

INSIDE

China to Promote International High-Tech Cooperation 1

Amendment to PRC Company Law Loosens Investment Restrictions 2

SAFE Opens Door for Domestic Residents' Offshore Financing and Return Investment..... 3

PRC Revises Securities Law 5

Tradable Shares Now Available to Overseas Investors..... 5

US Badgers China on Piracy War and China's Recent Efforts to Crack Down on Online Copyright Infringement 6

China to Adopt its First Anti-Monopoly Law 7

MOFCOM Issues Consultation Draft on Foreign-Invested Construction and Engineering Service Enterprise Measures..... 8

CHINA TO PROMOTE INTERNATIONAL HIGH-TECH COOPERATION

Key Points:

- **Will help expand trade in high tech and high-tech products**
- **Will expand R&D investment and cooperation with foreign investors**

At the Opening Ceremony of the Seventh China Hi-Tech Fair held in Shenzhen October 12-17, Vice Premier Zeng Peiyan spoke on "Promoting Technology Innovation and Achieving Mutual Development." Zeng's presentation emphasized that if China wants to encourage technological innovation, promotion of international cooperation is essential. He made the following four major points:

(1) It is important to expand trade involving high tech and high-tech products, especially advanced technology and equipment related to machine manufacturing, oil and chemicals, electronic information, resource utilization and environmental protection.

(2) To expand investment and cooperation in technological fields, the Chinese government will encourage foreign investors to set up R&D centers to invest and promote advanced technology as applied to manufacturing and agriculture and as it relates to technological reformation. At the same time, the Chinese government will encourage domestic companies to set up R&D centers overseas and participate in research and development of advanced technology and the establishment of international standards.

(3) China will strengthen bilateral and multilateral technology communication with other countries and promote international technology cooperation projects to expand communication channels concerning technology.

(4) To optimize a cooperative environment in technological development, China will strictly meet WTO commitments, promote freedom and facility of technology trade and cooperation, and improve the economic and social environment of technology cooperation. – *Wei Zhang*

AMENDMENT TO PRC COMPANY LAW LOOSENS INVESTMENT RESTRICTIONS

Key Point:

- ***Stronger protection for small and medium-sized shareholders***

Since its initial publication in 1993, the PRC Company Law has been amended four times. The most recent amendment, which takes effect January 1, 2006, is the most dramatic and extensive amendment of all, in containing more than 100 changed articles.

The basic purpose of the amendment is to loosen restrictions on investment and strengthen protection of small and medium-sized shareholders. While laws regarding foreign invested enterprises (“FIEs”) will remain the major governing laws for foreign investors, the following amendments to the Company Law should be noted, even though certain of them will not directly apply to FIEs.

1. Requirements for Capitalization Lowered

The Amendment lowers the requirements for company capitalization in three aspects. First, it lowers the minimum registered capital for all types of companies to RMB 30,000, whereas minimum registered capitalization formerly ranged from RMB 100,000 to RMB 500,000, depending on the type of company. Second, the Amendment allows a two-year deadline within which shareholders must contribute the registered capital, with the first installment required to be not less than 20% of the total registered capital. The old law required that in the case of domestically invested companies the registered capital be contributed in a lump sum prior to issuance of the business license. Note that these two changes will not affect the existing requirements for FIEs.

The significant change for FIEs is that the 20% restriction limiting the amount of registered capital that could be contributed in the form of intangible assets has been abolished. The Amendment now simply stipulates that of the total registered capital, 30% must be in cash. **This means that, beginning next year, up to 70% of registered capital may be contributed in the form of intangible property.**

2. Restrictions on Reinvestment and Requirement of Public Welfare Funds Lifted

Under the old law, the total amount of reinvestment in other companies could not exceed 50% of a company’s total net assets, which had the effect of limiting passive investment. This restriction also applied to reinvestment by FIEs. The Amendment lifts this restriction; i.e., there is no limit on the volume of a company’s reinvestment. However, companies are not permitted to invest in another enterprise as an investor with unlimited liability. For example, a company may not invest in a partnership as a general partner.

