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# InterConnect

A PUBLICATION OF BENESCH FRIEDLANDER COPLAN &amp; ARONOFF LLP'S TRANSPORTATION AND LOGISTICS GROUP

## Investing in China's Transportation and Logistics Business

China's joining the WTO in November 2001 has brought its transportation and logistics industry and market to a historical moment. The commitments China has made to opening its transportation and logistics industry to foreign investors have forever changed the status of this traditionally strictly state-controlled segment.

The following is a detailed account of China's accessions to the WTO on its transportation/logistics markets:

- Ocean transportation (including international cargo and passenger transportation): joint ventures ("JV") allowed; foreign ownership shall not exceed 49%.
- Accessory services (including shipping brokerage and customs processing services): JV allowed; no maximum limit on foreign ownership.
- Container warehousing: JV allowed; no maximum limit on foreign ownership.
- Ocean transportation agent; water transportation; air transportation (including repair services to aircrafts); international liner and maritime transportation: JV allowed; foreign partner ownership may not exceed 49%.
- Road freight: WFOE ("Wholly Foreign Owned Enterprise") is allowed.
- Rail freight: WFOE will be allowed beginning in December, 2007.

- International container multi-modal transportation: WFOE is allowed.
- All other transportation related services; warehousing and cargo transportation agency (excluding cargo inspection): WFOE is allowed.

### China's Transportation and Logistics Industry and Market

Under the investment restrictions described above, China approved 919 foreign invested transportation enterprises, reflecting an investment of \$5 billion (U.S.), by the end of 2004. As the restrictions on foreign investor's maximum ownership continue to expire and incentives and supporting measures are being offered to foreign investors, the pace of U.S. investment in China's transportation and logistics industries is expected to accelerate.

#### Booming Market

More than 80% of the Chinese population are farmers, living in countrysides where both cargo and passenger transportation services are extremely scarce and highly in demand. The Chinese government especially encourages foreign investments in cargo trucking and road transportation business in China's western and north-eastern regions, passenger transportation services in all countryside and remote areas, and cargo transportation services between cities and villages nationwide. The international trucking transportation business is also booming between China

and its neighboring countries, where China has signed bilateral trucking transportation agreements with more than ten countries and set up more than 60 international road transportation lines and stations. By 2005, the in-bound and out-bound trucking transportation volume reached 1.4 million vehicles/times, transporting more than 8 million passengers and more than 10 million tons of cargo.

#### Government's Attentions

On March 23, 2006, the State Counsel of the Chinese central government published its long term economic development plan, and selected 11 priority industrial areas that the State would be focusing on and encouraging investors to invest. Transportation has been declared by the Chinese

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government as the “life line” of the country's economy. In short, China's 2.6 trillion economy has been growing at a torrid pace of 11% per year for the last 20 years. Growing the economy demands adequate transportation services, and the transportation services depend on a growing economy. China is a market that presents both elements.

## *Less Rosy Pictures*

In spite of the high demand and huge market for transportation business in China, the profitability of such an investment has room for improvement. Historically, China's transportation business has not been a lucrative investment due to following reasons: (1) lack of sophisticated transportation systems and chain of operations; (2) lack of advanced management system and organized market order; (3) lack of high quality and most efficient transportation equipment and tools; and (4) lack of adequate financing support and effective combat on unfair competition. The Chinese government recognizes these problems and has been trying to improve

the economics of the industry by providing strong financial aid and incentive programs, introducing

advanced management systems by opening investment areas, acquiring highly efficient transportation vehicles and

equipment, and regulating and penalizing unfair competition.

## **Procedures and Legal Requirements of Investing in China's Transportation Market**

### *Application Process*

Beijing, Tian Jing, Shanghai, Chongdong, Jiangsu, and Gungdong have lead the way in encouraging and facilitating foreign investment in China's transportation and logistics industries.

In addition to the favorable developments in the provinces, the central government is also becoming involved in encouraging foreign investment in transportation and logistics. On March 31, 2006, the PRC Ministry of Commerce (“MOFCOM”) issued a Public Notice authorizing

foreign investment in transportation and logistics nationwide in China. Foreign investors can submit their applications, together with required documents, to the local MOFCOM. The local MOFCOM may approve the application or, depending on the size of the proposed investment, send it to the central MOFCOM.

## **Summary**

With the support of the Chinese government, China's transportation and logistics industry and market is undergoing significant changes towards sophistication and modernization. These changes present great opportunities and challenges to foreign investors. The road from investing to harvesting profits may be bumpy and challenging, but the future is undoubtedly promising and potentially rewarding.

For more information, please contact Bob Spira ([rspira@bfca.com](mailto:rspira@bfca.com) or 216.363.4413) or Charlene Lee ([clee@bfca.com](mailto:clee@bfca.com) or 216.363.4635).

