

2003 Year in Review: China Law

MICHAEL E. BURKE, QIANG BJORNBAK, ADAM F. BOBROW, FAYUN CHEN, EDWARD E. LEHMAN, THOMAS P. REDICK, AND LIHONG (JULIA) ZHU*

This article highlights selected 2003 legal developments in the People's Republic of China (PRC or China). In 2003, legal developments in China continued at a brisk pace as the PRC central government worked to implement not only many of the commitments it made as part of its accession to the World Trade Organization (WTO) but also its aims to further develop certain industrial sectors, increase protection for innovation, and to monitor and regulate commercial activity. To achieve these goals, *inter alia*, the PRC central government reorganized and restructured several major government agencies, notably, it created a new Ministry of Commerce (MOFCOM) to oversee foreign investment in China and to coordinate international trade and economic cooperation. In addition, China concluded significant free trade agreements, referred to as Closer Economic Partnership Agreements with the two Special Administrative Regions of Hong Kong and of Macau. Several new foreign investment regulations were issued, including clarifications of the regulations governing mergers and acquisitions of domestic Chinese enterprises by foreign investors and also the formation of joint venture foreign trade

companies. Certain international trade issues, such as the United States' use of a WTO-compliant safeguard against Chinese textiles, emerged in 2003. China's intellectual property regulation and enforcement processes continued to strengthen, and China continued to build its legal infrastructure in the foreign exchange and financial services sector. China also developed several important covering its telecommunications sector.

I. Government Reform

Among other changes, the Tenth National People's Congress approved the State Council's reform plan on March 10, 2003 to fold the State Economic and Trade Commission (SETC) and Ministry of Foreign Trade and Economic Cooperation (MOFTEC) into a newly established MOFCOM. MOFCOM assumed responsibilities both as China's primary regulator of foreign investment as well as coordinator of China's domestic and foreign trade and international economic cooperation. Moreover, MOFCOM is to develop relevant laws and regulations to implement China's WTO commitments.

The State Council's reform plan also (1) established a State Asset Management Commission and a Banking Supervision and Administration Commission; (2) renamed and restructured the State Development and Planning Commission (SDPC) to be the State

Development and Reform Commission (SDRC), the State Family Planning Commission to be the State Population and Family Planning Commission, and the State Drug Administration to be the State Food and Drug Administration; and (3) moved the State Administration of Work Safety to be directly under the supervision of the State Council.

II. Closer Economic Partnership Agreements

On June 29, 2003, representatives from the Hong Kong Special Administrative Region and China signed the *Mainland/Hong Kong Closer Economic Partnership Arrangement (CEPA)*, consisting of twenty-three articles and six attachments, including (1) *Arrangements for Implementation of Zero Tariff on Trade in Goods*; (2) *Rules of Origin for Trade in Goods*; (3) *Procedures for Issuance and Verification of Certificates of Origin*; (4) *Specific Commitments on Liberalization of Trade in Services*; (5) *Definition of Service Provider and Relevant Regulations*; and (6) *Trade and Investment Facilitation*. The CEPA was effective as of June 29, 2003, and the six attachments were effective on September 29, 2003, their date of signature. On October 17, 2003, the governments of China and the Macau Special Administrative Region signed the *Mainland/Macau Closer Economic Partnership Arrangement (Mainland/Macau CEPA)*, effective as of that date. The Mainland/Macau CEPA is substantially similar to the CEPA, and

this section of the article will focus on reviewing the CEPA.

The CEPA reduces or eliminates tariffs and non-tariff barriers on substantially all the trade in goods and services, and addresses trade facilitation between China and Hong Kong. As of January 1, 2004, zero tariff rates will apply for 273 categories of goods from Hong Kong. Duty free treatment will be phased in on additional Hong Kong products through the end of 2005. In addition, pursuant to the CEPA, China has committed to not apply quotas to goods of Hong Kong origin. Further, the CEPA mandates that no anti-dumping and countervailing measures may be applied to goods imported from and originated in the territory of either party.

Because Hong Kong is a significant trans-shipment point for goods and the site for many foreign service firms, the major issue in the negotiation of CEPA was the applicable rule of origin for goods and the definition of a Hong Kong service supplier. In the case of goods, the general rule of origin applied is substantial transformation or originating in the territory. The definition of a Hong Kong Service Supplier is generally a natural or juridical person but it is slightly different for each of the 18 categories of service supplier.

The CEPA liberalizes cross-border supply in eighteen service sectors. While Hong Kong's services liberalization commitments are the subject of continuing negotiations, China

also made services liberalization commitments in several sectors, including financial services, five value-added telecommunications services sectors (such as internet data center services, store and forwarding services, call center services, internet access services, and content services), and specified professional services (such as architectural services, engineering services, integrated engineering services, urban planning services, real estate services, advertising services, management consulting services, convention and exhibition services, transportation services, tourism and travel related services). The CEPA provides for the strengthening of cooperation in seven fields, including (1) promotion of trade and investment; (2) facilitation of customs clearance; (3) quarantine and inspection of commodities; (4) food safety and quality assurance; (5) electronic commerce; (6) transparency in laws and regulations, and (7) cooperation between small and medium-sized enterprises in the Chinese medicine and pharmaceutical industries. The parties may add other areas to this list, as agreed from time to time.

III. Foreign Investment Regulation

A. VENTURE CAPITAL ENTERPRISES

On January 30, 2003 the-then MOFTEC, Ministry of Science and Technology (MOST), State Administration for Industry and Commerce (SAIC), State Administration of Taxation

(SAT), and State Administration of Foreign Exchange (SAFE) jointly issued the *Regulation on the Administration of Foreign-Invested Venture Capital Enterprises*. In eight chapters and fifty-one articles, the regulation covers the creation, operation, and dissolution of foreign-invested venture capital enterprises (FIVCEs), foreign-invested enterprises that engage in venture capital activities. Article 3 of the regulation defines VC investment activities as equity investments in nonlisted high-technology companies, the provision of VC management services, and the attainment of capital gains over time. FIVCEs are to have between two and 50 investors, including at least one "principal investor." The principal investor is intended to serve as the FIVCE's manager. Each regular FIVCE investor must make a minimum capital contribution of US\$1 million. Aggregate capitalization from regular investors in partnership FIVCEs must exceed US\$10 million, and aggregate capitalization from regular investors in a corporate FIVCE must exceed US\$5 million. In addition to quantitative requirements, FIVCEs must have appropriate formation documents, employ more than three professional staff people with experience in venture capital investment. The principal investor must be an experienced venture capitalist who has overseen US\$100 million in investment (of which US\$50 million must be focused on venture capital) during three years prior to the FIVCE creation. A Chinese principal

investor must have overseen RMB100 million (US\$12.08 million) half of which was venture capital-focused during the three years prior to the FIVCE formation. An FIVCE's term is to be stipulated in its organizational documents, and normally may not exceed 12 years.

A FIVCE is restricted to investing its own funds in unlisted equities, providing venture capital investment consulting, providing management consulting to investee enterprises, or engaging in other operations as approved. Investments by a FIVCE must comply with the *Catalogue Guiding Foreign Investment in Industry* and the *Regulation on Guiding Foreign Investment Direction*. A FIVCE may not invest in projects that the catalogue lists as prohibited; directly or indirectly invest in listed securities (except where the FIVCE holds the securities following the investee's initial public offering); directly or indirectly invest in fixed assets that are not for its own use; or invest in other projects as prohibited by laws, regulations, or the FIVCE's formation documents. FIVCEs may not invest through loans or any funds other than the FIVCE's own funds, or provide credit or guarantees (excluding investment in bonds issued by an investee company or convertible bonds with a term of at least one year). FIVCE investments, and increases and transfers of, are subject to an approval and registration process. Investments into an encouraged or permitted category entity require the FIVCE to notify the local-level MOFCOM

where the investee is located. The local MOC must conclude its review and, if approved, issue an FIE Approval Certificate within 15 days of its receipt of completed application materials.

Investments into a restricted category entity require the same notification to the local-level MOFCOM, although the local MOFCOM has 45, not fifteen, days to review the investment application.

