



# CHINA LAW UPDATE

## OCTOBER 2008

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## In This Issue

The National Development and Reform Commission's **Circular on Further Strengthening and Standardizing the Administration of Foreign Investment Projects**, which was issued and became effective as of July 8, 2008, attempts to address problems with the regulation and administration of foreign investment projects in China—problems the commission perceives primarily to stem from the failure of branches and officials to follow existing rules and procedures (page 3).

**The Provisions on Encouraging the Establishment of Regional Headquarters by Multinational Corporations** is a legislative effort by the Shanghai municipal government to attract multinational corporations to the already-booming city (page 4).

The **Circular Economy Promotion Law of the People's Republic of China** gathers myriad environmental rules and regulations that are published elsewhere in Chinese law, and aspires to provide a comprehensive template for the country's transition to an environmentally sustainable economy (page 4).

The **Draft Amendment to the Insurance Law of the People's Republic of China** proposes revisions to China's insurance law (page 8).

The **Draft Amendment to the Patent Law of the People's Republic of China** proposes revisions to China's patent law (page 9).



## Circular on Further Strengthening and Standardizing the Administration of Foreign Investment Projects

**Issuing Body:** National Development and Reform Commission

**Issuing Date:** July 8, 2008

**Effective Date:** July 8, 2008

In this Circular, the National Development and Reform Commission (NDRC) attempts to address a number of perceived problems with how foreign investment projects are administered and regulated in China. The perception of the commission is that those problems stem primarily from the improper administration of foreign investment projects and the failure of government agencies to strictly implement applicable regulations. As a result, the Administration Circular does not so much introduce new regulations as remind NDRC branches and officials of existing rules and procedures—and reinforce the NDRC's commitment to enforcing them.

In this Administration Circular, the NDRC specifically cites a number of problems it seeks to address. According to the NDRC, some foreign investment projects, for example, have started construction without the required government verifications, while others have been properly verified but have not adhered to the requirements or limits contained in the verification. Some investors, the NDRC says, have also taken advantage of fluctuations in international capital markets and adjustments to China's foreign exchange policies to bring funds into China under the guise of foreign direct investment in a variety of ways: by establishing fake joint equity ventures; by making false declarations of total investment; and by establishing shell companies. According to the NDRC, those funds are being converted into RMB and used improperly, which the NDRC considers harmful to China's economy and international balance of payments.

The stated purpose of the Administration Circular is to strengthen the administration of foreign investment projects in China and prevent irregular inflows of foreign capital. The circular directs local NDRC counterparts to take the following actions and measures:

- Strictly implement the verification system for foreign investment projects.
- Strengthen oversight and authentication of foreign investment projects to prevent the formation of shell companies and the other types of questionable investments mentioned in this circular.
- Implement the administration of foreign investment projects by class and category.
- Standardize the administration of new projects and strictly adhere to the criteria for verification of foreign investment projects.
- Strengthen the supervision and inspection of projects that have already been verified.



## Provisions on Encouraging the Establishment of Regional Headquarters by Multinational Corporations

**Issuing Body:** Shanghai Municipal Government

**Issuing Date:** July 7, 2008

**Effective Date:** July 7, 2008

In 2002, the Shanghai Municipal Government instituted rules designed to encourage foreign multinationals to locate their regional (Asia) headquarters in Shanghai. With passage of the Provisions on Encouraging the Establishment of Regional Headquarters by Multinational Corporations, the municipal government has increased its efforts to attract and encourage multinational corporations to establish their regional headquarters in Shanghai. The rules were enacted and took effect on July 7, 2008.

Compared with the 2002 rules, these new provisions make a number of changes designed to make it easier and more appealing for corporations to locate their headquarters in Shanghai:

- The approval process has been shortened (to ten business days).
- The minimum required investment has been decreased (from US \$30 million to US \$10 million).
- The provisions expand the scope of activities that a multinational corporation's regional headquarters can engage in. Headquarters personnel can now engage in domestic distribution, import and export, logistics, outsourcing and finance management for enterprises that come under the umbrella of regional headquarters.
- The process for hiring foreign citizens and individuals who are not residents of Shanghai has been simplified.
- Customs clearance procedures are more convenient.