## How SAFE are You? The Practical Implications of the SAFE Port Act for the Transportation Industry

On October 13, 2006, President Bush signed into law the Security and Accountability for Every Port Act ("SAFE Port Act"). The SAFE Port Act combines various U.S. shipping and port security regulations into one piece of legislation. Though it generally addresses the security needs of

U.S. seaports, it includes specific provisions that will impact all facets of the transportation and logistics industry,

namely: (1) the Transportation Worker Identification Credential ("TWIC"); (2) threat assessments for port truck drivers; (3) the Container Security Initiative ("CSI"); and (4) the Customs-Trade Partnership Against Terrorism ("C-TPAT"). This article will summarize these relevant provisions and their expected impact on the transportation and logistics industry.

### Transportation Worker Identification Credential

TWIC stands for Transportation Worker Identification Credential. As proposed, TWIC is a secure identification credential, that uses "smart card," or biometric, technology. Transportation workers would be issued cards containing biometric information, such as a fingerprint, to access secure areas of transportation facilities. The card would verify the holder's identity by linking to the holder's biometric stored on the credential. The TWIC program creates a tamperproof ID credential that may be used and accepted across all modes of

the transportation system. The TWIC program also creates a uniform, national standard for secure identification of transportation workers and reduces the need for redundant credentials and background checks.

*[T]here may be a positive public perception that a company complying with these security requirements is supporting national security efforts at border protection.*

TWIC IDs will ensure compatibility with existing facility access control systems to leverage current security investments. TWIC IDs will also provide the government and

transportation facilities the ability to revoke access privileges to TWIC holders who are identified as a threat.

The goal of the TWIC program is to improve security of identity management by establishing a nationwide credential program for all modes of transportation.

The TWIC vetting or background check process is known as a Security Threat Assessment. An FBI criminal background check will be conducted, and will focus primarily on crimes such as espionage, treason, transportation security crimes, crimes involving possession of explosives, improper transportation of a hazardous substance, etc. These crimes will permanently disqualify an individual from receiving a TWIC card. Crimes such as kidnapping, rape, robbery, arson, extortion will result in an individual being disqualified for 5-7 years.

TWIC will aim to protect personal privacy by storing only a limited amount of personal information on the card and

employers will not receive information on employees' security threat assessment.

Currently, TWIC has been in pilot-program status. In May 2006, the Coast Guard and TSA issued a notice of proposed rule making to create a national TWIC program. The SAFE Port Act mandates that final regulations for the issuance of TWIC cards be promulgated by January 2007. A pilot TWIC program must commence no later than 180 days after signing of the SAFE Port Act (April 2007), and promulgation of regulations within two years of the conclusion of the pilot program.

While TWIC may not be of an immediate concern to you now, the SAFE Port Act clearly pushes TWIC ahead and makes implementation of a national credential for all transportation workers a reality.

### Threat Assessment for Screening of Port Truck Drivers

Not later than 90 days after signing SAFE Port Act (January 2007), the Secretary of Homeland Security must implement a threat assessment screening, including name-based checks against terrorist watch lists and immigration status check for all port truck drivers with access to secure areas of a port and who have a CDL but do not have a valid hazardous materials endorsement. The screening will be similar to screening already done on longshoremen and other port workers.

This portion of the SAFE Port Act will affect all drivers with access to secure areas of a port (unless those drivers have hazardous material handling clearance).

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## Container Security Initiative

The Container Security Initiative (“CSI”) was originally launched in 2002, deploying American inspectors to foreign ports to screen cargo before it leaves for the U.S. The purpose of CSI is to use intelligence and automated information to identify and target containers that pose a risk, prescreen containers that pose a risk, use technology to quickly detect and prescreen containers that pose a risk, and use better containers.

Containers that pose a risk are screened by the Customs and Border Protection while they are abroad in one of 50 ports (foreign ports) that are currently operational. Screening will be accomplished through non-intrusive inspection and radiation detection.

CSI screening should not delay low risk cargo. In fact, CSI aspires to “take advantage” of downtime as targeting and examination are accomplished during the lag time between the cargo’s arrival at the foreign port and the time it is loaded onto a ship for departure to the U.S.

CSI should actually make the movement of low risk cargo more efficient because CSI targets containers and screens them before they depart, so that when the container reaches the U.S. it can be released immediately.

## C-TPAT

The SAFE Port Act codified C-TPAT into law. C-TPAT is basically a joint effort between the public and private sector to improve the transportation industry’s internal security measures.

It was initiated by the Bureau of Customs and Border Protection (“CBP”) in November 2001 as an attempt to improve the physical security of containers as they move through international commerce. Its members include importers, brokers/forwarders, carriers, port authorities and foreign manufacturers. There are approximately 3,000 new C-TPAT members per year.

