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CHINA ISSUES LONG-AWAITED INCOME TAX RULES ON CORPORATE RESTRUCTURINGS

China has published the long-awaited rules on the income tax treatment of corporate reorganizations. The *Notice on Certain Questions Regarding the Enterprise Income Tax Treatment of Enterprise Reorganizations* (“**Final Reorganization Rules**”) was issued jointly by the Ministry of Finance (“**MOF**”) and the State Administration of Taxation (“**SAT**”) on 30 April 2009 and released to the public on 7 May 2009. The Final Reorganization Rules have retroactive effect back to 1 January 2008. Six types of enterprise reorganizations are covered by the Final Reorganization Rules: change of legal form, debt restructuring, share acquisition, asset acquisition, merger and de-merger. Article 75 of the *Implementing Rules of the Enterprise Income Tax Law of the People’s Republic of China* provides that a taxpayer should recognize gain or loss from reorganizations unless otherwise provided by the MOF and the SAT. The Final Reorganization Rules set out two types of tax treatment for the six types of enterprise reorganizations: normal tax treatment and special tax treatment. A taxpayer should recognize gain or loss from reorganizations with normal tax treatment. On the other hand, a reorganization that qualifies for the special tax treatment can be carried out without triggering enterprise income tax.

I. Baseline Requirements for Tax-Free Treatment

To qualify for the special tax treatment, the following conditions must be satisfied:

1. The reorganization has reasonable commercial purposes, and reduction, exemption or deferral of taxes is not a major purpose of the reorganization;

2. The assets or shares transferred under an acquisition must meet the prescribed proportion, i.e. no less than 75% of the total assets or shares of the target;
3. The key business activities cannot be changed within 12 months after the reorganization;
4. The equity consideration in the reorganization must meet the prescribed proportion, i.e. no less than 85% of the total consideration; and
5. The original main shareholder(s) that receive equity consideration under the reorganization cannot transfer the equity interest(s) within 12 months after the reorganization.

In addition, the Final Reorganization Rules incorporate the “substance over form” principle such that step transactions carried out within 12 months could be considered as one transaction to determine the relevant tax treatment. This is particularly relevant for potential transactions that would qualify for special tax treatment, only to then have a follow-on transaction to perhaps an unrelated buyer intended to avoid PRC tax.

II. Special Requirements for Cross-Border Transactions

For cross-border share acquisitions and asset acquisitions to qualify for special tax treatment, additional conditions must be satisfied:

1. A non-resident enterprise (i) transfers shares of a resident enterprise to another non-resident enterprise over which the transferor has “direct 100% share control”, (ii) such a transfer would not change the withholding tax burden on capital gains to be derived from the transferred shares

in the future and (iii) the transferor undertakes in writing to the competent tax bureau that it will not transfer the shares of the transferee that it receives as consideration within the next three years after the reorganization;

2. A non-resident enterprise transfers shares of a resident enterprise to another resident enterprise over which the transferor has “direct 100% share control”;
3. A resident enterprise invests assets or shares in a non-resident enterprise over which it has “direct 100% share control”¹; or
4. Other situations as approved by the SAT and MOF.

Under the above rules, the following reorganizations often contemplated by foreign investors may be able to qualify for tax-free treatment:

1. The transfer of a Chinese subsidiary from one offshore entity to another offshore entity, although some offshore pre-positioning may be necessary to satisfy the “direct 100% share control” requirement. This essentially allows foreign investors to transfer their Chinese subsidiaries to group entities that are set up in jurisdictions with favourable treaty terms with China, such as Hong Kong, Singapore and Ireland in order to enjoy the reduced withholding tax rate on dividend repatriation; and
2. The transfer of a Chinese subsidiary from the offshore shareholder to another Chinese subsidiary (e.g. a Chinese holding company). This will allow foreign investors to centralize their PRC operations under a Chinese holding company.

¹ Instead of a complete tax deferral, the gain from the transfer of assets or shares in this scenario will be recognized in equal instalments over 10 taxable years.

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Furthermore, the Final Reorganization Rules do not provide that cross-border mergers or de-mergers need to satisfy the additional conditions to qualify for special tax treatment. Therefore, we believe that mergers and de-mergers of Chinese subsidiaries of foreign investors should be able to qualify for special tax treatment as well, provided they meet the baseline conditions listed above.

It is also important to note that the Final Reorganization Rules leave the door open for cross-border reorganizations that do not directly satisfy the conditions #1 – 3 related specifically to cross-border reorganizations in Section II above to qualify for special tax treatment, if they can get special approval from the SAT and MOF.

III. Treatment of Merger/De-Merger Transactions

If a merger or a de-merger qualifies for special tax treatment, no gain or loss needs to be recognized and the original tax basis of the assets and shares are preserved. The accumulated losses and other tax attributes can be carried over to the post-merger or de-merger entities². If a merger or a de-merger is subject to normal tax treatment, gain or loss needs to be recognized under a deemed liquidation or asset transfer. Accumulated losses and other tax attributes cannot be utilized by the post-merger or de-merger entities.

The Final Reorganization Rules also clarify the treatment of pre-merger/de-merger tax incentives after a merger/de-merger. This will be of particular interest to Chinese subsidiaries of foreign investors that continue to enjoy transitional tax holidays under the pre-2008 income tax regime.

1. In a merger by absorption, the surviving enterprise can continue to enjoy its unutilized tax incentives³.
2. In a survived de-merger, the surviving enterprise can continue to enjoy its unutilized tax incentives⁴. The tax incentives of the non-surviving enterprise cannot be utilized by the surviving enterprise.
3. If the surviving enterprise is at a loss position in the year immediately prior the merger/de-merger takes place, the tax incentives to be utilized by the surviving enterprise would be zero.

However, the Reorganization Rules do not clarify whether there will be a claw-back of the tax incentives enjoyed by the non-surviving enterprise upon the merger.

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2 Limitation on loss carry-over under a tax-free merger = FMV of the net assets of the non-surviving entity x the interest rate on national debt for the longest term debt issued by the State in the year in which the merger occurs.

3 The amount of income of the surviving enterprise that will be eligible for the incentive after the merger is limited to the surviving enterprise's taxable income in the year before the merger.

4 The amount of income of the surviving enterprise that will be eligible for the incentive after the de-merger is limited to the surviving enterprise's taxable income in the year before the merger multiplied by the ratio of the surviving enterprise's assets after the de-merger to the surviving enterprise's total assets before the demerger.

INTERNET BUSINESS LAW IN CHINA FOR U.S. COMPANIES

Good news first: The People's Republic of China ("PRC") provides more than a billion potential consumer customers and has a rapidly growing population of Internet users exceeding 250 million and broadband subscribers exceeding 70 million. No U.S. company with aspirations for international expansion can afford to ignore the opportunities in China. And, Chinese regulators largely ignore U.S. companies in the sense that the Chinese authorities do not usually apply or enforce Chinese laws extra-territorially to companies that run their Internet businesses from locations outside the PRC unlike, say, the European Community and its member states' regulators. Thus, a U.S. company can create a Chinese-language version of its global Web sites with relative ease and disregard for the Chinese regulatory regime.

So, anything goes? Well, not so fast.

The Need to Go Onshore

Yes, anything goes for U.S. companies that can successfully operate their Internet businesses entirely off-shore, that is, outside of the PRC. Due to exchange control restrictions, China's grip on Internet gateways and also a perceived need for local sales and marketing representation, many U.S. companies feel a need to go onshore and establish presences in China.

- The vast majority of potential customers in China cannot or will not pay in US dollars and the Chinese currency, the Renminbi, is not freely tradable. This means that a U.S. company cannot charge in Renminbi, and only companies based in China can obtain blank official invoices from the government and process Renminbi payments.
- Internet users in China experience delays and slow speeds when they

access Web sites that are hosted on servers outside China, because all foreign Internet traffic is routed through government-controlled gateways. To compete effectively, U.S. companies with complex Web sites are forced to create at least mirror sites on servers in China or establish local servers to host content and e-commerce applications for the Chinese market.

- Many U.S. companies experience a need for up-to-date information on the very different and constantly evolving market conditions. Thus, they want to send employees to China and hire local representatives, also, to make and take calls at a local phone number, demonstrate a commitment to the market, provide a face to potential partners and customers, and pursue business opportunities in the same time zone with local talent.

The Perils of Going Onshore into the Heavily Regulated PRC Environment

With the drive to go onshore and set up shop in China comes the bad news: The People's Republic of China has heavily regulated Internet, e-commerce, telecom, and content publishing businesses on top of an already strict general regulatory regime that applies to all business activities, in particular foreign-controlled investment.

- Basic telecom services in practice are off-limits to foreign companies and many Internet services (classified as "value added services") cannot be offered by majority-foreign-owned enterprises.
- Joint ventures with Chinese companies are difficult to establish and control due to regulatory restrictions and mandatory corporate governance requirements that have

the effect of protecting Chinese shareholders.

- The establishment of subsidiary corporations and representative offices takes more time and investment than in most other jurisdictions.
- The PRC government requires service providers to censor all content offerings and actively pursues dissidents who publish critical views via email or bulletin boards (which puts U.S.-based Internet service providers and social networking operators in conflict with public policy and public opinion in the United States).
- Multiple agencies have jurisdiction over various aspects of Internet business activities.
- Although applicable laws and regulations are largely consistent, official guidelines and practice vary from province to province and town to town, and the reality in the marketplace often differs greatly from statutory wording, which makes planning and implementation difficult, costly, and time-consuming.
- The PRC tax environment is complex and tax rates are relatively high.
- Employment laws have been tightened and have increased the cost of labor significantly in recent years.
- Legal translation costs are also high.

Details of the Chinese Internet and Business Law

The Ministry of Industry and Information Technology ("MIIT") has overall responsibility in China for regulating the Internet. It recently underwent a change of name and is probably better known to U.S. companies familiar with China by its former name, the Ministry of Information Industry. Governmental authorities with jurisdiction over imports, tax, foreign

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exchange, and online payments also play important roles. In addition, Internet transactions are subject to industry sector authorities, such as those that administer pharmaceuticals, securities, audiovisual products, and news reporting.

The State Administration for Industry and Commerce, which is familiar to many foreigners as the agency in China that issues business licenses, also regulates all kinds of commerce. It has not taken an active role in regulating the Internet, but uncertainty prevails about the potential impact of its policies.

All telecommunications into and out of China are routed through four international communication gateways controlled by the MIIT, which can, and frequently does, take steps to firewall offending Web sites by blocking Internet protocol addresses, filtering and redirecting domain name systems, filtering uniform reference locations, and packet filtering. Under the Regulations for the Administration of Internet Information Services, effective from September 25, 2000, and subsequent legislation, vendors located within China are additionally subject to monitoring of their Web sites by Internet content providers and Internet service providers, which are required to keep records of site or service use for 60 days.

Another tool that has been used to regulate the supply of foreign goods and services over the Internet is China's foreign exchange control regime. Payments for items for the capital account (e.g. investment, purchase of securities) are subject to approval by the State Administration of Foreign Exchange, and all payments for the current account (e.g. purchases of goods and services, royalties) are subject to documentation requirements, in some cases quite detailed. Each remittance to a foreign vendor is channeled through an authorized foreign exchange bank in China that examines any required supporting documents. If the documents are not complete or the payment is for a restricted purpose, the bank will refuse to remit the payment or will

refer the matter to the local counterpart of the State Administration for Foreign Exchange.

