



# China Practice Global Vision



4th Edition of 2010

Han Kun Newsletter Working Group

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## Insights & Ideas

### **China State Council Released New Policies to Attract Foreign Investment (Author: Xiaolin TENG)**

On April 6, 2010, the State Council promulgated the *Several Opinions of the State Council on Further Utilizing Foreign Capital (Guo Fa [2010] No. 9)* (the “**Opinions**”). The Opinions set forth twenty pieces of opinions from five aspects. According to the Opinions, the PRC government will once again revise the *Catalogue for the Guidance of Foreign Investment Industries* (the “**Catalogue**”), further delegate approval powers for foreign investment projects to local approval authorities, encourage diversification in foreign capital utilization forms and accelerate the establishment of a security review system for foreign mergers and acquisitions. Here follow the highlights of the Opinions.

#### **Revise the Catalogue**

Since the year 1997, when China promulgated its first edition of the Catalogue, the PRC government intends to amend the Catalogue for the fifth time. Pursuant to the Opinions, the new edition will reflect the policies of opening more fields to the outside world, encouraging foreign capitals to invest in high profile manufacturing industry, high-tech industry, modern service industry, new energy resources and energy conservation and environmental protection industry, and strictly restricting foreign funds entering into heavy energy-consuming, highly polluted and resource-demanded projects and low-level expanded projects with over-capacity of production. The timeline to revise the Catalogue has not been released yet.

#### **Delegate the Approval Power of Foreign Investment Projects to Lower-Level Approval Authorities and Lift the Approval Threshold of the Central Government**

The Opinions calls to further delegate the approval powers of the Central Government, stating that projects falling under the encouraged and permitted industries as listed in the Catalogue with a total investment amount (including capital increase) less than 300 million U.S. dollars shall be subject to the examination and approval of local governments, except for the ones required to be examined and approved by certain ministries and commissions of the State Council pursuant to the Catalogue of Investment Projects Approved by the Government. Currently, all ministries and commissions of the State Council exercise their approval powers in accordance the relevant provision of the *Interim Measures for the Administration of Examining and Approving Foreign Investment Projects* (the “**Interim Measures**”) issued by the National Development and Reform Commission in October 2004. According to the Interim Measures, projects of the encouraged and permitted industries with a total investment amount less than 100 million U.S. dollars and projects of the restricted industries with a total investment amount less than 50 million U.S. dollars shall be subject to the examination and approval of local governments. The Opinions lift the

approval threshold of the Central Government from 100 million U.S. dollars to 300 million U.S. dollars. However, it is worth noting that the Opinions do not delegate the approval power for projects of the restricted industries with a total investment amount of 50 million U.S. dollars or above to local governments. It remains unknown to us if the government will revise the Interim Measures or issue any detailed rules regarding the change going forward.

### **More Preferential Policies to Attract Foreign Investments**

The Opinions provide for a number of preferential policies and measures to attract foreign investments, mainly including: (i) certain projects in industries encouraged for foreign investment will be given priority in land provision and be able to enjoy discounted land transfer price at 70% of the statutory minimum price; (ii) multinational corporations are encouraged to establish in China their regional headquarters, R&D centers, procurement centers, financial management centers, settlement centers, cost and profit accounting centers and any other functional institutions. Before December 31, 2010, articles imported by qualified foreign-invested R&D centers for the purposes of scientific and technological development will be exempt from import duties, value-added tax and consumption tax; (iii) the government will further improve the foreign exchange administration of foreign-invested enterprises (the “FIEs”) and allow FIEs encountered with temporary financial difficulties to extend their capital contribution schedule; (iv) foreign investors are encouraged to invest in labor-intensive industries which meet the environmental protection requirements in China’s central and western regions; FIEs and domestic companies in China’s central and western regions may continue to enjoy preferential policies on business income tax where certain requirements are met; foreign-invested banks are encouraged to set up branches and launch business in China’s central and western regions.

