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EIGHT NEW MEASURES ON REAL ESTATE MARKET

Key Points:

- *Reiterated policies on undeveloped land*
- *Taxation on residential houses*

In order to reduce real estate speculation and cool the overheating market, seven departments of the State Council have jointly promulgated eight nationwide measures (“Measures”) that took effect June 1. Among them, two major measures need to be particularly noted: 1) taxation measures on residential houses and 2) restated policies on undeveloped land.

1) Undeveloped Land

The Measures restate the policies on unimproved land, requiring strict implementation of relevant law and regulations that impose holding fees on sites remaining undeveloped for more than one year after

the date for commencement of development that was specified in the land use rights contract. For land left idle for more than two years after the date specified in the land use rights contract, the right to develop will be revoked and the associated land use rights will be reclaimed without compensation.

This policy was first adopted back in the 1980s and repeatedly stated in laws and regulations including the Land Management Law, the Urban Real Estate Administration Law, the Measures on Disposal of Idle Land, and related local implementation rules. Despite the explicit provisions in these laws, the holding fees or reclamation measure had never been strictly implemented.

However, last year, due to continuing concerns about a bubble in the real estate market, the Ministry of Land and Resources began intensifying control over undeveloped land. In an Urgent Circular issued in December 2004, the Ministry demanded that local

governments investigate the status of all idle land in urban areas. Meanwhile, the State Council released several Opinions or Decisions, as well as the Measures to emphasize the significance of clarifying the status of undeveloped urban sites. As a result, many local governments have issued detailed rules for implementation of the law. For example, Guangzhou provides that holding fees for land used for commercial purpose should be 1.2% of the total grant fee per month, while the percentage for land used for infrastructure is 0.4%. Jiangsu and Hainan Provinces have also announced their own standards for holding fees.

Therefore, it seems that governments, both central and local, intend to collect holding fees and push the development of land. Although most cities, including Beijing and Shanghai, have not yet adopted implementation rules, companies holding undeveloped land reclaimed should be alert to measures that might, possibly, allow it to be reclaimed.

2) Taxation on Residential Houses

The Measures impose a business tax of 5% payable on the full resale price of all residential houses sold within two years after being purchased. Previously, the holding period was one year. If a house is sold after two years, the business tax is levied only on the difference between the original purchase price and the resale price, and only on houses classified as “non-ordinary” residential houses.

To be classified as ordinary housing, the house must meet certain conditions, such as that its size be less than 120 square meters and the resale price lower

than 1.2 times the average price of houses in the same region. Local governments are allowed to adopt regional criteria increasing or decreasing the relevant size of the residence or the average price within the floating range of 20%. Most cities make full use of the range. For example, in Shanghai, ordinary housing is defined as less than 140 square meters in size and less expensive than 1.44 times the average price. Some cities, such as Nanjing, have even gone beyond the Measures, imposition of the business tax by, imposing a 20% personal income tax on the difference between the purchase and resale price.

– Lindsay Zhu

PBOC OPENS INTERBANK FOREX MARKET

Key Points:

- *Trading in foreign currencies on interbank forex market now allowed*
- *Renminbi (RMB) transactions not yet approved*

With the approval of the People’s Bank of China (“PBOC”), the China Foreign Exchange Trade System, a subsidiary of PBOC, launched a new interbank foreign exchange (“forex”) market on May 18 that allows domestic trading in foreign currencies.

“Domestic trade of foreign currencies” refers to the arrangers for facilitating transactions and clearing of foreign currency pairs by domestic financial institutes through the electronic trading and clearing platforms of the interbank forex market. The new trading system is targeted to sight transactions of only

foreign currencies and does not involve trading in renminbi (RMB).

The new market for interbank trade in foreign currencies is different from the previously established market for sale and settlement of forex, which has been in operation since 1994. Both the new foreign currency trading system and the 1994 forex trade system are part of the interbank forex market; however, the two systems trade different products and operate independently from each other. The forex sale and settlement system is for sight transactions and clearing of currency pairs between renminbi against the US dollar, Japanese yen, Hong Kong dollar, and euro through designated forex banks (i.e., designated banks and financial institutions that are qualified to conduct forex sale and settlement involving RMB). The newly permitted foreign currencies business implements a “price-competing system driven by price quotations of market-making banks,” under which the market-making banks quote their selling and buying prices of currency pairs; then the transaction system will select the best price from such quotations and make a real-time announcement. Simultaneously, it will match the best price quotation of the market-making bank with inquiries and requests raised by price-taking banks subject to the principle of “price and time priority” and provide real-time feedback regarding the success of the deal to both sides of the transaction.

The participating bodies consist of two types of banks: market-making banks and price-taking banks. A “market-making bank” is a bank that constantly provides both-side quotations of the buying and

selling prices for designated currency pairs and undertakes the obligation to maintain market involvement and circulation. A “price-taking bank” is a bank that offers on-site quotations 1) at real-time forex rates, 2) subject to customer orders, or 3) based on its then-price inquiries.