If the remittance is refused, the customer in China often has no legal alternative means to pay the foreign vendor. China thus effectively restricts the sales of certain goods and services from offshore by prohibiting payment for them.

The documentary requirements for remittances were quite burdensome, and purchasers often were unwilling to deal with them, putting foreign vendors at a competitive disadvantage vis-à-vis local vendors that accepted payment in local currency (Renminbi). Either the customer or the foreign vendor could retain the services of an agent in China to assist with remittances, but such assistance added to the cost of goods and services to the purchaser. Although the foreign exchange control regime remains in place, fortunately for foreign vendors and Chinese purchasers, China has gradually relaxed foreign exchange limits on both individuals and businesses.

Under the Detailed Implementing Rules of the Measures for the Control of Foreign Exchange of Individuals, effective February 1, 2007, individuals may now purchase up to US\$50,000 of foreign currency each year and remit up to US\$10,000 or US\$50,000 (depending on the source of the funds being remitted) of foreign currency each day for current account payments on the basis of a valid identification document. Capital account payments still require approval by the State Administration for Foreign Exchange.

Companies are not subject to any general monetary limits on remittances as long as they are made for permitted business purposes, but must provide supporting documentation.

Although small as a percentage of the total Chinese population, debit card and, to a lesser extent, credit card usage is rapidly increasing in China. Cross-border payment in Renminbi is not permitted, and the purchaser must have a foreign

exchange debit or credit card to make a cross-border purchase. Foreign exchange cardholders must deposit foreign exchange with the card-issuing bank or give a pledge over their savings deposits. Total charges using the card generally may not exceed 80 percent over the secured amount. Separate limits apply to credit card purchases by companies for business purposes.

A word of caution is warranted regarding offshore Web sites. China can clearly extend its jurisdiction to them, if it wishes, even if enforcement of a judgment or administrative decision may be difficult. Foreign vendors should anticipate that China will try to exert some control over offshore Web sites that have a direct effect in China as Chinese Internet regulations develop and foreign exchange controls are loosened. For example, Chinese privacy laws could be applied to protect the interests of Chinese customers if an offshore Web site collects and uses the customers' personal information.

When goods are imported from offshore, the purchaser or an agent must pay import duty, import level value-added tax, and consumption tax, if any. The duty and taxes are paid when the goods are cleared through customs. Although foreign vendors generally do not bear any Chinese tax burden on such goods, import duty and taxes add to the cost of the goods to the purchaser. Cross-border trade is now facilitated by the services of FedEx, UPS, and other international courier services, which may provide assistance with customs clearance.

Software purchased from offshore is a special case because it may be treated as an import of a good or provision of a service (i.e. a license) or both. If shipped on a CD through customs, the Chinese purchaser or the agent pays the duty and applicable import-level taxes. China does not impose import duty on software, but does impose import-level value-added tax at the rate of 17 percent on the total of software media and qualifying royalties. In practice, software purchased over the Internet is often

imported through customs (sometimes by sending a blank CD through customs if the customer has already downloaded the software), and the purchaser pays value-added tax in China on the full value of the media and software in order to generate documents to support payment to the vendor.

If software is sold and delivered over the Internet without clearing Chinese customs, the transaction will not generate any customs documents to support payment through an authorized foreign exchange bank; however, the vendor and purchaser can often generate payment documents by treating the sales as a non-trade transaction. Non-trade transactions under China's foreign exchange regime include licensing of technology and trademarks (e.g. software downloaded over the Internet) and provision of services in person or over the Internet.

A sale of software over the Internet can be treated as a software license that generates royalty payments. It must be supported by a license agreement between the vendor and purchaser. Under Chinese tax laws and treaties, royalties to licensors that have no establishment in China are passive income subject to withholding, typically at the rate of 10 percent of the gross amount of the payment. Royalties for certain intangible rights, such as a license of software, are also subject to withholding of business tax at the rate of 5 percent of the gross amount of the payment. The taxes are now added together, resulting in a combined rate of 15 percent, which the purchaser deducts from remittances sent to the foreign vendor.

Non-trade remittances by Chinese consumers are subject to the foreign limits described above. In addition, all non-trade remittances must be supported by a Tax Clearance Certificate if the remittance amount exceeds US\$50,000. As part of the liberalization of foreign exchange controls in China, however, the Circular of the State Administration of Taxation on Relevant Issues of the Trial Tax Filing System for Remittances Offshore for the Foreign Service Trade,

issued March 6, 2008, allows companies in certain trial areas, including Shanghai, Tianjin, and Fujian Province, to remit payments in excess of US\$50,000 and settle withholding taxes later.

Because software may be treated as either a product or a service, software vendors are well advised to plan sales to China to minimize the risk of duplicative taxation. In most cities, the value-added, passive income, and business taxes are paid to two tax bureaus (i.e. state and local tax bureaus) or departments and are allocated to different government coffers, creating a substantial risk that value-added, passive income, and business tax will all be levied on the same purchase of software.

Turning to sales and services supplied from within China, Chinese foreign exchange regulations require sales to Chinese customers to be denominated and paid in the local currency, Renminbi. Customers typically prefer paying local currency because they do not have to deal with China's foreign exchange control regime and business customers receive a value-added tax ("VAT") invoice, which they require to credit the input tax against the tax received from their customers, which must otherwise be paid to the tax bureau.

Under the Foreign Invested Commercial Enterprise Regulations, effective from June 1, 2004, a foreign vendor that wishes to sell goods within China can establish a subsidiary in China. The subsidiary may deal only in classes of products listed in its business scope, which is subject to approval by the Ministry of Commerce ("MOFCOM") or its local counterpart. Certain activities and classes of goods (such as publication of books, newspapers, and magazines) are prohibited to foreign investment, but most are either fully open, or foreign investment is permitted subject to certain restrictions.

A subsidiary of a foreign vendor can import and sell goods within its business scope. The subsidiary can record a Web site to market its products under the

Regulations for the Administration of Internet Information Services, effective from September 25, 2000. If the Web site is used to market and sell the subsidiary's own products, it is generally considered a "non-commercial Internet information service" and requires only recordal with the telecommunications authorities to operate.

On the other hand, supplying services from within China raises thorny issues of law and practice. China restricts foreign investment in certain industries. The Catalogue for Guiding Foreign Investment in Industry, which was last amended and took effect on December 1, 2007, classifies industries and assigns them to the category of prohibited, restricted, or encouraged. All industries not listed are permitted.

Most Internet services fall under the Telecommunications Regulations of the People's Republic of China, promulgated on September 20, 2000, and, along with most telecommunications services, fall in the restricted category.

Internet services are subject to differing treatment according to their classification as "basic telecoms" or "value-added telecom services." The Regulations for the Administration of Foreign-Invested Telecommunications Services, promulgated December 5, 2001, limit foreign ownership to 49 percent of a Chinese-foreign joint venture providing basic telecoms services and 50 percent of a Chinese-foreign joint venture providing those value-added services listed in the Schedule of Specific Commitments on Services, which China agreed to upon accession to the World Trade Organization. Value-added services not listed in the Schedule are subject to further restriction or prohibited.

The dividing line between basic and value-added telecoms services is not always clear, but basic telecoms mainly include services requiring telecom infrastructure, such as fixed-network telephone services and mobile cellular communications services, as well as voice-over Internet protocol ("VOIP").

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In practice, no direct foreign investment in basic telecoms is currently permitted.

Value-added telecoms include services of potential interest to Internet vendors, such as (1) online data processing (e.g. online banking, auctions, payment processing, and back-office functions), (2) data storage services, (3) Internet information services (e.g. Internet content providers (“ICPs”)), (4) data hosting, (5) Internet access services (e.g. Internet service providers (“ISPs”)), and (6) call centers (e.g. centers providing technical or training assistance online or by telephone). Items 1 to 3 are open to 50 percent Chinese-foreign joint ventures, although we are not aware of any foreign-invested joint venture that has been granted an online data processing permit (item 3).

Items 4 to 6 are not in the World Trade Organization Schedule and are subject to tighter restrictions than other value-added services or are prohibited to foreign investment. Under the Mainland-Hong Kong Closer Economic Partnership Arrangement, however, signed June 29, 2003, Hong Kong companies (including those with foreign investment that meet certain criteria) are permitted to establish joint ventures to provide Internet data center, data storage, call center, and Internet information services (i.e. ICPs).

Although many more foreign investors have applied, only about 19 Chinese-foreign joint ventures have received permits from the MIIT to provide value-added services, and the majority are authorized as Internet content providers. Some delay in approving further value-added permits to foreign-invested joint ventures was experienced because of a 2008 reorganization of the MIIT, but the MIIT began operating in June and its new Web site is now online.

Given the restrictions on foreign investment in value added services, foreign companies have found several creative workarounds to provide Internet services. A common strategy, relying on the recent provenance and ambiguity

of many of China’s commercial laws and regulations, is to establish a subsidiary with a business scope to provide permitted services, such as consulting services or technology development, but additionally use the subsidiary to engage in related services falling in a so-called grey-area of the regulatory regime. For example, some foreign subsidiaries offering portal-like functions have been established with a business scope that includes development of software or research into new technologies.

Other strategies include contracting with a licensed, third-party local company to which a foreign subsidiary leases equipment. The local company provides value-added services on behalf of the subsidiary. Some foreign subsidiaries have “rented the license” of a local company by assuming operational control and/or sharing revenue of that company through a mix of service, license, loan, stock option, and other contracts. This last arrangement is sometimes called the China-China-foreign (“CCF”) structure, as it typically involves a local company with the appropriate license, either a wholly owned foreign subsidiary or a joint venture between a Chinese and a foreign company and a foreign parent company. The foreign company or subsidiary supplies the capital and technology required by the local company.

The CCF structure has been used for many years, but it can be risky. It was created when China Unicom built out its mobile telecoms infrastructure in the 1990s. Despite a prohibition on foreign investment in telecoms that was in effect at the time, many foreign companies sought ways to participate in the build out and subsequent operation of the network (classified as basic telecoms). With the tacit approval of the regulatory authorities, those companies and China Unicom used the CCF structure to channel more than US\$1 billion into the build out. In 1999, however, the Ministry of Information Industry (now Ministry of Industry and Information Technology (“MIIT”)) ordered the foreign investors

to divest their interests. In addition to being excluded from future operational profits, some investors were not able to recoup their full capital.

Despite the implosion of this arrangement, many companies have subsequently used variations of the CCF structures to invest in value-added services in China. The CCF structures used by high-profile players, including Sina.com and Sohu.com, are ongoing and information about them is publicly available.

It is clear, however, that the MIIT is not comfortable with the structure. In its Notice concerning Strengthening the Administration of Foreign Invested Value-Added Telecom Business Operations, issued on July 13, 2006, the MIIT expressly cracked down on cooperation between foreign and local telecoms companies by requiring local companies to own the domain names and trademark registrations used for value-added services operations. Foreign companies typically are reluctant to transfer established intellectual property assets to China for organizational and control reasons. In addition, transfer of an established mark or domain name may result in substantial tax costs to the transferor. The Notice additionally prohibits local companies from covertly renting, lending, or transferring their value-added licenses to any party.

