Introduction to the New Property Law of the People's Republic of China

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I. Introduction

On March 16, 2007, the National People's Congress of the PRC adopted the new Property Law （wuquan fa物权法literally: "Law of the Rights in Things"). For the first time in the legal history of the PRC, this law provides for basic ownership rights in immovables (real property) and movables (personal property). Since individual property rights are the foundation of any market economy, the promulgation of a full Property Law is significant. For businesses and persons engaged in real property investment in China, the law is of fundamental importance. In providing for absolute ownership rights for private individuals and businesses, the Property Law marks a major change in the rights of both Chinese citizens and foreign investors. This law is set to go into effect on October 1, 2007.

The Property Law is quite difficult to understand. There are three reasons for this. The first and most significant reason is that the Property Law is based on civil law models, primarily Chapter 3 of the German Civil Code. The Law also draws heavily on the Swiss and Japanese Civil Codes. Its fundamental principles differ significantly from the U.S. and British common law based real property system. In addition, the civil method of exposition is quite unfamiliar to most civil law practitioners. The structure and method tends only to make sense to those familiar with the German and Japanese codes. Second, understanding of the Property Law is further complicated because it incorporates many provisions intended to deal with unique Chinese characteristics that would never be mentioned in a pure, German civil law type code, including those provisions meant to address the Chinese government's monopoly on land ownership and those dealing with prohibitions on illegal land transfers and theft of government property. Third, the Property Law was a hotly debated law, opposed by many elements of Chinese society. It is therefore intentionally vague on many important issues. This vagueness was the price paid to allow any form of Property Law to be adopted. The drafters frankly admit that if

all the critical issues concerning property rights in China had been resolved in the Property Law, the law would never have been adopted. These issues are explicitly left for later resolution.

The Law is divided into Five Parts, 19 Divisions and 247 Sections. I will introduce the law division by division and explain the most significant features. The Property Law covers both immovables (real property) and movables (personal property), but I will limit my discussion only to the Divisions of the Law concerning real property.

II. Part I: General Principles

Part I of the Property Law contains three Divisions.

A. Division 1: Fundamental Principles

A major focus of debate over adopting the Property Law centered on two concerns. First, many opponents of the Law argued that providing for private property would violate the fundamental principles of China's socialist system. Second, many opponents argued that allowing for private property would protect prior illegal acquisitions of state property by local officials and would prevent the state from taking back such property. The eight sections of this division center on responses to these concerns.

The relative protection afforded to state owned property versus privately owned property is the most important issue addressed in this division. Many opponents of the Property Law argued for giving state property rights priority over individual property rights. The Property Law rejects this position by according equal protection to the property rights of the state, the collectives and private individuals. Section 4. The drafters provide two reasons for why this equal protection is necessary. First, the purpose of the Property Law is to provide for property rights as the basis for a market economy. Since the state and collectives are heavily involved in ownership rights in the economy, it is necessary for the smooth functioning of the economy to treat them on the same basis as private persons. Second, the drafters refer to the most recent revision to the Constitution which provides that the party and the state must represent the vast majority of the people. The drafters quite openly pointed out that the vast majority of the people in China insist on individual property rights being on an equal footing with the state. The drafters essentially indicate they had no real alternative on this issue.

B. Division 2: Creation, Change, Transfer and Termination of Property Rights.

This division focuses on the technical issues relating to Property Rights. For immovables, the key provisions are as follows:

1. The Property Law requires creating a unified registry for all interests in land. Under the Property Law, there are three fundamental interests in land: ownership of land, ownership of buildings and fixtures on the land and mortgages affecting the land

and/or the buildings and fixtures. All such interests must be recorded in the official government register. Under China's current system, it is not uncommon to register the three interests mentioned above in three different registries. As can be imagined, this creates uncertainty and confusion. Some of the major cities such as Beijing, Shanghai and Guangzhou have already adopted a unified registry but it is expected that the second tier and smaller cities may need some time to do so.