Previously, the Company Law required maintenance of two types of reserve funds. The Amendment now abolishes the requirement that a company reserve 5-10% of its profits as a public welfare fund. However, a statutory public accumulation fund must still be maintained on an annual basis.

3. One-Shareholder Companies Permitted; “Piercing the Corporate Veil” Concept Adopted

The Amendment permits a company to have only one shareholder, either an individual or a company, while the old law required at least two shareholders. However, in order to protect creditors, the Amendment also includes six risk-control methods including raising the relevant minimum registered capital required to RMB 100,000, which must be contributed in a lump sum; noting the company’s one-shareholder nature on its business license; and stipulating that each person may establish only one one-shareholder company.

One of these measures, the Company Law, for the first time, has adopted the concept of “piercing the corporate veil,” providing that if the sole shareholder cannot prove that his or her personal assets are independent from the assets of the company, the shareholder will be liable to the company’s creditors. This principle also applies to all other types of companies in instances in which their shareholders are found to have abused the independent status of the company and therefore impaired the interest of its creditors.

4. Protection for Small and Medium Shareholders

Measures for protecting small- and medium-size shareholders include (1) adopting a cumulative voting system; (2) granting the shareholders the right to force the company to repurchase their shares if

the company refuses to distribute profits for five years; (3) in cases in which the continued existence of a company would impair the interest of shareholders, permitting shareholders with a 1/10 voting interest to apply to liquidate the company; and (4) permitting shareholders to bring a lawsuit against the directors or management for violating their fiduciary duties on behalf of the company in situations in which the board of directors or supervisors fail to bring suit.

– Lindsay Zhu

SAFE OPENS DOOR FOR DOMESTIC RESIDENTS’ OFFSHORE FINANCING AND RETURN INVESTMENT

Key Points:

- *Various registrations required*
- *Repatriation of income through SPC*

On October 21, 2005, the State Administration of Foreign Exchange (“SAFE”) promulgated Circular No. 75 (the “Circular”), concerning domestic residents’ (*jumin*) overseas financing and return investment through offshore special purpose companies (“SPC”). The Circular, which took effect on November 1, 2005, annuls previous SAFE Circulars No. 11 and No. 29, both limiting such operations for *jumin*.

The Circular contains numerous definitions. Under the Circular, the terms “domestic residents,” or *jumin*, includes domestic resident legal persons and domestic resident natural persons. “Domestic resident natural persons,” in turn, include all PRC citizens, whether or not living in the PRC, as well as ***all foreigners habitually living in the PRC for***

reasons related to their economic interests. (Note: “habitually,” in practice, usually refers to “cumulatively living in the PRC for 183 days or more or continuously living in the PRC for 90 days or more per calendar year, with a taxable income.”) “Offshore special purpose companies” is defined as offshore companies directly established or indirectly controlled by *jumin* for the purpose of overseas equity fundraising (including financings using convertible notes), with assets or rights and interests in domestic enterprises owned by such persons. The Circular defines “control” as acquisition of any right of operation, profit or decision making with respect to any SPC or any domestic enterprise through acquisition, trusteeship, holding through agency, voting right, repurchase or convertible bonds. “Return investment” means direct investment within the PRC by *jumin* through SPC by the way of, including without limitation: (1) purchase or swap of the PRC party’s shareholding in domestic enterprises; (2) establishments of foreign investment enterprises; and (3) enterprise purchases or acquisition of control of domestic assets by agreement (including where such acquired assets are used to establish foreign investment enterprises or to increase the domestic enterprise’s registered capital levels in the foreign investment enterprise).

The Circular requires *jumin*, before they establish or control an SPC, to register overseas investment foreign exchange with the local SAFE office with required documents including an application letter providing information regarding the domestic enterprise, shareholding of the SPC and offshore financing plan; the incorporation certificate of the domestic resident legal person or identification of the domestic resident natural person; the offshore financing plan; and the verification document regarding the source of foreign exchange and the

approval regarding the overseas investment made by the domestic resident legal person from relevant authorities. To the extent that *jumin* have established or controlled an SPC prior to the effectiveness of the Circular, but have not registered such investment with the SAFE, they are required prior to March 31, 2006 to file a supplementary registration with the SAFE office where the *jumin* are located. In addition, following such supplementary registration, *jumin*, among other things, must (1) update registrations or records with the SAFE for certain events relating to the SPC; (2) repatriate any foreign exchange income received by the SPC within 180 days of receipt; and (3) repatriate specified amounts of funds raised for domestic use as provided in the *jumin*’s financing plan after completion of offshore fundraising through the SPC.