China tends to target high-profile players, and in 2006 it was widely reported in the Chinese press that the MIIT was scrutinizing Google for allegedly using the license of Ganji.com, a local company, to provide value-added services in China. Google subsequently applied through a joint venture subsidiary and received an Internet Content Provider permit. Despite such cases, variations of the CCF structure and other workarounds are reportedly still widely used in the value-added space in China by both experienced and new players.

What will the future bring for Internet services in China? Currently, a significant issue is the rapidly evolving nature

of Internet services and the difficulty of fitting them within the Chinese telecom regulatory regime. China is clearly determined to develop Internet commerce, however, as evidenced by a slew of regulations and notices in the past several years, such as the Several Opinions of the General Office of the State Council on Accelerating the Development of E-Commerce, issued on January 28, 2005. While there is still no easy way for foreign Internet vendors to participate, the enormous potential of China will no doubt continue to stimulate creative efforts to enter the Chinese Internet market.

What to Do? Planning and Execution on the PRC Internet Business Plan

U.S. companies going to China should carefully assess which of their activities require a local presence and consider tailored strategies for individual business lines.

Sophisticated services targeted at large companies may be better offered from offshore, ideally under a slightly different brand and with clearly divided organizational structures to separate these offerings from onshore activities. The same applies to advertising-financed business models that target multinationals that are also outside of China and want to use an Internet forum to promote products sold through different channels. To support such business lines from a market perspective, the U.S. company could deploy a representative office with a limited business scope.

U.S. companies that want to successfully target consumers or small to mid-sized companies in China, however, will have to go onshore. They have to evaluate the PROs and CONs of partnering with Chinese companies that hold necessary licenses, or work with independent intermediaries, with the obvious disadvantages regarding margins and control. Tax and customs planning is also vital.

A final word on joint ventures: Equity joint ventures are costly and time-consuming to set up and dissolve for any jurisdiction, but China's regulatory regime takes the pains to an extreme, especially when U.S. companies try to structure off-shore joint ventures to minimize the impact of local corporate law inflexibilities. Most perceived advantages of equity joint ventures can be simulated and achieved through carefully crafted contractual cooperations, except the exit options of a public listing and third-party sale. But, these are often not realistic options anyhow for U.S. companies that enter China to promote their global brand.

So, be wary when you enter the land of the dragon. You cannot afford to stay away, but you need to prepare all stakeholders in your business for an adventurous journey.

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CHINA MERGER CONTROL: GLOBAL TRANSACTIONS SUBJECT TO SCRUTINY, DIVESTMENT CONDITIONS

- Acquisition of Lucite by Mitsubishi Rayon cleared in China, subject to significant, China-specific divestment conditions
- Filing thresholds mean that many global transactions will now be subject to review and clearance in China
- Decision underlines the need for parties to consider the competitive impact of their transactions in China, and local market conditions, even if the primary focus of a transaction lies elsewhere

On April 23, 2009, following three months of review, the Anti-Monopoly Bureau of the China Ministry of Commerce (“**MOFCOM**”) issued a statement clearing the acquisition of Lucite International Group Limited (“**Lucite**”) by Mitsubishi Rayon Company Limited (“**Mitsubishi Rayon**”). The clearance was, however, subject to a number of substantive conditions, intended to remedy competition concerns MOFCOM had identified on certain chemicals markets in China.

This ruling is significant. It shows that MOFCOM is fully prepared to take a strong stance in applying the new Anti-Monopoly Law, not only in transactions centred close to home (as in the recent, well-publicised prohibition of Coca-Cola’s attempt to buy Huiyuan Juice) but also in relation to regional or global deals, where China may not be the only country impacted.

Mitsubishi Rayon describes itself as the leading supplier of methyl methacrylate (“**MMA**”) in Asia. MMA is a polymer used primarily to produce poly-methyl methacrylate (“**PMMA**”), or acrylic glass. PMMA, in turn, is used in a wide range of applications as a glass substitute,

including TV screens and motorcycle helmets.

While Mitsubishi Rayon’s stated objective in acquiring Lucite is the building of a substantive MMA and PMMA presence in Europe, Lucite also has a significant Asian business, including a manufacturing plant in China.

MOFCOM’s Concerns

MOFCOM states that it began its analysis by identifying the relevant markets impacted as MMA and PMMA, with the relevant geographic market for both of these being China. The basis for MOFCOM reaching this view has not been published, though draft Market Definition Guidelines, published in January 2009 and revised in March 2009, set out the overall methodology that MOFCOM applies.

Having established its frame of reference, MOFCOM evaluated the competitive impact of the transaction. According to MOFCOM, the combined business would account for 64% of MMA sales in China. This placed the combined business well ahead of the next largest producers, named as PetroChina Jilin Petrochemical Company and Heilongjiang Zhongmeng Longxin Chemical Company Limited. MOFCOM expressed fears that the combined business would be able to restrict or even exclude competitors such as these from the China market.

MOFCOM also expressed concern that Mitsubishi Rayon would be better able, as a result of the transaction, to restrict competition in the downstream PMMA market. This could be done either by refusing to supply its PMMA competitors with MMA, or giving its own PMMA business preferential terms or access to supply.

Remedies

Mitsubishi Rayon and Lucite presented MOFCOM with a series of undertakings intended to remedy the competition concerns identified. Following negotiations, a revised set of undertakings was submitted by the parties. These were accepted by MOFCOM, and the transaction was cleared on this basis. MOFCOM’s announcement sets out the following conditions:

1. Lucite China will agree the sale, to one or more third party buyers, and at cost price, of fifty percent of its MMA production for a period of five years following completion. In order to avoid any need for intensive ongoing monitoring, these sales must be agreed for the full five year period at the outset. An auditor must be engaged by Mitsubishi Rayon to verify that the true cost price is being charged.
2. If sufficient MMA buyers cannot be found within six months (extendable by MOFCOM, at its discretion, to one year), Mitsubishi Rayon agrees to the outright divestment of Lucite China under the supervision of an independent trustee appointed by MOFCOM.
3. Mitsubishi Rayon must continue to operate and manage Lucite’s Chinese MMA and PMMA businesses separately from its own between completion and the agreement of a sale of either the requisite MMA output, or Lucite China itself. The two businesses must not exchange any commercially sensitive information (including pricing and customer information) during this period.

4. Unless prior MOFCOM approval is obtained, Mitsubishi Rayon must not make any further acquisitions impacting the MMA, PMMA or related markets in China, or set up any new plants involving production of MMA, PMMA or related products in China, for a period of 5 years following completion.

Violation of the conditions is stated as carrying a penalty for Mitsubishi Rayon of between RMB 250,000 (US\$36,600) and RMB 500,000 (US\$73,200). MOFCOM also has the ability to unwind the transaction in the event of non-compliance.

Analysis

This case highlights MOFCOM's willingness to intervene in multinational transactions where it believes that competition in China may be adversely affected. It also demonstrates MOFCOM's ability both to identify concerns and agree relatively complex undertakings to remedy them. In this case, the use of a two-tiered remedy gives the parties an opportunity to implement a less drastic approach than outright divestment of assets, while providing MOFCOM with the reassurance of outright divestment should the more novel approach of selling a percentage of future production fail.

MOFCOM's announcement highlights the extent of consultation that took place with other stakeholders. In addition to requesting written comments on the transaction, discussion sessions were organized at which rival producers and trade associations were able to set out their concerns. The outcome of this case again emphasizes that MOFCOM will place significant weight on third party comments.

More generally, this case underlines the need for transaction parties to consider merger filings at an early stage in order to avoid unnecessary (and potentially costly) delays. It is notable in this case that, by the date originally announced by the parties for closing the transaction

(late January 2009) the transaction was still awaiting clearance in jurisdictions including mainland China and Taiwan.

The express restriction of future M&A or expansion activity echoes the undertakings obtained from InBev in relation to its acquisition of Anheuser-Busch, the only other conditional clearance under the AML to date. In that case, Anheuser-Busch agreed not to buy further shares in four named Chinese brewers without obtaining prior approval from MOFCOM. Similar practice can be found in the US merger control regime. It was, for many years, customary for the US Federal Trade Commission and Department of Justice, in cases raising serious issues, to obtain an undertaking from the buyer not to make further acquisitions on the same markets for a ten year period. Such commitments may now become a standard feature of the Chinese system.

Practical Implications

- Companies and their advisers must plan ahead if they wish to close transactions in a timely manner. Pre-closing merger reviews now exist in over 70 jurisdictions. These can have very significant timing implications, and even alter the shape of the final transaction. Competition issues should therefore be considered at an early stage.
- Even where China is not the primary focus of a transaction, parties must consider the impact of the deal in China. In this case, conditions were imposed in China due to local competition issues being identified, even though the deal had already been cleared unconditionally in a number of other Asian and European jurisdictions. This ruling confirms that MOFCOM can and will intervene in global transactions where it believes local competition issues exist.
- A significant period of pre-filing correspondence with MOFCOM can be expected, especially where

there are issues or a high volume of opposition from customers or competitors. In this case, the review period commenced on January 20, 2009, almost one month after the merger report was initially filed (December 22, 2009).

- The views of competitors, customers and trade associations will be actively sought by MOFCOM, and should be anticipated.
- Where significant competition issues are likely to be identified, parties should actively engage with MOFCOM in proposing remedies. As in other jurisdictions, the burden is on the parties, not the regulator, to put forward solutions.
- Where MOFCOM finds remedies acceptable, it appears to be open to clearing transactions before expiry of the full review period (in this case, MOFCOM could have taken until May 20, 2009 to complete its review).
- Although the maximum fine for non-compliance, and indeed outright failure to file, is relatively low (RMB 500,000), the ability also exists for MOFCOM to unwind or prohibit transactions under the AML. It remains to be seen how MOFCOM will enforce these powers in practice (particularly where implementation takes place primarily or entirely outside the jurisdiction), though it is already clear that MOFCOM takes enforcement of the AML seriously.
- Companies must also keep in mind their relationship with Chinese authorities more generally, and the wider reputational impact of non-compliance with the AML or failing to file.

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CHINA UNVEILS SPECIAL TAX ADJUSTMENTS

On January 9, 2009 the State Administration for Taxation (“SAT”) released Implementation Measures for Special Tax Adjustments (“**Final STA Measures**”). The Final STA Measures contain 13 chapters and 118 articles. What is new and compelling to multinational investors in the regulations include dealing with the significant compliance burden of the new documentation requirements and tapping into the opportunities provided by cost sharing.

What are Special Tax Adjustments

It may be helpful to start by clarifying the term “special tax adjustments” under which the transfer pricing regulations have been issued. Special tax adjustments (*te bie na shui tiao zheng*) refer to “tax avoidance” associated with:

- transfer pricing;
- use of tax havens via controlled foreign corporations (“CFCs”); and
- sham arrangements entered into solely for tax evasion.

Policies designed to crack down on these policies are known in China as “anti-avoidance”. So transfer pricing adjustments are a subset of special tax adjustments.

The Documentation Requirement – the Essentials

The most anticipated aspect of the STA Measures was the documentation requirements and the biggest guessing game was the threshold level. Under the Final STA Measures, taxpayers must prepare contemporaneous documentation for 2008 by December 31, 2009 and are also required to submit nine intercompany disclosure forms as part of the tax return due by May 31, 2009. Enterprises whose tangible transactions are less than RMB 200 million (US\$29.3 million) and other related-party

transactions are less than RMB 40 million are exempted.