2. The Law provides that ownership or any change in ownership of land or buildings and fixtures is effective only upon registration in the official land register. The land register is also conclusive evidence of ownership. This means that in the case of multiple sales of the same property, the first party to register the sale will prevail over any other claimants to the property, no matter who was first with the contract of sale. This follows the German approach to this issue, and rejects the French and Japanese approach which provides that the contract of sale is effective to transfer ownership and registration simply provides notice to innocent third parties.

3. Since registration in the land registry is such a critical matter, the Law provides for two important protections:

a. An interested party has the right to petition for a correction of mistakes in the land registry. If the registrar declines to make the correction, the interested party has the right to file suit. If a mistake in the registry causes damage to an interested party, that party has the right to claim for damages against the registry. Section 19.

b. An interested party has the right to sue for damages against any person who submits falsified documents for an entry in the land registry and to receive from the registry that accepted the falsified documents. Section 21

4. Multiple sales of a single property are a major issue in China. The Property Law addresses this issue by providing for a system of notice filing. Notice of the pendency of any transaction that would affect land or buildings may be filed with the land registry. During the pendency of such filings, no competing transactions will be processed. Section 20

C. Division 3: Protection of Property Rights

Division 3 provides for the standard civil set of legal measures for protection of property rights. These are:

1. Claim for recognition of right.

2. Claim for return of the original property.

3. Claim to eliminate or mitigate danger/damage to property.

4. Claim to repair, rebuild, exchange or restore property to its original condition.

5. Claim for damages due to injury to property.

These claims are all made through arbitration or through the people's courts. The claim for the right to return of the original property can be used by the state itself to require the return of property illegally taken for private purposes by local government officials. Since this is a major concern of the Property Law, such claims should be anticipated. It is not clear how this will affect transactions in land and buildings entered into by innocent third parties such as foreign investors. Since the government itself estimates 50% to 70% of transfers of land use rights are illegal, this provision has the potential to cause significant uncertainty.

III. Part 2: Ownership

Part 2 provides various rules of ownership. For the first time in the PRC, the Property Law provides for ownership by private persons. Private persons have the right to ownership of all property except land. Private ownership includes buildings and fixtures located on land. This Part also includes the rules for real property concepts of neighboring rights, common ownership and condominium ownership,

A. Division 4: General Principles

1. The Property Law provides for the following general principles:

a. An owner of property has the right to occupy, utilize, enjoy the fruits of and dispose of property.

b. An owner of property has the right to subject the property to use rights and security interests.

2. The Property Law provides for certain special measures limiting ownership rights in land and buildings.

a. Ownership of land and buildings is subject to state seizure by through eminent domain. The state has the right to take land owned by collectives and buildings and personal property owned by private persons for a public purpose. The state is required to provide compensation for such takings. The state taking farmland for commercial buildings and taking urban residences for urban redevelopment is a major social issue in China. Abuses in this area are common, well documented, and a cause of unrest. Two major issues arise. First, what is a public purpose? Many Chinese argue urban redevelopment and commercial development for manufacturing and leisure activities are not public purposes. However, the vast majority of land and building seizures are for just such primarily commercial purposes. Second, what is the standard for determining compensation when land and buildings are taken by the state? Many Chinese

believe the standard should be fair market value, not the tiny amounts of compensation currently paid.

Earlier drafts of the Property Law included various provisions that would have defined "public purpose" and would have required payment of fair market value or some market based compensation for land and buildings. However, all of these protective provisions were eliminated from the law as adopted. In the commentary issued by the NPC, the drafting committee admits the statute is purposely vague in not addressing these issues. The controversy over these issues was too great and an attempt to resolve them in the Property Law would have indefinitely delayed adoption. The NPC candidly admits these major issues await resolution in some other forum.

b. Protection of agricultural land. Land owned by collectives is reserved exclusively for agricultural purposes. To be used for housing, manufacturing or other commercial purposes, such land must first be transferred to state ownership. Much unrest in the rural areas of China arises from such transfers. Section 42 of the Property Law attempts to address the issue of improper transfers of agricultural land:

> "The state engages in special protection of agricultural land, severely limits the conversion of agricultural land for construction purposes and controls the quantity of land used for construction purposes. It is not permissible to seize collectively owned land in violation of the limits and procedures provided by law."