B. EQUITY JOINT FOREIGN TRADE CORPORATIONS

On January 31, 2003, the-then MOFTEC issued the *Interim Measures Governing the Establishment of Chinese-Foreign Equity Joint Foreign Trade Corporations*. Investors seeking to form a Chinese-Foreign Equity Joint Foreign Trade Corporation (CEJFTC), must have an average annual foreign trade value with China exceeding US\$30 million in the three years before application; investors forming a CEJFTC to be registered in China's western provinces must have an average annual foreign trade value with China exceeding US\$20 million in the three years before application. A CEJFTC's registered capital must exceed RMB50 million (RMB30 million if the CEFTJC is located in China's western provinces), and a foreign investor is to provide at least 25% of the venture's registered capital. The parties' capital contributions may be made in cash, tangible property, and intangible assets (such as industrial properties, special technologies

and a right to use a site). A CEJFTC may import and export cargo, technology, services, and commodities as an agent or for its own account. A CEJFTC is to have its own name and operational infrastructure suitable for the foreign trade business.

C. SINO-FOREIGN COOPERATIVE EDUCATION

On March 1, 2003, the State Council issued the *Regulations of the People's Republic of China on Sino-Foreign Cooperative Education (Education Regulations)* to strengthen the development of foreign educational exchange and cooperation programs. The *Education Regulations* encourage Sino-foreign efforts in higher education and occupational education. The *Education Regulations* prohibit the establishment of educational institutions to engage in compulsory education, military, police and politics education, and religious education. The value of investors' intellectual property investment may not exceed one-third of the educational institutions' registered capital, except for foreign educational institutions that are invited by Chinese government to run a school in China. The *Education Regulations* mandate a licensing procedure for investors to follow, and prohibits the arbitrary collection of fees. Fees and related items are to be determined and publicized as provided in relevant regulations, and such fees, which must be paid in *renminbi*, may not be increased without advance government approval.

D. MERGERS AND ACQUISITIONS OF DOMESTIC ENTERPRISES BY FOREIGN INVESTORS

On March 7, 2003, the then-MOFTEC, SAT, SAIC, and SAFE jointly issued the *Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (M&A Provisions)*. The *M&A Provisions* allows foreign investors to acquire stock and assets of domestic Chinese enterprises. Such acquisitions may be accomplished through the purchase of the outstanding equity of shareholders in a domestic Chinese enterprise or through a subscription of newly issued shares of such a company. In either case, the domestic company will be converted into a foreign invested enterprise (FIE) upon the purchase. Alternatively, a foreign investor may purchase a domestic enterprise's assets and then either operate those assets through an existing FIE or contribute those assets to a newly formed FIE. In equity acquisitions, the resulting FIE will succeed to the obligations to creditors of the prior domestic enterprise. In an asset acquisition, the selling domestic company will retain its creditor obligations. The foreign investor, the domestic enterprise, and other parties may enter into agreements regarding the disposition of rights and obligations of the domestic company, provided such arrangements do not harm the interests of third parties or the public. Both equity acquisitions and asset acquisitions must be approved by MOFCOM or its provincial-level branches and such be

registered with the local SAIC bureau. The *M&A Provisions* require that the purchase price to be based on an appraisal of the equity interest or the assets to be sold – sale at a price below an appraised value is expressly prohibited.

The *M&A Provisions* requires the reporting and review of transactions that may result in excessive market concentration. The foreign investor must obtain MOFCOM and SAIC approval if an intended transaction would involve (1) a party to the intended transaction has a business turnover in the China market that exceeds RMB1.5 billion; (2) the aggregate number of mergers and acquisitions of domestic enterprises in the relevant industry in China during the past year exceeds ten; (3) a party to the intended transaction holds a share of the relevant Chinese market that equals or exceeds 20%; or (4) the transaction will result in the share of the Chinese market of a party to the transaction reaching 25%. Even if the proposed transaction does not meet any of the foregoing circumstances, MOFCOM or SAIC may still require the foreign investor to submit a report if any competing domestic company, relevant authority, or industrial association so requests, or upon MOFCOM's or SAIC's own initiative. If reporting is required, MOFCOM and SAIC must convene a hearing with relevant state departments, bodies, and interested parties before approving or rejecting the proposed merger or acquisition. Reporting requirements also

apply to certain offshore transactions, including where (1) a party to the offshore transaction owns assets in China with a value in excess of RMB3 billion; (2) a party to the offshore transaction has a business turnover in excess of RMB1.5 billion in the Chinese market in the then present year; (3) a party to the offshore transaction and its affiliates collectively hold at least 20% of the relevant market share in China; (4) as a result of the offshore transaction, a party to the transaction and its affiliates have acquired a Chinese market share of at least 25%; or (5) as a result of the offshore transaction, a party thereto will, directly or indirectly, hold equity in more than 15 FIE's in the relevant industrial sector in China. A party to the transaction may apply to MOFCOM or SAIC for an exemption from such investigation in specified circumstances. It remains unclear how and whether the reporting requirements and antitrust provisions will be enforced.

E. ESTABLISHMENT OF HOLDING COMPANIES

On June 10, 2003 MOFCOM issued the *Decision Concerning Revision of the Interim Provisions on Foreign Invested Investment Companies and Their Supplementary Regulations (IC Provisions)*. As provided in the *IC Provisions*, a holding company may invest in all sectors that China has opened to foreign investment, such as "encouraged," "permitted," and "restricted"

projects. A holding company may (1) assist or represent its subsidiary enterprises by purchasing machinery, equipment, office equipment and raw materials, components and parts needed in production for its own; (2) sell products manufactured by its subsidiary enterprises in China and abroad, and provide after-sale service; (3) balance foreign exchange, under SAFE supervision, among its subsidiary enterprises; (4) provide its subsidiary enterprises with services such as technical support, sales and market development, training for employees, and intra-enterprise personnel management; and (5) assist its subsidiary enterprises in seeking loans and providing them with guaranty.

There are three requirements to establish a holding company (1) the foreign investor must have total assets exceeding US\$400 million in the year before application; (2) have a foreign-invested enterprise inside China, with registered capital exceeding US\$10 million; and (3) more than three approved investment projects. Alternatively, a foreign investor may satisfy the above requirements by having ten or more foreign-invested enterprises inside the territory of China engaged in the production or infrastructure, with the registered capital exceeding US\$30 million. The Chinese investor must have total assets exceeding RMB100 million in the year before the application, and the venture's registered capital must exceed US\$30 million.

Holding companies that engage in systems integration are allowed to import a certain amount of finished products for resale as part of the system. Separately, a holding company is permitted to import finished products for market testing purposes. In both of these cases, the annual cap on imports has been raised from 20% to 35% of the holding company's registered capital that has been contributed in cash. Holding companies with paid-in capital exceeding US\$30 million are permitted to borrow up to four times their registered capital. The *IC Provisions* allow a holding company with registered capital exceeding US\$100 million to borrow up to six times its registered capital. As a practical matter, establishing holding companies in economic sectors "restricted" to foreign investment remains difficult.

IV. International Trade Regulation

The second anniversary of accession of China's accession to the WTO, December 11, 2003, was marked by little ceremony. That date was the implementation deadline for a variety of specific commitments and an additional round of tariff cuts; some of the developments for the year in the area of trade related directly to the implementation of commitments to change laws increasing liberalization in specified service sectors; and increases in tariff rate quotas for agricultural commodities. For the most part, however, legal activity related to WTO accession

this past year was notably lower and trade relations between Washington and Beijing were punctuated by several unfair trade actions taken by industries in the United States against goods imported from China, culminating in the decision by the U.S. government to utilize the textile safeguard provision of ¶242 of the Working Party Report on China's WTO Accession. The reduction in activity related to trade laws seems unsurprising given the flurries of activity in 2001, as China prepared to accede to the WTO, and in 2002, during its first year of membership. China's slowdown in activity disturbed observers because they recognized 2003 as an opportunity for the Chinese government to make changes, not only in individual laws, but also in rulemaking and legislative procedures. There is some concern as to whether some of the regulations and notices released by the PRC government actually substantially contribute to its capacity to meet or implement its WTO commitments. The transparency commitment to publish trade-related measures for comment before they went into effect went largely unobserved; judicial review of administrative decisions remained generally unavailable; and provincial and other local governments often failed to comply with the accession obligations.

Chinese and U.S. industries, on the other hand, pursued causes of action in a variety of venues. Aside from dumping cases in both countries, several U.S. industries took advantage of

the two China-specific safeguards in U.S. law. Although several cases were initiated with the U.S. International Trade Commission under §421 of the Permanent Normal Trade Status legislation, the President decided in both cases in which market disruption was found, not to impose a safeguard. The ITC concluded the third case with a finding of no market disruption. The U.S. textile industry also filed petitions under the textile-specific safeguard as soon as the regulations implementing the safeguard were published. With regard to three textile product categories, the Committee for the Implementation of Textile Agreements (CITA) did find surges and requested consultations with the Chinese government, requiring China to limit its exports of those products to the U.S.