The SAT Dials Back

The Final STA Measures are in line with draft measures circulated in March 2008 for comments, but obviously alarmed by the financial crisis, the SAT has dialled back the requirements. Most importantly, the documentation threshold was raised significantly from the draft value of RMB 20 million and the deadline for preparing 2008 documentation was extended to December 31, 2009. There has also been some simplification in information required and one of the disclosure forms has been dropped.

But Boxes in the Taxpayer (with a Novel Approach to Arm’s Length)

Stepping out ahead of other tax authorities, the SAT has boxed in the taxpayer by narrowing the room for economic gaming. As is well-known, creative transfer pricing economists can justify a remarkably wide range of financial results under the arm’s-length rubric.

The SAT takes dead aim at two of the most powerful tools in the economist tool kit – the inter-quartile range and capital intensity adjustments. In an audit, says the SAT, the target’s profit should be adjusted to the “median” value and capital intensity adjustments can be used only with SAT approval. Taken at face value, these constraints would mean that enterprises would be boxed in to generating “acceptable profits” (for example, 5% to 10%).

Is the Door Really Closed?

First, it should be noted that the SAT positions are discussed in contexts of an audit not documentation. In other words, these instructions are to tax officials who are conducting an audit not to taxpayers preparing documentation.

Second, at other places, such as in discussing the transactional net margin method, the SAT acknowledges that it is reasonable to make adjustments. Thus, it may be possible for the taxpayer to use adjustments and ranges in preparing documentation recognising that there may be a challenge if and when they are audited.

Capturing the Impact of the Financial Crisis

The SAT recognises the impact of the financial crisis and multinationals – especially significant job-creators – should take advantage of this to support their position. They should provide information on their globally declining profits, as well as 2009 quarterly data on comparable companies. They can also share negative and impending industry developments, such as bankruptcies, declining sales, and so forth.

Technology Cost Sharing – Useful for the Minority

In the Final STA Measures, the SAT has finally come out in favour of cost sharing. For a minority of companies this could be a very useful way to minimise global taxes. We are speaking of multinationals who are in loss in their home markets but profitable in China. These companies could have their Chinese entities do a cost-sharing “buy in” of pre-existing technology thereby shifting profits and cash out of China and back home.

Service Cost Sharing – a Possible Opportunity

The difficulty of paying a service fee out of China (without taking a tax hit) is a common complaint by global tax directors. The Final STA Measures endorse the concept of service cost sharing (for group marketing and procurement services). This could be the best news to come out of the Final STA Measures, but unfortunately one crucial area has not been clarified: the business

tax and corporate income tax treatment associated with a service cost sharing payment. Service fees paid out of China are subject to such taxes if a permanent establishment exists and the question is whether a cost sharing payment would be exempt from such taxes. Multinationals should stay tuned as to this important matter.

More and More Developed

The Final STA Measures come at an interesting time. China needs taxes as the country seeks to pay for its US\$585 billion economic stimulus plan (a staggering 15% of GNP). But at the same time, the message from the highest levels is that the number one priority is job creation and growth. We believe China will continue to maintain its investor-friendly attitude and that tax inspectors will take a balanced and reasonable position. The Final STA Measures impose significant burdens on multinationals but these can and should be handled in a practical and cost effective manner. On balance, the Final STA Measures are a necessary step forward and signal that China is acting more like an advanced economy.

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Articles

CHINA WEEE COMPLIANCE UPDATE FOR U.S. COMPANIES

The *Regulations on the Administration of Collection and Treatment of Waste Electrical Appliances and Electronic Products* (“**China WEEE**”) were issued at the end of February this year. In short, there are currently no immediate actions required from U.S. companies yet, but we recommend monitoring the situation as it develops and considering whether to participate in the formulation of the implementing rules, product catalogues etc. supplementary to China WEEE.

Four and half years after its first draft was published for comment, China WEEE was finally issued by the State Council of China on February 25, 2009. It will become effect on January 1, 2011. Before then, U.S. companies who sell electrical appliances and electronic products (or components) (“**Electronic Products**”) in China can continue to do business as they do now. Nevertheless, they should make full use of the time period before January 1, 2011 to get ready for China WEEE compliance and, more importantly, to participate in the formulation of the implementing rules to ensure that the rules do not adversely affect their business activities.

Who Has to be Concerned About China WEEE?

Any U.S. company that makes or sells any products (or components for products) that use electricity and end up in China should (1) assess whether their products are covered by China WEEE, (2) determine the various compliance obligations and risks of the companies in the supply chain, and (3) develop a compliance and risk management program.

U.S. companies who have subsidiaries in China that make and/or sell Electronic Products in China should do the same for their subsidiaries.

What Products Are Covered?

This question will be answered in a product catalogue supplementary to China WEEE, which is not yet available.

Collection and treatment of any product listed in the *Catalogue for Waste Electrical Appliances and Electronic Products Treatment* (“**WEEE Catalogue**”) must follow China WEEE. The National Development and Reform Commission, together with the Ministry of Environmental Protection (“**Environment Ministry**”) and the Ministry of Industry and Information Technology (“**IT Ministry**”) are now drafting the WEEE Catalogue. These government departments will also be in charge of adjusting the WEEE Catalogue from time to time in the future.

Although the WEEE Catalogue is still being drafted, when answering some reporters’ questions on China WEEE, officials of the Legislative Affair Office of the State Council and the Environment Ministry named nine products – TV set, refrigerator, washing machine, air conditions, computer, cell phone, copy machine, fax machine and printers—and said that huge amounts of these products are discarded in China now a days. It is therefore expected that these nine kinds of products will be included in the WEEE Catalogue.

Before the WEEE Catalogue is issued, U.S. companies should play an active role, either directly or through the relevant associations, to ensure that the WEEE Catalogue formulated does not adversely affect their business interests or to minimize the adverse affect, and to seek clarification of exceptions that may possibly apply to their products.

What Are the Obligations of the Manufacturers and Importers?

Contribute to the WEEE Fund

Domestic Chinese manufacturers (including Chinese subsidiaries of U.S. and other foreign companies) and importers of Electronic Products or their agents are required to contribute to a centralized fund (“WEEE Fund”) used for subsidizing the costs of collecting and treating waste Electronic Products. U.S. and other foreign manufacturers are not directly required to contribute to the WEEE Fund.

China WEEE itself does not provide for any penalties for failing to contribute to WEEE Fund.

Detailed rules governing the collection, use and administration of WEEE Fund have yet to be formulated by the Ministry of Finance together with the Environment Ministry, the National Development and Reform Commission and the IT Ministry. China WEEE specifically provides that, when determining the standards for collecting contributions to WEEE Fund and for subsidizing waste collection and treatment activities, the government should listen to the opinions of the Electronic Product manufacturers, the waste Electronic Products treatment companies, the relevant industry associations and the experts in the relevant areas. This is another area where U.S. companies should play an active role to have their opinions heard.

Product standards and labeling requirements

China WEEE restates the requirement that has appeared in the *Measures for the Administration of the Control of Pollution Caused by Electronic Information Products* (“**China RoHS**”) that Electronic

Products manufactured in China or imported into China shall comply with the relevant national standards on Electronic Products pollution control. (More specific substance restrictions, testing and certification requirements do not yet apply while the Chinese government is working on a catalogue relating to China RoHS – which has still not been issued). In addition, Electronic Products must be labeled (on the product itself or in its manual) with information on the relevant hazardous substances contained and information regarding its collection and treatment.

If any Electronic Product is not labeled with such information, the relevant product quality authority at the county or higher level can require its manufacturer (if it is manufactured in China) or its importer or the importer's import agent (if it is imported) to make corrections within a given time and pay a penalty of up to RMB 50,000 (approximately US\$7,000).

Encouraged to collect waste electronic products

Unlike EU's WEEE legislation, and unlike its draft for comment issued in 2004, China WEEE does not require the manufacturers and importers to establish a system to collect waste Electronic Products. It merely "encourages" manufacturers to collect or entrust distributors, repair shops, after-sale service providers or waste Electronic Products recycle operators to collect the waste Electronic Products. It is currently unclear whether it will affect the manufactures' obligations to contribute to WEEE Fund if they decide to collect waste Electronic Products themselves, entrust others to do so, or do nothing about the collection at all.

Other Provisions of China WEEE

In addition to providing for the above obligations for manufacturers and importers, China WEEE uses most of its articles regulating waste Electronic

Products collection companies and treatment companies and their activities.

What to Do Between Now and January 1, 2011?

Without the detailed rules referred in China WEEE – namely the WEEE Catalogue, the rules on WEEE Fund, etc.– the above obligations of manufacturers and importers cannot be effectively enforced. The Chinese government will need the time before January 1, 2011 to draft these detailed rules and get the government departments ready for China WEEE enforcement. Manufacturer and importers should also make full use of this period of time to get ready, and to make sure that their voices be heard by the government departments formulating the relevant rules.

Once WEEE Catalogue is issued, U.S. companies selling products to China must ascertain whether their products are covered by WEEE Catalogue, thus regulated by China WEEE. If yes, additional time and cost for China WEEE compliance must be taken into account in planning their businesses in China.

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CONTRACT LAW

Supreme People's Court's Interpretations on the Contract Law (2)

The *Interpretations of the Supreme People's Court of Several Issues Concerning the Application of the Contract Law of the People's Republic of China*, 最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(二) (“**Interpretations**”), were published by the Supreme People's Court on April 27, 2009, and entered into effect from May 13, 2009.

General Provisions

Stated aims

The Interpretations address issues relevant to the application of the *Contract Law* and have been formulated in order to correctly try contractual disputes.

Application

The Interpretations are applicable to cases of disputes over contracts formed after the implementation of the *Contract Law* that are pending at the time of the implementation of the Interpretations. The Interpretations should not be applicable to cases that were finally adjudicated before the implementation of the Interpretations and a retrial of which has been applied for by a party or decided upon pursuant to the adjudication supervision procedure.

Formation of Contracts

1. In the event of a dispute between parties as to whether a contract has been formed, the People's Court will in general, unless otherwise provided in law or by the parties, make a finding that a contract has been formed if it can determine the names of the parties, the subject matter and the quantity.
2. If the parties have not concluded a written or oral contract but the People's Court can deduce from their civil acts that the parties had the intention of concluding a contract, it may make a finding that it is a

contract concluded “in another form” as stipulated in the first paragraph of Article 10 of the *Contract Law*.

3. If a person offering a reward publicly states that he will pay compensation to anyone who completes a certain act and the person who completes such act petitions to have the person offering the reward pay the compensation, the People's Court will support such petition unless any of the circumstances set forth in Article 52 of the *Contract Law* apply to the reward including:

- a party uses fraud or coercion to conclude a contract, thereby harming the interests of the state;
- it is concluded in a malicious conspiracy to harm the interests of the state, a collective or a third party;
- it conceals an illegal objective by giving it a legal form;
- it harms the public interest; or
- it violates mandatory provisions of laws or administrative statutes.

4. Article 39 of the *Contract Law* provides that when a contract is concluded using standard clauses, the party providing the standard clauses should abide by the principle of fairness when determining the rights and obligations of the parties, and should, in a reasonable manner, draw the attention of the other party to clauses which exempt or limit his liability and, if so requested by the

other party, explain such clauses.

