 In China the rules governing the environment and liability for clean-up are very light and relaxed.

True



False



Can't
say



Comment: China has established a legal system of environmental protection. Environment Protection Law provides fundamental protection for the environment. Article 13, for instance, provides that units constructing projects that cause pollution to the environment must observe the state provisions concerning environmental protection for such construction projects. The environmental impact statement on a construction project must assess the pollution the project is likely to produce and its impact on the environment and stipulate the preventive and curative measures; the statement shall, after initial examination by the authorities in charge of the construction project, be submitted by specified procedure to the competent department of environmental protection administration for approval. The department of planning shall not ratify the design plan descriptions of the construction project until after the environmental impact statement on the construction project is approved. Article 28 provides that enterprises and institutions discharging pollutants in excess of the prescribed national or local discharge standards shall pay a fee for excessive discharge according to state provisions and shall assume responsibility for eliminating and controlling the pollution. The provisions of the Law on Prevention and Control of Water Pollution shall be complied with where they are applicable. The income derived from the fee levied for the excessive discharge of pollutants must be used for the prevention and control of pollution and shall not be appropriated for other purposes. The specific measures thereof shall be prescribed by the State Council. Chapter 5 defines the legal responsibility of polluting the environment.

Besides, China has developed dozens of special laws on environmental protection including Water Pollution Prevention and Control Law, Law on the Prevention and Control of Atmospheric Pollution, Law on Prevention and Control of Pollution From Environmental Noise, Law on Appraising of Environment Impacts, etc

China observes the principle of "those who created the pollution shall clean it up". Legally speaking, China has strict requirements and high standards of environmental protection.

Openness to foreign business

Generally These indicators measure the degree to which the country is open to foreign businesses. The indicators are quite generic and therefore subjective.

Foreign direct investment

Q18 In China foreigners may freely own and control local companies outside protected industries, such as media, banks and defence.

True



False



Can't say



Comment: The existing regulation of FDI in China's domestic legal system mainly includes Law on Chinese-foreign Equity Joint Ventures, Chinese-foreign Cooperative Joint Venture Law and the Law on Foreign-Funded Enterprises. In the international and regional investment legal system, FDI is covered by bilateral treaties, regional and multilateral treaties.

For industries and domains that FDI can enter, China has issued the Catalogue of Industries for Guiding Foreign Investment (2011 Revision), complied with its commitment at the WTO. The Catalogue divided industries into four categories: "encouraged", "allowed", "restricted" and "prohibited". In the first three categories especially the "encouraged" category, foreign capital is allowed to get in.

At present, China has become one of the major global FDI destinations. Many preferential treatments in relation to land and tax are granted by the government.

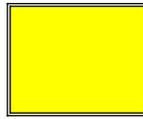
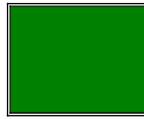
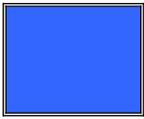
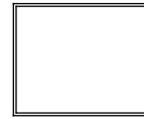
FDI should be approved before entering China. And there are strict limits on foreign investors controlling domestic corporations through M&A. M&A cases related to foreign capital is likely to be prohibited by provisions of China's Anti-monopoly law. For example, in the M&A case between Coca Cola Co. Ltd and Huiyuan Co. Ltd, the Ministry of Commerce cited Article 27 of the Anti-monopoly law to reject the request.

In addition, China has established a preliminary foreign security review system. In 2011, the Ministry of Commerce promulgated the "Provisions on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors" to review M&A cases related to national security.

In conclusion, foreign investors enjoy freedom and even "super national treatment" within the Chinese legal system. Although there are restrictions from national security review and Anti-monopoly law, the overall environment of foreign investment in China is becoming more and more transparent and fair.

Exchange controls

Q19 In China, there are no exchange controls. Businesses may therefore have foreign bank deposit accounts in foreign currency, borrow in foreign currency and repatriate profits to foreign shareholders in foreign currency.

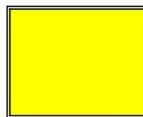
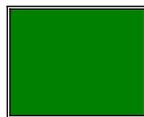
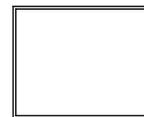
True**False****Can't
say**

Comment: China has strict controls on foreign exchange. State Administration of Foreign Exchange (SAFE) is the particular foreign exchange management institution and China has promulgated the Regulations on Foreign Exchange Control (“the Regulations”).