### **Encourage Diversification of Foreign Capital Utilization Forms and Accelerate Establishment of a M&A Security Review System**

The Opinions set forth measures to encourage diversification of foreign capital utilization forms, most of which have been reflected in recently released laws and regulations. For example, the Opinions encourage foreign capital to participate in the reorganization and restructuring of domestic companies by way of equity participation and mergers and acquisitions, and call for the establishment of a security review system for foreign mergers and acquisitions. Furthermore, the Opinions encourage foreign investors to establish venture capital enterprises, actively utilize private equity investment funds and urge the Chinese government to perfect the exit mechanism for foreign-invested VC/PEs. The State Council promulgated the *Administrative Measures on Establishment of Partnerships within the Territory of China by Foreign Enterprises or Individuals* in March 2010 and Shanghai government approved the first foreign-invested equity investment partnership, both of which foretell the above policies as set forth in the Opinions. In addition, the Opinions support A-share listed companies to bring in domestic and foreign strategic investors and continue to support qualified PRC enterprises to get listed on overseas stock exchanges. In

practice, very few small and medium sized private companies are able to successfully get listed abroad due to invisible restrictions of the approval procedures. It remains to be seen whether these policies in the Opinions will be actually carried out.

## **Conclusion**

The Opinions also set out approaches to simplify the government approval procedures and improve the efficiency of the approval process so as to enhance the foreign investment environment. The opinions further urge the government to grant preferential land, tax and foreign exchange treatments to foreign investors. The Opinions give us many expectations on how the PRC government will carry out the new foreign investment policies and we are eagerly awaiting detailed measures to come out soon.

## Legal Updates

### 1. China Launches Pilot Reform of the System of Verification and Write-off of Import Payments in Foreign Exchange (Author: Lulu HAN)

On April 7, 2010, the State Administration of Foreign Exchange (“SAFE”) issued the *Notice on Issues Related to Implementation of the Pilot Reform of the System of Verification and Write-off of Import Payments in Foreign Exchange* (the “**Notice**”). The Notice provides that some cities/provinces will launch, on a pilot basis, the reform of the system of verification and write-off of import payments in foreign exchange (the “**Reform**”) from May 1, 2010. The Notice includes two annexes, namely, the *Measures for the Pilot Reform of Administration of Import Payments in Foreign Exchange of Trade in Goods* (the “**Measures**”) and *Detailed Implementation Rules of Measures for the Pilot Reform of Administration of Import Payments in Foreign Exchange of Trade in Goods* (the “**Detailed Implementation Rules**”).

#### **Main Points and Changes**

The main points of and changes brought about by the Notice and its annexes are set forth as follows:

- ◆ Pilot areas. According to the Notice, the Reform will first be launched on a pilot basis in seven cities/provinces, including Tianjin, Jiangsu, Shandong, Hubei, Inner Mongolia, Fujian and Qingdao.
- ◆ Upon implementation of the Reform, law-obeying enterprises will not need to carry out on-site verification and write-off formalities for their normal import payments. The Notice provides that import entities shall file information related to the verification of import payments with the Banks, which in turn will submit the same to local SAFE branches accordingly. Local SAFE branches will only conduct on-site verifications against enterprises which are carrying out unusual transactions. Law-obeying enterprises will not be subject to on-site verification and write-off formalities any more. Before the promulgation of the Notice, almost all import entities (including law-obeying enterprises) needed to go through on-site verification and write-off formalities.
- ◆ Banks will no longer carry out on-line verification procedures against importing enterprises when making forex payment. The Detailed Implementation Rules provide that where dealing with forex payment matters for import entities, banks do not need to verify electronic account books of goods import declaration forms on-line through “China E-Port-System of Import Payments in Foreign Exchange”.
- ◆ SAFE will maintain a directory which classifies import entities into different categories.

According to the Measures, after obtaining its foreign trade operation right, an import entity shall register with local SAFE branches, which will then place the entity in the directory; where the registered information changes, the import entity shall conduct modification registration with local SAFE branches; where the import entity ceases its operation or its foreign trade operation right is revoked, they shall conduct cancellation registration with local SAFE branches. The directory is accessible nationwide. Where an importing entity wishes to make foreign exchange payments at a place other than its place of incorporation/registration, it does not need to conduct beforehand recordation with the local SAFE branches.