A. TRADING RIGHTS EXPANDED

China based foreign invested enterprises (FIEs) have been able to import raw materials and other goods for their own use and benefit without the governmental approval for some time. China is now easing restrictions on foreign trading rights for FIEs over a three-year period in accordance with the phase-in schedule detailed in China's WTO accession package. Foreign trading rights were previously extended to FIEs with minority foreign ownership, although implementation of these new rights remains uneven. New regulations that became effective

September 1, 2003 provide full foreign trading rights to domestically funded Chinese companies more than one year prior to the scheduled granting of such rights to FIEs. The new regulations result in a clear discrepancy between the relatively low thresholds for domestically invested foreign trade enterprises compared to the significantly higher thresholds applicable to FIEs.

B. CARTAGENA PROTOCOL

The Cartagena Protocol on Biosafety (Protocol), a treaty regulating biotech crops and other "living modified organisms" (LMOs) produced using modern gene-splicing methods, entered into force on September 11, 2003. As of December 10, 2003, a total of 78 nations had ratified the Protocol. China has signed, but not yet ratified the biosafety protocol. China has instituted a new "biosafety" law and also passed GM (genetically modified) food labeling, which the US has shunned as "anti-biotech" in its intent, and misleading to consumers. U.S. grain exporters to China are concerned that China may invoke legal restrictions on imports of biotech crops to selectively ban shipments of grain (commodities) from the US if those commodities "may contain" any trace of a particular biotech crop. Details of Protocol implementation are to be discussed at the first meeting of the parties to the Protocol in Kuala Lumpur, Malaysia on February 23 - 27, 2004. The Protocol is expected to require that commodities shipments that

"may contain LMOs" state that fact, along with a list of LMOs, on their invoice or other import-export shipping label. Such requirements could pose an enormous challenge to U.S. agricultural interests. Given its unique position as innovator and over-regulator of biotech, China provides a nation worth monitoring by anyone interested in agricultural biotechnology.

C. FOREIGN TRADE LAW REDRAFT

In December 2003, MOFCOM released a draft of the yet-to-be-implemented *Foreign Trade Law* for comment. This new version of the law will implement China's commitment to eliminate the restriction on trading rights and provides MOFCOM with new powers of investigation in trade remedy cases. The most significant change concerns trade remedies as stated in the draft's chapter allowing intellectual property rights holder to bring an action against allegedly infringing imported goods. Such action appears to be copied from the action available under §337 of the United States Tariff Act of 1930. The draft law does not make clear how such investigation will be conducted or what remedies will be available through it. Note that the proposed changes in the circulated draft are not guaranteed to be in the final version of the revised law, although the draft remains a useful barometer of the trend of thought by relevant responsible PRC authorities

V. Customs Regulation

A. CUSTOMS: FREE TRADE ZONES

In early 2003, MOFCOM and the General Administration of Customs (GAC) jointly issued a circular (*Circular 22*) allowing four free trade zones (Shanghai, Shenzhen, Tianjin, and Xiamen) to grant import and export rights to enterprises within those zones. According to *Circular 22*, the approving procedures and standards should be the same as those for enterprises outside the zones. The Waigaoqiao Free Trade Zone in Shanghai was the first trade zone to publish implementing rules in accordance with *Circular 22*. As a result, manufacturing enterprises within the zone may apply for import/export licenses so that they can legally conduct business directly with domestic enterprises without employing state owned trade agents, which may help reduce the sales costs significantly. Although the promulgation of *Circular 22* and relevant implementing rules by local authorities did not introduce significant advantages to trading companies, it was a positive development for foreign investors with production facilities in the free trade zones.

B. CUSTOMS: LICENSE FEES

On May 30, 2003 the GAC issued the *Measures of the General Administration of*

Customs of the People's Republic of China for the Valuation of License Fees Related to Imported Goods, effective July 1, 2003. The measures implement several of the requirements found in Article VII of the *General Agreement on Tariffs and Trade 1994* by defining the circumstances under which license fees should be considered "related to imported goods" with respect to patents, proprietary technology, trademarks and copyright, and provide guidelines for determining when the payment of license fees is a "condition of sale" of the goods. The measures also require license fees for "distribution or resale rights" to goods to be included in their declared value.

C. CUSTOMS: CLEARANCE PROCEDURES

On September 18, 2003, the GAC issued the *Provisions of the General Administration of Customs for the Administration of Declarations for Imported and Exported Goods*, effective November 1, 2003, outlining the procedures to obtain customs clearance for imported and exported goods. Trading enterprises are to register with GAC upon establishment and conduct customs clearance procedures in their own name or through a professional agent. Customs declarations must now be made through an electronic data declaration form that carries the same legal validity as the old paper declaration form.

D. Customs: Multifunctional Equipment

In October 2003, the GAC issued *Announcement 58, The Declaration of Import and Export Goods*. *Announcement 58* provides that in the case of incomplete multi-functional machinery and electrical products, the tariff classification will be based on the products' planned function, so long as the declared goods demonstrate the basic features of the complete goods when declared. With respect to goods whose main planned functions *can* be determined, classification should follow Rule 3, paragraph 2 of the General Rules of Classification (these are essentially what are referred to in other countries as the General Rules of Interpretation) and be classified according to the products' main planned functions. In the case of goods whose main planned functions *cannot* be ascertained, the classification should be according to Rule 3, paragraph 3 of the General Rules of Classification and be classified using the last item number in the sequence of all possibilities. *Announcement 58* may have significant implications for companies exporting high technology, multi-functional electronic products to China, which products reflect the rapid convergence between data processing, data display and video display functions.

VI. Intellectual Property

A. Patents: Patent Agency Measures

According to State Intellectual Property Office (SIPO) statistics, 308,487 patent applications were filed in 2003, a 22% increase over the number filed in 2002. 2003 was the first time in the past eight years that domestic applications exceeded foreign applications. It was also the first time service-invention applications exceeded non-service invention applications. Given this burgeoning activity, on June 6, 2003, SIPO issued the *Measures for Management of Patent Agencies (Patent Measures)*. The *Patent Measures* outline the requirements to establish a patent agency and require a patent agency to have (1) an appropriate agency name; (2) a partnership agreement or articles of association; (3) partners or shareholders as stipulated therein; (4) registered capital exceeding RMB50,000 for a partnership patent agency or RMB100,000 for a limited liability company patent agency; and (5) fixed offices and necessary working facilities. A patent agency's partners and shareholders should (1) have a patent agent qualification; (2) have more than two years' patent agent experience; (3) engage in full-time patent agency services; (4) be under sixty-five years of age when applying to establish a patent agency; (5) not have violated relevant law. The patent agency itself should (1) have been established for more than two years; (2) have more than ten patent agents; (3) completed the previous years' annual examinations; (4)

have more than two full-time patent agents assigned or as engaged by the patent agency; (5) have fixed offices and necessary funds; and (6) have a name composed of the agency's full name and the name of the city in which the agency is located.

B. PATENTS: EXPECTED FUTURE DEVELOPMENTS

Revisions to the *Patent Law* were considered in 2003, and may be concluded in 2004.

Revisions to the *Patent Law* will address patent protection for high-tech inventions, as SIPO has accelerated its research on the patentability of genes, trans-gene technology, e-business, and computer software. Related to this issue, SIPO is analyzing the drafting of patent applications in those fields and how to conduct substantive examinations. Under the current *Patent Law*, there is a lack of patentability for "animal and plant varieties," and no patent right is granted to trans-gene animals and plants. Possible revisions to the *Patent Law* may provide an indirect protection for trans-gene animals and plants through an effective extension of process patent. Currently, the examination standard for invention patents on computer software applies the business method, meaning that a computer program relies on the rules and processes of intellectual activities and may not be granted a patent right. However, if the software patent application's content is "to solve technological problems and to achieve technological effect through technological means,"

it is under the *Patent Law's* protection.

The State Council's 2003 legislative plan listed the formulation of regulations on service technology achievements as a second level project, and SIPO accelerated its related research, investigation, and drafting work accordingly. On December 28, 2002, the State Council issued *Order No. 368, the Decision of the State Council on the Revision of Implementation Regulations of Chinese Patent Law*, effective as of February 1, 2003. *Order No. 368* extends the time limit for international applications under PCT Chapter I entering the national phase from 20 months to 30 months from the priority date. This revision will benefit applicants with international applications and will provide them with a longer time to consider whether to proceed with the national phase.

