

**GUIDELINES ON ESTABLISHMENT OF
A MODERN LEGAL GOVERNANCE SYSTEM
FOR CHINESE ENTERPRISES**

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ACC China Liaison Committee
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1. INTRODUCTION

- 1.1 With the continuing development of the Chinese socialist market economy, the expansion of the separation of regulatory and management functions of Chinese state-owned enterprises (hereinafter "Enterprises"), and the challenges and opportunities presented by the further opening of the Chinese market following China's entry into the WTO, improving the overall management systems of Enterprises has become increasingly important.
- 1.2 With the continuing development of the Chinese socialist market economy legal system, Enterprises face increasing legal risks, domestically and internationally. As Chinese Enterprises "go out" of China in ever increasing numbers to buy/sell goods and services; establish sales operations and channels; invest in resources, production assets and business operations; and access international capital markets, the legal risks faced by Chinese Enterprises will increase more rapidly.
- 1.3 The legal risk management function is an integral part of the overall management system of an Enterprise. Effective management of legal risks will prevent or reduce economic losses and at the same time will enhance the business reputation of the Enterprise and contribute to the Enterprise's overall economic performance. This will also contribute to the improvement of the overall legal environment and development of the rule of law in China.
- 1.4 Effective legal risk management should be carried out through a modern enterprise legal governance system. Accordingly, based on international best practices and recognizing the requirements of China's socialist market economy, ACC has developed these Guidelines on Establishment of a Modern Enterprise Legal Governance System for Chinese Enterprises (hereinafter "Guidelines") for reference by Chinese Enterprises.

2. CATEGORIES OF LEGAL RISKS

- 2.1 As used in these Guidelines, "legal risk" refers to the potential for economic loss and other impairment on the part of an Enterprise in the form of:
 - operational loss (loss of revenues or profits, increased costs or liabilities, etc.);
 - civil claims, judgments or awards (including legal defense and settlement costs);
 - administrative or criminal penalties or sanctions;
 - damage to the Enterprise's assets, including tangible and intangible property;

- damage to reputation;
- etc.

resulting from

- violations by the Enterprise of applicable laws;
- infringement by the Enterprise of the lawful rights of third parties;
- non-compliance by the Enterprise with its contractual obligations;
- failure on the part of the Enterprise to take effective steps to create, protect or enforce its lawful rights;
- etc.

3. LEGAL RISK MANAGEMENT PRINCIPLES

3.1 Failure to recognize and manage legal risks may result in loss of an Enterprise's assets, therefore the senior management of the Enterprise has ultimate responsibility for management of legal risks. The effectiveness of the senior manager's management of the Enterprise's legal risks shall comprise a part of such senior manager's performance review.

3.2 Each Enterprise should establish an independent legal affairs management department. Senior management of the Enterprise should be assisted in the management of legal risks by the legal affairs management department of the Enterprise, which should be headed by a Chief Legal Officer (CLO). The CLO should be part of the Enterprise's senior management team.

3.3 The CLO shall work together with the rest of the senior management team to develop a legal risk management strategy for the Enterprise, which shall be reviewed and updated according to a plan adopted by the senior management team. The effectiveness of the senior managers' review and update of that plan shall comprise a part of such senior manager's performance review.

3.4 Legal risks take many different forms depending on the nature of the Enterprise's legal relationships, and legal risks change as the domestic and international commercial and legal environment changes. Enterprises shall therefore adopt a modern enterprise legal governance system, which enables all departments and subsidiaries of the Enterprise to take systematic preventative and remedial measures on a uniform basis, and evaluate legal risks and legal risk management priorities on a periodic basis.

4. DEVELOPMENT OF LEGAL RISK MANAGEMENT STRATEGY

4.1 The legal risk management strategy should be coordinated with the overall business strategy of the Enterprise. Depending on the nature of the Enterprise's business operations, the legal risk management strategy shall outline a system for compliance and risk assessment relating to:

- regulatory compliance management (including securities regulatory compliance for listed companies, industry regulatory compliance and general regulatory compliance);
- contract management;

- intellectual property rights management;
 - claims/litigation management;
 - domestic and international business transactions management;
 - corporate governance and corporate secretarial management;
 - management of environmental health and safety ("EHS") legal matters;
 - management of employment legal matters;
 - corporate investments, divestitures, mergers, acquisitions and reorganizations;
 - etc.
- 4.2 As part of the development of the legal risk management strategy, the Enterprise shall conduct an initial audit of the actual and potential legal risks faced by the Enterprise and establish legal risk management priorities. This audit shall be performed under the direction of the CLO with the active support and participation of the Enterprise's senior management.
- 4.3 The senior management of the Enterprise shall address the critical legal risks identified in the audit and identify concrete steps to be taken to mitigate to acceptable levels such legal risks and the timeline and priorities for such actions.
- 4.4 The CLO of the Enterprise shall be responsible for developing detailed plans for implementation of the legal risk management strategy. Such detailed plans shall, where appropriate, incorporate legal risk management best practices of leading international and domestic enterprises, as modified to reflect the particular requirements of the Enterprise. The senior management of the Enterprise shall review and comment on and, following any necessary modifications, approve such implementation plans.
- 4.5 The Chief Executive Officer (or equivalent) of the Enterprise shall be responsible to direct the implementation of the Enterprise's legal risk management plans. The CLO of the Enterprise shall have the leading role in the implementation and management of those aspects of the Enterprise's legal risk management strategy that require professional legal skills and experience. Implementation of the legal risk management plan should be coordinated with relevant aspects of the Enterprise's financial management, operational management and general risk management functions.
- 4.6 The Enterprise senior managers, with the assistance of the CLO, shall develop and implement effective training programs in respect of legal risk management policies and practices adopted by the Enterprise. Preventative law training should be provided for areas of significant risk as a priority matter.
- 4.7 The senior managers, with the assistance of the CLO, shall establish an independent legal risk audit function to evaluate compliance with the approved legal risk management strategy. Such audits shall be performed on a regular periodic basis under the direction and supervision of the CLO. The effectiveness of the senior managers' review and update of that audit shall comprise a part of such senior managers' performance review.
- 4.8 In a group company, the senior management of the group company shall be responsible to ensure that a common legal risk management strategy and related