According to the Interpretations, at the time of the conclusion of a contract, if the party that provides standard clauses with provisions that exempt him from or limit his liability highlights those provisions through the use of text, symbols, font, etc. in a manner that is sufficient to draw the other party's attention thereto and, at the request of the other party, he explains the relevant standard clauses, the People's Court will make a finding that the phrase “in a reasonable manner” mentioned in Article 39 of the *Contract Law* has been complied with.

A party that provides standard clauses should bear the burden of proof.

5. The People's Court may make a finding that the following practices constitute “trading practice” as mentioned in the *Contract Law*, if such practices do not violate mandatory provisions of laws or administrative statutes:
 - a practice that is regularly employed in the place of the transaction or in a certain field or industry and was or ought to have been known by the counterparty to the transaction at the time of conclusion of the contract; or
 - a customary practice often employed by the parties.

A party that claims trading practice should bear the burden of proof.

6. If a party that has the obligation to apply for approval or registration,

etc. under a contract that only enters into effect after approval or registration fails to make such an application in accordance with the law or the contract after the formation of the contract, such failure constitutes “another act counter to the principle of good faith” as mentioned in item (3) of Article 42 of the *Contract Law*, and the People’s Court may, based on the specific circumstances of the case and pursuant to the opposite party’s petition, render a judgment permitting the opposite party to carry out the relevant procedures himself. The other party should be liable for damages in respect of the expenses and the opposite party’s actual loss incurred as a result thereof. A party that provides standard clauses should bear the burden of proof.

Validity of Contracts

1. If a party failed to take note of standard clauses exempting or limiting the liability of the party that provided those clauses due to the other party’s violation of the provisions of the first paragraph of Article 39 of the *Contract Law* concerning his obligation to draw attention and explain those standard clauses, and the other party petitions to have those standard clauses annulled, the People’s Court will support such petition.
2. Once the principal has borne the liability arising from a valid act of agency in accordance with Article 49 of the *Contract Law*, he may recover the losses incurred as a result of the act of agency from the person who acted without power of agency.
3. If a seller concludes several sales and purchase contracts for the same subject matter, none of which is rendered void under the circumstances set out in Article 52 of the *Contract Law*, and a buyer, due

to his inability to acquire ownership of the subject matter in accordance with his contract, petitions to pursue the liability of the seller for breach of contract, the People’s Court will support such petition.

Performance of Contracts

1. A People’s Court may, depending on the specific circumstances of a case, name a third party as specified in Article 64 or 65 of the *Contract Law* as a third party without an independent right of claim, but may not, *ex officio*, name such party as a defendant in such contract action or as a third party with an independent right of claim.
2. If an obligor waives his own unmatured claim or the security for a claim, or extends the period for performance of a matured claim in bad faith, causing injury to the obligee, and the obligee institutes a legal action for the right of annulment pursuant to Article 74 of the *Contract Law*, the People’s Court will support such right.
3. A People’s Court’s confirmation of a “price which obviously is unreasonably low” as stipulated in Article 74 of the *Contract Law* should be based on comprehensive consideration, namely with the eye of the average business operator in the place of the transaction and with reference to the guideline price of the pricing authority or market transaction price prevailing at the time and in the place of the transaction, while having regard to other relevant factors.

In general, the price of an assignment may be deemed to obviously be unreasonably low if it is less than 70 percent of the guideline price or market transaction price prevailing at the time and in the place of the transaction; and, in general, the price of an assignment may

be deemed to obviously be unreasonably high if it is more than 30 percent above the guideline price or market transaction price prevailing at the time and in the place of the transaction.

The People’s Court may annul the acquisition by the obligor of property of a third party at a price which obviously is unreasonably high pursuant to a petition by the obligee and by making reference to Article 74 of the *Contract Law*.

4. If a payment made by an obligor is insufficient to perform all of his obligations of the same type borne toward a single obligee, it should first be used to set off the matured obligation, if any. If several obligations have matured, it should first be used to set off the unsecured obligation, if any, or the one with the lowest amount of security; if the amounts of security are identical, it should first be used to set off the obligation that presents the heaviest burden. If the burdens are identical, setoff should be effected in the sequence in which the obligations matured, and if the maturity dates are identical, the obligations should be set off pro rata, unless the obligee and the obligor have provided otherwise in respect of the obligation(s) to be performed or the sequence of performance and setoff.
5. If an obligor is required to pay interest and expenses in addition to the principal obligation and a payment made by him is insufficient to perform his entire obligation, the People’s Court will effect setoff in the following sequence in the case where the parties have not stipulated a sequence:
 - (1) the expenses incurred in realizing the claim;
 - (2) the interest;
 - (3) the principal obligation.

Legislation Summaries

Discharge of Contractual Rights and Obligations

1. Article 92 of the *Contract Law* provides that when the rights and obligations under the contract have been discharged, the parties should perform such obligations as giving notice, providing assistance and maintaining confidentiality, etc. in accordance with trading practice and adhering to the principle of good faith. If a party petitions for compensation for his actual loss caused by the other party breaching an obligation stipulated in Article 92, the People's Court will support his petition.
2. If a party objects to termination of a contract or setoff of an obligation as specified in Article 96 or 99 of the *Contract Law* but raises his objection and institutes a legal action in a People's Court only after the expiration of the stipulated period for such objections, the People's Court will not support such objection. If the parties have not stipulated a period for objection and a party institutes a legal action with a People's Court three months or more from the date on which the contract termination or obligation setoff notice reached him, the People's Court will not support such objection.
3. If a material change in objective circumstances that was unforeseeable by the parties at the time of conclusion of the contract, is not caused by *force majeure* and does not constitute a commercial risk occurs after the formation of the contract and makes continued performance of the contract manifestly unfair to one party or realization of the purpose of the contract impossible, and a party petitions a People's Court to amend or terminate the contract. The People's Court should determine whether the contract is to be amended or terminated based on the principle of fairness and

while taking into account the specific circumstances of the case.

Liability for Breach of Contract

1. If a party petitions a People's Court by instituting a counteraction or raising a defense for adjustment of liquidated damages pursuant to the second paragraph of Article 114 of the *Contract Law* (i.e. the liquidated damages stipulated are lower than the loss incurred or that the liquidated damages stipulated grossly exceed the loss incurred), the People's Court should support such petition.
2. If a party petitions a People's Court for an increase in the liquidated damages when the liquidated damages stipulated grossly exceed the loss incurred, the amount of such increased liquidated damages may not exceed the actual loss. If, in a petition filed after the liquidated damages have been increased, the said party claims compensation for his loss from the other party, the People's Court will not support such petition.
3. If a party asserts that the stipulated liquidated damages are too high and petitions to have them reduced appropriately, the People's Court should weigh the matter and render its ruling based on the actual loss and while taking into account such overall factors as the status of performance of the contract, the extent of the fault of the relevant party and the anticipated benefits, etc.

In general, if the liquidated damages stipulated by parties exceed the loss caused by 30 percent or more, they may be found to "grossly exceed the loss incurred" as mentioned in Article 114 of the *Contract Law*.

2009 Action Plan for Protection of Intellectual Property Rights (“IPR”) in China

The 2009 Action Plan on IPR Protection in China, 2009年中国保护知识产权行动计划, was promulgated on April 21, 2009, and took effect from that date.

I. Work Plan for the Establishment of a Legal System for Intellectual Property Rights

- (1) Draft, formulate and amend certain laws and statutes on patent protection
 1. Duly amend the *Implementing Regulations for the Patent Law of the People’s Republic of China*;
 2. Complete the adaptive amendment of the *Patent Search Guide* and operational rules;
 3. Duly amend the *Regulations on Patent Agency* and the rules and normative documents of the relevant authorities on the administration of patent agencies;
 4. Expedite the issuance of the *(Provisional) Regulations on the State Standards in Respect of Patents*;
 5. At the appropriate time, publish the *Guide for Search Standards for Chinese Medicine Invention Patents*;
- (2) Draft, formulate and amend certain relevant laws and statutes on trademark and copyright protection
 1. Expedite the amendment of the *Trademark Law of the People’s Republic of China*; at the appropriate time, initiate the amendment of the *Implementing Regulations of the Trademark Law of the People’s Republic of China*;
 2. Study and formulate the *Regulations on Trademark Agency*;
 3. Amend the *Regulations on the Recognition and Protection of Well-Known Trademarks* and further improve the system for recognizing and protecting well-known trademarks;
 4. Promote the implementation of the amendment and formulation of the *Regulations for the Protection of the Copyrights of Folk Literature and Art*; study the implementation of the amendment and formulation of the *Measures for the Administration of the Voluntary Registration of Works* and the *Measures on the Statutorily Permitted Remuneration for Textbooks*;
- (3) Draft, formulate and amend additional laws, statutes and regulations on intellectual property rights
 1. Complete the amendment of the *Implementing Measures for the Regulations of the People’s Republic of China for Customs Protection of Intellectual Property Rights*;
 2. Proactively promote the amendment of the *Law of the People’s Republic of China Against Unfair Competition*; improve the relevant provisions on the protection of business secrets;
 3. Research and draft the guiding principles for the protection of business secrets;
 4. Research and formulate ancillary regulations for the *Law of the People’s Republic of China on Employment Contracts*; provide guidance to enterprises in connection with concluding competition restriction agreements with workers;
5. Research and formulate the *Regulations for the Administration of Biogenetic Resources*;
6. Formulate the *Strategy and Action Plan of the People’s Republic of China for the Protection of Biodiversity*; strengthen the protection of genetic resources and relevant traditional knowledge;
7. Promote the progress of the legislation of the *Law of the People’s Republic of China on the Protection of Non-material Cultural Relics*;
8. Initiate research on amending the *Regulations of the People’s Republic of China for the Protection of New Plant Varieties*;
9. Issue the *Regulations for the Naming of Plant Varieties*;
10. Research and formulate the *Provisional Measures for Naming and Administering Cultural Ecology Protection Zones*;
11. Formulate the *Measures for the Administration of Pharmaceutical Standards*; improve the system for administering pharmaceutical standards;
12. Promote and implement the *Several Policies on Promoting the Industrial Application of Achievements Resulting from Proprietary Innovation*;

13. Continue to promote research on amending the *Law of the People's Republic of China for Promotion of the Transformation of Scientific and Technological Achievements* and its relevant *Detailed Implementing Measures*; further regulate and safeguard the implementation, transformation and industrial application of scientific achievements and their intellectual property rights;
 14. Expedite research on and drafting of the *Regulations on the Administration of Human Genetic Resources*; according to law, improve the system for the protection, development and utilization of China's human genetic resources and construct a reasonable mechanism for obtaining genetic resources and sharing the benefits derived therefrom;
- (4) Draft and formulate judicial interpretations of intellectual property rights
1. Complete the *Explanation of Several Issues on the Application of the Law in the Protection of Well-Known Trademarks in the Trial of Civil Disputes Such as Those Which Involve Trademark Infringement, Etc.*;
 2. Initiate the drafting of judicial interpretations of standards for determining patent infringement and submit them to the adjudication committee of the Supreme People's Court for discussion;
 3. Initiate the drafting of judicial interpretations of issues concerning the procedures for civil litigation involving anti-monopoly disputes; publish and implement said interpretations within one year.