It is difficult to know what to make of this provision. It seems to forbid transferring agricultural land to the state for construction purposes, but it does not absolutely prohibit such transfers and, in fact, it says nothing more than that parties must obey the law when such transfers occur. Since this section has no mandatory effect, its purpose is not clear.

B. Division 5: Ownership Rights of the State and Collectives and Ownership Rights of Private Persons.

1. Ownership rights of the state. This Division provides that the state owns all land not owned by collectives. The state also owns natural resources, radio wave spectrums, cultural relics, mineral resources, military installations and basic infrastructure. The rights of the state with respect to ownership are exercised by the State Council.

2. Ownership rights of collectives. Collectives own agricultural land and land for residential purposes located in rural villages and townships. Collectives also own businesses founded by collectives using their own capital. A major issue in China is that the term "collective" is quite vague. It is often extremely difficult precisely to identify the collective or to determine who is authorized to make decisions on behalf of the collective. The Property Law makes no decisive pronouncements in this area and leaves the decision to the "relevant laws and regulations" even though such "laws and regulations" often do not exist. All of this increases the uncertainty in dealing with land ownership issues in the rural areas.

3. Ownership rights of private persons. Private persons have the right to ownership in their income and basic property such as homes, items of daily use, tools, and materials of trade. The ownership right extends to their savings and capital investment in businesses. The right to inheritance is guaranteed. In addition to natural persons, the right of ownership of legal persons is also protected. Where the state, collectives and natural persons all invest in a single legal person, the rights of all three are protected on an equal basis depending on the amount of the investment.

C. Division 6: Condominium Ownership Rights

The vast majority of urban Chinese live in multi-family structures. The property law provides for the first legal regime governing condominium ownership. When these units were owned and operated by the state, there was no need for any special legal regime. The explosion in private ownership of condominium units over the last ten years began with conversions of state owned units to private ownership, but has now expanded to purely commercial residential housing sales. The condominium rules are based on the condominium law of Japan. Most civil law countries provide for condominium laws in a separate statute. China has included condominium law rules in the Property Law because they are so important and to make the Property Law as complete as possible.

An owner of a condominium has three distinct sets of rights:

1. Individual ownership right in the specific dwelling unit and the parking space assigned to that unit.

2. Common ownership right in the common areas of the residential complex. Under Chinese law, common ownership is either common ownership or common ownership by shares. The Property Law does not specify which type applies in the case of condominium ownership, but common ownership is the most probable. The Law does not delineate between what constitutes individual portions and what constitutes common portions, leaving this to the formation documents for each condominium project. Many condominiums already exist that have not clearly addressed this issue. Newer condominiums are also often very vague on these issues. Division of private and common areas is therefore likely to be the source of some dispute in the future.

3. Right to participate in managing condominium affairs, either through voting in the general meeting of owners or through voting for or participating in the condominium owners association. The rules for operation and voting for the general meeting and owners association are general and unspecific. The stated reason for this is that the tremendous variety of condominium type arrangements in China makes one set of rules virtually impossible to impose. This lack of detailed rules is likely to be a source of dispute, especially for existing condominium projects that have never had a formal owner management structure.

Because of the newness and uncertainty of China’s condominium system, the local government is charged with supervising and assisting in forming condominium

management for condominium owners. Since many existing condominium projects have never implemented any form of owner management, a primary task of the local government is to ensure owners associations are formed. Local governments are to act in a consulting capacity, providing examples of form agreements and advising on formal procedures. Local governments do *not* have the right to interfere with or direct the affairs of the owners once a proper owner's management system has been implemented.