training and audit functions are adopted and implemented on a uniform and consistent basis for common elements of business operations across all business departments and subsidiaries of the group company. The effectiveness of the senior managers' review and update of that audit shall comprise a part of such senior managers' performance review.

- 4.9 The CLO shall develop objective methodologies to permit senior management of the Enterprise to measure the performance of the relevant departments in respect of the implementation of specified aspects of the Enterprise's legal risk management strategy.

5. STRUCTURE AND ROLE OF ENTERPRISE LEGAL AFFAIRS MANAGEMENT DEPARTMENT

- 5.1 The CLO shall be the responsible manager of the legal affairs management department. The CLO shall be a person with appropriate legal education (preferably LLB, LLM or equivalent) and related legal professional qualifications and experience.
- 5.2 In almost all cases, the CLO should report directly to the CEO, Chairman of the Board or other equivalent senior manager of the Enterprise.
- 5.3 In a group company, the general counsel of a subsidiary can report to the CEO, Chairman of the Board or other equivalent senior manager of such subsidiary or to the CLO of the group company or to both in such manner as the group company CLO and the CEO of such subsidiary may decide. Regardless of the reporting structure selected for the general counsel of a subsidiary, the legal professional qualifications and performance of the general counsel of such subsidiary shall be subject to review and evaluation by the group company CLO, who shall report the findings of the review and evaluation to the responsible senior executive of such subsidiary and to the CEO, Chairman of the Board or other equivalent senior manager of the group company.
- 5.4 The CLO shall develop a staffing and budget plan for the Enterprise that provides for sufficient legal professional resources in the Enterprise to implement the approved legal risk management strategy plan and to manage the core categories of the legal affairs of the Enterprise. The CLO shall also develop a plan for cooperation with outside legal professionals to provide support for elements of the approved legal risk management strategy plan which require specialized support (e.g. in respect of litigation, major corporate transactions, international legal matters, etc.) to supplement the internal legal affairs management department resources. The budget for such external legal services may be included in the budget of the legal affairs management department or in the budget of other departments that will receive the benefit of such external legal services. In all cases, the work of the outside legal professionals shall be supervised and coordinated primarily by the CLO and other legal professionals in the Enterprise's legal affairs department.
- 5.5 Where circumstances and staffing so permit and the needs of the Enterprise so require, the CLO may establish separate working teams within the legal affairs management department to manage specialized legal matters (e.g. regulatory compliance, intellectual property rights, corporate governance, contract management, claims/litigation management, EHS, employment, major corporate transactions, etc.)

or to provide specialized legal support for a particular line of business or geographical division of the Enterprise.

- 5.6 The other legal professionals and staff in the legal affairs management department of the Enterprise shall report directly or indirectly to the CLO of the Enterprise as the CLO shall determine. If a legal professional in the Enterprise legal affairs management department is assigned to provide specialized legal support for a particular line of business or geographical division of the Enterprise, then the reporting structure may be handled in the same manner as referenced in paragraph 5.3 above.
- 5.7 The legal professionals in the legal affairs management department of the Enterprise shall have relevant legal education and training backgrounds and qualifications. The CLO shall develop a program for the continuing in-house and external training and education of the legal professionals in the Enterprise's legal affairs management department. The training and education program shall set the required number of hours of training and education that are to be completed by legal professionals each year.
- 5.8 The CLO shall develop a system for evaluation of the performance of legal professionals and staff in the legal affairs management department of the Enterprise. This evaluation should be done periodically and involve assessment of professional skills and other relevant technical and commercial abilities appropriate for the individual's role and responsibilities. The CLO shall develop a plan for identifying, developing and retaining high-performing legal professionals and staff.
- 5.9 The CLO shall establish a system for knowledge management for the legal affairs management department of the Enterprise. This system may include information technology-based systems for management of legal document templates and precedents and other legal information and other means of sharing of best practices within the Enterprise's legal affairs management department and with other enterprise legal counsel in other enterprises and with other legal professionals.
- 5.10 In a group company, the group company CLO shall take steps to promote the centralization and uniform coordination of the delivery of common legal services applicable to multiple business departments and subsidiaries of the group company and uniform implementation of related legal affairs management department systems in the various business departments and subsidiaries of the group company. Where approved by the CLO legal professionals from the group company legal affairs management department and from the subsidiaries' legal affairs management departments may form virtual teams to manage common legal risk management matters on a coordinated basis.

6. MISCELLANEOUS

- 6.1 ACC will update these Guidelines from time to time to reflect the changing requirements and best practices of Enterprises.
- 6.2 ACC will cooperate with the Law and Policy Division of SASAC to develop related training materials and programs to assist Chinese Enterprises in the implementation of legal governance systems for Enterprises.

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