The new system initially allows trading in eight more currency pairs including the US dollar against the Australian, Canadian, Hong Kong dollars, the British pound, the euro, the Swiss franc, and the Japanese yen; and the euro against the yen. The regular time for transactions is 7 a.m. to 7 p.m. (Beijing time), Monday through Friday, with closure in observance of public holidays.

The new system will have a significant impact on China’s financial markets. First, it provides domestic financial institutions with a new business tool for generating revenue and opens a new market to China’s financial system. In the past, no platform for transactions in any foreign currency pairs was provided, and domestic trade of foreign currencies was mainly conducted by overseas banks. China’s interbank forex market used to organize transactions by adopting an electronic price-competing system, in which price-taking banks voluntarily made price quotations through the transaction terminal and then the transaction system made a match for the deal based on the principle of “price and time priority.” The new system encourages competition on price quotations among market-making banks.

Second, quotations by market-making banks on a real-time, constant and two-sided basis will enable transactions to be conducted more efficiently.

Third, Chinese commercial banks and other domestic financial institutions are now allowed to participate in the trade of foreign currencies as market-making banks, which will make them more competitive in the market and further improve China's forex market system. – *Maureen Meng*

FOREIGN EXCHANGE RULES EASED TO ENCOURAGE OVERSEAS INVESTMENT

Key Points:

- **Quota for foreign exchange purchases increased**
- **Local SAFE bureaus' extent of approval authority raised**

On May 19, 2005, the State Administration of Foreign Exchange ("SAFE") issued the "Circular on Extending the Pilot Regions for Reform of Foreign Exchange Administration of Overseas Investment", (the "Circular")

This Circular promulgates three important measures: 1) the pilot regions allowing PRC companies to expand overseas will be extended from 24 provinces, autonomous regions and municipalities to the entire country; 2) the total permitted annual quota of foreign exchange purchases for Chinese companies investing overseas has been increased from US\$3.3 billion to US\$5 billion nationwide; and 3) the local administration bureaus' extent of approval authority for any one transaction has been raised from US\$3 million to US\$10 million.

According to one news release published by SAFE regarding this Circular, the above quota may be increased from time to time to reflect the then current demand for foreign exchange. In reference to the third measure, for investors who would like to purchase foreign exchange in an amount less than US\$10 million for overseas investment, the local authority's approval will be sufficient.

The purpose of this Circular is to support the national "Go Out" policy, which encourages Chinese enterprises to invest overseas and expand internationally. Since October 2002, SAFE has gradually extended the pilot regions so as to support these overseas investments. By the end of last year, SAFE had approved the investment of US\$5.1 billion in total for 1,152 overseas projects.

Although the key requirements for a Chinese enterprise to invest overseas remain unchanged, this Circular is yet another form of support for Chinese overseas investments. – *Wei Zhang*

CSRC STARTS REFORM TO FLOAT NON-TRADABLE SHARES OF LISTED COMPANIES

Key Points:

- **Selected listed companies to participate in a pilot program**
- **Shareholders of non-listed shares to be subject to lock-up requirements**

For historic reasons, the majority of shares of most of the listed companies in China are not listed on the

stock exchange. These non-listed shares, held by the government or organizations (private or non-private) and hence called “state owned shares” or “legal person shares”, are not permitted to be traded on the stock exchange, but can be transferred by private agreement. Such treatment has, over the years, become a major obstacle to the development of China's capital markets. The State Council, in its “Several Opinions for Enhancing Reform, Opening, and Stable Development of the Capital Market”, issued in January 2005 -- commonly known as the “Nine Opinions” -- laid out a principle of reform to resolve these “problems of share division”. As one step in implementing the Nine Opinions, the China Securities Regulatory Commission (“CSRC”) issued the “Circular Regarding Certain Issues Relating to Trial Reform of the Share Division Problems in Listed Companies” (the “Circular”) on April 29, 2005, signifying the start of the first major reform of China's stock market since its establishment more than a decade ago.

The Circular makes it clear that, given the complexity of the “problems of share division,” reform needs to start on a trial basis. Initially, only those listed companies designated by the CSRC based on recommendations by the shareholders of such listed companies and recommendation by the sponsoring organization will participate in the pilot programs. Major requirements for such pilot programs include, among others:

(1) Timely disclosure of the program details and suspension of trading during specified periods;

(2) A special general meeting for shareholders to vote on the program, which will require at least three public notices for such a meeting and the availability of a network voting system; and

(3) Approval by at least two-thirds of shareholders of listed shares voting.

(4) Shareholders of the non-listed shares are subject to lock-up periods after such shares become listed (12 months for all shareholders of non-listed shares; in addition, for shareholders of non-listed shares holding over 5% of all shares of the company, during the subsequent 12 months and 24 months not more than 5% and 10% of all shares of the company, respectively, may be sold).