Current item foreign exchange is not strictly restricted by the government. Article 5 of the Regulations provides that international payments in foreign exchange and the transfer of foreign exchange under the current items shall not be subject to any state control or restriction. But there are specific provisions on trading of current item foreign exchange. Article 14 of the Regulations provides that current item foreign exchange expenditure shall be bought from relevant state institutions. Article 13 provides current items of foreign exchange revenue can sell to financial institutions concerned. Transaction under capital account transactions are more strictly regulated in the third chapter of the Regulations.

Alien ownership of land

Q20 In China, foreign-controlled companies can own and lease land in China without a permit.

True**False****Can't
say**

Comment: As for ownership of land in China, according to Article 2 and 8 of the Land Administration Law (2004 Amendment), China resorts to a socialist public ownership i.e. ownership by the State and ownership by collectives of land. Land in urban districts shall be owned by the State. Land in the rural areas and suburban areas, except otherwise provided for by the State, shall be collectively owned by peasants. Consequently, foreign-controlled companies cannot own land in China.

As for the land use right in China, the right to use land may be transferred by law. Foreign-controlled companies, including Chinese-foreign equity joint ventures, Chinese-foreign cooperative joint ventures and wholly foreign-owned enterprises, can use land (Art. 85 of the Land Administration Law), and, as Chinese companies do, lease land after obtaining approval in accordance with Article 11 and 12 of the Land Administration Law.

Application of the law

Generally These indicators deal with the application of the law, as opposed to what the law actually says. They are bound to be generic and subjective, a matter of impression.

Unpredictability and arbitrariness in the application of the law can increase legal risks.

Q21 In China, the higher courts usually treat big businesses as fairly as they treat individuals and do not favour local interests over foreigners.

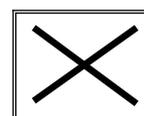
True



False



Can't say



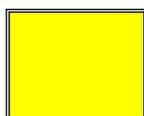
Comment: Compared to individuals, it is hard to say whether big companies are treated unfairly. There is no simple and direct answer to this question due to the absence of distinct empirical data. Big companies have stronger financial support than individuals to compete in the lawsuit, but the courts do not necessarily rule in favour of them. For example, big companies may apply standard terms in commercial transactions with individuals. According to article 40 of the Contract law, the standard terms supplied by the party that exempts itself from its liabilities shall be invalid, so the courts would be tough on big companies when ruling.

Judging from the performance of the higher courts, there are some cases ruling in favour of foreigners, and some other cases against them. Take one case regarding Q20 for example: the case published in the Gazette of the Supreme People's Court (No. 6, 2012) was a dispute over a claim of property right, where a Japanese company and a Chinese company disputed a land use right. The Japanese company wanted to obtain the land use right of state-owned land by way of contract transfer, but the courts of both first and second instances did not support its claim. Finally, the Supreme Court set aside the rulings previously made by the lower courts and supported the claims of the Japanese company in the retrial. Therefore, it is difficult to say the higher courts favour Chinese over foreigners out of local interest.

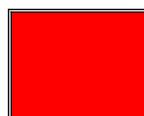
Costs and delays of commercial litigation

Q22 The costs and delays of commercial litigation in the higher courts in China are not considered materially greater than in developed countries.

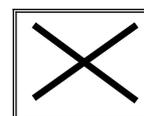
True



False



Can't say



Comment: With respect to cost, according to the Measures on the Payment of Litigation Costs, the litigation costs paid by a party concerned to the court shall include: a) case acceptance fee; b) application fee; c) the traffic expenses, accommodation expenses, living expenses, and subsidies for missed work that witnesses, appraisers, interpreters and adjusters may incur by appearing in the people's court at designated dates. For example, the acceptance fee for commercial cases shall be rendered in proportion to the amount claimed. Generally, for the part of the amount claimed which is no more than 10,000 Yuan, 50 Yuan shall be paid for each case, while at the top, for the part of more than 20 million Yuan, the fee shall be paid at the rate of 0.5%. Since it is unclear how much commercial litigation in developed countries would cost, it is hard to make a comparison.