When SPCs use capital raised from offshore financings for return investment or to provide shareholder loans or other debt capital to a domestic enterprise, domestic enterprises are to follow currently effective laws and regulations relating to formalities in connection with foreign exchange administration. After completing overseas investment foreign exchange registration and corresponding registration of corporate changes (such as increases in registered capital), *jumin* may pay SPC profits, dividends and proceedings from such events as liquidation, share transfer and decreasing of registered capital. – *Wei Zhong*

PRC REVISES SECURITIES LAW

Key Points:

- *Improves public investor protection*
- *Strengthens regulatory measures*
- *Provides for flexible market development and innovation*

Dramatically amended, the new PRC Securities Law (“New Law”) is aimed at improving public investor protection and rules of public offerings and listings, strengthening regulatory measures, and also providing flexibility for future development of the capital market and financial innovation.

First, in contrast to the old law, the New Law embraces the flexibility to adopt new regulations in the future that will allow a combination of securities, banking and trust businesses, securities derivatives transactions, financing provided to individual investors by securities companies, and stock transactions by state-owned companies, as well as welcoming more players into the capital market, such as commercial banks.

Second, with an eye to investor protection, the New Law confirms the establishment of Securities Investor Protection Funds and, further, specifies investors’ right to damages in the case of insider trading, market manipulation or fraud.

Third, the New Law takes measures to improve the quality and accountability of listed companies, including provisions for joint liability of the listed companies, controlling shareholders, actual controlling parties and for superior management in the case of false information disclosure, material omissions or misleading

statements. However, at the same time, the thresholds for public offering and listing are also lowered.

Fourth, the New Law provides the CSRC with more tools for investigation while, at the same time, returning to the stock exchanges the power of approval, suspension and termination of listings, all while retaining the power to approve public offerings.

Fifth, the New Law emphasizes legal liabilities for violation and non-compliance with securities laws and regulations, and provides for more severe penalties than before. However, in the eyes of some observers, the criminal penalties for severe violation are not sufficiently strict. – *Zijie Li*

TRADABLE SHARES NOW AVAILABLE TO OVERSEAS INVESTORS

Key Points:

- *Foreign investors granted right to purchase tradable shares*
- *Part of continuing reform of financial markets sector*

Over the years, there has been much criticism of the structural problems resultant from the many “dualities” of China’s capital markets sector, most particularly the distinction between the A and B share capital markets and the distinction between tradable and non-tradable shares. However, reform of China’s capital markets sector has been afoot and ongoing. The late 2002 liberalization of the financial markets saw qualified foreign institutional investors (QFIIs) being granted the right to invest in China’s A-Share capital market in which shares are traded in RMB. Prior to that reform,

QFIs were restricted to the B-Share market in which shares were traded in foreign currency. In September of this year, as part of ongoing capital markets restructuring, China went further by effectively undertaking a merger of the tradable and non-tradable share markets. This reform was almost immediately followed by the announcement by some 40 A-market listed companies – of which half are state owned – of an intention to launch the flotation of their non-tradable shares on the Shenzhen and Shanghai bourses.

Now matters of reform have progressed even further. As part of the ongoing reform of capital markets and state-owned assets management, and in a move designed to reinvigorate these sectors, overseas strategic investors are now permitted to directly purchase tradable shares, a move designed to operate in parallel with the abovementioned system that permits overseas strategic investors to invest in tradable shares via QFIs. China's capital markets restructuring efforts will soon witness two-thirds of state-owned non-tradable shares being converted into newly floating tradable shares that are expected to fetch a staggering RMB 200 billion. – *Diarmuid O'Brien*

US BADGERS CHINA ON PIRACY WAR AND CHINA'S RECENT EFFORTS TO CRACK DOWN ON ONLINE COPYRIGHT INFRINGEMENT

Key Points:

- ***China urged to improve copyright protection***
- ***Asked to provide proof of action, clarify position on WTO IP agreement***

The *South China Morning Post* has reported that, after years of speaking softly, the United States is again “wielding a big stick” against China on the “nagging issue” of intellectual property rights, as the issue is weighing more heavily on Sino-US relations. Jon Dudas, chief adviser on intellectual property issues for President Bush and also director of the US Patent and Trademark Office, came to Beijing the first week of November to impress upon Beijing the importance of improving its copyright protection regimen, preceded by a formal request the week before for China to provide specific case-by-case proof of action and clarify its position on counterfeiting and IPR infringement under Article 63.3 of a World Trade Organization (“WTO”) agreement known as Trade-Related Aspects of Intellectual Property Rights (“TRIPS”). Such a formal request for clarification under Article 63.3 could theoretically provide evidence for the United States to build a case and take further action through the WTO under Article 64.

“Under pressure from Congress, the administration started a WTO review process in April, which officially put China on an IPR watch list,” said James Zimmerman, a partner at Squire Sanders and vice chairman of AmCham China. “Congress wanted the US trade representative to file a more formal complaint under the TRIPS agreement, but the [representative’s] strategy was to engage China in the consultation process, which is likely to be more effective.”

In other news, the General Administration of Press and Publication and National Copyright Administration of China recently announced that the government will take strong action against violators to protect intellectual property rights. In recent years, online downloading has become a major channel by which internationally pirated videos and Internet games have entered the

Chinese cultural market. These actions seriously violate the legal interests of copyright owners, as exemplified by a recent lawsuit against the leading Chinese search engine Baidu for providing free music downloads. Several global media corporations including Universal, TimeWarner, EMI and Sony BMG are seeking 1.67 million yuan (US\$206,000) in compensation. – *Jie Chen*

CHINA TO ADOPT ITS FIRST ANTI-MONOPOLY LAW

Key Point:

- ***Will prohibit monopoly agreements, abuse of dominant market position and control of concentration***

Several existing Chinese laws and regulations, such as the PRC Anti-Unfair Competition Law and the PRC Pricing Law, cover anti-monopoly law issues. The most recent set of regulations, the Provisional Rules on Merges with and Acquisition of Domestic Enterprise by Foreign Investors (the “Provisional Rules”), imposed a notification obligation on foreign acquiring or merging parties when the volume of the proposed merger or acquisition reached a certain level. However, China’s existing anti-monopoly laws and regulations have been, in general, vague, fragmented and not systematically enforced.

Since 1994, a working group organized by several government agencies and academic institutions has been drafting a comprehensive Anti-Monopoly Law. Following approximately 10 years of effort, the group released its latest draft this past July (the “Draft”), which is expected to receive final approval from the Chinese legislature in 2006.

The Draft provides that the law is to prohibit “monopolistic conduct,” which can be classified into three categories: (1) monopoly agreements; (2) abuse of dominant market position; and (3) control of concentration. According to the Draft, “monopoly agreements” means any agreement, decision or concerted action among competitors with the purpose or effect of eliminating or restricting competition, and “dominant market position” refers to the market power of one or several market participants as a whole to control the price or quality of products or other trading conditions in the relevant markets. The “control of concentration” section of the Draft requires that mergers, acquisitions or other transactions qualifying as “concentrated” be reported to the anti-monopoly authorities before the transaction is executed, a control mechanism similar to the notification obligation of the Provisional Rules. As the Draft is written, the law, if adopted, may apply to both monopolistic conduct taking place, or having taken place, inside or outside the territory of China if it has the effect of eliminating or restricting competition in China.

The Draft provides for the establishment of a special anti-monopoly authority to take charge of anti-monopoly issues. At present, the Ministry of Commerce (“MOFCOM”) and the State Administration of Industry and Commerce (“SAIC”) are dealing with some anti-monopoly issues concurrently. For example, under the Provisional Rules, the authorities to which foreign investors are required to report are MOFCOM and SAIC. Given the shortage of qualified personnel and varying departmental politics among government agencies, it has not been easy for China to establish a nationwide anti-monopoly enforcement entity. Some observers are expecting that instead of establishing a separate entity, the Chinese government may

establish an anti-monopoly authority inside MOFCOM or SAIC, using relevant personnel from the two agencies.