C-TPAT qualification involves several steps. The first is the completion and submission of a Supply Chain Security Profile that establishes an applicant’s commitment to ensuring adherence to C-TPAT security criteria. This commitment involves not only surveying the applicant’s business partners, including manufacturers, suppliers, vendors, and transportation service providers, but also obtaining written certification that the business partners are compliant with C-TPAT criteria.

The list of C-TPAT criteria is extensive. It includes qualification of the partner in C-TPAT (or, in the case of a foreign partner, a similar government program in its country); facility security (including entryways, lighting, parking, fencing, and general structural soundness); transportation security (including locks and seals, access, storage, handling, and the physical condition of cargo containers); personnel security (including entry controls, ID cards, background checks, and termination procedures such as changing passwords and locks); and documentation and information technology security.

When the applicant’s profile is complete, it must submit its profile and application

on-line. Selected applications and profiles are validated by CBP through a company briefing, review of the profile, and one or more on-site visits at both the company and its foreign supply chain partners to evaluate their willingness to comply and their actual compliance with C-TPAT criteria. If the applicant passes the validation, it then enters into an agreement with CBP that contains supply chain security commitments.

The impact of C-TPAT has both tangible and intangible elements. In terms of intangibles, such as public relations, there may be a positive public perception that a company complying with these security requirements is supporting national security efforts at border protection.

More concrete impacts result from the fact that a company can only qualify for C-TPAT if its entire supply chain also qualifies. Therefore, when a large manufacturer applies, it in effect forces all components of its supply chain to participate in C-TPAT if they want to continue to do business with the manufacturer. As a consequence, a program that began with a mere seven volunteers has grown to almost ten thousand participants.

A company that has qualified with C-TPAT will experience fewer audits, inspections and other border delays at the hands of CBP.

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For more information, contact Nicole Dorsky at 216.363.4593 or [ndorsky@bfca.com](mailto:ndorsky@bfca.com) or Clare Taft at 216.363.4435 or [ctaft@bfca.com](mailto:ctaft@bfca.com).



## You May Have to Pay Your Drivers Overtime

The Fair Labor Standards Act ("FLSA") requires employers to pay most of their employees time and a half for all hours they work over forty in a workweek. Many states have similar laws, and some have more onerous laws. California, for example, generally requires overtime premium to be paid for all hours over forty in a workweek and eight in a work day. The FLSA contains many exemptions to its overtime requirement. Executives, administrators and professionals are a few categories of employees who may be "exempt" from the FLSA's overtime requirement.

Truck drivers are generally exempt from the FLSA's overtime requirement. Section 13(b) of the FLSA provides an exemption for "any employee with respect to whom the Secretary of

Transportation has power to establish qualifications and maximum hours of service pursuant to the provisions of [the Motor Carrier Act]." The Secretary of Transportation has the power to regulate the qualifications and the maximum

hours of service for most commercial drivers of trucks involved in interstate commerce. 49 U.S.C. § 3102. A truck is involved in interstate commerce

as long as what is being transported actually moves in interstate commerce. 29 C.F.R. § 782.7(b)(1).

Historically, the motor carrier exemption could apply to drivers of small vans or trucks as well as tractor-trailers. However, in 2005, Congress enacted the Safe, Accountable, Flexible, and Efficient Transportation Equity Act of 2005 ("SAFETEA-2005"). SAFETEA-

*[U]ntil the Wage and Hour Division advises otherwise, employers should pay overtime premium to any driver not driving commercial vehicles as defined by SAFETEA-2005.*

2005 amended the Motor Carrier Act by changing the definition of a commercial motor vehicle to: "a...vehicle..., if the vehicle (A) has a gross vehicle weight rating or gross vehicle weight of at least 10,001 pounds, whichever is greater; (B) is designed or used to transport more than 8 passengers... for compensation; (C) is designed or used to transport more than 15 passengers [not for compensation]; or (D) is used in transporting [hazardous material]."

Based on the legislative history, Congress did not contemplate that a change in the definition of commercial motor vehicle would impact an employer's overtime requirements. Nevertheless, until the Wage and Hour Division advises otherwise, employers should pay overtime premium to any driver not driving commercial vehicles as defined by SAFETEA-2005. Since SAFETEA-2005 may have diluted an important and often-used overtime exemption, employers in the trucking business should consider calling their attorneys for advice concerning their specific issues.

For more information, contact Joe Gross at [jgross@bfca.com](mailto:jgross@bfca.com) or 216.363.4163.

