China

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Recommended Citation
Qiang Bjornbak et al., China, 40 Int'l L. 547 (2006)
https://scholar.smu.edu/til/vol40/iss2/27

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In 2005, the People's Republic of China (PRC or China) continued to develop regulatory frameworks in many important economic areas. This article will review developments in eight important legal areas. In February and August, the Ministry of Commerce (MOFCOM) and the State Council issued the first comprehensive and permanent regulations in
the franchising and direct markets sectors. The Chinese government agencies most related to international trade, including MOFCOM, have improved transparency and international cooperation and developed policies that favor domestic industries, such as automobiles and steel. In 2005, the Chinese government took a number of steps toward a stronger and more transparent intellectual property rights regime. Also, in 2005, China continued to take a middle path on the approval of agricultural biotechnology and biodiversity initiatives. In late 2004, the National Development and Reform Commission issued a regulation that added a confusing layer of bureaucratic complication for the foreign investor establishing an enterprise in China, the effects of which began to be felt in 2005. This year, the State Administration of Foreign Exchange issued three notices relating to administration of outbound investment and foreign exchange registration by PRC domestic residents that both stopped and attempted to re-start such investment activity. Lastly, the Chinese government issued a series of regulations aimed at maintaining the continuous and healthy development of the real estate market. On October 27, 2005 China announced the latest major revisions to its Company and Securities Law.

I. New Franchising & Direct Selling Regulations

In 2005, the Ministry of Commerce issued two new sets of regulations that affect distribution. The Measures for the Regulation of Commercial Franchises1 (Franchise Measures) came into effect on February 1, 2005. These replace the measures issued in 1997 for trial implementation. While the new Franchise Measures are more detailed, there are still very significant questions about when they apply, what must be disclosed, and the required pilot stores or existing outlets.

On August 23, 2005, the State Council promulgated the Regulations for the Administration of Direct Selling2 (Direct Selling Regulations) to come into effect on December 10, 2005. According to the Ministry press release, “[t]he purpose of the regulation is to avoid fraudulent conduct, protect legal rights and interests of citizen[s], legal person[s] and other organizations, maintain order [in the] market economy under socialism and keep social stability.”

Both regulations appear to have been shaped, at least in part, by the government’s concern for consumer protection. In China, counterfeiting is not limited to U.S. intellectual property but can include even such items as baby formula.3 In this context it is not entirely surprising that the new Franchise Measures require the franchisor to warrant the quality

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of the goods supplied by its designated suppliers. The Franchise Measures also require a franchisor to have a stable supply system and to be able to guarantee quality. The franchise agreement is required to include provisions on consumer complaints.

The concerns about fraudulent conduct do not appear to be limited to end consumers, but extend also to distribution structures such as direct selling and franchising. Unlike multi-level marketing operations in other countries, China will not permit the remuneration of direct seller salespersons on the basis of sales by salespersons recruited by that person. Foreign direct sellers are required to have been involved in direct selling for at least three years outside China.

In the Franchise Measures, the issue that has generated the most concern is the requirement that a franchisor have at least two company-owned units (or units owned by its subsidiary) in China for more than one year. This is similar to the experience requirements in the Direct Selling Regulations as mentioned above. In other countries, concerns have been expressed about immature franchisors who sell an unproven concept. For foreign franchisors, the concern is also whether the concept has been proven to work locally or needs costly adaptation.

A closely related question regarding the new Franchise Measures is whether foreign franchisors are now permitted to franchise directly in China. The Franchise Measures do contain a section entitled "Special Provision on Foreign-Invested Enterprises" but these provisions do not deal with this issue specifically either way. Some commentators suggest that a foreign franchisor may grant a master franchise and have the master franchisee fulfill the requirement for company-owned units, while others suggest that the franchisor must still fulfill this requirement even when granting a master franchise.