II. Plan for the Enforcement of Intellectual Property Rights

- (1) Develop initiatives
1. Organize and coordinate the development of a nationwide intellectual property rights enforcement initiative;
 2. Develop a "lightning storm" enforcement initiative which focuses on cracking down on patent infringement and counterfeiting;
 3. Develop a "heaven's net" enforcement initiative which focuses on cracking down on patent fraud;
 4. Initiate an initiative to overhaul the cultural market to commemorate the celebration of the 60th anniversary of the establishment of the People's Republic of China; protect intellectual property rights and maintain market order;
 5. Launch an initiative to overhaul the cartoon and animation market, with an emphasis on cracking down on infringement and piracy in the cartoon and animation market;
 6. Develop an initiative in 2009 to crack down on and control infringement and piracy on the internet;
 7. Further promote the use of genuine software by enterprises; continue to duly evaluate and select the second batch of exemplary units which use genuine software;
 8. Organize dedicated enforcement investigations of products which are sold in rural areas such as agricultural materials, building materials, food and home electrical appliances;
- strictly investigate and deal with infringing actions which violate the relevant laws and statutes on quality and intellectual property rights;
9. Strengthen online "elimination of pornography and illegal publications"; launch initiatives to crack down on infringement and piracy; clean up the cultural environment on the Internet;
- (2) Strengthen day-to-day enforcement
1. Continue to expand the extent of trademark administrative enforcement and severely crackdown on trademark infringement and counterfeiting, with an emphasis on protecting trademarks related to agriculture, food trademarks, pharmaceutical trademarks, famous trademarks and foreign-related trademarks;
 2. Further regulate and strengthen the transfer of suspected criminal cases involving trademarks;
 3. Promote the "trademark licensing business system" in large and medium-sized cities throughout China; engage in standardized trademark regulation of large-scale wholesale and retail merchandise markets;
 4. Expand the degree of protection for world expo marks in accordance with the *Regulations for the Protection of World Expo Marks*;
 5. Further improve systems such as those for reporting, investigation, circulation of information, gathering statistics and recordal in copyright administrative enforcement; duly enforce the *Provisional Measures for Rewards for Reporting, Investigation and Handling in Crack Downs on Infringement and Piracy*; give incentives to meritorious personnel who report, investigate and handle cases involving infringement and piracy;

6. Strengthen the day-to-day enforcement and investigation of unlawful infringing actions such as the falsification of the place of origin, falsification or fraudulent use of factory names or factory addresses; crackdown on such unlawful actions as falsification or fraudulent use of quality marks; focus efforts on the investigation and handling of a batch of large and significant cases;
7. Strengthen the administration and follow-up supervision of the issuance of production permits for licensed product varieties; crack down on the production and sale of uncertified products and products with “license sets”;
8. Strengthen the supervision and investigation of the agricultural products market; crack down on falsification and fraudulent use of geographic marks on agricultural products;
9. Strengthen the enforcement of the protection of new plant varieties; promptly investigate and handle unlawful actions such as infringement and counterfeiting involving new plant varieties;
10. Expand the extent of the protection for proprietary intellectual property rights at the import and export phase at the port; severely crack down on unlawful actions such as illegal import and export of infringing products; protect the lawful rights and interests of the owner; promote the expansion of China’s enterprises with proprietary brands into the international market;
11. Crack down on the pirated reception, transmission and broadcasting of television programs;
12. Strengthen research on the abuse of intellectual property rights;

strengthen communication and negotiation with the relevant departments of foreign governments on the abuse of intellectual property rights.

III. Work Plan for Intellectual Property Rights Adjudication

1. Proactively promote the development and establishment by courts in each local area of exploratory and pilot programs for intellectual property rights courts to uniformly accept civil, administrative and criminal cases involving intellectual property rights;
2. Expedite research on resolving the issue concerning the uniform acceptance by the relevant intellectual property rights courts in Beijing of cases involving the determination of patent and trademark licensing rights;
3. Create an overall plan for and make appropriate adjustments to the system of jurisdiction for the trial of cases involving intellectual property rights; continue to strictly adhere to the designated system of jurisdiction for cases involving technology such as those which involve patents; explore the establishment of a system for grassroots courts’ interregional jurisdiction in cases which involve general intellectual property rights such as copyright, trademark, unfair competition and intellectual property right agreements;
4. Establish independent intellectual property rights courts at the Supreme People’s Court, at the Higher People’s Court, at Intermediate People’s Courts which accept a considerable number of civil cases involving intellectual property rights, and at grassroots courts which are

designated to accept civil cases involving intellectual property rights; at other Intermediate People’s Courts establish collegiate benches for the uniform trial of civil cases involving intellectual property rights;

5. Promote the simplification and improvement of procedures for the determination of patent and trademark licensing rights;
6. Convene the 2nd National Seminar on Court Judgments in Patent Cases and, based on the amended Patent Law of the People’s Republic of China, clarify the relevant principles and policies in connection with judgments in patent cases;
7. Convene a national seminar on court judgments in cases which involve intellectual property rights; sum up the experience of such judgments; create a unified judicial policy; promote the thorough implementation of a national strategy for intellectual property rights.

IV. Work Plan for the Establishment of an Intellectual Property Rights Mechanism

- (1) Establish a mechanism for coordination between departments and interaction between regions
 1. Continue to improve the national strategy for intellectual property rights and implement an interdepartmental joint conference system to expand the extent of overall planning and coordination in the implementation of major interdepartmental strategies for intellectual property rights;
 2. Issue several opinions on strengthening the work involved in intellectual property rights,

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- implementing an intellectual property rights strategy and promoting the reform and opening up and economic and social development in the Yangtze Delta region; strengthen the construction of mechanisms for cooperation in intellectual property rights in the Yangtze Delta region;
3. Construct mechanisms for cooperation in intellectual property rights; launch industry pilot projects for intellectual property rights;
 4. Strengthen assistance for the defense of intellectual property rights; improve mechanisms for assisting the defense of intellectual property rights; strengthen key constructs for assisting the defense of intellectual property rights;
 5. Select a group of government departments, judicial authorities, research and development institutes, intermediaries, educational institutions and market entities to serve as key contact units for the protection of patents; establish a national mechanism for key contacts for the protection of patents;
 6. Initiate the “5•26” project the principal content of which is regional pilot projects for the protection of patents;
 7. Proactively promote the establishment of a mechanism for an “online interface for sharing information” between administrative enforcement and criminal justice institutions;
 8. Formulate and implement the *Guidelines for Public Security Institutions in the Handling of Criminal Cases Involving Intellectual Property Right Infringement*; consolidate awareness of the law; standardize the system for handling cases;
 9. In accordance with the requirements of the *Notice on Establishing a Coordinated Cooperation Mechanism for Jointly Strengthening the Protection of Intellectual Property Rights* strengthen the supervision, direction, investigation and review of rewards and punishments, to further improve the system for administration and criminal protection of intellectual property rights;
 10. Resolutely crack down on unfair competition which infringes on business secrets; establish an efficient system for transferring criminal cases involving infringement of business secrets;
 11. Strengthen contacts with enterprises and associations in key industries which have sustained serious losses from counterfeiting and infringement; bring into play the role of enterprises and industry associations; increase the focus and effectiveness of law enforcement in cracking down on counterfeiting;
 12. Strengthen and improve mechanisms for coordination between the copyright, public security and telecommunications authorities; establish swift and effective mechanisms for coordinating crack downs on Internet piracy;
 13. Strengthen communication and coordination between public security agencies and customs; further improve mechanisms for interdepartmental coordination in cracking down on crimes involving transnational infringement of intellectual property rights;
- (2) Strengthen departmental administration of intellectual property rights
1. Vigorously implement projects for strengthening intellectual property rights administration at the county level;
 2. Understand the public’s diverse demands in connection with patent investigations; further adjust the emphasis and direction in the administration of the quality of patent investigations; improve external quality feedback mechanisms and systems for evaluating the quality of investigations;
 3. Coordinate the resolution of conflicts involving variety names and trademark protection;
 4. Further establish a robust system for the protection of non-material cultural relics, including traditional knowledge and folk literature and art; continue to promote the establishment of a system for non-material cultural relic lists; strengthen the protection of inheritors; arrange the reporting of the third batch of state-level non-material cultural relics;
 5. Implement the “project for the rescue, protection and support of China’s *Kunqu* opera” and the “project for the support of key state-level Beijing opera houses and performance troupes”; encourage the creation of national traditional cultural works;
 6. Formulate and implement a drug quality master file system; strengthen the protection of the key secrets of enterprises;
 7. Continue to implement pilot projects under the special protection policy for traditional knowledge related to Chinese medicine;
 8. Improve the establishment of a system for the protection of products through the use of geographic marks; construct a system of combined standards

centered on quality and technical requirements and based on local standards; strive to complete combined standards for 40 percent of the products with geographic marks;

9. Strengthen coordination with enterprises through contact and communication; develop joint cooperation such as training in cracking down, prevention, law enforcement, sharing information and publicity and education to increase awareness of intellectual property rights protection among enterprises in China and promote proprietary innovation among enterprises;
10. Strengthen research on the status of intellectual property rights in the radio, film and television sector; strengthen radio, film and television intellectual property rights, the system and mechanisms for protection of new media intellectual property rights and research on technology for the protection of radio, film and television digital copyrights; promote the development of innovative industries in film and television. Develop new audio-video media.

intellectual property rights into the plan for promoting the commemoration of the 60th anniversary of the establishment of the People's Republic of China;

3. Focus on tracking a batch of enterprises under the central government with strong proprietary innovation capabilities and sound foundations in intellectual property rights; utilize dialogue and discussion between corresponding parties, meetings and seminars, and promotion by the media to promptly summarize and popularize the experience of and methods used by enterprises under the central government to strengthen the protection of intellectual property rights;
4. Incorporate laws and statutes for the protection of intellectual property rights into a nationwide plan for the promotion of legal monitoring systems in 2009; intensify the development of public education in and publicizing of intellectual property rights laws and statutes;
5. Duly bring into play the superior advantages of promotion via radio, film and television; proactively launch the relevant promotion of intellectual property rights;

(2) Develop large-scale promotional activities

1. Organize a nationwide intellectual property rights promotion week in 2009;
2. Initiate projects for the establishment of intellectual property rights culture in China;
3. Focus on local government and enterprises to promote and implement the relevant guidelines for handling patents in the formulation of standards; guide China's enterprises to

attain international standards in their proprietary innovative technology; proactively participate in the formulation of international standards;

4. Host the "2009 China Trademark Festival"; issue the Report on the Development of China's Trademark Strategy";
5. Intensify the publicizing of cases involving the administrative enforcement of trademarks; encourage and promote local administrations for industry and commerce to publicize more typical cases involving trademark administrative enforcement; further strengthen the transparency of the investigation and handling of trademark cases;
6. Launch "Copyright Protection in China" — a large scale series of promotional activities for the protection of copyrights in commemoration of the 60th anniversary of the establishment of the People's Republic of China;
7. Proactively promote the establishment, evaluation and selection of model cities, model units and model bases for copyrights; establish typical examples of superior copyright protection; promote advanced experience in copyright protection; promote the development of the relevant copyright industries;
8. Organize a series of "Cultural Relics Day" activities; intensify the promotion of non-material cultural relics;
9. Conscientiously and thoroughly implement the "Fifth Five Year Plan for the Popularization of the Law"; make laws and statutes for the protection of intellectual property rights key content in such major educational activities for the promotion of the legal system as the "Promotion of the

V. Work Plan for the Promotion of Intellectual Property Rights

(1) Focus of the promotion

1. Notify each district and each department to implement the requirements of the central government; promote new trains of thought, new measures and new results for implementing a strategy for the protection of intellectual property rights; promote a batch of advanced models for the protection of intellectual property rights;
2. Incorporate the promotion of

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Law at Six Levels”;

10. Organize activities commemorating the 10th anniversary of the implementation of the system for the protection of new plant varieties in China; commend the owners of varieties who have made a contribution to the protection of new plant varieties in China;
 11. Intensify promotional activities; increase knowledge of the law and awareness of the legal system among enterprises and workers; cause enterprises to self-consciously carry out the relevant legal terms and strengthen the awareness of workers in connection with the safeguarding business secrets;
 12. Focus on intensifying the launching of activities with the slogan “Rejection of piracy starts with me” among university, middle school and elementary school students and in municipalities and communities;
- (3) Hold seminars and discussions; formulate and issue promotional materials
1. Hold a “Summit on Intellectual Property Rights in China”;
 2. Hold a “National Conference for Foreign Investors on the Protection of Intellectual Property Rights”;
 3. Hold a “The 2009 Conference on the Protection of the Intellectual Property Rights of Pharmaceuticals and the International Seminar on the Protection of Pharmaceutical Test Data”;
 4. Continue to participate in the “2009 Conference on Trademarks on Both Sides of the Taiwan Strait”;
 5. Issue the “White Paper on the Status of the Protection of

Intellectual Property Rights in China”;

6. Compile the “Annual Report on Intellectual Property Rights in China’s Institutes of Higher Learning”;
7. Issue the *Annual Report for 2008 on the Judgments of the Supreme People’s Court in Cases Involving Intellectual Property Rights* and the Ten Major Cases Involving the Judicial Protection of Intellectual Property Rights in China in 2008.

