



## CHINA UPDATE 2006

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## Mainland and Hong Kong Finalize Treaty on Enforcement of Court Judgments

### Key Point:

- **Arbitration likely to remain the forum of choice in cross-border contracts**

Mainland China and the Hong Kong SAR recently announced finalization of a treaty that will allow for the reciprocal enforcement of monetary commercial court judgments in each other's jurisdiction. This treaty, likely to be effective at the end of this year, complements the recently concluded Mutual Arrangement between the two jurisdictions, which allows for the reciprocal enforcement of commercial arbitration awards in each other's jurisdiction. The treaty could be significant in terms of commercial agreements between mainland Chinese and Hong Kong parties, enabling a successful litigant to apply for enforcement in the jurisdiction of the other party. While the exact content of the new treaty is unknown, it is clear that if litigation is preferred to arbitration, such agreements will need to contain a definitive clause providing for dispute resolution before the courts in either mainland China or the Hong Kong SAR, as the case may be, but not both. The treaty is unlikely to alter the current legal obligation of mainland parties to resolve commercial disputes, *inter se*, before the mainland courts or an approved mainland arbitral commission.

Like the Mutual Arrangement, this treaty will contain escape provisions that allow the courts in one jurisdiction to refuse enforcement of a commercial court judgment issued in the other. Although the treaty is still being finalized, it is safe to say that these escape provisions are likely to substantively mirror the exemptions in the Mutual Arrangement including:

- i. the incapacitation of a party to an agreement for litigation;
- ii. failure to serve notice of litigation on a party, or the inability of a party to present its case;
- iii. when a matter falls outside the remit of a court judgment's provision for litigation;
- iv. inconsistency of the procedures adopted with the agreement of the parties or the law of the jurisdiction where the litigation occurred;
- v. a court judgment that is not yet binding on the parties or that is subject to appeal, or has been set aside or suspended.

Enforcement will also be denied in Hong Kong where enforcement would be contrary to public policy, and will be denied in the mainland if it would be contrary to the latter's public policy.

The treaty is further evidence of the tremendous growth in economic integration between the two jurisdictions over the past five years, especially

since the mainland and Hong Kong began implementing the Closer Economic Partnership Agreement. Notwithstanding the treaty, however, due to the general lack of familiarity with litigation procedures in the other's jurisdiction, arbitration is likely to remain the forum of choice for dispute resolution between parties entering mainland/Hong Kong cross-border contracts. The treaty will be finalized and effective later in the year.

– *Diarmuid O'Brien*

### China Preparing to Begin Government Procurement Agreement (“GPA”) Negotiations

**Key Points:**

- *China will start negotiations to join the GPA countries by the end of 2007*
- *More work needs to be done before China can join*

According to some recent news reports, China is preparing to enter negotiations to join the group of countries subject to the Government Procurement Agreement (“GPA”). The GPA will allow companies of member countries to bid for government contracts in other member countries. GPA is a World Trade Organization agreement, although it is not mandatory for WTO members to join the GPA.

When China joined the WTO in 2001, however, it promised to initiate negotiations for membership in

the GPA “as soon as possible.” Also, China has promised to open its government procurement market to Asian-Pacific Economic Cooperation (“APEC”) members by 2020. According to PRC Minister of Commerce Yu Guangzhou, China will start GPA negotiations by the end of 2007.

To implement its promise, China has carried out a series of measures to prepare for GPA membership. In 2002, it issued the Government Procurement Law (effective January 1, 2003) and relevant regulations as the basis for the country's procurement system. However, as Mr. Yu indicated, China's government procurement system is still in its initial stages, and this sector still lacks specialists and complete operational mechanisms. Some terms in the Government Procurement Law are obscure and misleading and may cause problems in practice. For example, the term “medium and small sized enterprises” is used in the law, but its definition is unclear. Work remains to be done before China is fully ready to join the GPA countries.

This could be good news for suppliers from outside the country who wish to participate in China's government procurement market. While non-Chinese companies may already participate in the Chinese government procurement process, observers believe that by joining the GPA membership, China will further open up its

government procurement market and improve transparency in its government procurement procedures.

– *Liu JingNan (Jennifer)*

## China Resumes IPOs and Listings

### **Key Point:**

- *Measures follow principles in newly revised Securities Law*
- *Provide for stricter requirements*

On May 17, 2006 the PRC securities authority issued the Administrative Measures on Initial Public Offering and Listing of Shares, signifying the resumption of approval for initial public offerings and stock listing in China after a suspension of over one year. These Measures, which follow the principles in the newly revised Securities Law, provide for stricter requirements than previous measures regarding corporate governance and clarify the financial status of qualified issuers and disclosure by publicly traded companies.