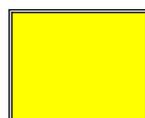
As to the time taken by case trial, according to the Civil Procedure Law, the case of second instance shall be closed within three months after the appeal is docketed, while an extension is permitted under special circumstances. The performance of the higher courts could be evaluated by the ratio of acceptance to closing of the civil cases of second instance: in 2011, Chinese courts accepted 575, 082 civil cases in the second trial, and closed 571, 762 of them, with the ratio being 99.42%. This indicates that almost all the civil cases of the second instance in that year were closed, so it is difficult to say the case trials have taken too much time of the party concerned.

Overall ranking

This overall ranking is achieved by a survey of all the rankings as shown this table:

	Question	Rating
1.	Insolvency set-off	
2.	Security interest	
3.	Universal trusts	
4.	Director liability for deepening insolvency	
5.	Financial assistance to buy own shares	
6.	Public takeover regime	
7.	Exclusion of contract formation	
8.	Termination clauses	
9.	Exclusion clauses	
10.	Governing law clauses	
11.	Foreign jurisdiction clauses	Can't say
12.	Arbitration recognition	
13.	Class action	
14.	Security of land title and land registers	
15.	Land development restrictions	
16.	Employment law	
17.	Environmental restrictions	
18.	Foreign direct investment	
19.	Exchange controls	
20.	Alien ownership of land	
21.	Court treatment of foreign big business	Can't say
22.	Costs and delays of commercial litigation	Can't say

True



False



**Can't
say**



Commentary and suggestions for change

Since the reform and opening-up in 1978, China has made great improvements in its legal construction, which, however, still faces a number of problems.

In the field of financial law, although China is at the top of the global rankings by capital market scale, its legal system of financial supervision needs to be further improved. In particular, the current legal system cannot effectively promote financial innovation or maintain financial stability. China's financial system is dominated by state-owned banks intended to provide indirect funding for enterprises, in which case, the securities market cannot soundly serve the function of direct funding. In addition, small and medium-sized enterprises have been commonly exposed to financing difficulty.

As for private property protection, in 2007, China promulgated the Real Right Law and has for the first time stipulated in law that no entity or individual may encroach, plunder or destroy private property right. This act has been seen as great progress.

Also in 2007, China promulgated the Labor Contract Law, setting up a high standard of labor protection, which has stirred much controversy. Actually, a high standard of labor protection might increase the labor costs for enterprises in such a developing country as China, therefore it remains to be tested whether the market can withstand the pressure.

Foreign direct investment has enjoyed great expansion since China's accession to WTO. In 2012, China has become the largest FDI destination across the world and for the reason that many preferential treatments on land and tax are granted by the government. However, the current FDI approval system of China is rather strict, and needs to be further opened up.

With the rapid development of the Chinese economy, environmental pollution caused during the process of industrialization and urbanization has gained wide attention. China has enacted high standards of environmental protection, the implementation of which, unfortunately, is insufficient.

In spite of being a great country with a long history, China started late in its legal modernization which witnessed the introduction of a large number of rules and regulations from other jurisdictions. We need to reflect on whether such "law transplantation" could conform to China's realities and further promote Chinese social development. Nevertheless, even the relatively well designed law might have problems during enforcement, such as corruption and local protectionism. Good law needs good enforcement. Only the benign interaction of legislation, administration and judicature can promote Chinese legal development.

Profiles of the contributing students

The survey was carried out by the following students:

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Allen & Overy Global Law Intelligence Unit

The Allen & Overy Global Law Intelligence Unit is part of the international firm of Allen & Overy and produces papers, surveys and other works on cross-border and international law within the field of its practice. Allen & Overy is one of the largest legal practices in the world with approximately 5,000 people, including some 512 partners, working in 40 offices worldwide. For further information, please contact Philip Wood, philip.wood@allenoverly.com or Melissa Hunt, PA to the Intelligence Unit melissa.hunt@allenoverly.com

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Philip Wood is one of the world's leading comparative lawyers and practitioners. He has written about 18 books on financial law. He was formerly a partner and head of the banking department of Allen & Overy. For many years he has been developing innovative and pioneering methodologies for assessing legal jurisdictions and has produced a book of maps of world financial law. His university textbook on the Law and Practice of International Finance has been translated into Chinese and a Japanese version is forthcoming.

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