

ASIAN News



WTO - AND NOW?

Numerous publications have dealt with the entry of China into WTO and its potential impact on the ability of foreign investors to enter the China market. Has China delivered what it promised? Looking at the changes of the legal landscape in the last couple of months, one has to give praise to the Chinese regulators for their efforts to comply with WTO requirements.

Revisions of the key areas of intellectual property laws, foreign investment laws, customs laws have taken place and are being implemented while this article is written.

One can sense a new business atmosphere and realizes that things are changing. In addition, the government is actively reviewing approval and registration procedures and trying to reduce them to the minimum needed. China deserves to be praised for its efforts to accommodate foreign investors and we are looking forward to seeing the swift implementation of the current legislation as well as of further changes to come.

Björn Etgen
Beiten Burkhardt
Beijing

PR China

Import of Technology Liberalized

Trying to attract more advanced technology into China, the Chinese legislators made a stride by revising the existing technology license regime significantly. On December 11, 2001, the State Council issued Regulations on the Administration of Technology Import and Export ("Regulation"). On December 30, 2001, the Ministry of Foreign Trade and Economic Cooperation ("MOFTEC") and the State Economic Trade Commission ("SETC") followed by introducing other regulations, including a list of technology, which is prohibited or restricted from import. All these regulations became effective on January 1, 2002.

Import of different types of technology is subject to either registration or approval. For import purpose, technology is categorized as follows: freely introduced technology ("Free Technology"), technology restricted from import ("Restricted Technology") and technology prohibited from import ("Prohibited Technology").

Free Technology may be imported into China without further examination and approval. Contracts for import of Free Technology become effective upon their execution. Although registration with the relevant Commission for Foreign Trade and Economic Cooperation ("COFTEC") is still mandatory, issuance of the registration certificate by the COFTEC is no longer a precondition for the effectiveness of such contracts.

Matters are more complicated when it comes to Restricted Technology. To import Restricted Technology, the importer shall file an application with the competent COFTEC. Upon issuance of a "Letter of Intent on Technology Import Licensing" by COFTEC, the parties may then sign the contract and apply to COFTEC for issuance of a Technology Import Permit and verification of this contract. Such contract will only become effective upon issuance of a Technology Import Permit by COFTEC.

Despite a liberalization of the original technology regime, including removal of the original 10-year duration limitation for technology import contracts, the current applicable regulations still impose certain limitations on such contracts and it also remains to be seen how the authorities implement the relaxed provisions.

Contact: Yanfeng Zhang
Beiten Burkhardt Beijing

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News Flash

PR China: On March 19, 2002, the China Securities Regulatory Commission issued "Special Regulations for the Content and Format of the Prospectuses of Listed Companies Involving Foreign Investment", providing additional mandatory information disclosure requirements for such companies.

PR China: The "PRC Administrative Provisions on Compulsory Commodity Certification" became effective on May 1, 2002. From now on products subject to compulsory certification may only leave factory for sales, be imported or used after they have passed compulsory certification with the competent authority.

Hong Kong: The Hong Kong International Arbitration Centre announced new rules, namely, Electronic Transaction Arbitration Rules. It aims to simplify resolution of disputes between on-line sellers and dissatisfied customers and to boost consumer confidence over transactions done via the Internet. This serves as an alternative dispute resolution to court proceedings.

PR China: The amended "Law of the PRC on the Inspection of Commodity Imports and Exports" was adopted on April 28, 2002, replacing the previous quality licensing system for imports, exports and their producers with a system of certification and licensing system for inspection organizations.

PR China: The "Measures for Administration of the Import of Audio and Video Products" were issued on April 2, 2002, establishing a system under which approval must be obtained from the Ministry of Culture for the import of audio and video products.

PR China

New Investment Guidance Catalogue 2002

1. General

In its effort to channel and direct Foreign Direct Investment ("FDI") in compliance with WTO requirements, a new "Catalogue for Directing Foreign Investment" ("Guidance Catalogue") became effective on April 1, 2002 replacing the Guidance Catalogue of 1998.

The Guidance Catalogue contains a list of industry sectors, classifying them into the three categories "encouraged", "restricted" and "prohibited". Projects not mentioned in the Guidance Catalogue are deemed "permitted".

The more open a sector is to foreign investment, the less centralized is the approval process and the more advantages and benefits a project will enjoy, such as tax benefits, favorable land use conditions, etc.