## Benesch's e-Document Retention Team: Keeping Information Under Control

Benesch has recently formalized its e-Document Retention Team under the leadership of Howard Levy. Lawsuits in the digital age have become more perilous to companies and their counsel. As digital information and databases expand, the vast amounts of content generated are increasingly difficult to control. The law has certain requirements, and the penalties for failing to have a rational policy for retaining or discarding data have been severe. Our team is already busy assisting clients.

The team's attorneys help clients establish and implement retention policies to avoid legal mishaps and appropriately control relevant business documents. In addition, outside expertise may be needed to determine whether a company is appropriately handling its metadata, disk drives, databases, and other repositories of electronic information. We regularly work with leading technical firms with expertise in this field.

"A number of prominent companies that have failed to maintain electronic documents in the face of discovery, or even when they knew or should have known that a lawsuit was threatened, have faced sanctions," said Dave Mellott, a member of the e-Document Retention Team. He continued, "The old rules of spoliation of evidence – destroying evidence in the face of a lawsuit – are more complicated when storage capacity may be limited. In view of these risks, companies should have a rational e-document retention policy. The goal is to retain documents that are most pertinent to the business while still

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being able to regularly purge or discard noncritical documents in both hard copy and electronic form."

The digital world continues to expand at a dizzying rate. Estimates place the number of person-to-person e-mails alone between 36 and 40 billion worldwide on an average day. Clearly, managing and properly retaining relevant company information will continue to be a challenging proposition. The legal requirements are also clear – to ignore them or fail to achieve full compliance exposes you to serious risk.

*To listen to a podcast by Benesch attorney Howard Levy on this topic, please visit Benesch's Web site at [www.bfca.com](http://www.bfca.com). Click on The Benesch Beat icon on the home page, and then select "Electronic Document Discovery and Retention."*

For additional information regarding e-discovery, please contact Howard Levy at [hlevy@bfca.com](mailto:hlevy@bfca.com) or 216.363.4508 or Mike Buck at [mbuck@bfca.com](mailto:mbuck@bfca.com) or 216.363.4694.

## On the Horizon

### Trucking Industry Defense Association Mini Seminar on Truck Accident Litigation

Eric Zalud will be attending.

February 8, 2007 | Miami, Florida

### Legal Issues Involved in International Transportation

Marc Blubaugh

Project EAGLE Seminar: Transportation Contracts and the International Treaties that Govern Them

February 9, 2007 | Columbus, OH

### Current Legal and Business Issues Affecting Transportation and Logistics

Marc Blubaugh

### Broker and Freight Intermediary Issues

Eric Zalud

Transportation Loss Prevention and Security Association's Annual Meeting; Martha Payne is on the Association's Board of Directors

April 18, 2007 | Orlando, FL

### Northeast Ohio's Global Challenge

A symposium sponsored by the Cleveland Bar Association; Bob Spira is Chairman of the Symposium Committee

April 24, 2007 | Cleveland, OH

### Resources for the Transportation Attorney

Bob Spira and Eric Zalud

Transportation Lawyers Association Annual Conference

May 1-5, 2007 | San Antonio, TX

For further information and registration, please contact Megan Crossman at 216.363.4174 or [mcrossman@bfca.com](mailto:mcrossman@bfca.com).

**For more information about the Transportation and Logistics Group, please contact one of the following:**

**Eric Zalud, Chair**

216.363.4178

[ezalud@bfca.com](mailto:ezalud@bfca.com)

**Marc Blubaugh**

614.223.9382

[mblubaugh@bfca.com](mailto:mblubaugh@bfca.com)

**Nicole Dorsky**

216.363.4593

[ndorsky@bfca.com](mailto:ndorsky@bfca.com)

**David Neumann**

216.363.4584

[dneumann@bfca.com](mailto:dneumann@bfca.com)

**Martha Payne**

541.764.2859

[mpayne@bfca.com](mailto:mpayne@bfca.com)

**Frank Reed**

614.223.9304

[freed@bfca.com](mailto:freed@bfca.com)

**Robert Spira**

216.363.4413

[rspira@bfca.com](mailto:rspira@bfca.com)

**Clare Taft**

216.363.4435

[ctaft@bfca.com](mailto:ctaft@bfca.com)

**Thomas Washbush**

614.223.9317

[twashbush@bfca.com](mailto:twashbush@bfca.com)

Pass this copy of *InterConnect* on to a colleague, or email [kmasuga@bfca.com](mailto:kmasuga@bfca.com) to add someone to the mailing list.

### Cleveland

2300 BP Tower

200 Public Square

Cleveland, Ohio 44114

Phone: 216.363.4500

Fax: 216.363.4588

### Columbus

88 East Broad Street

Suite 900

Columbus, Ohio 43215

Phone: 614.223.9300

Fax: 614.223.9330

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

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