- ◆ SAFE will conduct off-site verification against total imports of an import entity. According to the Measures, local SAFE branches shall conduct off-site total quantity comparisons between data of import payments and data of imported goods, verifying the authenticity and consistency of import payments in foreign exchange of import entities. In addition, the index system of monitoring and warning shall be established, to monitor and analyze situations of import payments in foreign exchange and goods imports, implement risk warning and identify unusual transactions and import entities engaging in unusual transactions.
- ◆ On-site verification will only be conducted against usual transactions. Based on results from off-site verifications, monitoring and warnings, local SAFE branches shall conduct on-site verifications against import entities whose indexes of total quantity verification exceed the provided scope or have other unusual situations. Methods of on-site verification include requiring entities which are subject to the verification to submit reports, meeting with people in charge of import entities, on-site investigations, etc.
- ◆ Import enterprises are ranked and put into different categories. According to the Measures and the Detailed Implementation Rules, SAFE shall assort import entities based on the assessments every half a year. On the basis of off-site total quantity verifications, monitoring results, and on-site verifications situations, local SAFE branches will divide import entities into “First Tier Import Entities”, “Second Tier Import Entities” and “Third Tier Import Entities”. Local SAFE branches conduct differentiated management against import entities under different tiers in handling such formalities as import payments examination, import payments registration, etc.

## **Summary**

The promulgation and enforcement of the Notice will greatly facilitate external payments under trade items and reduce the burden on enterprises and banks. The Reform reflects the change in foreign exchange administration of Chinese government and realizes the transition

from on-site verification and write-off to off-site verification and from supervision over behaviors to supervision over entities. The Reform has greatly simplified the procedures of import payment for enterprises, reduced costs of enterprises, and, more importantly, guaranteed the smooth operation of the normal business of law-obeying enterprises. The Notice provides for some transitional measures, according to which, import entities of pilot areas and non-pilot areas shall complete verification and write-off procedures with respect to their import payments occurring before January 1, 2010 at local SAFE branches before July 31, 2010. If import entities do not complete the verification and write-off procedures within the prescribed period and no proper justifications ever exist, they shall be subject to punishments by local SAFE branches or the said import payments shall be treated as import payments subject to future examination. We suggest that import entities to carry out relevant verification and write-off formalities as soon as possible in accordance with the transitional measures as stated above, so as to avoid possible punishments.

## **2. Summary of Opinions of the Supreme People's Court Concerning Issues on Trial of Administrative Cases on Determination of Trademark Right (Author: Kun MA)**

On April 20, 2010, the Supreme People's Court promulgated *Opinions of the Supreme People's Court Concerning Issues on Trial of Administrative Cases on Determination of Trademark Right* ("**Opinions**"), which sets forth the law application standards for issues existing in trial of administrative cases on determination of trademark right by the courts. Main content of the Opinions is as follows:

### **Identification of "other unhealthy influences"**

Section 8, Article 1 of the *PRC Trademark Law*, acting as an open term, provides that those marks "detrimental to socialist morals or customs, or having other unhealthy influences" shall not be used as trademarks. However, the law fails to define what constitutes "other unhealthy influences", which leads to a divergence of understanding and application in practice. The Opinions gives an explanation as to how to identify "other unhealthy influences" by stipulating that in judging whether a mark has other unhealthy influences, the possibility of negative influence to public interests and public order arising from such sign shall be considered. The Opinions further states that circumstance only impairing civil rights shall not belong to "other unhealthy influences".

### **Judgment of "Distinctive Characteristics"**

Having distinctive characteristics is an important factor for realizing trademark function. The *PRC Trademark Law* prescribes that, a trademark for registration shall be so distinctive as to be distinguishable and marks that lack distinctive characteristics shall not be registered as trademarks. The Opinions use many articles to regulate judgment of distinctiveness of a

certain mark, some of which are principle rules, whereas others provide guidance to specific trial issues.

◆ Principle of judging distinctiveness

Article 5 of the Opinions stipulates that, judging distinctive characteristics of disputed trademarks shall conform to general public recognition and entire principle.