The former categories "Restricted A" and "Restricted B" have been consolidated, forming the one new category "restricted". In the past, projects under the category "Restricted B" had to be approved by central authorities, irrespective of the size of the project. Under the new rules, projects which are in the restricted category and involve amounts below US\$ 30 million only require approval by provincial level authorities and their approval must only be filed with central authorities. This delegation of approval authority to a lower level will benefit foreign investors, as it proved in the past that a decentralized approval hierarchy is of advantage and will speed up the approval process.

2. Exceptions

However, the general principles as outlined above are subject to several exceptions. These exceptions are to adjust the general classification to high-priority political issues. Therefore, they reflect the strengthening of the central and the western regions as well as China's accession to the WTO.

- "Permitted" or "restricted" projects that are also listed in the Western Catalogue (a catalogue specifying investment conditions for the western provinces) enjoy the same benefits as projects in the "encouraged" section. Therefore, also in this case the approval procedure is less complicated and tax benefits apply.
- Certain projects in the service sector which used to be "prohibited" are now deemed "restricted". This applies to projects whose gradual liberalization is laid out in the WTO-agreements. The service sector traditionally faced severe restrictions. These restrictions being removed, foreign investors face unparalleled business opportunities.
- "Permitted" projects that export all of their products shall be deemed as "encouraged".
- "Restricted" projects that export at least 70% of their products may be classified as "permitted" upon approval by the relevant provincial or central authority.

3. Special Restrictions

The provisions provide the possibility to impose special restrictions:

- Only joint ventures are allowed;

- The Chinese party is required to hold a majority share;
- The Chinese party is required to hold a relative majority share.

While no definition of these restrictions was given in the past, the new provisions contain a more or less detailed explanation:

- If the Chinese side is required to hold a majority share, one or several Chinese shareholders together have to hold a stake of more than 51%.
- If the Chinese side is required to hold a relative majority share, the combined shares of all Chinese investors have to be larger than the share of each foreign investor. For example, if the sole Chinese investor holds a 40% share and two foreign investors hold a share of 30% each, this requirement is fulfilled.

4. Summary

The Guidance Catalogue will keep its leading role in guiding foreign investment in China. The categorization of a project is and will be the basis of any solid investment plan. As shown above, the overall direction of Chinese economic policy is more and more favorable to foreign investors. More and more sectors that have been off limits so far, are being opened up to foreign investment. It is obvious that the Chinese government considers foreign investment as one of the pillars of future economic development, and therefore further liberalization and opening can be expected. This process is boosted by China's accession to the WTO.

Contact: Björn Etgen
Beiten Burkhardt
Beijing

Hong Kong

Lifting the Corporate Veil

An incorporated private limited company in Hong Kong is a separate legal entity distinct from its shareholders. It has "separate legal personality" and can enter into legal transactions in its own name.

This "separate personality" concept may be abused in group companies situations or where subsidiary relationships exist. The existence of separate companies is sometimes a façade to avoid liabilities. If so, the court is prepared to "pierce the corporate veil" to find liability on the companies' officers or members who exercise ultimate control.

Two recent cases illustrate the Hong Kong court's attitude in this aspect. In *Yue Tai Plywood & Timber Co Ltd v. Far East Wagner Construction Ltd HCA3147/2000*, the plaintiff ("YTP") supplied goods to the first defendant ("FEC"), which shared the same business place and registered office with the second defendant ("FEE"). Mr. A was a director and shareholder of FEC, and also FEE's director and controlling shareholder. YTP dealt with Mr. A who did not distinguish between the two defendants. When FEC failed to pay YTP, FEE gave YTP three dishonoured cheques signed by Mr. A. The court accepted YTP's arguments that the defendants' operation was blurred since they were run as a combined operation. They should be aware of each other's business. Hence, FEE was liable to YTP.

However, this may not be a true "lifting the corporate veil" case because no subsidiary relationship between the defendants is mentioned. No legal authorities in this area were cited.

In *Typhoon 8 Research Ltd v. Seapower Resources International Ltd. [2001] 4 HKC 311*, the plaintiff ("TR") sued to recover deposit paid under its tenancy with the second defendant ("WH"), a property-holding subsidiary of a Hong

Kong public company of which the first defendant ("SP") was the ultimate holding company. Senior staff of SP conducted the tenancy negotiations. TR argued that SP made a collateral promise by saying that no guarantee for returning the deposit was necessary from SP, though this was not included in the tenancy. The court refused to pierce the corporate veil to hold SP liable based on this alleged "collateral promise" since SP was simply WH's agent. They were separate entities. It was ultimately WH which signed the tenancy.

The above demonstrates that the court has sole discretion whether to lift the corporate veil in a particular case. The court is prepared to do so for doing justice.

