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Executive Summary

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❑ China Further Clarifies Conditions for Foreign Investment

Over the past year, this law firm's Corporate Group has assisted more than a dozen companies in establishing their subsidiaries in southern China. When establishing a foreign-invested company (FIE) in China, one of the biggest challenges is inconsistency between administrations in different localities, and sometimes even within the same locality or department. Authorities and individual officials tend towards much discretion in determining conditions, as well as the content and format of documentation required, when handling approval and registration procedures. Besides a precise knowledge and understanding of the legal framework, as critical to a successful business incorporation process is to establish a good channel of communication with the relevant authorities.

The new Company Law that went into effect on 1 January 2006, as also discussed in our Issue 10 (2005) of this Legal Newsletter, introduces some important changes in particular relating to the capitalization of companies in China and to corporate governance. The *Administrative Rules on Company Registration* from the State Administration for Industry and Commerce, effective on the same date, provide more details on company registration procedural matters. With respect to FIE's however, they fail to clarify many contradictions with existing laws and implementing rules for wholly foreign-owned enterprises (WFOE's) and joint ventures (JV's).

Circular No. 81 with the appended *Suggestions on Implementation of Several Issues Applicable for Law of Examination, Approval, Registration and Administration of Foreign-funded Enterprises*, issued on 24 April 2006 by the State Administration for Industry and Commerce (SAIC), the Ministry of Commerce (MOFCOM), the General Administration of Customs (GAC) and the State Administration for Foreign Exchange (SAFE), clarifies some of these issues. Effective immediately, these Implementing Rules are to be referred to by local approval authorities and administrative authorities when handling applications of foreign investors to establish subsidiaries in China. At the very least, we hope they will make approval and registration procedures a little more transparent.

Liaison Office and Branches

One major topic of discussion among foreign investors and their legal advisors in the past six months has been the change in status of liaison offices. Under previous conditions, many FIE's established in one locality registered liaison offices in other localities. Since December of last year however, the SAIC and its local counterparts seized to register such offices, as they are not mentioned in the new Company Law.

The Implementing Rules confirm that registration of liaison offices will no longer be accepted, and registered offices will not be able to renew their licenses (Article 25). As confirmed in the *Reply of the Responsible Person of SAIC FIE Registration Bureau for questions related to "the Appended Suggestion on Implementation of Several Issues Applicable for Law of Examination, Approval, Registration and Administration of Foreign-funded Enterprises"* of 10 May 2006, liaison offices can however continue to exist as non-registered entities, as long as they engage only in liaison or consulting services (i.e. may not conduct operational activities, including manufacturing or sales).

If an FIE wants to establish a secondary office for operational purposes, whether in the same or in a different locality, it will have to establish it as a branch. Under the Implementing Rules (Article 24), registration procedures for establishment of branches have been simplified: approval from the original approval authority of the headquarters is no longer required – only registration with the local registration authorities of the locality where the branch is established. After registration, such a branch can engage in activities within the scope of its headquarters.

Capital Contribution Schedule

One of the most important changes introduced by the new Company Law is a lowering of the minimum registered capital for general limited liability companies to RMB 30,000. The only additional condition, especially for FIE's, is that the capital should be sufficient to capitalize the planned operations.

There has been a discussion about when such capital should be contributed. Under the existing FIE regulations, which continue to be in force, foreign investors should contribute at least 15% of the total registered capital within three months of issuance of the business license. The new Company Law sets this standard at 20%. Over the past months, we have seen both standards applied by local branches of the AIC in different localities. The Implementing Rules (Article 9 and 15) clarify that for new FIE's, if the registered capital is contributed in lump-sum then such contribution must be made within six months of issuance of the business license. But if contribution of registered capital is made in installments, then a first installment of at least 15% must be made within three months. On the other hand, for increase of registered capital of existing FIE's, the first installment must consist of at least 20% of the increased registered capital.

If investors fail to contribute the registered capital in time, they will be liable for penalties as per the *Administrative Regulations for Registered Capital for Companies* passed by the SAIC on 27 December 2005.

As regards the form of contribution, Article 27 of the new Company Law stipulates that at least 30% of the total registered capital should be contributed in currency, and that non-monetary contributions must be in kind, or in the form of intellectual property rights, land use rights, or other non-monetary properties. The *Administrative Rules on Company Registration* further explain that contributions in the form of labour, credit, nature of a natural person, business reputation, franchise or pledged property are prohibited. The Implementing Rules (Article 10) do permit investors to contribute funds raised from a loan.

Another very important clarification relates to the valuation of non-monetary assets. While the Company Law stipulates that such contributions must be "assessed and verified", the Implementing Rules state that where the shareholders of a Chinese-foreign equity joint venture contribute the capital in non-monetary property (land use rights excluded) such as in kind (including machinery and equipments) and industrial property rights, the price may be appraised and fixed by the parties to the joint venture through negotiation. This indicates that official appraisal in such circumstances may no longer be necessary.