In addition, under these Provisions on Encouraging the Establishment of Regional Headquarters by Multinational Corporations, an existing entity that qualifies as an investment or management company may apply for regional headquarters status in order to take advantage of the preferential treatment available for regional headquarters.



## Circular Economy Promotion Law of the People's Republic of China

**Issuing Body:** Standing Committee of the National People's Congress

**Issuing Date:** August 29, 2008

**Effective Date:** January 1, 2009

As China's economy has developed rapidly over the past several decades, the country has struggled to figure out how to maintain a healthy environment. At China Law Update, we have periodically covered legislative efforts to address this important issue, such as the Circular on Enhancing the Environmental Monitoring of Export Enterprises (December 2007) and the PRC Law on the Prevention and Control of Water Pollution (May 2008).

In August, the Standing Committee of the Eleventh National People's Congress passed China's most comprehensive environmental legislation of recent years, the Circular Economy Promotion Law of the People's Republic of China (Circular Economy Promotion Law). It will take effect on January 1, 2009.

The term "circular" essentially equates to Western use of the words "green" or "sustainable." While most if not all the provisions of this law have already been codified elsewhere (for example, in China's Energy Conservation Law), the Circular Economy Promotion Law is nevertheless an important piece of legislation, if only because it highlights government efforts to encourage development of a sustainable economy in China. It is in many respects new territory for China; indeed, the Standing Committee added the word "Promotion" to the law's title in its third and final reading as a way of stressing this point, and emphasizing the role of the law in encouraging sustainable economic development.

The law is, however, relatively brief—seven chapters and 58 articles, some of them only a single sentence—and leaves many details to be addressed in enabling rules and regulations. Agencies such as the General Administration of Quality Supervision, Inspection and Quarantine have already held hearings to discuss such matters as the packaging of commodities. Similarly, the Circular Economy Promotion Law mentions several as-yet-unpublished catalogues (for example, a catalogue of articles subject to compulsory recycling; another lists "encouraged, restricted and eliminated techniques, equipment, materials and products") that will help determine the law's impact.

If fully implemented, the Circular Economy Promotion Law will surely have a profound impact on foreign-invested companies and the entire Chinese economy.

### General Principles

The stated purposes of the Circular Economy Promotion Law are: to promote development of the "circular economy"; to promote the more efficient use of resources; to protect and improve the environment; and to realize sustainable development. The law uses the term "circular economy" to refer to "reducing, reusing and recycling activities conducted in the process of production, circulation and consumption." This definition has prompted reference to the "three R's": reduce (consumption), reuse (products or components) and recycle (raw materials).

The development of China's circular economy, the law says, "shall be propelled by the government, led by the market, effected by enterprises and participated in by the public." According to this law, that mandate is to be factored into industrial, economic and social planning at every level of government.

### **Management and Administration**

The Circular Economy Promotion Law does not specify which agency or agencies are responsible for its administration, but responsibility is expected to fall to the National Development and Reform Commission (NDRC). In addition, the law directs governments at virtually every level to establish policies and procedures for encouraging, managing, and taking responsibility for all aspects of the law. Even individuals are told to "consume resources in a reasonable way and save resources." Industrial associations are encouraged to provide technical guidance and service.

Under the guidance of the State Council, government agencies are charged with developing a national development plan for China's circular economy. Lower-level governments are similarly charged with developing plans for industry to accomplish the goals of the Circular Economy Promotion Law. Construction projects, for example, are supposed to take into consideration pollution, land use and water consumption.

Government agencies at the national level are supposed to develop extensive evaluation, monitoring and reporting systems.