C. TRADEMARKS: PROTECTION OF WELL-KNOWN MARKS

On April 17, 2003, the SAIC issued the *Recognition and Protection of Well-known Trademarks Provisions (Trademark Provisions)*, effective as of June 1, 2003. The *Trademark Provisions* replace tentative provisions issued in 1996 in part because of conflicts between the tentative provisions and 2001's revisions to the *Trademark Law*. Specifically, the definition and standards used to judge well-known trademarks as provided in the 1996 provisions conflict with

2001's changes to the *Trademark Law*. In addition, the 2001 revisions to the *Trademark Law* changed the authority for recognizing well-known trademarks from a process dominated by SAIC's Trademark Office (TMO) to a process involving the TMO, the Trademark Review and Adjudication Board (TRAB), and administrative authorities for industry and commerce (AICs); courts also have power to recognize well-known trademarks.

The *Trademark Provisions* provides three situations in which it may be necessary to determine the status of well-known marks (1) trademark opposition; (2) trademark cancellation; and (3) trademark infringement. Under such circumstances, parties may request that the respective authorities recognize their marks as well known in order to stop the registration and use of certain marks. Pursuant to the *Trademark Provisions*, an applicant must submit the following documentation to determine whether a mark is well known (1) degree of knowledge about the trademark in the relevant public sector; (2) evidence of a consistent period of trademark use; (3) the period, extent and territory of trademark promotion; (4) records of trademark protection as a well-known trademark; and (5) other materials, including annual production volume of items using the mark. The *Trademark Provisions* delete the former criteria that required registration and usage in China to determine a well-known mark.

The first step of evaluation under the *Trademark Provisions* requires an AIC (where trademark infringement has occurred) to examine submitted materials for compliance with the requirements of Article 13 of the *Trademark Law*. If the AIC decides that the submitted materials meet the requirements of Article 13 of the *Trademark Law*, it will issue a formal notice accepting the case and will forward the materials to the provincial-level AIC. The provincial-level AICs have fifteen days from the date of receipt to evaluate the submitted materials and forward them to the TMO if the provincial-level AIC believes the materials meet the requirements of Article 13 of the *Trademark Law*. Such AICs may rely on previous determinations on well-known trademarks if the scope of protection of the current case is similar to previous cases and the other party does not challenge the determination or cannot provide contrary evidence as to the previous determination. If the scope of protection is different from the previous determination or if the other party challenges the determination and provides relevant evidence, the TRAB or the TMO may review the materials to decide whether the trademark is well known on a case-by-case basis.

Note that the provincial-level AIC (where trademark infringement occurred) may directly accept the case at the request of the parties and such an AIC may directly submit relevant

materials to the TMO at the direct request of the parties. In turn, the TMO should make a decision on the status of well-known trademarks within six months of receiving the relevant materials and should send a notice of the decision to the provincial-level AIC where the trademark infringement occurred. The *Trademark Provisions* state that decisions on well-known trademarks will face review by judges according to the principles of the *Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs)*, as acceded by China in connection with its WTO accession.

D. TRADEMARKS: IMPLEMENTATION OF MADRID SYSTEM OBLIGATIONS

On April 17, 2003, the SAIC issued the revised *Madrid International Registration of Marks Implementing Procedures (Madrid Procedures)*, effective as of June 1, 2003, and designed to facilitate China's implementation of the *Madrid Agreement Concerning the International Registration of Marks* and the *Protocol Relating to the Madrid Agreement Concerning International Registration of Marks* (collectively the *Madrid System*). The Madrid Procedures supersede regulations of the same name from 1996, and make China's trademarks system more consistent with the *Madrid System*.

Under the *Madrid System*, the International Bureau of Intellectual Property (International

Bureau) may only accept international marks registration applications submitted by a nation's chief administrative authority overseeing trademark issues. The relevant Chinese authority is the Trademark Bureau, one of whose main duties is to receive and forward such applications for international registration. Under the *Madrid Procedures*, the process for the territorial extension and deregistration of marks under the *Madrid System* are to be handled through the Trademark Bureau, while the renewal, transfer and change of international registration of trademarks, territorial extension, deregistration, renewal, transfer and change of international registration of trademarks under the *Madrid System* may be handled either through the Trademark Bureau or directly through the International Bureau.

As the *Madrid System* only allows international registration of marks to the nationals of a contracting member, the *Madrid Procedures* provides that China must be the country of origin for applicants seeking international registration of marks through the Trademark Bureau. The *Madrid Procedures* require such an applicant to (1) have real and effective industrial or commercial establishment in China; (2) have a domicile in China; or (3) be a Chinese national.

The *Madrid Procedures* specify that an applicant is to complete an application form that includes (1) its name, address, and telephone number; (2) the pinyin of the mark subject to

registration; (3) the goods or services for which the mark is to be registered as well as the corresponding class or classes according to the *Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks*; and (4) the registration number of the mark or the application number of the mark. In addition, the *Madrid Procedures* require an applicant to submit (1) a copy of the Trademark Registration Certificate issued by the Trademark Bureau or a copy of the Acceptance Notice of Application for Trademark Registration issued by the Trademark Bureau, as appropriate; (2) evidence as to the importance of international registration; (3) a copy of an identity certificate, such as a copy of the business license, an identity card, or a residence permit; and (4) two drawings, between 20mm x 20mm and 80mm x 80mm, of the mark to be registered. In addition, if color is to be claimed as a distinctive feature of the mark, the applicant is to make such claim explicit, file a notice specifying the color or the combination of color, and append color copies of said mark to its application.

In normal cases, the Trademark Bureau will forward an application to the International Bureau within one month of receipt unless the application materials are incomplete or incorrect, or the application fee has not been paid within fifteen days of the applicant's receipt of the Notice

of the Payment of Application Fee. If there are only minor mistakes or omissions in the application materials, the Trademark Bureau may notify the applicant to correct or complete the application materials within fifteen days from the notice. If the applicant does so, its date of application will be retained as if the application material were complete and correct when the Trademark Bureau received it. The International Bureau will register the marks following receipt of the application; the registration's date of application to the International Bureau will be the date of application to the Trademark Bureau if the International Bureau has received the application within two months from the date of application.

E. TRADEMARKS: RELATED DEVELOPMENTS

In 2003, the China Trademark Office received more than 452,000 applications, breaking the record established by the United States (375,000) in 2002. By the end of 2003, China has approved a total of 1,973,000 trademark registrations. In February 2003, the State Council abolished the administrative examination and approval process for trademark agency, trademark agent, trademark printing administrative staff and trademark printing entity qualifications. As a result, the number of trademark agencies throughout China increased to more than 840 by the end of 2003.

In November 2003, two Chinese government trademark websites (<http://www.ctmo.gov.cn> and <http://sbj.saic.gov.cn>) went active, containing information on trademark-related law and regulations, trademark registration procedures, guidelines for trademark applications, trademark news, statistics, and trademark consultancy. As of December 26, 2003, the twelve most recent volumes of the *Trademark Gazette* (covering all preliminarily approved marks published for opposition, and information related to the registration, renewal, change, assignment, cancellation, revocation, opposition, appraisal, record of license, service announcement of marks) could be viewed free of charge on these websites.

F. COPYRIGHT

On July 24, 2002, the National Copyright Administration (NCA) issued *Measures for Implementation of the Administrative Punishment of Copyright (Copyright Measures)* stating that it was the appropriate authority for copyright administration. The *Copyright Measures* allow the NCA to impose administrative penalties such as (1) an order for an infringer to cease its tortuous activity; (2) confiscation of illegally-obtained income; (3) confiscation of infringing duplicates; (4) fines; (5) confiscation of materials, tools, and devices used to make infringing items; and (6) other penalties as specified in relevant laws, regulations, and stipulations. Under the *Copyright*

Measures, the NCA may confiscate materials, tools, and devices used to make infringing items only in "serious circumstances," defined as (1) illegally-obtained income exceeding RMB5,000 for an individual or RMB30,000 for an enterprise; (2) the value of illegal operations exceeding RMB30,000 for an individual or RMB100,000 for an enterprise; (3) infringing duplicates reaching two thousand copies for an individual or five thousand copies for an enterprise; (4) repeated copyright infringement by the subject of a criminal copyright infringement prosecution; or (5) other serious consequences or results as defined in relevant law or regulation. The *Copyright Measures* provide enforcement personnel with certain emergency powers, including (1) preventing or correcting infringement; (2) advance copyright registration to protect against infringing duplicates and the materials, tools, and equipment used for such infringement; and (3) collecting relevant evidence.