Notably, under these measures, all shares of newly listed issuers will be transferable in the stock markets, including those held by founders and strategic investors, which will be transferable subject to lockup periods. China CAMC Engineering Co., the first company approved for listing after the Measures came into being, has already begun its public trading on the Small and Medium Enterprise (SME) Board of the Shenzhen Stock Exchange.

Even before the resumption of new IPO and stock listing approval, more than half of the existing listed companies had gone through the process of changing all of their shares that were previously not transferable into transferable shares. It is likely that within the year, China will have an integrated stock market without the previous segregation between shares held by founders and strategic investors, which were not transferable on the public stock market, and transferable shares.

The resumption of IPOs and listings in an integrated stock market has significance to investors from outside China. As opposed to the situation before the resumption, in which investors from outside China had no exit channels in the open market, shares privately placed with non-Chinese strategic investors may now be traded on the public market, subject to applicable lockup periods. This should certainly inspire non-Chinese investors to become enthusiastic strategic investors in Chinese companies. In December 2005, relevant authorities issued the Administrative Measures on Strategic Investment by Foreign Investors in Listed Companies (“Strategic Investment Measures”), which provided qualifications, documentation requirements and stock dealing conditions needed for strategic investment by non-Chinese investors. In addition, in a complementary amendment, non-Chinese holding companies registered in China have been given the capacity as foreign investors to qualify to invest in listing companies or to be listed

as strategic investors, applying the above Strategic Investment Measures.

– *Li Zijie (Lesley)*

## New Regulation Strengthens Protection of Copyrighted Work on the Internet

### Key Points:

- *Requires royalty payment to copyright holders*
- *Provides penalties for infringement*

On May 18, 2006, the State Council promulgated a new regulation to strengthen the protection of copyrighted work disseminated over the Internet. China is preparing to sign the Internet Treaty under the World Intellectual Property Organization (“WIPO”), and this regulation is a part of a package of regulations required of countries joining the treaty.

While the PRC Copyright Law grants copyright owners the right to publish or disseminate works over wired and wireless networks, the new regulation focuses on publication or dissemination over the Internet and provides a range of protection for works published there, as well as penalties for copyright infringement.

The regulation requires persons who disseminate a copyrighted work through the Internet to obtain authorization from the copyright owner and pay royalties to the owner. In certain circumstances

such as educational uses, where authorization is not required, users such as universities must adopt proper technical measures to prevent the work from being accessed by the public.

The administrative government office has the authority to investigate possible copyright infringements. The government office may request the network administrator or owner to provide detailed information on the suspected infringer if it believes an infringement has occurred, such as name, contact information, IP address and other necessary information. If the network provider, administrator or owner refuses to cooperate with the government, the authority may confiscate that provider’s equipment.

If the copyright owner discovers that his or her work has been offered, linked to or stored in any Internet space without permission, he or she may send a written notice to the network administrator or owner. The network administrator or owner must suspend all access to the work immediately and notify the client who added the link or stored the work on the network. If the network administrator or owner receives a written counterargument from the client, the administrator or owner must reactivate the link and access to the stored work to the public and forward the counterargument to the alleged copyright owner. The administrator or owner is then exempt from further obligation and liability in connection to the disputed copyright issue.

The regulation also specifies penalties for violations. Copyright holders will have the right to claim civil damages against parties for unauthorized dissemination of their work on the Internet or for offering techniques or means by which to bypass technical measures in place for protecting their work on a network. The infringer or violator may also be fined by the authority and its illegal income may be confiscated.

The authority may confiscate the equipment of, impose an RMB100,000 fine upon, and even pursue criminal prosecution of parties who develop, import or offer the means by which to bypass copyright protection techniques or equipment.

– *Weiheng Jia*

## CSRC Issues Draft Rules Concerning Acquisition of Listed Companies

### Key Points:

- *Foreign acquisitions permitted*
- *Full bid offer is voluntary*
- *Payment by stock or asset allowed*

China's securities regulator, the China Securities Regulatory Commission ("CSRC"), has provided new draft rules on the acquisition of listed companies for public comment. Under these draft rules, non-Chinese investors (exclusive of non-Chinese individuals) are permitted to acquire shares of listed companies, provided that such

acquisitions are approved by relevant state departments and compliant with industry access permit and industry policy, and that these investors submit to China's justice and arbitration jurisdiction.