VI. Work Plan for Training and Education in Intellectual Property Rights

- (1) Training of intellectual property rights law enforcement and judicial personnel
 1. Focus on launching activities for the training and education of grassroots public security personnel and People’s Police in the enforcement of intellectual property rights; proactively join with the relevant authorities and organizations abroad to hold training programs in intellectual property rights for criminal law enforcement personnel; increase the capabilities and standards for the handling of transnational and cross-border criminal cases involving intellectual property rights;
 2. Join with owners of intellectual property rights to develop activities for training of frontline Customs law enforcement personnel; increase the ability of Customs personnel to detect and capture infringing goods;
 3. Develop training and guidance of personnel who are in charge of the investigation and handling of Customs cases; increase the ability of senior personnel in

charge of cases to handle difficult cases;

4. Proactively utilize such platforms as the EU-China Project on the Protection of Intellectual Property Rights (IPR2) to strengthen the training of trademark law enforcement teams;
 5. Develop training and guidance of grassroots copyright law enforcement personnel; increase the law enforcement capabilities of copyright law enforcement personnel using new technology;
 6. Augment teams of judges which handle intellectual property rights; augment core staff and professional skilled personnel for rendering judgments; improve the professional structure of teams which render judgments;
 7. Strengthen training in the rendering of judgments involving intellectual property rights; make amendments at the appropriate time; supplement the overall plan for professional training in connection with judgments involving intellectual property rights with an emphasis on strengthening grass roots-level and basic construction; hold specialized training sessions for grassroots court personnel who handle judgments involving intellectual property rights;
 8. Involve the intellectual property rights content of training programs in investigative institutions; hold intellectual property rights training activities in conjunction with the EU-China Project on the Protection of Intellectual Property Rights (IPR2);
- (2) Popularization of intellectual property rights through education
1. Continue to promote the amendment of standards

for compulsory education curriculum; strive to include the relevant content on intellectual property rights in the *Standards for Ideological and Moral Education Curriculum*;

2. With a focus on the different requirements of scientific and technical administrative personnel, scientific and technical personnel participating in the implementation of state science and technology planning and entrepreneurs, develop across-the-board training and practical guidance in knowledge related to intellectual property rights;
3. Develop training in “applied standards and intellectual property rights issues” for industrial enterprises;
4. Strengthen promotion of and education in laws and statutes on intellectual property rights among key target groups such as cadres in leadership positions, public servants, youth and operational management personnel at enterprises;
5. Further strengthen intellectual property rights training for public servants in accordance with the requirements of the *Regulations for the Training of Public servants (for Trial Implementation)*;
6. Organize and develop training in intellectual property rights for personnel working in the field of Chinese medicine, training in intellectual property rights for major dedicated science and technology projects in the field of medicine and health and training in intellectual property rights for medical enterprise, medical institution, and local pharmaceutical supervisory personnel;
7. Incorporate laws and statutes on intellectual property rights in the

curriculum for public servants at radio, film and television systems; organize training sessions in intellectual property rights at radio, film and television systems;

8. Develop activities for copyright training for copyright owners, copyright users, mayors responsible for copyright administration in key municipalities and the directors of copyright administrations in each province (district and municipality) and key municipality nationwide and activities to popularize training for the public in knowledge related to collective copyright management;
9. Continue to implement plans to build teams of skilled lawyers who have a high level of expertise in intellectual property rights; strengthen training in intellectual property rights; continuously increase the capabilities of lawyers in providing services for filing intellectual property rights applications and handling intellectual property rights disputes, and participating in cases involving foreign intellectual property rights;
10. Strengthen the training of judicial evaluation personnel in intellectual property rights; intensify pre-job training and training for job reassignment;
11. Develop activities to train copyright agents nationwide; cultivate skilled personnel for copyright transactions; duly lay the foundation for scientific mechanisms for standardizing China’s copyright agency organizations and for the qualifications of copyright agents.

VII. Plan for International Exchange in the Area of Intellectual Property Rights

- (1) Constructing a mechanism for cooperation in international exchange
 1. Construct and improve mechanisms for communication and exchange of information related to intellectual property rights with foreign countries; further strengthen cooperation with such international organizations as the World Intellectual Property Organization (“WIPO”);
 2. Continue to maintain and develop mechanisms for bilateral and multilateral cooperation which have been established in the area of intellectual property rights, expand the method and scope of exchange and cooperation through various means; increase the levels of exchange and cooperation;
 3. Increase communication and cooperation with international organizations such as foreign law enforcement agencies and international police organizations; develop joint law enforcement activities;
 4. Continue to strengthen exchange and cooperation in the area of intellectual property rights between China and The United States, China and Europe, China and Switzerland and China and Russia through mechanisms for dialogue and working groups specializing in intellectual property rights and through other such channels as the Japan Official and Civil Joint Mission to China on Intellectual Property Rights 日本知识产权官民联合访华团; strengthen exchange and cooperation in the area of intellectual property rights;

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- (2) International exchange and cooperation activities
 1. Jointly host an interregional international intellectual property rights summit with the WIPO;
 2. Continue to promote cooperation between the World Intellectual Property Organization and the Hong Kong Special Administrative Region (“**Hong Kong SAR**”); assist the Hong Kong SAR government to duly hold regional seminars;
 3. Closely monitor and conduct in-depth research on relevant changes in the trends in the financial crisis and their impact on cooperation in the area of intellectual property rights;
 4. Develop cooperation with WIPO in the areas of patent information and patent document transmission; implement the content related to information and basic resources in the cooperation agreements between China and The United States, China and Japan, and China and Europe;
 5. Strengthen communications with international standardization organizations and organizations which formulate standards in developed countries; participate in the work of ISO “patent evaluation working groups” and IEC and ITU standardization activities;
 6. Further strengthen international exchange and cooperation in trademark, trade secrets and intellectual property rights in connection with combating unfair competition; proactively expand the breadth and depth of cooperation; conscientiously implement project activities under the cooperative framework agreement;
 7. Duly carry out the relevant work in the area of copyright protection under the WTO China Trade Policy Review and the China Transitional Review;
 8. Proactively participate in the relevant WIPO discussions on the issue of international protection of folk literature and art; promote the establishment of regulations for the international protection of folk literature and art which are internationally binding;
 9. Continue to handle the relevant work of the WTO Council for Intellectual Property Rights and the Asia-Pacific Economic Cooperation (“**APEC**”) Intellectual Property Rights Experts Group; participate in the intellectual property rights agenda of international organizations; continue to participate in negotiations on intellectual property rights topics in the free trade zone negotiations; continue to duly carry out the relevant work in connection with WTO cases involving intellectual property rights disputes;
 10. Continue to conscientiously implement the *Memorandum on Cooperation Between the Customs Administrations of China and the United States on Strengthening the Enforcement of the Law in Connection with Intellectual Property Rights*, and the *Action Plan of the Customs Administrations of China, Japan and Korea for the Protection of Intellectual Property Rights*; duly implement the relevant work in connection with the *Action Plan of the Customs Administrations of China and Europe for the Protection of Intellectual Property Rights*;
 11. Organize international negotiations on the relevant “international system for obtaining genetic resources and sharing the benefits derived therefrom” under the *Convention on Biological Diversity*;
12. Hold the second round of the East Asia Plant Variety Protection Forum and the 42nd Session of the Working Group on Vegetable Technology of the International Union for the Protection of New Varieties of Plants (“**UPOV**”); duly carry out the work of the rotating Office of the Secretary of the East Asia Plant Variety Protection Forum;
13. Proactively promote the launching of the research, development and application of patent technology for film and television products by Chinese film and television media enterprises and outstanding foreign enterprises;
14. Hold a Sino-European international seminar on judicial protection for network copyrights and international seminar on judicial protection for intellectual property rights.

VIII. Work Plan for Promoting the Protection of the Intellectual Property Rights of Enterprises

1. Intensify the work related to pilot projects and demonstration projects for intellectual property rights; focus on promoting strategic pilot projects for the intellectual property rights of enterprises and institutions; initiate projects for cultivating and promoting outstanding enterprises with proprietary intellectual property rights;
2. Continue to duly carry out the work related to intellectual property rights in connection with enterprises which go abroad to participate in expos in

accordance with the requirements of the *Notice on Strengthening Intellectual Property Rights in Connection with Enterprise Which Participate in Expos Abroad* issued by the nine ministries and commissions;

3. Proactively organize and launch trademark pilot projects and demonstration projects; strengthen the guidance of the formulation and implementation of trademark strategies by each locality; establish points of contact for enterprises; conduct across-the-board evaluation of the status of the implementation of trademark strategies by pilot enterprises;
4. Promote and implement the *Program for Implementing Mechanisms for Defending Intellectual Property Rights Abroad*; construct a website and database of experts for the defense of intellectual property rights abroad; organize and compile the relevant reports on the defense of intellectual property rights abroad;
5. Explore the establishment of a service station for the intellectual property rights of Chinese enterprises onsite at well-known expos; enhance intellectual property rights awareness among Chinese enterprises which participate in expos and enhance the capability of such enterprises to handle intellectual property right disputes;
6. Guide enterprises under the central government to duly guard against foreign-related infringement of intellectual property rights and legal proceedings; duly guard against the loss of intellectual property rights in connection with such sectors as enterprise investment abroad, cross-border mergers and acquisitions, cooperation in international projects, project

contracting and provision of labor services;

7. Continue to launch pilot projects for innovative enterprises with an emphasis on enhancing the ability of enterprises to create, apply, protect and manage intellectual property rights; use the acquisition of more intellectual property rights as the key assessment and evaluation standard; guide enterprises in the implementation of intellectual property rights strategies.