D. Division 7: Neighboring Rights

As in all civil law jurisdictions, rights in real property are not absolute. All rights in real property are burdened with basic obligations owed to neighboring property. These obligations to neighboring property are the following:

1. The obligation to allow access to water and to allow discharge of water.

2. The obligation to allow access to roads other means of transportation.

3. The obligation to allow access for construction, laying of cables, laying of pipe, etc.

4. It is not permissible to allow construction that will interfere with access to sunlight, view or airflow of the neighboring property in violation of government regulation. In densely populated areas like Chinese cities, access to sunlight, view and airflow are important and frequently disputed rights. This is particularly true as traditional neighborhoods are converted to high-rise projects and as large buildings are constructed within residential neighborhoods. Chinese building regulations have extensive rules related to these rights. However, these rules are frequently violated. Though this provision limits claims to circumstances where government regulations are violated, the fact such violations are common means this provision could be the source of substantial litigation.

5. It is not permissible for the interested party on one parcel of land to expel onto neighboring land solid waste, polluted air, polluted water, noise, light or electromagnetic radiation in amounts exceeding government regulations. This provision basically allows an interested party to sue to enforce government environmental regulations. Given the weak enforcement of such regulations in China, this provision could be the source of substantial litigation.

6. During excavation, construction of buildings, laying of cables and the like, it is not permissible to endanger neighboring property. Reckless excavation is very common in China. This provision too could be the source of substantial litigation.

E. Division 8: Common Ownership

There are two forms of common ownership: ownership by shares and undivided common ownership. Absent a specific agreement, common ownership is assumed to be ownership by shares except in the case of a family relationship, where the opposite assumption is made.

1. The basic attributes of ownership by shares is:

Each common owner has a percentage ownership in the undivided property. The amount of each share is based on the amount contributed by the party to purchase the property. If this amount cannot be determined and there is no express agreement, the common owners will all have equal shares.

The common owners share in income and expenses in proportion to their share interest. However, with respect to third parties, common owners have joint liability.

Each common owner has the right to sell his share in the property, subject to the right of first refusal of the other common owners to purchase that share.

Each common owner has the right to petition for partition of the commonly owned property.

Many of these features of common ownership by shares are disadvantageous in a commercial setting. Any of the provisions can be modified by agreement except for joint liability to third parties.

2. The basic attributes of undivided common ownership is:

Each common owner has an undivided ownership interest in the entire property.

Each common owner has a right to the income of the property and also the obligation for the expenses of the property. The common owners have joint liability with respect to third parties.

No common owner has a right to sell any portion of the property absent the consent of all of the other common owners.

As a general rule, a common owner does not have the right to petition for partition of the property. However, partition is permissible if a) there is a compelling reason or b) the underlying relationship is terminated. A compelling reason is not defined in the statute, but the commentaries suggest a major medical expense would be such a reason. Termination of the relationship most commonly would be divorce.

As with ownership by shares, the default rules for undivided common ownership can be modified by agreement.

The Law does not provide whether ownership by a partnership is ownership by shares or undivided ownership. The majority of scholars believe the answer should be ownership by shares. Partnerships that do not desire such a result should clearly set out the terms of their relationship in a partnership agreement.

IV. Part 3: Use Rights

Since the state and collectives own all land, a major issue under the Property Law was to determine the nature of the rights of private persons who make use of land for agriculture, residential construction and commercial construction. Since all of these rights involve the long-term use of land owned by another, the Chinese settled on characterizing all of these rights under the category of use rights. The Chinese term employed is yong yi quan用益权。The term is based on the German Civil Code concept of nutzungen BGB 1030 – 1089, which is in turn based on the Roman Law concept of usufruct. However, use rights as defined in the Property Law are dramatically different from German nutzungen and from Roman usufruct. In order to avoid any confusion, I will use the term "use rights".

Section 117 defines use rights as follows: "The holder of use rights enjoys the legal right to occupy, use and take the benefit from the immovable or movable property owned by another person." In terms of basic rights, the holder of use rights enjoys all the fundamental benefits of property ownership except the right to alienate or otherwise dispose of the ownership interest. Though the ownership of the underlying land cannot be alienated, use rights are property rights that can be purchased and sold, mortgaged, gifted and inherited. Thus, classification of use rights as a form of property is essential to the creation of a market economy in China.