In accordance with the draft rules, 5% shareholding by an investor of a listed company is the initial threshold of acquisition, which will be subject to disclosure obligations. The same disclosure obligations apply to each 5% increase or decrease thereafter of the shareholding in a listed company, while 20% or more of shareholding of a listed company by an investor will be subject to the obligation of more detailed disclosure. If an investor holding 30% of the shares of a listed company plans to increase its shareholding in the subject company, it must make a tender offer unless it obtains a waiver from the CSRC.

A major change proposed by the new draft rules is that the acquiring party is no longer required to make a tender offer for all of the outstanding shares of the target company. The new draft rules make the full bid offer voluntary. However, in a tender offer, the acquiring company will be required to take over at least 5% of the issued and outstanding shares of the target company.

The offer price of a tender offer cannot be lower than the higher of: (i) the highest price at which the acquirer bought the shares within six months prior to the date on which the offer is made; or (ii) the arithmetic average of the daily weighted average

price of the shares within 30 trading days prior to the date on which the offer is made. If part of the shares of the target company are not listed and traded and the price of the unlisted shares is not consistent with the listed shares, the takeover offer price of the listed shares will be determined pursuant to the stipulations described in the preceding paragraph. The takeover offer price for the unlisted shares will not be lower than the higher of: (i) the highest price a purchaser pays for the unlisted shares of the target company within six months prior to the date on which the tender announcement is made; or (ii) the latest audited net asset value of each share of the target company.

The draft rules also regulate management buyouts and indirect acquisitions. Listed companies

conducting management buyouts have stricter corporate governance requirements imposed upon them. The same disclosure obligations apply to indirect acquisitions.

Under the draft rules, shares acquired by takeover of a listed company are not allowed to be transferred within 12 months of completion of the acquisition, unless the shares are to be transferred between entities under the control of the same entity.

Under the draft rules, when making acquisitions in public companies, acquirers must appoint a financial adviser certified by the CSRC.

– *Wei Zhong*

## Articles and Publications

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

<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](http://www.ssd.com/publications/pub_detail.aspx?pubid=9426)

“Cal Law 2005 Roundtable Series: Doing Business in China,” *GC California Magazine*, November 2005. The article features **Jerome J. Joondeph Jr.**, partner in Squire Sanders’ Palo Alto office, on a panel discussing US companies and law firms setting up operations in China. Access to the article is available at: [http://www.ssd.com/resources/news\\_detail.aspx?newsid=12381](http://www.ssd.com/resources/news_detail.aspx?newsid=12381)

**Wei Zhong**, “Legal Analysis for International Protection of Chinese Brands,” *China Development Observation*, Issue 12, 2005. Mr. Zhong is an associate in Squire Sanders’ Beijing office. *China Development Observation* is a journal published by the State Council Development Research Center, the most influential think tank in China. Access to the article (in Chinese) is available at: <http://www.chinado.cn/ReadNews.asp?NewsID=466>

**Aaron R. Winger**, “Awareness of Foreign Filing Requirements for Inventions Originating Abroad Prevents Adverse Consequences for Foreign Investors,” *New Matter* (quarterly publication of the Intellectual Property Section of the California State Bar), Vol. 31, No. 1. Mr. Winger is a national partner in Squire Sanders’ Shanghai and Palo Alto offices.

**Dan Roules**, partner in Squire Sanders’ Shanghai and Beijing offices, was quoted about the economic climate of China in an article, “Keeping Pace: Fast-Moving Markets Bring New Challenges,” in the March 2006 issue of *Counsel to Counsel* magazine. The article is available on the Squire Sanders website at: [http://www.ssd.com/publications/pub\\_detail.aspx?pubid=9555](http://www.ssd.com/publications/pub_detail.aspx?pubid=9555)

*China Alert*, "Revised PRC Company Law Leads to Contradictions: Representative Offices, Branches and Liaison Offices of Domestic Companies (Including FIEs)," April 2006. The article is available on the Squire Sanders website at:

[http://www.ssd.com/publications/pub\\_detail.aspx?pubid=9557](http://www.ssd.com/publications/pub_detail.aspx?pubid=9557)

**Amy L. Sommers** and **Ju (Lindsay) Zhu**, "The Amended Law to the Company Law of the People's Republic of China: Encouraging Foreign Investment, Strengthening Shareholder Protections," *Bloomberg Corporate Law Journal*, Spring 2006.

## Presentations and Recent Events

**James M. Zimmerman**, partner in Squire Sanders' Beijing office, was a speaker at China Day, a program sponsored by United Commercial Bank Holdings, on June 26, 2006 in New York City.

**Mr. Zimmerman** will serve as a moderator at a plenary session, "Hot Topics in Asia," at the American Bar Association Annual Meeting in Honolulu, Hawaii on August 5, 2006.

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

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