Individual Shareholder Companies

Under the new Company Law, limited liability companies with only one shareholder ("single-shareholder companies") were classed separately, subject to a higher registered capital (of RMB 100,000, up from RMB 30,000) and other limitations, i.e. that individuals may not establish more than one single-shareholder company, and a single-shareholder company may not establish another single-shareholder company). According to the Implementing Rules (Article 2), the same limitations apply to single-shareholder companies established by foreign individuals. However they do not apply to WFOE's in which the single shareholder is a company; i.e. a foreign corporate investor may establish more than WFOE in China, and such WFOE's may establish wholly-owned subsidiaries.

Application Document Requirements

The Implementing Rules also include certain clauses which follow up on documentary requirements for the

registration process. Firstly, it is stipulated (Article 5) that investors' company registration documents (or ID documents if the investor is a foreign individual), to be submitted to the AIC for registration and designed to prove the existence and background of the investor, will always need to be notarized, then (except in Hong Kong and Taiwan, and perhaps in other countries which have entered into special treaties with P.R. China) legalized by the local Chinese embassy or consulate of the country where the investor is registered. While this process may be time-consuming, a consistent application of this rule at least will give investors more transparency. Unfortunately, the Implementing Rules remain silent on which other documents should or should not be notarized and legalized; thus once again, a good contact with local authorities will be necessary to avoid unexpected burdens.

Secondly, one additional document has been added to the list of required materials (Article 9). All investors should, through a signed, sealed, notarized and legalized *Power of Attorney on Delivery of Legal Documents*, authorize a third party in China to accept the service of legal documents in the name of the investor. Such party can be any company or individual in China, including the subsidiary of the company, the company's representative or lawyer, and so forth. Any related change must be registered with the relevant registration authorities.

Activities Beyond the Approved Business Scope

Under Chinese law, a company may engage only in the activities as designated in the approved and registered business scope of such company. Under the Implementing Rules, penalties for such *ultra vires* activities have been further defined as follows:

(1) If a company engaged in business that falls outside its stated business scope but falls within the encouraged or permitted categories of the *Catalogue for Guiding Foreign Investment*, the company shall be ordered to seize such business activities, or change its registered business scope. In case of failure to adhere to such order, the company may be fined between RMB 10,000 and RMB 100,000 as per Article 73 of the *Administrative Regulations on Company Registration*.

(2) On the other hand, if such business activities fall within the restricted or prohibited categories then this will be regarded as engaging in activities without a proper license. The FIE can be subjected to the confiscation of assets, penalties, suspension of its business license, and in serious cases criminal liabilities for its senior responsible staff.

Conclusions

The incorporation of a company in China, compared to other countries, remains a relatively complex process. While many investors may have already familiarized themselves with Chinese business practices, dealing with the authorities remains a major challenge. Thus for good reason, many foreign companies decide to retain a consultancy or law firm to handle application procedures on their behalf.

Regulatory changes in some instances simplify procedures, and in some instances add extra burdens. This is true for the new Company Law and the *Administrative Regulations on Company Registration*, as for the Implementing Rules analyzed in more detail above. Fortunately, it is unlikely that such burdens will make foreign companies reconsider their China strategy. This law firm's Corporate Group looks forward to another year of assisting a host of foreign companies to overcome such challenges and build a successful business in China.

Maarten Roos / Phenix Zheng
Wang Jing & Co.

❑ China Releases New Dispute Resolution Policy for Domain Names

China has more than 100 million Internet users, ranking second in the world after only the United States. In recent years the country has also seen a sharp increase in registered .cn domain names – totaling more than 1 million in the first quarter of 2006.

These figures, and the fact that a local People's Court in Beijing recognized, for the first time last April, that an internet domain name can be considered a form of property with actual property value, make domain name dispute resolution in China an urgent concern.

In 1997, the Ministry of Information Industry established the China Internet Network Information Center (CNNIC) to administer the China Domain Name Registry Service and System. The latter issued its first policy on domain name dispute resolution in September 2002. Cases of dispute, however, are handled by the appointed dispute resolution service providers: the Domain Name Dispute Resolution Center (DNDRC) of the China International Economic and Trade Arbitration Commission (CIETAC) and the Hong Kong International Arbitration Center (HKIAC).

Statistically, the majority of cases between 1997 and 2005 saw the disputed domain name transferred to the complaining party. In these cases the main points to consider were:

- Whether the disputed domain name is identical with or confusingly similar to the complainant's name or a mark in which the complainant has civil rights or interests (e.g. it is the owner of a registered trademark);
- Whether the disputed domain name holder has no right or legitimate interest in respect of the domain name;
- Whether the disputed domain name holder has registered, or is using, the domain name in bad faith.