◆ Principle of judging foreign language trademarks' distinctive characteristics

Article 6 of the Opinions stipulates that, judging distinctive characteristics of foreign language trademark shall be on the basis of general domestic public recognition to foreign language trademark as a commercial mark.

◆ Circumstance of lacking distinctive characteristics

Article 9 of the Opinions stipulates that, if a mark only or mainly describes quality, material, function, quantity, weight and origin of a commodity, such mark shall be determined to be lacking of distinctive characteristics.

### **Identification of Common Name**

According to Section 1, Article 11 of the *PRC Trademark Law*, marks which only contain common names of a commodity shall not be registered as trademarks. Given the difficulties in identifying common names in judicial practice, the Opinions set forth standards for identification of common names.

Article 7 of the Opinions stipulates that, when determining whether a disputed trademark belongs to common names, the court shall examine whether it is a legal or conventional commodity name. Names which are classified as common names in accordance with law, state standard or industry standard, deemed to standing for a class of commodity by public cognition, and listed as commodity names by professional reference book and dictionaries, shall be determined as common names. The standard of "common" shall be on a national wide basis in principal and on a special-circumstance basis as an exception.

### **Understanding and Application of Article 31 of the PRC Trademark Law**

In accordance with Article 31 of the *PRC Trademark Law*, no trademark application shall infringe upon another party's existing prior rights, nor shall an applicant rush to register in an unfair manner a mark that is already in use by another party and that enjoys substantial influence. The Opinions provides further guidance as how to construe and interpret Article 31:



- ◆ Further emphasis: Article 17 of the Opinions stipulates that prior rights that have been prescribed by the *PRC Trademark Law* shall be protected in accordance with specific provisions of the *PRC Trademark Law*. However, those prior rights which are not addressed by the *PRC Trademark Law* shall be protected by Article 31.
- ◆ Definition of “existing”: Article 17 of the Opinions gives a definition to “existing” as specified in Article 31 of the *PRC Trademark Law*, providing that, to judge whether impairing prior right shall defer to the date of trademark application. In consideration of the legislative purpose of Article 31, Article 17 of the Opinions prescribes that in the event prior rights do not exist at the time of approval of registration of the disputed trademark, the registration of the trademark shall not be influenced.
- ◆ Identification of “unfair manner”: In accordance with Article 18 of the Opinions, if evidence demonstrates that the applicant register a trademark which is already in use by another party and enjoys substantial influence under circumstance that the applicant has been fully aware or should be aware of such condition, the court can affirm that the applicant has adopted an unfair manner.
- ◆ Identification of “already in use by another party and enjoys substantial influence”: the Opinions gives further explanation that, the trademark which has been used in PRC and has been known by the public shall be identified to be already in use and have substantial influence.

### **Understanding and Application of Article 41 of the PRC Trademark Law**

Article 41 of the *PRC Trademark Law* is relevant to the dispute and adjudication of improper registration trademarks. Article 19 of the Opinions identifies “other improper means” by combination of enumeration and an open term. To judge whether the registration of a trademark is acquired by any other improper means, the court shall consider if the registration disturbs trademark registration order, impairs public interest, improperly occupies public resources or seeks improper benefits by other improper manners. At the same time, behaviors infringing specific civil interests shall be judged in accordance with Section 2 and Section 3 of Article 41 of the *PRC Trademark Law* and other relevant provisions.

Besides, the Opinions sets forth detailed explanations to rush registration (Article 15 of the *PRC Trademark Law*), protection scope of dissimilar commodity in respect of well-known trademark (Article 13 of the *PRC Trademark Law*), standards of judging trademark likeness and similarity (Article 28 of the *PRC Trademark Law*), affirmation of ceasing to use the registered trademark for three consecutive years (Article 44 of the *PRC Trademark Law*).

### 3. China's SAIC Clarified Restrictions on the Qualifications of Legal Representatives (Author: Yeting CAI)

On April 15, 2010, China's State Administration for Industry and Commerce ("SAIC") issued the *Circular on Further Enhancing the Work of Implementation of Restrictions on the Qualifications of Legal Representatives of Enterprise Legal Persons* (Gong Shang Qi Zi [2010] No. 82) (the "Circular"), which urges local AICs to strictly follow restrictions on the qualifications of legal representative of enterprises.