### **Reduction, Reuse and Recycling**

The law's mandates for reduction, reuse and recycling are extremely broad, and encompass virtually every facet of the Chinese economy. The Circular Economy Promotion Law touches, in principle, upon building demolition, water use in the hotel industry, the use of tap water for road cleaning and planting, the planning of industrial parks, and myriad other topics.

Specific industries mentioned in the law include architecture and construction; product and packaging design; mining; agriculture; engine and motor vehicle manufacturing; energy production; forestry; and many others.

In accordance with the Circular Economy Promotion Law, businesses that produce products or packages which are listed in a yet-unpublished catalogue will be required to recycle or reuse specified products or materials.

The law identifies "key enterprises" in industries (such as steel and coal) that use large amounts of energy or water, saying they are subject to special supervision and administration. As with much of the Circular Economy Promotion Law, the applicable rules are codified elsewhere (in this case, the Energy Conservation Law).

Progress will be monitored in a variety of ways, including a statistical measuring system, national standards, and product labeling.

The law also mandates regular publication of a catalogue listing techniques, materials, equipment and products that are "encouraged," "restricted" and "eliminated." Enterprises are supposed to "give preference" to materials that are recyclable, biodegradable or otherwise environmentally friendly. Eventually the Circular Economy Promotion Law will encompass rules for product packaging.

Conservation of water is broadly mandated, as are desalination and the use of seawater in coastal regions. Energy conservation, too, is broadly encouraged, and in some cases (for example, motor vehicle manufacturing) mandated.

The Circular Economy Promotion Law directs governments and government agencies at every level to “take the lead in using energy-saving, water-saving, land-saving, material-saving and environment-friendly” products, equipment and facilities.

The Circular Economy Promotion Law restricts the production and distribution of “one-off” goods, although the details of such restrictions are as yet undetermined. A directory of restricted one-time-use goods will be published, with various government departments responsible for developing tax, import, and related rules.

Specific (albeit, again, extremely general) provisions also call for the efficient use of energy; the use of various biofuels; the development of environmentally friendly timber harvesting; an information exchange system concerning industrial waste management; and improved sewage treatment.

## **Incentives**

As an incentive to foster development of China’s sustainable economy, the Circular Economy Promotion Law directs provincial and municipal governments to establish funds to support development of the circular economy, including funds for research and development of new technology and information products.

Tax preferences will be given to industries and activities that promote the conservation of energy, water and materials.

Financial institutions, the law says, shall give priority to loans and businesses promoting the policies outlined in the Circular Economy Promotion Law.

The state is further directed to establish pricing policies that encourage conservation and the “reasonable” use of resources.

Other economic incentives include fees for waste disposal and deposits for recycling.

In procurement and other programs that disburse government money, preference is supposed to be given to products that reflect the priorities contained within the Circular Economy Promotion Law.

## **Legal Liability**

The Circular Economy Promotion Law holds governments and government agencies accountable for enforcement of the law, with higher levels of government being authorized to punish individuals.

Enterprises that produce or sell prohibited equipment or products can likewise be punished. Enterprises can be assessed fines of RMB 50,000 to RMB 200,000. In the case of “serious” violations, businesses can be shut down.

Businesses that import prohibited materials or equipment may be fined as much as RMB 1 million, with a minimum fine of RMB 100,000.

The law also provides for a variety of other fines and the possible revocation of business licenses.

Where “a crime is constituted,” the Circular Economy Promotion Law provides for criminal punishment.

## Summary

The Circular Economy Promotion Law is an extremely broad and potentially far-reaching attempt to direct and shape China’s economic development in ways that conserve energy, water and materials, and that protect the environment. Whether the law accomplishes those stated goals, of course, depends both on the enacting regulations and enforcement.