IX. Work Plan for Providing Services to Owners of Intellectual Property Rights

- (1) Enhance the standards for public services related to intellectual property rights
 1. Enhance the standards for patent document services oriented towards society and the general public; augment the construction of intellectual property rights exhibition centers, patent display halls, and patent document archives; duly construct online "patent document inquiry counters"; provide customers with high-quality search, translation and inquiry services;
 2. Complete the construction of China's electronic system for the examination and approval of patents; augment the deepening of patent data; promote the construction of a system for patent searches and services;
 3. Initiate the construction of a three tier patent information public backbone network, including a state patent data center, regional patent information service centers and local patent information outlets;
 4. Construct databases on skilled personnel such as a state database

of intellectual property rights experts and an information base on high-level skilled personnel in the field of intellectual property rights; promote the establishment at the provincial level of databases on skilled personnel in the field of intellectual property rights by each province (district, municipality); also establish a platform for an information network for skilled professional personnel;

5. Improve the mechanisms for trademark examinations; optimize work processes; enhance the efficiency and quality of trademark examinations; ensure the completion in 2009 of the examination of 1.3 million (1,300,000) trademark registration applications. Shorten the trademark examination period from 30 months to 19 months;
6. Continue to halt activities which affect trademark registration and harm the trademark rights and interests of the concerned parties, such as malicious filing of applications for, malicious objections to, and malicious transfer of trademarks; strive to safeguard orderly trademark registration;
7. Improve and expand systems for online trademark applications and online trademark searches; provide more convenient and faster services to Chinese and foreign applicants;
8. Organize and operate the phase one project for the platform for copyright oversight by the state; initiate the relevant work for the phase two project for the platform for copyright oversight; fully utilize the technical advantages of the platform for copyright oversight; enhance the effectiveness of crack downs on infringement and piracy;

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9. Intensify research on such issues as the registration of contracts, the registration of works, and the registration of pledges; promote the issuance of the relevant regulations as quickly as possible; promote the orderly development of the copyright industry;
 10. Spur the development of a group of professional intellectual property rights information service organizations and cultivate a group of professional personnel skilled in intellectual property rights information services by providing intellectual property rights information services for major dedicated science and technology projects sponsored by the state;
 11. Promote the establishment of an information reporting system to report on the progress of major dedicated science and technology projects and state science and technology planning and to monitor and analyze relevant patent information;
 12. Launch research on monitoring and warning mechanisms related to intellectual property rights information in key industry and trade sectors; regularly publish information on patent warnings for key trades and sectors;
 13. Focus on key businesses and key sectors in industry and information technology; construct a patent information database to satisfy the basic requirements of industries and enterprises to search for and to utilize information on intellectual property rights;
 14. Expedite the construction of a platform for information on the protection of new plant varieties; promote the digitalization of applications, examinations, testing, licensing and information disclosure;
 15. Proactively seek out products with agricultural product geographic marks; establish an information base with basic information on agricultural product geographic marks;
 16. Improve the relevant patent information platform for the registration of pharmaceuticals;
- (2) Develop intermediary services for intellectual property rights
1. Continue to promote projects which promote the evaluation of intellectual property right assets; implement local plans for the promotion of the evaluation of intellectual property right assets;
 2. Continue to strengthen the oversight of the orderly conduct of trademark agents; create new oversight methods; establish a credit database for trademark agencies;
 3. Construct a system for copyright public services; further support the development of copyright industry associations and copyright intermediary organizations; strongly support the establishment of a system for collective copyright management organizations; strengthen the oversight of collective copyright management organizations; construct normal channels for use by works;
 4. Improve the system of legal services related to intellectual property rights; expand the scope of legal services related to intellectual property rights; improve service methods; more effectively utilize the function of legal services in such areas as the creation, application, protection and management of intellectual property rights;
 5. Strengthen guidance for lawyers in their provision of legal services related to intellectual property rights; improve and strengthen administrative measures; fully bring into play the role of professional self-discipline to safeguard the regulated, orderly development of legal services related to intellectual property rights;
6. Strengthen coordination; conduct investigation and research on and submit working measures for the establishment of the relevant system for lawyers acting as agents in intellectual property rights business areas such as patent agency and trademark agency;
 7. Encourage and guide judicial evaluation organizations to apply for certification as test labs or investigative organizations; promote the establishment of the standardization of intellectual property rights judicial evaluation organizations; research and formulate standardized classifications for judicial evaluations of intellectual property rights; strive to implement centralized administration of judicial evaluations of intellectual property rights; provide technical support for legal proceedings involving intellectual property rights;
 8. Regulate public intermediary organizations and industry associations and fully utilize their social function in the protection of business secrets;
 9. Promote the establishment of radio and television associations for the protection of intellectual property rights (or radio and television collective copyright management organizations); transform associations for the protection of movie copyrights into collective copyright management organizations.

Highlights of New Legislation

Auto Industry

Rules for the Administration of Market Access of Producers of New Energy Motor Vehicles and of the said Products.

新能源汽车生产企业及产品准入管理规则

Issued on: June 17, 2009
Effective from: July 1, 2009

Banking

Notice of the China Banking Regulatory Commission on Issues Relevant to Further Standardizing the Investment Management Concerning Personal Financial Business of Commercial Banks.

中国银监会关于进一步规范商业银行个人理财业务投资管理有关问题的通知

Issued on: July 6, 2009
Effective from: July 6, 2009

Copyright

Measures for the Administration of Reproduction.

复制管理办法

Promulgated on: June 30, 2009
Effective from: August 1, 2009

Economic Plans

State Industrial Technology Policy.

国家产业技术政策

Published on: May 15, 2009

Foreign Exchange

Measures for the Administration of Pilot Projects for Renminbi Settlement of Cross Border Trade.

跨境贸易人民币结算试点管理办法

Issued on: July 1, 2009
Effective from: July 1, 2009

Import & Export

Measures for the Administration of the Classification of Producers of Industrial Products for Export.

出口工业产品企业分类管理办法

Issued on: June 14, 2009
Effective from: August 1, 2009

Investment Abroad

Notice of the National Development and Reform Commission on Issues Relevant to Improving the Administration of Overseas Investment Projects.

国家发展改革委关于完善境外投资项目有关问题的通知

Issued on: June 8, 2009
Effective from: June 8, 2009

Labor

Provisional Regulations for the Supervision and Administration of Occupational Health of Workplaces.

作业场所职业健康监督管理暂行规定

Issued on: July 1, 2009
Effective from: September 1, 2009

Land & Property

Implementing Measures for the Regulations on Land Surveys.

土地调查条例实施办法

Issued on: June 17, 2009
Effective from: June 17, 2009

Law of the People's Republic of China on the Mediation and Arbitration of Disputes over the Contracting of Agricultural Production on Rural Land.

中华人民共和国农村土地承包经营纠纷调解仲裁法

Issued on: June 27, 2009
Effective from: January 1, 2010

National Security

Law of the People's Republic of China Concerning Maintenance of State Secrets (Amended Draft)

中华人民共和国保守国家秘密法(修订草案)

Issued on: June 27, 2009

State-owned Assets

Operational Rules for Transactions of State-owned Property Rights of Enterprises.

企业国有产权交易操作规则

Issued on: June 15, 2009
Effective from: July 1, 2009

Supreme People's Court

Several Opinions of the Supreme People's Court on Duly Carrying Out Administrative Trials under the Current Situation.

最高人民法院关于当前形势下做好行政审判工作的若干意见

Issued on: June 26, 2009
Effective from: June 26, 2009

Seminars, Publications and Other News

Baker & McKenzie hosted a webinar entitled “China’s Healthcare Reform Plan: Are You Ready for the Challenges and Opportunities?” on June 17, 2009. Speakers included **Winston Zee**, **Andrew Chiu** and **Vicky Wang**.

Jon Eichelberger, **Danian Zhang**, **Brendan Kelly**, **Howard Wu**, **Marco Marazzi**, **Jeffrey Wilson**, **Martin Commons**, **Jennifer Chen**, **Joseph Deng** and **Barbara Li** from Baker & McKenzie’s China offices took part in the “Restructuring in China – are you prepared?” seminar hosted by Baker & McKenzie on June 23, 2009 at the China World Hotel in Beijing.

Winston Zee, **Tracy Wut** and **Andrew Chiu** spoke at the “Getting Ahead of the Curve – Catch the Wave of China’s Healthcare Reform” seminar organized by Baker & McKenzie at the JW Marriott Hotel Hong Kong on June 24, 2009.

Tracy Wut and **Martin Commons** presented to the Hong Kong Corporate Counsel Association on the topic “China’s Anti-Monopoly Law – Ready for Lift Off?” at Baker & McKenzie’s Hong Kong office on June 25, 2009.

Michelle Gon and **Clement Ngai** spoke at the “Contract and Commercial Law Series 2009 – How to Protect My Company in Technology Related Agreements” seminar hosted by Shanghai Corporate Counsel Association at the Centre, Shanghai on June 25, 2009.

Joseph Deng, **Grace Shie** and **Jennifer Van Dale** spoke at the “Legal and Tax Issues of Cross-border Mobility between China and Hong Kong” conference at Grand Hyatt Hong Kong on July 8, 2009.

Eugene Lim, **Martin Commons** and **Beng Ti Tan** spoke at the China Supply Chain Quarterly Briefing at Baker & McKenzie’s Hong Kong office on July 13, 2009.

Richard Weisman and **Glenn DeSouza** gave a presentation on “China Transfer Pricing Documentation Systems Class – Retuning for Financial Crisis” at the Hong Kong Institute of Chartered Secretaries seminar on July 13, 2009.

Andreas Lauffs, **Jonathan Isaacs** and **Olivia Wong** will speak at the CCH seminar “Reduction of Costs: Best Tactics under PRC Employment Laws” on September 10, 2009 at the Grand Hyatt Hotel, Hong Kong.

Chunfai Lui and **Martin Commons** will speak at the LexisNexis-sponsored seminar “Coping with the Latest Regulatory Development of China’s AML for Competition Compliance Excellence” on September 11 & 18, 2009 in Beijing and Shanghai.

Beatrice Schaffrath presented, from the China and Asia regional perspectives, on the following panels at the Baker & McKenzie International Environmental conference, Chicago – June 10-11, 2009: “Global Product Stewardship: Regulation and Policy”; “The Global Financial Crisis and its Impact on Environmental Policy and Enforcement”; “Update on Global Climate Change Developments”.

Beatrice presented on “Legal Issues of CDM Projects in China” at the Wind Power/Clean Energy Conference on July 9, 2009 in Beijing.

Beatrice will present, with **Michelle Gon**, at the LexisNexis-sponsored seminar “Foreign Corrupt Practices Act (FCPA) Enforcement, Due Diligence and Best Practices” on August 6-7, 2009 at the Courtyard by Marriott Hotel in Shanghai. Beatrice and Michelle, and representatives from Ernst & Young will also present at the LexisNexis-sponsored seminar, “Foreign Corrupt Practices Act (FCPA) Enforcement, Due Diligence and Best Practices” on September 3-4, 2009 at the Crown Plaza Hotel in Beijing.

On September 16, 2009, Beatrice will speak on Anti-corruption issues and applicable laws and regulations at Baker & McKenzie Compliance Seminar in Hong Kong.

Beatrice will present, with Michelle Gon, at the CCH-sponsored seminar “Combating Corporate Fraud in Times of Economic Uncertainty” on September 24, 2009 in Shanghai.

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