In anticipation of China's ratification of international treaties on the Internet with the World Intellectual Property Organization (WIPO) in the second half of this year, the CNNIC recently reviewed its Dispute Resolution Policy, and issued the *Rules for Settlement of Disputes over Internet Domain Names*, which came into effect on March 17. The most important changes relate to:

- The introduction of a two-years time limit for initiating complaints for arbitration;
- A new definition of cybersquatting; and
- A clarification of guidelines for the defense of complaints.

Time-limits for Complaints

In the past, there was no time limit for initiating complaints with the DNDRC – complaints would be handled no matter when the domain name was originally registered. Under the new Rules, a complaint must be made no later than two years after registration of the domain name for the DNDRC to have jurisdiction; beyond this period, a claim can only be filed directly in court.

Defining "Cybersquatting"

Cybersquatting refers to the registering, selling or using of a domain name with the intent to profit from the goodwill of another's trademark. Some individuals and companies have made it a practice to buy up domain

names using the names of existing businesses, and later selling these domain names to such businesses for profit.

Under Chinese law, such activities were already prohibited if in bad faith, cybersquatting referring to a situation where "the disputed domain name holder has registered or acquired the domain name for the purpose of selling, renting or otherwise transferring the domain name to obtain unjustified benefits". The new Rules however take a different approach, defining "cybersquatters" as those who register a domain name and "sell or rent it to competitors of a company whose rights are infringed upon." Thus selling to non-interested third parties is no longer prohibited.

Arguments for Defense

A new provision has been introduced providing for three circumstances under which the holder of the disputed domain name would be deemed to enjoy legitimate interest in the domain name:

- Use of the domain name or corresponding name of the domain name in good faith in the course of providing goods or services;
- Establishment of a certain reputation in the domain name, even though the holder has not registered the domain name as a trademark; or
- Reasonable or legitimate use of the domain name in a non-commercial way, without intention to obtain commercial benefits by deceiving the public.

Conclusions

One shall pay attention to the fact that the introduction of “establishment of a certain reputation concept” in the *Domain Name Dispute Resolution Policy* is something new, which follows others reform on IP introduced in China since 1996. Such a move is a significant step forward WIPO international concept.

Readers will also notice that the new Rules actually make it more difficult to file a successful complaint with the DNDRC, making it easier for holders of domain names to defend their positions. The two-year time limit in particular is a crucial point: companies are advised to regularly consult the .cn domain name registry (at http://www.cnnic.net.cn) to ensure there are no attempts by third parties to register domain names which may harm their interests!

David Maurizot
Wang Jing & Co.

❑ Wang Jing & Co. News

Wang Jing & Co. Engages Japanese Enterprises

From 24 to 28 April 2006, Mr. WANG Jing, Mr. PAN Lidong and Japanese Client Service Manager Mr. Hiroki YAMADA of this Firm made a trip to Japan to pay courtesy visits to Clients and business partners, including several well-known Japanese multinationals and law firms. Besides further deepening our relations with these esteemed companies, this has been a chance to learn more of the key interests and concerns of Japanese enterprises relating to their business in China.

For one, we noticed that with the economic development of China and the opening to foreign investment of the domestic trade sector, more and more foreign-invested commercial enterprises (FICE) have already been or are in the process of being established in China. Thus key issues such as how to establish wholly foreign-owned enterprises (WFOE), legal issues and commercial risks concerning domestic trade for WFOE's, control of risks under contractual terms & clauses and debt recovery in domestic trade, corporate management of foreign-invested enterprises (FIE), labor issues, and the protection of intellectual property in China have become the focus of attention for may foreign companies.

As an international-oriented full-service law firm, we have been instructed by quite a number of foreign investors and their FIE's in China to handle aforementioned legal issues. Hence during the meetings with Japanese companies and law firms, we briefly introduced our experience in handling similar issues.

This business visit in Japan has helped us enhance our mutual understanding and communication with long-term business partners and Clients, and established business relationship with several new Clients. We trust that informing Japanese companies on China's latest policy and laws will be helpful to them, and our better understanding of their concerns will aid us to improve and strengthen our legal services to Japanese and other foreign Clients.

Wang Jing & Co. Co-organizes Symposium on "Finding Your Way in European Intellectual Property"

Many Chinese enterprises in Guangdong Province are actively looking to expand their business in foreign markets. To give them a better understanding of the intellectual property system in Europe, and taking advantage of the opening of 99th Chinese Export Commodities Fair (Canton Fair), the Guangdong Intellectual Property Protection Association and the Chintellectual Property Foundation (at www.chintellectualproperty.org), in association with the European Union Chamber of Commerce in China and Wang Jing & Co., invited authoritative experts to speak on European intellectual property rights at the White Swan Hotel Guangzhou on 24 April 2006. Among the speakers were European Patent Attorneys Mr., Kim Tan and Mr. Otto Oudshoorn, European Trademark and Design Attorney Mr. Peter van der Wees, and Mr. Peng Kai, IP Consultant of this Firm.

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