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## Draft Amendment to the Insurance Law of the People’s Republic of China

**Issuing Body:** Standing Committee of the National People’s Congress

**Issuing Date:** August 29, 2008

As China’s economy has grown, its insurance industry has also rapidly expanded and become an increasingly important part of that growing economy. The laws governing the nation’s insurance industry, however, have not fully reflected that growth—and change—particularly in how insurance companies are allowed to invest funds. Another commonly cited problem is how Chinese law treats intermediaries such as insurance agents and insurance assessment firms.

The Standing Committee of the National People’s Congress completed its first reading of the Draft Amendment to the Insurance Law of the People’s Republic of China (Draft Insurance Law Amendment) on August 29, 2008. Major changes contained in the Draft Insurance Law Amendment are summarized below.

- The proposed law significantly expands the types of investment vehicles in which insurance companies will be allowed to invest their funds. Under present law, insurance companies can invest only in Chinese treasury bonds and Chinese government agency bonds. As currently written, the Draft Insurance Law Amendment allows insurance companies to invest in marketable securities, including bonds, stocks and securities investment funds. The proposed law also permits insurance companies to invest their funds in real estate.
- The Draft Insurance Law Amendment provides that an insurance company can take the form of a limited liability company, while existing law provides that “insurance companies may only be in the form of a joint stock limited company or solely state-owned company.
- The Draft Insurance Law Amendment also adds conditions that must be met by a “major shareholder” of an insurance company: It must be continuously profitable; have a good reputation, with no record of material irregularities or illegalities within the most recent three years; and have no less than RMB 200 million in net assets. While the law does not specifically define “major shareholder,” it seems likely that this term would be interpreted to mean 5 percent or more of shares or equity in a company.
- The Draft Insurance Law Amendment tightens requirements for the paid-in capital of an insurance company. Under existing law, RMB 200 million of an insurance company’s registered capital must be paid-in capital. The draft would require all registered capital to be paid-in capital.



- The Draft Insurance Law Amendment imposes restrictions on the qualifications of directors, supervisors and senior managers of an insurance company. The amendment provides that no individual can serve as a director, supervisor or senior manager of an insurance company if he has been disqualified from serving in that capacity for a financial institution (such as a bank or an insurance company) in the preceding five years due to a violation of law or regulation; or if he has had his license to practice as a professional (such as lawyer or accountant) revoked.
- The Draft Insurance Law Amendment also changes how insurance intermediaries are treated. The proposed law clarifies that non-dedicated insurance agencies are indeed to be considered (and regulated as) insurance agencies, and insurance assessment firms are also insurance intermediaries. In the case of individual agents, the Draft Insurance Law Amendment removes requirements in existing law that an individual agent must obtain the insurance agency business permit.

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## Draft Amendment to the Patent Law of the People's Republic of China

**Issuing Body:** Standing Committee of the National People's Congress

**Issuing Date:** August 29, 2008

In the past few years, the Chinese government has made a concerted effort to reshape the Chinese economy, supporting industries that provide higher-paying jobs and foster technological innovation. That effort is reflected in several pieces of legislation summarized by China Law Update in the past year, including the PRC Enterprise Income Tax Law (China Law Update, May 2007), which provides special incentives for high-tech enterprises; the Measures on Administration of the Recognition of High-Tech Enterprises, the Catalogue of High-Tech Sectors Supported by the State on a Priority Basis, and the Circular on Issuance of the Working Guideline for Recognition and Administration of High-Tech Enterprises (all in the July 2008 issue).

Similarly, in June 2008 China's State Council issued the Compendium of China's National Intellectual Property Strategy, which stated a goal of developing China into "a nation with an internationally top level of creating, using, protecting and managing [Intellectual Property Rights] by 2020."

Less than three months later, the Standing Committee of the National People's Congress completed its first reading of the Draft Amendment to the Patent Law of the People's Republic of China (Draft Patent Law Amendment). This draft aspires to foster technological innovation by making it easier—and more profitable—to register, own and enforce patents in China. If passed, it will be the third major revision to China's patent law, which was first enacted in 1985 and revised in 1992 and 2000.