Shortly after issuance of the Circular, a first group of four listed companies was selected to undertake the pilot program. A second group of companies was to be selected in June. —Yong Zhao

NDRC ISSUES RULE TO DESULFURIZE COAL-FIRED POWER PLANTS

Key Points:

- **Desulfurization technology improved**
- **Regulation of the supplier market of desulfurization**

On April 28, 2005 the National Development and Reform Commission (“NDRC”) issued the “Suggestions for Faster Development of Desulphurization of Coal-Fired Power Plants”.

Most of China's electricity is produced by coal-fired facilities. This produces serious environmental problems and causes economic losses of 110 billion yuan (US\$13.3 billion) a year. To reduce these losses, China has decided to use technology to change sulfur dioxide (SO₂) into gypsum, a kind of building material. About 3 billion KW in electricity plants incorporating desulfurization capabilities units will be constructed in the next 10 years.

The NDRC's mandate establishes a goal for desulfurization: within three years, to develop a market-driven industry; to improve desulfurization technology standards; and to have 95% domestically produced desulfurization equipment.

In addition to encouraging power plants to equip themselves with desulfurization facilities, the mandate promises to offer technical guidance, supports and preferential policies to help with high costs.

Regulating the supplier market of desulfurization is one of the NDRC's concerns. It stipulates that general contractors working in this area shall own advanced, complete, and mature desulfurization technologies and have the necessary economic capability to perform desulfurization contracts as well as good financial standing, experience and a complete quality guarantee system. The mandate urges continuous improvement of the market-entry permit system and desulfurization bidding process and suggests post-evaluation of projects by engaging experts from within and outside China, if available. – *Zhong Wei*

CHINA'S NEW ONLINE COPYRIGHT REGULATIONS

Key Points:

- **ISPs required to monitor ICP content, or face liability**
- **Wake-up-call for ISPs to take greater responsibility**
- **Enforcement difficulties likely to ensue**

Effective May 30, 2005, new regulations on online copyright protection have been issued by the National Copyright Administration and the Ministry for the Information Industry. Of course, prior to these regulations, online copyright received protection through the Copyright Law and its implementing regulations. However, these dedicated regulations serve to enhance considerably online copyright protection by (1) placing the onus of protection on ISPs, requiring them to monitor and appraise the content of website material posted by their ICP customers, and (2) introducing strict penalties for ISPs that fail to satisfy this monitoring standard.

Now, for the first time, ISPs will be held liable for failing to take remedial action in respect of copyright infringing materials posted by ICPs. If a copyright holder discovers that its works is being illegally posted on websites, it may complain directly to the relevant ISP, with proof of its copyright. Once satisfied that a violation has occurred, the ISP is obliged to remove the infringing content and log the details of the infringing activity and the infringer. The incentive to take remedial action is to be found in a new regulatory provision that imposes hefty penalties on ISPs for failure to act. In each case, the penalty is

equivalent to three times the illegal income generated by the infringing activity, or, if the income unknown, by a penalty sum not exceeding RMB100,000. Given that infringers do not record their illegal revenue, it is likely that most penalties will lie within this latter parameter. Nevertheless, the regulations are a wake-up-call for ISPs to take greater responsibility in terms of business ethics and behavior, and certainly a few successful cases against ISPs should sharpen their focus.

Some difficulties with implementation are likely to arise. Firstly, as the level of IPR awareness and

enforcement varies considerably throughout China, ISPs will find that over-zealousness in observing the new regulations could see ICPs fleeing to regions that are less inclined to take action. So too, a vicious circle could be created where ISPs that derive sizeable revenue from copyright infringing websites, may be reluctant to take tough action that would result in the loss of such revenue. – *Diarmuid o'Brien*

Presentations, Articles and Publications

- July 15** **James M. Zimmerman** of SSD's Beijing office will provide closing remarks at the CPR/CCPIT US-China Business Mediation Congress at the Great Wall Sheraton Hotel in Beijing. The event, sponsored by the International Institute for Conflict Prevention and Resolution, based in New York, and the Conciliation Centers of the China Council for Promotion of International Trade, based in Beijing, focuses on best practices for managing commercial disputes. Zimmerman's remarks will discuss the management and resolution of business disputes in China and the role that US industry has played in the development of China's dispute resolution practices.
- July 21** **Amy Sommers** of SSD's Shanghai Office will serve as a panelist presenting on the regulatory framework and access to China's insurance sector in the ABA Section of International Law live audio webcast "Business Opportunities & Challenges in China Today"
- July 27** **Amy Sommers** of SSD's Shanghai Office will make a presentation in Seattle, Washington, USA, on Chinese growth and current challenges to the Rotary Club of Seattle, which with more than 700 members, is one of the largest Rotary Clubs in the world.

James Zimmerman, *China Law Deskbook, Second Edition (2005): A Legal Guide for Foreign-Invested Enterprises*. More information is available on the ABA's Web site:

<http://www.abanet.org/abastore/index.cfm?section=main&fm=Product.AddToCart&pid=5210139>.

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