The Circular emphasizes that where circumstances occur and render the incumbent legal representative unqualified in accordance with the *PRC Company Law* and other relevant laws and regulations, he/she shall not be allowed to continue to act as the legal representative of the company he/she is working with or to act as the legal representative of other companies during the statutory restriction period. The scope of restriction shall be strictly limited to the position of legal representatives and shall not be extended to shareholders, i.e., the person may continue to act as a shareholder of an enterprise. When the restriction period is expired, such restriction shall be lifted timely through setting automatic removal procedures and the restriction period shall not be extended. Where the legal representative of an enterprise is unqualified for this position any longer due to AIC's decision of revoking the enterprise's business license or the decision of shutting down its business and such decisions are revoked later on, the restriction on its legal representative shall be removed on a timely manner by the original AIC which rendered the decisions.

In addition, the Circular requires local AICs to strengthen their information collection and management to ensure restriction information be recorded timely, accurately and completely. Where the business license of an enterprise has been revoked or the enterprise is ordered to close down its business due to its violations of law, the local AIC which made or implemented these punishment decisions shall input the relevant information of the enterprise and its legal representative to its business management system timely. Provincial-level AICs shall take actions to ensure that the relevant information in the whole system is updated daily and local AICs shall communicate actively with the relevant government departments, courts and other authorities to enlarge sources of restriction information.

Finally, the Circular demands that all local AIC shall actively explore and improve the system for classified supervision over enterprise credit and mechanism for sharing government information. To urge companies to lawfully and honestly conduct business, local AIC shall explore and establish information bases of legal representative credit and conduct classified guidance and management on legal representatives by means of administrative law enforcement, administrative guidance and etc.

#### **4. Circular of the State Council on Resolutely Curbing the Housing Price in Certain Cities From Rising Too Fast (Author: Qing GUO; Yue ZHENG)**

The State Council of the People's Republic of China issued a circular (i.e., the *Circular of the State Council on Resolutely Curbing the Housing Price in Certain Cities From Rising Too Fast* [Guo Fa (2010) No. 10]) on April 17, 2010 to further curb the rising house price. The key points of such circular are highlighted as follows:

- ◆ Intensifying the implementation of differentiated housing loan policy. As to the family (including borrower, spouse and minor children) who is going to buy the first self-living house with a construction area of more than 90 m<sup>2</sup>, they should pay at least 30% of the total housing price as the down payment to apply for a bank loan; As to the family who is going to buy a second house, they should pay at least 50% of the total housing price as the down payment to apply for a bank loan, and the interest rate of the loan shall not be less than 1.1 times of the benchmark interest rate; As to the family who is going to buy a third house, the down payment rate and interest rate of the loan should be considerably increased and the specific rate should be decided by commercial bank based on risk management rule.
- ◆ Strictly restricting the speculation in real estate. Based on risk analysis, commercial banks may suspend issuing housing loan to the purchaser who is going to buy a third or more houses at some area, where the house price is overheated or increasing too fast or the house supply is short. The housing loan shall be suspended for those non-local residents who can not provide the proof that they have already paid the local tax or social insurance more than one year. Based on the actual situation, the local government could adopt temporary measures to restrict the amount of house purchase during a limited period.
- ◆ Utilizing taxation policy to adjust the housing consumption and real estate profits. The Ministry of Finance and the State Administration of Taxation should expedite the research and formulation of the taxation policy concerning the guidance of reasonable individual housing consumption and the adjustment of individual housing income.
- ◆ Reinforcing the supervision of land purchase and financing of real estate developers. During the process of land bidding and land development construction, the shareholders of real estate developers should not provide loan, loan transfer, security or other financing conveniences for the real estate developers. Commercial banks shall not issue loan to the new development projects of those real estate developers which own idle land or conduct speculation in land. And Securities regulatory departments shall suspend the approval of the aforesaid real estate developers' listing, refinancing and material assets restructuring.

## **Important Announcement**

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