Before the adoption of the Property Law, Chinese courts often characterized use rights as contract rights, a type of obligation under civil law. Contract rights cannot form the basis for a free exchange based market economy. Contract rights are particular and personal to the contracting parties while property rights are general and abstract rights. Contract rights are defined by the terms of the contract, while property rights are determined by the provisions of the law. Contract rights are not alienable and are not inheritable, while property rights are both alienable and inheritable. Since all rights concerning land held by private persons in China fall under the classification of use rights, categorization of use rights as property rights has an enormous impact.

Almost as an afterthought, Part 3 includes a section on easements created by agreement.

The major impact of the Property Law is in characterization of use rights as property rights. The major use rights are defined in great detail in other statutes and regulations concerning real property law that have been adopted during the past ten years. The Property Law for the most part merely repeats the provisions of the existing law in basic terms and makes little or no change to the existing law. The discussion below focuses on the provisions of the Property Law that make substantial changes or clarifications in existing law.

A. Division 10: General Principles

In addition to defining use rights, this division provides the following:

1. As a general rule, the state follows the policy of transfer of use rights in land and natural resources to others in exchange for a fee.

2. After use rights are granted, the owner does not have the right to interfere in the enjoyment of such rights on the part of the holder of use rights.

3. When the government seizes land through eminent domain, the holder of use rights in that land is entitled to compensation under the same terms as the owner of the land.

B. Division 11: Farmland Contract Management Use Rights

Farmers in China work their land under household land use contracts between the rural household and the rural collective that owns the land. This system is detailed in the Land Management Law and the Household Land Contract Law. The Property Law mostly follows these laws, but makes the following adjustments and clarifications:

1. Household land contracts must be in writing.

2. The contracts must be registered in the local land registry.

3. Any changes in the contracts must be registered in the local land registry.

4. Once land use contracts are granted, the local authorities are prohibited from changing the terms of the land contract through reapportionment or other measures. This is a significant change from current practice. In many rural areas, the terms of land contacts are adjusted on an annual basis to account for changes in residence patterns and in cropping patterns. This practice was commonly used to punish households for disagreeing with local leaders. This practice is now prohibited and rural households are given the right to defend their land contract rights against these improper acts by local authorities.

5. The basic term of the land contract is 30 years. Section 126. Many rural residents have complained this 30-year term is too short and it takes away their incentive to make long-term improvements in “their” land. The Property Law seeks to address this issue by providing that at the end of the 30 year term, the contract right will automatically renew “in accordance with relevant national law.” This provision appears to provide for a permanent right to rural farmland in a form similar to fee simple ownership. However, the term of the renewal and any additional conditions for renewal, including payment of fees, is not specified. As a result, the uncertainty regarding rights in rural farmland has not been removed.

6. Holders of rural land contract rights have the right to alienate such rights through transfer and exchange, but only in accordance with local regulations and only after approval by the regulatory authorities. These restrictions severely limit this right to sell or exchange rural land rights. In general, rural land contract rights can only be sold or exchanged with another farmer in the same collective who has the requisite farming experience. Sale or exchange with outsiders, even those with farming experience, is prohibited. This section does not change the current situation. The Property Law commentaries explain it is not possible to establish a rule on this issue appropriate for every part of China and then encourage the local regions to promulgate their own rules on this issue that are in accordance with local conditions. For example, Guangdong Province has already issued rules that have substantially opened the market in transfer of farmland contract rights. It is expected other more developed provinces will follow Guangdong's lead, while the less developed provinces will continue taking a highly restrictive approach. The concern in the less developed regions is that the lack of employment opportunities outside farming will cause the farmers to transfer their land for small payments to deal with immediate monetary needs and then end up landless. In regions with no alternative employment, there is fear this will lead to local unrest and unplanned migration to the major cities.