Contact: Ada Lee
Beiten Burkhardt
Hong Kong

PR China

Shanghai Reforms Administrative License Regime

The Chinese government at the central and local level has been actively pushing the reform on administrative license regime ("Reform") since 2001 to prepare itself for the accession to the WTO. China's highest legislation organ, the National People's Congress, has listed the Administrative License Law on its legislation agenda of 2002.

The measures Shanghai has taken to revoke or adjust items subject to administrative license ("Items") may be summarized as follows:

1. Revocation

Items shall be revoked if they meet one of the following conditions:

- have no legal basis;
- fail to be compatible with the nature of market economy;
- belong to decision-making power of natural persons or economic entities; or

- do not fall within government functions.

2. Rectification

Some Items should be rectified in terms of the mode of administrative license as follows:

- Procedural Measures

For example, time limits for grant of an administrative license were specified or shortened; also application documents to be submitted were specified.

- Combined Approval

For an Item which involved more than one administrative organ, one of these organs should be designated as the sole or leading approval organ.

- Transfer to lower-level or non-administrative organs

For example, some Items were transferred from the municipal authority to the district authority or to trade associations.

- Elimination of Trivial Procedures

For example, most of the procedures of preliminary examination were revoked; also most of the procedures for issuance of a business licenses were rescinded.

A high percentage of the Items of Shanghai were revoked or adjusted during the Reform. For example, 742 Items were adjusted or revoked on the municipal level. More Items are expected to be revoked or adjusted as the Reform continues.

However, unfortunately few major changes were made in the approval and registration process for establishment of foreign invested enterprises. It appears that the Shanghai government intends to maintain a strict administration in this area.

Contact: Rainer Burkardt / Larry Liu
Beiten Burkhardt
Beijing



Yanfeng Zhang

Graduated from University of Pennsylvania with an LL.M. degree and Renmin University of China with an LL. B. degree specializing in commercial law and international business.

Ms. Zhang is admitted to the New York State Bar. She has also passed the national bar examination of the PRC.

After she completed university Ms. Zhang worked for a large, well-known Chinese company before joining BEITEN BURKHARDT in May 1996.

Her main areas of practice are foreign direct investment projects, mergers, acquisitions and tax. Ms. Zhang speaks Mandarin and English.

PR China

China Revises Commodity Inspection Law

The PRC Commodity Inspection Law on Imports and Exports (Law) was promulgated in 1989. In order to be compatible with the WTO, the Law was revised in April 2002, The revisions can be summarized as follows:

1. Purpose of Inspection

The purpose of inspection had been to suit the needs to develop foreign trade. Now it is revised to protect the health and safety of human beings, the lives and health of animals and plants, and the environment.

2. Content of Inspection

The content of inspection had been quality, specifications, quantity, weight, and compliance with the requirements of safety and hygiene. Now it is revised to verify whether import & export goods comply with the compulsory technical standards of the state.

3. Inspection Standards

Inspection standards had included compulsory standards of the state and the standards agreed by trading partners. Now they are changed to compulsory standards of the state and relevant international standards.

4. Compulsory Commodity Certification

Under the old regime of commodity inspection, quality license was applied to imports and exports while compulsory commodity certification was applied to domestically-manufactured products. Now compulsory commodity certification replaces quality license and is applied to imports and exports as well.

5. Confidentiality Obligation of Inspection Organizations

Confidentiality obligations are imposed for the first time on inspection organizations regarding commercial secrets they become aware of during their inspection activities.

6. Administrative Litigation

In the new version of the Law an applicant for inspection may initiate administrative litigation directly without having to go through the procedure of administrative review.

Commodity inspection has been viewed traditionally as one major technological trade barrier in international trade and been constantly fought off by the WTO. The PRC revised the Law to the effect that commodity inspection will not constitute a tool for trade protectionism.

Contact: Larry Liu
Beiten Burkhardt
Beijing

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HONG KONG

Ada Lee
Tel: +852-2524 6468
Fax: +852-2524 7028
kpmg-bb-hongkong@kpmg.com

BEIJING

Björn Etgen
Tel: +86-10-8529 8110
Fax: +86-10-8529 8123
kpmg-bb-beijing@kpmg.com

MUNICH

Jürgen Burkhardt
Tel: +49-89-350 6500
Fax: +49-89-350 65123
kpmg-bb-muenchen@kpmg.com

Offices: Beijing • Berlin • Brussels • Budapest • Cologne • Dusseldorf • Frankfurt a.M. • Hamburg • Hong Kong • Leipzig • London • Moscow • Munich • Nuremberg • St. Petersburg • Warsaw

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