G. INTELLECTUAL PROPERTY: SHANGHAI IP OPINION

On May 20 2003, the Shanghai Municipal Government issued the *Strengthening Protection of Intellectual Property Rights in Foreign Trade and Economic Cooperation Opinion (IP Opinion)*, focusing on intellectual property issues in the conduct of foreign business. The Shanghai Copyright Bureau, the Shanghai AIC, the Shanghai Intellectual Property Office,

Shanghai Customs and the Shanghai Foreign Economic Relation & Trade Commission all endorsed the *IP Opinion*. The *IP Opinion* apparently will be distributed to all levels of city, district and county governments for dissemination to local companies to further educate them on the importance of intellectual property protection.

The *IP Opinion* addresses several intellectual property issues. Article 6 provided that OEM manufacturers must hold a license to produce items with another's trademark, and the products must contain an indication that the OEM manufacturer was authorized to manufacture the product. If such action is not taken, the foreign trademark holder will be deemed liable for any loss. Article 7 addresses anti-improvement clauses that have traditionally included in international technology transfer contracts, and is consistent with Article 29 of the *Administration of Registration of Technology Import and Export Contracts Procedures* which disallows contractual provisions such as tying, anti-improvement clauses or terms that prevent the transferor from acquiring similar or competing technology. Article 13 of the *IP Opinion* requires a Shanghai foreign trading enterprise that has registered a trademark in the country to which it exports products and its Shanghai manufacturer that has registered the same trademark in China to settle any conflicts amicably. Article 18 protects Chinese brands from being

stricken from the national trademark register due to non-use or dilution because they have been sidelined by an associated stronger brand used by a joint venture to which such Chinese trademark holder is a party.

H. INTELLECTUAL PROPERTY: PLANT VARIETY RIGHTS

The Ministry of Agriculture's (MOA) *Provisions on Handling Cases of Infringement of Rights to New Varieties of Agricultural Plants (PVR Provisions)* came into effect on February 1, 2003. The *PVR Provisions* make transparent the MOA's procedures for handling infringement claims by holders, or in some cases licensees, of agricultural plant variety rights (PVRs) that have been granted by the MOA in accordance with 1997's *Protection of New Varieties of Plants Regulations* and 1999's *Protection of New Varieties of Plants Regulations Implementing Rules (Agriculture)*. The latter two regulations provide that any plant variety that is the subject of a PVR is to have the characteristics of novelty, distinctness, uniformity, stability and an adequate denomination. As provided in the latter two regulation, applicants should file the following information in connection with their PVR application (1) for purposes of determining novelty, information related to whether the seeds, seedlings or asexual reproduction materials of the applied variety have been sold prior to the application filing date (if such items have been sold,

information as to the date and place of the first sale and whether such sale was agreed to by the variety rights holder is to be included); (2) a power of attorney executed by the applicants or their representatives; (3) the name(s) of breeders and applicants, including addresses, contact information, contact person, breeding places and duration of applied variety; (4) a detailed specification of applied variety including proposed denomination, scientific and Chinese names, description of background materials, breeding process and methods, declaration of selling, declaration of DUS, declaration of adaptability to growing or environmental conditions, and main points of culture techniques; and (5) three color photographs sized 8.5cm x 12.5cm or 10.0cm x15.0cm, including an explanation to distinguish the candidate variety with a similar variety.

The *PVR Provisions* discuss for the first time how provincial-level and above agricultural departments should handle PVR infringement claims. The *PVR Provisions* are largely consistent with China's obligations under TRIPs. The *PVR Provisions* only allows infringement cases, defined as involving the commercial, unauthorized production or sale of a PVR's propagating material or the repeated use of such material in the development of other propagating varieties, to be accepted by the relevant MOA branch. The rights holder (in whose name the PVR has been

registered) and certain licensees (such as licensees under a sole license) may file a claim under the *PVR Provisions*. Licensees under an exclusive license may file a claim only where the rights holder has not filed a claim, and general licensees must either seek the consent of the rights holder or rely on contractual provisions in their license in order to file a claim. An eligible claimant must submit a letter of request conforming to the provisions of *PVR Provisions* Article 6, specifying the claim's nature and reasons and relevant facts. The request letter must be signed or stamped with the claimant's seal and must include the original PVR certificate issued to the rights holder. If a case is not accepted, the relevant department must inform the claimant within seven days of the claimant's filing of the request letter, and include its reasons for rejecting the case. The *PVR Provisions* state that administrative action on an infringement claim will not be entertained if either party has filed an action with a People's Court.

If accepted, the administrative department of agriculture at the provincial level or above will appoint a three or more person odd-numbered panel to review the claim. The *PVR Provisions* state that the relevant agricultural department must serve a copy of the claim on the respondent within seven days of receipt, and the respondent must file a defense within fifteen days of receipt of the complaint. The respondent's answer is to be provided to the claimant

within seven days of receipt. The reviewing panel has no timeframe within which it must render a written decision.

This panel will assess the claim's merits based on the parties' written submissions. The PVR Provisions state that a hearing may be held if deemed necessary, and the parties will be given seven days notice of such hearing. Because the *PVR Provisions* are silent on the substantive issues the panel must consider, the panel has significant discretion as to how it handles the substantive issues arising in an infringement case and in deciding what importance it will attach to certain arguments or evidence.

The panel's decisions must be in writing, detail the panel's reasoning and legal basis behind its decision. The panel may impose certain penalties such as an order to cease infringement activities or an order to destroy any propagating material in the possession of the infringer. A panel decision may include punitive measures such as the confiscation of illegal income derived by the infringer or the imposition of a fine, but a panel may not impose a compensation award (although *PVR Provisions* Article 14 specifies the basis upon which compensation, payable to a successful claimant, should be calculated). Enforcement of binding decisions requires an application to a People's Court.

VII. Foreign Exchange

On April 1, 2003, SAFE issued the *Issues Relating to Improving the Administration on Forex in relation to FDI (FDI Forex Notice)*, providing foreign investors with more routes to contribute capital to FIEs. Subject to approval by the local SAFE branch, the *FDI Forex Notice* allows certain foreign investors to open onshore "special forex accounts," in one of four classifications (1) an investment account, opened when a foreign investor contracts for a project; (2) an acquisition account, opened when a foreign investor wishes to establish an FIE, to be used for acquiring land use rights, equipment or other assets during the FIE's pre-establishment period; (3) an expenses account, opened when a foreign investor intends to establish an FIE, to be used for market research and establishment preparations during the FIE's pre-establishment period; and (4) a security account, opened when a foreign investor needs to provide a funding security to a domestic institution. SAFE retains discretion to determine the limits on the amounts such special forex accounts can hold, as well as the account's duration and its scope of receipt and payment of funds. Upon establishment, funds settled and transferred from such special forex accounts may be treated as a capital contribution made by the foreign investor to the FIE. Any remaining balance may then be transferred to the capital account of the FIE as a part of the

capital contribution. Each foreign investor is permitted to open one special forex account, unless SAFE approves additional accounts.

The FDI Forex Notice allows foreign investors to contribute funds directly to an FIE's capital account (1) from an offshore account in a designated offshore forex bank; or (2) by using the forex in an onshore non-resident individual cash remittance account. Foreign investors also may, pursuant to *The FDI Forex Notice* and subject to their ratio of capital contribution made to the FIE, convert specific items into FIE's registered capital (1) a proportional amount of the FIE's development funds and reserve funds; (2) the FIE's undistributed dividends and accrued interest; (3) principal and accrued interest of the FIE's registered foreign debt held by the foreign investors; and (4) investors' early-recouped investments or assets derived from liquidation, equity transfer or reduction of registered capital from FIEs in which they have invested.

The FDI Forex Notice states that SAFE will not approve onshore transfer of forex funds between (1) FIEs (foreign-invested holding companies excluded) and their domestic investee enterprises; or (2) the domestic investee enterprises invested by the same FIE (foreign-invested holding companies excluded). If a foreign investor contributes capital in kind, and the value of the in-kind contribution is in doubt, SAFE will use the valuation of the relevant Chinese

authority. *The FDI Forex Notice* provides that a guarantee letter is not required to remit forex from a Sino-foreign cooperative joint venture if the venture itself is debt free.