According to Chinese government statistics, relatively few patent filings in China (about 20 percent) cover inventions. And of those invention patents, more than half—53 percent, according to the State Intellectual Property Office (SIPO)—are actually owned by foreigners. Thus, while some of the changes embodied in the Draft Patent Law Amendment are intended to bring Chinese patent law into conformance with international treaties, its overarching purpose is to encourage creativity and improve the innovative capacity of Chinese industry.

The Draft Patent Law Amendment has been made available to the general public and is expected to pass final review by early 2009, at the latest. We have summarized below the major changes contained in this draft.

- **The “Absolute Novelty” Standard.** The Draft Patent Law Amendment raises the standard for granting a Chinese patent, adopting the “absolute novelty” standard that is used internationally. This provision would require that the invention not be known publicly either inside or outside China.
- **Where to File.** The Draft Patent Law Amendment would for the first time allow Chinese citizens and businesses to file for a patent abroad before filing in China. However, the proposed law contains a provision requiring those who file abroad for a patent to submit the patent to SIPO under the guise of protecting security.
- **Licensing of Patents.** The Draft Patent Law Amendment would allow SIPO to grant a compulsory license to exploit a patent if the patent holder has not done so within three years of when the patent was issued. A compulsory license may also be granted if the patent holder is determined in legal or administrative proceedings to have used the patent in an anti-competitive manner. In addition, the law would allow a co-owner of a patent to act alone to practice, or license others to practice, a jointly owned patent.
- **Protection Measures.** The Draft Patent Law Amendment provides greater protection to patent holders in China. For example, it would increase penalties for infringing on a patent and provide for statutory damages (compensation defined by law) when the damage to the patent holder cannot be determined. In the present draft, those statutory damages range from RMB 10,000 to RMB 1 million, depending on the type of patent as well as the nature and extent of the patent infringement.
- **Changes to Conform to International Treaties.** Some of the changes contained in the Draft Patent Law Amendment bring Chinese law into conformance with international treaties. One provision, for example, provides for a compulsory license to manufacture and export patented drugs to certain countries for public health purposes. Another requires an applicant for a patent to disclose the source of genetic material for a gene-based patent.
- **Stronger Protection for Design Patents.** The Draft Patent Law Amendment grants to the holder of a design patent the right to restrict or prohibit use of the patented design for sales activity (such as in an advertisement or store display) without permission of the patent holder.

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## Faegre & Benson LLP's China Practice

Established in 1886, Faegre & Benson LLP is one of the 100 largest law firms in the United States. Its more than 500 lawyers, based in seven offices in the United States, England, Germany and China, are experienced in handling corporate, commercial, real estate, intellectual property, complex litigation and many other types of matters for businesses operating worldwide.

Faegre & Benson offers an experienced China practice team of American and Chinese legal professionals dedicated exclusively to China-related business and serving as the bridge between China and other regions of the world. The firm's office in Shanghai, China, is staffed by lawyers and other legal professionals who are fluent in Mandarin and English and have lived and worked extensively in Shanghai and other parts of China. John Grobowski, the managing partner of the Shanghai office, has more than two decades of experience in the China business environment and is currently the Vice Chairman of the American Chamber of Commerce in Shanghai.

Faegre & Benson's China practice has represented clients ranging from privately held emerging companies to Fortune 100 multinationals in the telecommunications, software, automotive, chemicals, pharmaceuticals, consumer products, hotel, construction, architecture, engineering and insurance industries, among others. Its key areas of practice include foreign direct investment, mergers and acquisitions, private equity and venture capital, technology and trademark licensing, supply and distribution, franchising, restructurings, finance and financial services, offshore listings, customs, real estate, employment and dispute resolution.

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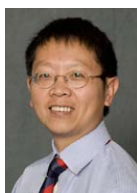
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