– Guojun Ye

MOFCOM ISSUES CONSULTATION DRAFT ON FOREIGN-INVESTED CONSTRUCTION AND ENGINEERING SERVICE ENTERPRISE MEASURES

Key Points:

- *Foreign-invested construction and engineering service enterprises defined*
- *Application procedures: approval, registration and qualification*

MOFCOM promulgated a Draft on October 9, 2005, that remained open to the public for comments until October 15, 2005. Its proposed new measures aim to regulate the establishment of foreign-invested construction and engineering services. **These measures are expected to become effective on December 11, 2006.**

“Foreign-invested construction and engineering service enterprises” are defined as “foreign-invested construction engineering supervision enterprises,” “foreign-invested construction engineering tendering agency enterprises” and “foreign-invested construction engineering cost consultancy enterprises.”

In order to set up the abovementioned foreign-invested enterprises, applicants are required to obtain approval from the appropriate authorities of commerce. A-level applicants are required to apply to MOFCOM, while B-level or below applicants are required to apply to provincial authorities of commerce. In addition, the

applicants are required to register with the appropriate Administration of Industry and Commerce within 30 days of approval. Thereafter, qualifications (A-level, B-level or C-level) must be obtained from appropriate construction authorities. Application procedures and relevant documentation lists are detailed in the Draft.

The Draft also stipulates that foreign investors must contribute no less than 25% of registered capital. The foreign investors or service providers must engage in relevant engineering consultancy services in their countries or be certified professional technicians, as well as show evidence of related engineering services achievements. – Carole Fan

Presentations, Articles and Publications

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

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

Amy L. Sommers, "Foreign Investment Verification: Reform, Status Quo, or Bafflement?," *China Business Review*, November-December 2005. Access to the article is available at:

http://www.ssd.com/publications/pub_detail.aspx?pubid=9426

©Squire, Sanders & Dempsey L.L.P.
All rights reserved
November 2005

This newsletter provides free information on the influence of certain aspects of the Chinese legal environment and does not constitute legal advice.

Squire Sanders Contacts:

<p>BEIJING</p> <p>Daniel F. Roules Sungbo Shim James M. Zimmerman Squire, Sanders & Dempsey L.L.P. Suite 2501, 25th Floor, North Tower Beijing Kerry Centre 1 Guanghua Road, Chaoyang District Beijing 100020, China +86.10.8529.6998 Email: droules@ssd.com sshim@ssd.com jzimmerman@ssd.com</p>	<p>SHANGHAI</p> <p>Daniel F. Roules Amy L. Sommers Squire, Sanders & Dempsey L.L.P. Suite 1207, 12th Floor Shanghai Kerry Centre 1515 Nanjing Road West Shanghai 200040, China +86.21.6103.6300 Email: droules@ssd.com asommers@ssd.com</p>
<p>HONG KONG</p> <p>James Tsang John Lo Squire, Sanders & Dempsey Room 4008 Gloucester Tower The Landmark, 11 Pedder Street Central, Hong Kong +852.2509.9977 Email: jtsang@ssd.com jlo@ssd.com</p>	<p>TOKYO</p> <p>Ken Kurosu Steven S. Doi Squire Sanders Gaikokuho Kyodo Jigyo Horitsu Jimusho Ebisu Prime Square Tower, 16/F 1-1-39 Hiroo Shibuya-ku, Tokyo 150-0012 Japan +81.3.5774.1800 Email: kkurosu@ssd.com sdoi@ssd.com</p>



Asia • Beijing • Hong Kong • Shanghai • Tokyo

Europe • Bratislava • Brussels • Budapest • London • Madrid • Milan • Moscow
Prague • Warsaw

North America • Cincinnati • Cleveland • Columbus • Houston • Los Angeles • Miami
New York • Palo Alto • Phoenix • San Francisco • Tallahassee • Tampa
Tysons Corner • Washington DC • West Palm Beach

Latin America • Caracas • Rio de Janeiro • Santo Domingo

Associated Offices • Bucharest • Buenos Aires • Dublin • Kyiv • Santiago