VIII. Financial Services

A. BANKING: ANTI-MONEY LAUNDERING RULES

In early 2003, the People's Bank of China (PBOC) promulgated the *Provisions on Anti-Money Laundering for Financial Institutions* and two separate measures concerning requirements for financial institutions to report "large and suspicious" *renminbi* transactions and foreign exchange transactions, both effective March 1, 2003. Financial institutions in China, including foreign-invested financial institutions, are required to establish a strict internal systems to control money laundering, including implementing a record retention policy and a system to report large or suspicious transactions to the PBOC or SAFE. Securities and fund management companies and insurance companies are excluded from the scope of these rules because they are not under PBOC jurisdiction.

These rules reinforce existing guidelines regarding confirming the identity of account holders, verifying the source of cash deposits and purpose of remittances, and record keeping. Financial institutions are to report "large" transactions to PBOC, including (1) single transfers

between legal persons, organizations and privately- owned businesses of RMB1 million or above; (2) single cash deposits or withdrawals of RMB200,000 or above; and (3) transfers between settlement accounts of individuals, and transfers between settlement accounts of RMB200,000 or above. Similar reporting to the SAFE is required for (1) cash deposits, withdrawals, purchase or conversion of foreign currency of US\$10,000 equivalent or more per day; and (2) non-cash foreign exchange transactions of US\$100,000 equivalent or more per day for individuals, or US\$500,000 per day for business entities. In addition, "suspicious" transactions must be reported, as determined by the amount, frequency, direction and purpose of the transactions.

B. BANKING: CHINA BANKING REGULATORY COMMISSION

On April 26, 2003 the National People's Congress approved the creation of the China Banking Regulatory Commission (CBRC), now responsible for carrying out the examination and approval functions of the PBOC, as well as its responsibilities related to the supervision and administration of banks, financial assets management companies, trust and investment companies and other savings and financial organizations. On April 28, 2003, the CBRC announced that it will be organized into fifteen departments. The CBRC First Division will be

responsible for the supervision and administration of state-owned commercial banks and asset management companies. The CBRC Second Division will be responsible for the supervision and administration of shareholding commercial banks and municipal commercial banks, and the CBRC Third Division will be responsible for the supervision and administration of policy banks, postal savings agencies and foreign-invested banks.

C. BANKING: AUTO FINANCE COMPANY MEASURES

On October 3, 2003, the CBRC issued the *Measures for the Administration of Car Finance Companies*, permitting automobile companies and non-banking financial institutions to establish automobile finance companies with the right to lend money and extend loan guarantees to car buyers and dealers. These measures were eagerly awaited and although they were issued past the original WTO-committed deadline, they lay out the first clear requirements for foreign investment in this area. The chief investor must be a manufacturer or seller of automobiles or a non-banking financial institution with total assets of at least RMB4 billion and annual revenue of at least RMB2 billion. Minimum registered capital is RMB500 million. Automobile finance companies are not permitted to establish branches, and the same investor is not allowed to establish more than one automobile finance company in China.

D. BANKING: RENMINBI BUSINESS EXPANDED

On October 24, 2003, the CBRC promulgated the *Announcement Regarding Further Opening Renminbi Business to Foreign Invested Financial Institutions*, effective December 1, 2003, allowing foreign-invested financial institutions to conduct *renminbi* business in four additional cities: Jinan, Fuzhou, Chengdu and Chongqing. Upon examination, approval and registration, a foreign-invested financial institution may provide *renminbi* services to domestic Chinese enterprises. Successful applicants should be profitable for the two years prior to application, and must submit specific information to the CBRC.

E. BANKING: INVESTMENTS IN DOMESTIC FINANCIAL INSTITUTIONS

On December 8, 2003, the CBRC issued the *Measures for the Administration of Investments and Share Purchases of Domestic Financial Institutions by Foreign Financial Institutions*, effective December 31, 2003, allowing specified investments by foreign financial institutions into domestic Chinese financial institutions. Only a foreign investor with assets exceeding US\$10 billion to invest in or purchase shares of a domestic commercial bank and US\$1 billion or more to invest in or purchase shares of any other type of domestic financial institution may so invest, and no single investor may acquire more than 20% of a domestic

Chinese financial institution. The transaction must be closed, with consideration paid in cash, within 60 days after receipt of approval from the CBRC.

F. BANKING: BANK REGULATORY REFORM

On December 27, 2003, the National People's Congress enacted several laws and amendments affecting China's banking sector. This new legislation will be effective as of February 1, 2004. The *Amendment to the Law on the People's Bank of China* removes from PBOC much of its authority to supervise and regulate China's commercial banks, credit cooperatives, policy banks, financial asset management companies, trust and investment companies, financial companies, financial lease companies and other banking institutions. Such supervisory power will be transferred to the CBRC. The PBOC remains as China's central bank, with authority to formulate and implement monetary policies and to monitor and safeguard financial markets, including a new power to trade bonds on the open market. In certain circumstances, the PBOC may request the CBRC to investigate a regulated financial institution.

The *Law on Supervision and Administration of the Banking Industry of the People's Republic of China* codifies the CBRC's mandate as regulator China's banking sector. Its responsibilities include the supervision and administration of all financial institutions in the

banking sector and the authority to approve the establishment and dissolution of a regulated financial institution. This new law embodies the basic rules and principles of the *Basel Core Principles for Effective Banking Supervision* by, among other items, giving the CBRC the power to enforce prudential requirements. This law also creates an information sharing mechanism among the CBRC, the PBOC and other financial sector regulators.

The Amendment to the Commercial Banking Law of the People's Republic of China attempts to strengthen the supervision and regulation of commercial banks by requiring commercial banks to formulate risk management and internal control policies. Also, this amendment expands the permissible business scope of commercial banks to include acceptance and discounting of negotiable instruments, sale and purchase of bonds, provision of banking card services and sale and purchase of foreign exchange. Significantly, this amendment eliminates the requirement that wholly state-owned commercial banks provide loans to special projects approved by the State Council and requires the State Council to adopt measures for compensating banks that incur losses from such loans.

G. SECURITIES: INVESTMENT MANAGEMENT BUSINESSES

On May 15, 2003, the China Securities Regulatory Commission (CSRC) issued the

Notice on Relevant Issues Concerning Securities Companies Performing Mutual Investment

Management Services. The notice states that the CSRC is currently drafting administrative measures to standardize the performance by securities companies of mutual investment management services. Pending the implementation of new measures, the notice prohibits securities companies from offering mutual investment management services and requires them to cease the implementation of all existing mutual investment plans. Securities companies already providing mutual investment management services were to submit relevant contracts, product descriptions and marketing materials to the CSRC by May 20, 2003.

H. SECURITIES: LISTED SHARES OF ACQUIRED COMPANIES

On May 20, 2003, the CSRC issued the *Notice on Relevant Issues Concerning the Conditions for Public Trading of Shares of Acquired Companies Involving Tender Offers.* The notice sets forth the conditions under which an acquired company's listed shares of may continue to be publicly traded, may become subject to a delisting notice, or may be delisted. The notice provides that the purchaser is subject to certain disclosure obligations and, if foreign investor, must comply with the special provisions for the acquisition of listed companies by foreign investors.

I. SECURITIES: BONDS ISSUED BY SECURITIES FIRMS

On August 29, 2003, CSRC issued the *Interim Measures on the Administration of Bonds of Securities Companies*, effective October 8, 2003. The measures allow Chinese securities companies to issue bonds upon approval by the CSRC. The company must have been profitable in the most recent fiscal year, must have assets of at least RMB500 million for private issues and at least RMB1 billion for public issues, and must have no securities violations for two years. The value of the newly issued bonds may not exceed 40% of company's net assets, and bond interest is limited to an amount equal to the average annual profit distributed by the company for the most recent three years.

J. SECURITIES: TOUGHER IPO RULES

On September 19, 2003, the CSRC promulgated the *Notice on the Further Standardization of Work Related to Initial Public Offerings*, effective October 1, 2003, tightening the rules under which a company limited by shares may conduct an initial public offering. As of January 1, 2004, a company must be established for at least three years and must not have undergone significant restructuring (in either its business or management team) for at least three years before it can apply for an initial public offering. The IPO's total value is limited

to twice the unaudited net asset value of the company in the year prior to the offering.

Controlling shareholders may purchase no more than 30% of the total value of the new offering.