C. Division 12: Urban Land Construction Use Rights

Under the system established by the Land Management Law, land in urban areas owned by the government is transferred to persons for development. For the most part, the Property Law follows the provisions of the Land Management Law. The key clarifications and adjustments in the Property Law are as follows:

1. Land use rights can be transferred for a fee or by land grant. No fee is received for a land grant. The Property Law provides that land to be developed for commercial purposes must be transferred by agreement for a fee. Transfer by land grant for commercial purposes is strictly prohibited. For land transferred by agreement, the transfer should be conducted by auction, bid or other public method. Private sale by agreement is prohibited. This provision is significant because land for development purposes is often transferred in China today in violation of these provisions. Much or all of the profit in many development projects relies on the transfer of land use rights to the developer at an artificially low price. Compliance with this provision would prevent that practice, and would therefore undermine the basis of much of China's commercial real estate development.

The risks to a truly innocent party who acquires land use rights where the initial transfer was illegal are not clear. Often the foreign investor will enter into a project only after several transfers of land use rights, making it difficult or impossible for that investor to determine whether the initial transfer was in compliance with law. It is not clear if the remedy will be limited to punishing only the parties in the initial transaction of if the penalty will be for the state to retake the land use right.

However, where the foreign investor participates in the initial transaction, the risk of the government retaking the land use right is high. Purchase by a foreign investor of land use rights in a non-public transaction is a clear violation of the law. Likewise the subsequent purchase of land use rights at an obviously artificially low price is clear evidence that a violation of the law has occurred somewhere in the process and would make it difficult for the investor to plead ignorance. Most of the conditions of initial transfer of land use rights are easily determined under the current system and should be investigated.

2. Land use rights must be reduced to writing and must be registered in the appropriate land registry.

3. Land use rights can be alienated, mortgaged and inherited in the same manner as ownership rights. All changes must be registered in the appropriate land registry.

4. Under current law, land use rights in residential property is for 70 years, in industrial property for 50 years, and in recreational property for 40 years. The Property Law addresses the issues surrounding expiration of land use rights as follows:

a. For residential property, the land use right will automatically renew at the end of its term. The Property Law is intentionally silent on the term of that extension and on whether a fee will be required for it. The NPC commentary on the Law indicates this silence was intentional, since there was substantial disagreement on the issue.

b. For non-residential property, the Property Law does not change to existing law. Existing law provides that at the end of the term, the holder of land use rights may apply for an extension, with the state having total discretion as to whether to grant or deny the extension. If no request for an extension is made, or if the extension is denied, then the land use right reverts back to the state. At that time, all ownership interest in buildings and fixtures also reverts back to the state with the state having no obligation to reimburse the owner of the buildings and fixtures. The provision does provide that an agreement binding the state on renewal will be honored. However, since the state never agrees to such limitations on its power, this provision is essentially meaningless.

D. Division 13: Rural Residence Land Use Rights

In rural areas, residents obtain land use rights for housing from the local cooperative. The rules for such rights are set out in the Land Management Law. Since land for housing construction is extremely limited in rural areas, the housing right is also highly restricted and the right to transfer and sell such rights is limited. The Property Law makes no changes in the existing law, other than to emphasize that all such land use rights must be registered in the local land registry.

E. Division 14: Easements.

Division 14 provides for easements by agreement. This is a new form of use right in China. This division provides for free creation of easements by agreement between landowners. These are easements by agreement and differ from the prescriptive type easements arising from neighboring rights discussed above. Presumably, however, the written easement approach of this division will be used to formalize the arrangements concerning certain neighboring rights. This would certainly be advisable for rights such as the right to access roads and rights to lay cable and pipe. However, this issue does not seem to have been formally considered by the drafters of the Property Law.

The basic provisions for creation of easements by agreement are as follows:

1. Easement agreements must be made by written contract containing the basic terms of the agreement.

2. The agreement takes effect when executed. There is no requirement for recording. Agreements that are not recorded do not bind innocent third parties.

3. Easement agreements cannot be assigned independent of the property they encumber. Absent an agreement to the contrary, when the underlying property right is transferred, the easement agreement transfers with it.