K. SECURITIES: SECURITIES INVESTMENT FUND LAW

The National People's Congress passed the *Securities Investment Fund Law of the People's Republic of China (Investment Fund Law)* on October 28, 2003, which will become effective on June 1, 2004. The *Investment Fund Law* regulates closed-end funds and open-end funds that are publicly offered and sold. Only CSRC-approved fund management companies may establish and manage investment funds. Such fund management company must have (1) registered capital exceeding RMB100 million; (2) principal shareholder(s) who are in the securities management, securities investment consulting, trust asset management, or other financial asset management business; and (3) each principal shareholder with registered capital exceeding RMB300 million.

To establish a fund, a fund management company must apply to CSRC for approval. If approved, the fund management company may start selling fund units to the public. To achieve a valid public offering for a closed-end fund, the fund management company must sell more than 80 percent of the total amount of the units approved by CSRC. For an open-end fund, the fund

management company must sell more than the minimum amount of units (as approved by CSRC) to a minimum number of buyers (as stipulated by CSRC). Funds may invest only in listed stocks, bonds and other securities products designated by CSRC. The *Investment Fund Law* prohibits the use of fund assets for (1) underwriting securities, extending loans, or buying other funds; (2) making equity investments in the fund management company or custodian; and (3) buying securities issued or underwritten by the fund manager's or fund custodian's controlling shareholder.

L. Securities: Supreme Court Interpretation of Company Law

On November 4, 2003, the Supreme People's Court published a the *Provisions Regarding Several Issues on the Adjudication of Cases Involving Company Disputes*, introducing several new concepts to Chinese law, including "nominal shareholder" (similar to a trustee shareholder), stock buy-backs, bonus stocks, and the use of securities as part of a capital contribution. These provisions also provide detailed rules on the protection of minority shareholders, the fiduciary duties of directors and senior management personnel, and discuss the circumstances under which a court may pierce the corporate veil.

M. SECURITIES: MANAGEMENT OF CLIENT ASSETS BY SECURITIES COMPANIES

On December 18, 2003, the CSRC issued the *Trial Measures on the Management of Client Assets by Securities Companies*, effective February 1, 2004, requiring securities companies wishing to manage client assets to establish a separate department, hire qualified personnel, and implement risk control procedures. Such securities companies may engage in asset management accounts for individual clients, restricted portfolio asset management plans and unrestricted portfolio asset management plans for multiple clients, and special purpose asset management accounts for clients with special projects.

N. SECURITIES: EQUITY INCENTIVE PLAN FOR HIGH-TECH SOES

Throughout 2003, the Ministry of Finance (MOF) and MOST issued guidelines and a follow-up notice on the launch of an equity incentive pilot project for state-owned, unlisted high-technology enterprises. The goal is to promote innovation in such enterprises by rewarding technical personnel and managers who make significant contributions to the development of an enterprise with an interest in an equity incentive plan. Such enterprises meeting certain criteria, including a requirement that annual research and development spending accounted for 5% of annual sales during the past three years, may apply to the relevant government departments to

participate in the pilot project on equity incentive plans.

O. INSURANCE: NON-LIFE INSURANCE COMMITMENTS

On December 1, 2003, the China Insurance Regulatory Commission issued the *Announcement on the Fulfillment of Related WTO Commitments*, effective as of that date, enabling foreign invested property insurance companies to conduct all non-life insurance business, with the exception of statutory insurance. Further, five additional cities, Fuzhou, Xiamen, Ningbo, Shenyang and Wuhan, were opened to foreign investment in the insurance sector by this announcement.

IX. Telecommunications and Technology

A. TELECOM CATALOGUE ISSUED

On February 21, 2003, the Ministry of Information Industries (MII) issued a revised *Catalogue of Telecommunications Services (Telecom Catalogue)*, effective April 1, 2003. The Telecom Catalogue retains MII's distinction between Basic Telecom Services and Value Added Telecom Services, but leaves unclear certain distinctions between such services.

B. SERVICE STANDARDS

On May 27, 2003, MII's Telecommunications Administration Bureau issued the

Announcement on Soliciting Opinions for the Telecommunications Service Standard. This new service standard amends the 2000 *Telecommunications Service Standard (for Trial Implementation)* and is intended to improve the provision and quality of telecommunications services by specifying the basic principles, criteria and indices of telecommunications service standards. IP telephony business and Internet data transmission business are subject to this new service standard.

C. NETWORK ACCESS FOR MOBILE PHONES

On April 4, 2003, the MII issued the *Notice on Further Strengthening the Administration of Network Access for Mobile Phones*. The notice simplifies the process under which new mobile telecommunications products are tested for network access approval. Applicant manufacturers are required to submit a standardized application form to the MII's Telecommunications Equipment Authentication Center detailing the design and production parameters and the sales prospects of any new mobile phone units. Successful applicants must guarantee the normal use, design and functioning of the product. Post-certification inspections are conducted at irregular intervals on samples from both the factory and the marketplace.

D. SUPREME COURT INTERPRETATION OF TECHNOLOGY CONTRACT DISPUTES

On November 10, 2003, the Supreme People's Court circulated the *Interpretation Regarding Several Issues on the Laws Applicable to the Adjudication of Disputes Involving Technology Contracts*, effective December 10, 2003. The interpretation discusses various provisions of China's *Contract Law*, such as provisions related to technology development contracts, technology transfer agreements, and technology consulting and service contracts. The interpretation also discusses procedural issues involved in the adjudication of technology contract disputes.

E. ENCRYPTION POLICY FOR WIRELESS LANs

On November 26, 2003, the General Administration of Quality Supervision, Inspection & Quarantine and the Standardization Administration of China jointly issued the *Announcement Regarding Implementation of Mandatory National Standards for Wireless LAN*, effective as of December 1, 2003. Pursuant to this announcement, Chinese and overseas computer manufacturers are required to use Chinese encryption standards in terminal equipment for Chinese wireless local area networks. Implementation of the announcement prohibits the importation, manufacture and sale in China of any equipment used in wireless LANs unless it

complies with Chinese standards. The announcement does not apply to (1) noncompliant products that have been manufactured and imported into China before December 1, 2003; (2) non-compliant products that are the subject matter of purchase contracts executed before December 1, 2003; or (3) LAN equipment re-processed or manufactured in China for overseas markets. The standard will enhance security but will also augment government access, control and regulation of the sector, and provide a domestic market advantage to Chinese equipment manufacturers.

X. Other Developments of Note

A. PRICE DISCRIMINATION

On June 18, 2003, the State Development and Reform Commission (SDRC) issued an anti-price discrimination regulation, effective as of November 1, 2003. This regulation restricts certain activities undertaken by a business operator manipulating an item's market price. Under the new regulation, business operators may not engage in price fixing or restricting production quantities, through agreements, resolutions, or coordination. Also, business operators may not (1) restrict resale prices by its distributors by taking advantage of their dominant market position; (2) make predatory profits; (3) dump goods with the purpose of harming competitors, or sell goods

below cost in the form of kickback, subsidy or donation; or (4) conduct price discrimination.

B. FREIGHT FORWARDING DEVELOPMENTS

On January 11, 2003, the then-MOFTEC issued the *Measures for the Administration of Foreign-Invested International Freight Agencies*, raising the foreign ownership cap in an international freight forwarding agency to 75%. These measures also contain provisions detailing the acquisition of existing international freight agencies. Related thereto, MOFCOM issued the *Supplementary Provisions to the Measures for the Administration of Foreign Invested International Freight Agencies* on December 7, 2003 and the *Detailed Rules on the Provisions for the Administration of International Freight Agencies* on January 1, 2004. Both regulations became effective on January 1, 2004. The supplemental provisions require an international freight agency to be established as a limited liability company or a company limited by shares, with a controlling shareholder that meets certain criteria in regard to experience and resources. The new rules also provide that international freight agencies only may establish affiliates or branch companies one year after the parent commences actual business operations, and specify the procedures for the examination and approval, registration, annual review and regulation of international freight agencies.

C. ONLINE AUDIO-VIDEO PROGRAMS

Effective February 10, 2003, the *Measures for Administration of the Transmission of Audio-Video Programs Over the Internet and Other Information Networks* issued by the State Administration of Radio, Film and Television (SARFT) asserts SARFT jurisdiction over the transmission of audio-video programs over all types of networks. These measures categorize audio-video programs into four basic groups (1) news; (2) film and television programs; (3) entertainment; and (4) professional. Those transmitting audio-video programs in all four categories must be licensed by SARFT. Chinese website operations are prohibited from providing connection services to unlicensed website operators inside or outside China.

D. FOREIGN-INVESTED CONSTRUCTION ENTERPRISES

On April 8, 2003, the Ministry of Construction issued the *Implementing Measures Concerning the Administration of Qualifications Contemplated in the Regulations for the Administration of Foreign-Invested Construction Enterprises*, providing guidance to foreign construction companies seeking to set up construction subsidiaries in China. Among other issues, these measures detail China's system of qualification grading for foreign-invested construction companies and rules governing the qualifications of expatriate managers of foreign-

invested construction companies.

E. PERIODICALS DISTRIBUTION

On March 17, 2003, the General Administration of Press and Publications and the then-MOFTEC jointly issued the *Measures on the Administration of Foreign Invested Books, Newspapers and Periodicals Distribution Enterprises*, effective May 1, 2003. These measures cover foreign-invested wholesale and retail enterprises that distribute books, newspapers and periodicals through traditional channels and online, and provide that a foreign-invested books, newspapers and periodicals distribution enterprise may be established through a traditional joint venture or through the acquisition of an existing domestic distribution enterprise. The venture's registered capital must exceed RMB30 million for wholesale enterprises and exceed RMB5 million for retail enterprises. MOFCOM and the General Administration for Press and Publications shall jointly conduct examination and approval of such a foreign-invested wholesale or retail enterprise.

F. TRAVEL AGENCIES

On June 12, 2003, MOFCOM and the National Tourism Administration (NTA) jointly issued the *Interim Provisions on the Establishment of Foreign Invested and Wholly Foreign-*

Owned Travel Agencies, effective July 14, 2003. These provisions allow creation of travel agencies as a wholly foreign-owned enterprises (WFOE) if the foreign investor's annual revenue exceeds US\$500 million. A foreign party to a tourism joint venture must have annual revenue in excess of US\$40 million, be a member of their home country's tourism association, and tourism must be their primary business. Registered capital of foreign-invested travel agencies must be at least RMB4 million.

G. CCC MARKS

On May 1, 2003 China reorganized its compulsory products certification system by centralizing certification authority under the new Certification and Accreditation Administration of the People's Republic of China (CNCA) under the General Administration of Quality, Inspection and Quarantine (AQSAQ). CNCA's mandate is to establish an internationally recognized certification system and to bring about unified technical standards, a unified catalogue, unified marks, and unified certification fees. As of August 1, 2003 Chinese customs will no longer allow goods to enter China unless the goods are stamped with the new CCC (China Compulsory Certification) mark or are accompanied with an exemption letter issued by the Beijing office of the CNCA or a designated local branch. Similarly, goods not bearing the

new CCC mark may not be distributed in China, unless the goods bear one of the old marks and were imported before August 1, 2003. CCC marks may be issued at one of 99 designated testing laboratories or nine designated certification centers throughout China. The certification process is supposed to take approximately 90 days, beginning with an initial inspection of the relevant overseas manufacturing facility.

Exemption certificates are available for imported items such as products imported for a research purpose, products imported as parts for assembly and re-export, products imported where the end products are exclusively for export, products imported to develop new product lines, products imported for equipment maintenance, and obsolete products. The validity period for most exemption certificates is 30 days, but the certificates may be valid for up to one year. Most exemption certificates are valid for a single use, but in certain cases they may be issued for multiple imports.

H. PHARMACEUTICALS IMPORTS

On August 18, 2003, the State Food and Drug Administration (SFDA) issued the *Measures for the Administration of the Importation of Pharmaceutical Products*, effective January 1, 2004, requiring pharmaceuticals importers to obtain a registration certificate from the

SFDA at the port of entry prior to actual import. The measures also penalize distributors of imported pharmaceuticals that fail to obtain an SFDA registration certificate.

I. MOFCOM TRANSPARENCY

On November 25, 2003, MOFCOM issued the *Interim Measures for Public Government Affairs*, effective as of the same date, implementing some of China's WTO commitments on administrative transparency. Under these measures, before completing a new regulation, policy, administrative measure or administrative procedure, MOFCOM may choose to consider the regulation internally or it may consult with experts. If a draft regulation is vital to the interests of citizens, legal persons or other organizations, MOFCOM may solicit comments from the general public before completing the regulation. Assuming a new regulation is deemed confidential, it will be published through three channels (1) the MOFCOM website (<http://www.mofcom.gov.cn/>); (2) the MOFCOM Gazette; and (3) the International Business Daily.

J. ACQUIRING STATE-OWNED ENTERPRISES IN SHANGHAI

On August 4, 2003 three authorities in Shanghai, the State-owned Asset Supervision and Administration Commission, Foreign Investment Work Commission, and Administration for

Industry and Commerce (AIC), jointly promulgated the *Implementing Rules on Foreign Investment in Acquiring State-Owned Enterprises Several Opinions (SOE Implementing Rules)*.

The *SOE Implementing Rules* specify the steps for foreign investors to acquire state-owned properties in Shanghai: (1) the submission of an application to the Comprehensive Service Window for Foreign Investment in Merger and Acquisition; (2) an asset evaluation; (3) the execution of a property transfer contract by the entrusted agents of the parties; (4) the transfer of property and registration of the transfer; (5) the approval by the Foreign Investment Commission of the property transfer; and (6) the registration of changes with the AIC with respect to both the state-owned enterprise and the new foreign invested enterprise.

XI. Conclusion

In 2003, China enacted revised regulations on mergers and acquisitions between domestic and foreign enterprises, as well as new regulations on Sino-foreign education ventures. China continued to strengthen its intellectual property regime. The banking, securities, and insurance sectors further opened to foreign investment. The development of telecommunications regulation in China continued. Foreign investors now have greater access to China's freight forwarding and construction sectors. Legal development should be expected to continue at a fast pace in 2004.

* Mr. Burke, B.S.F.S., Georgetown University School of Foreign Service; J.D., Georgetown University Law Center, is a Vice Chair of the China Law Committee. A Fellow at the Asian Institute of International Financial Law at Hong Kong University's Faculty of Law, Mr. Burke edited this article and drafted the government reform, venture capital, customs, Shanghai IP opinion, foreign exchange, financial services, telecommunications and technology, and other developments of note sections of this article. Ms. Bjornbak, B.A., East China Normal University; Certificate in Chinese Law, Fudan University; LL.M., University of Liverpool School of Law; J.D., Southwestern University School of Law, is a Vice Chair of the China Law Committee, and practices in Los Angeles with the Law Offices of Qiang Bjornbak. Ms. Bjornbak drafted and co-edited the foreign investment and intellectual property sections of this article. Mr. Bobrow, B.A., Georgetown University; M.A., Washington University; J.D. Washington University School of Law, is an Attorney-Advisor in the Office of the General Counsel at the U.S. Department of Commerce and is a Vice Chair of the China Law Committee. Mr. Bobrow drafted the international trade section of this article. Any opinions expressed in

Mr. Bobrow's section of this article are his alone and do not represent any policy or opinion of the U.S. Department of Commerce. Mr. Chen, B.A., Foreign Languages Department of Anhui Normal University; LL.B., Fudan University School of Law; LL.M., University of Liverpool School of Law, is an Executive Chairman for International Business Committee of the Lawyers Association of Jiangsu Province and a Managing Partner of Jiangsu Jin Ding Partners, PRC Lawyers, Nanjing. Mr. Chen drafted the foreign investment section of this article. Mr. Lehman, J.D., Loyola University of Chicago, is a Vice Chair of the China Law Committee and is the Managing Director of Lehman, Lee & Xu in Beijing. Mr. Lehman drafted the intellectual property section of this article. Mr. Redick, B.A., University of Michigan; J.D., University of Michigan, is a Member of Gallop, Johnson & Neuman, L.C. in St. Louis, and is Chair of the Agricultural Management Committee in the ABA Section on Environment, Energy & Resources. Mr. Redick drafted the subsection in the International Trade section addressing the Cartagena Protocol. Ms. Zhu, LL.B., Sichuan University School of Law; LL.M., Nanjing University School of Law, 1994; LL.M., Saint Louis University School

of Law, 1997, is an Associate in the San Francisco office of Wang & Wang, LLP, and drafted the Closer Economic Partnership Agreement section of this article. Special thanks to Beatrice Schaffrath and Amy Sommers, two China Law Committee Vice Chairs, for their review of and comments on this article. Any opinions or errors herein are the sole responsibility of the authors. This article is intended as a general overview of legal developments, and is not substantive legal advice.