Foreign franchisors also have a number of concerns regarding the interpretation of the disclosure requirements. In the United States a franchisor is not required to provide prospective franchisees with information regarding potential sales of the franchise to be sold, including such information as the average sales at existing outlets. Article 19 of the new Franchise Measures sets out China's requirements, and includes in article 19(9), a requirement that "other disclosures requested by the franchisee." Article 19(2) requires the disclosure of the "number, location, and operational results of its franchisee" and there is a debate as to whether "operational results or status" means that earnings claim information must be provided. When interpreting such provisions it should

5. Franchising Measures, supra note 1, at art. 10(5).
6. Id. at art. 7(5).
7. Id. at art. 13(9).
9. Id. at art. 7(1).
10. Franchising Measures, supra note 1, at art. 7(4).
11. Id. at arts. 32-37.
14. The actual phrase is "jingying qingkuang" which may be translated as operational circumstances or situation.

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be remembered that China is a civil law jurisdiction and less weight should be placed on
the actual wording that in a common law system.

The Franchise Measures are not law themselves but subordinate legislation and as such
must be interpreted with regard to the provisions of China's Contract Law. Following the
lead of civil law jurisdictions such as Germany and Québec, article 42 of the Contract Law
provides for what is often called pre-contractual good faith. In both Germany and Québec
the courts have interpreted such provisions in franchise cases as requiring the disclosure of
financial performance information. Thus, it would not be surprising to see similar obli-
gations imposed on franchisors in China. Franchisors will thus have to disclose all material
facts.

Other concerns regarding the disclosure requirements include whether the disclosures
of items, such as terminated franchisees, litigation, and locations, are limited to those
occurring in China or include matters or operations from other jurisdictions. While the
wording of the requirement for litigation is not limited, there has been verbal advice that
it will be limited to franchise-related litigation. Finally, there are provisions prohibiting a
franchisor from intentionally exaggerating the benefits of the franchise operation or from
intentionally omitting information regarding situations where the franchise operation
might affect the interests of others.

The Franchise Measures also have provisions regarding what must be dealt with in the
franchise agreement. The provisions regarding franchise fees, deposits, and renewals, re-
quire that these matters be resolved by the parties “based on the principles of fair dealing
and reasonableness.” There is some concern that such language may be broad enough to
allow judges to go beyond examining the procedural fairness in determining these provi-
sions to changing the substantive terms to accord with some notion of substantive fairness.

Although the Direct Selling Regulations are significantly stricter than the Franchise Mea-
sures, they have been welcomed by the foreign direct selling industry because they replace
the absolute ban on direct selling that has been in place since 1998. Direct selling is defined
as a method of sale whereby salespersons are recruited to promote products directly to
consumers somewhere other than in a fixed place of business. This broad definition may
catch methods other than what is generally known as multi-level marketing.

To become a direct seller in China an organization must meet a number of criteria, such
as having a good commercial reputation and not having a record of a major violation of the

15. Hetong Fa [Contract Law of the People's Republic of China] (adopted at the Second Session of the
download/contractlawPRC.asp.
16. For Germany see Landgericht Kaiserslautern-Aktenzeichen 4 O 607/00, 26 Mai 2004 and Landgericht
Essen—Aktenzeichen 18 O 238/04, 9 Mai 2005 (on file with author); for Québec see Cadieux c. St-A. Photo
Corporation, Cour supérieure 500-05-006829-947 (le 9 avril 1997) and Investissements Stanislas et Patricia Bricka
2001) (on file with author).
17. Franchising Measures, supra note 1, at art. 19(2).
18. Id. at art. 19(5).
21. Id. at arts. 13-15.
22. Id.
24. Direct Selling Regulations, supra note 2, at art. 3.
law in the last five years. A direct seller must post a bond starting at RMB ¥20 million (approximately US $2,475,465.00) but it is adjusted monthly to be equal to 15 percent of revenues.\textsuperscript{25} The bond is to be used to remunerate salespersons and consumers if the direct seller defaults or goes bankrupt.\textsuperscript{26} Direct sellers must also establish a branch or sub-branch in each province or municipality where they do business.\textsuperscript{27} The restrictions on the operations of direct sellers are equally significant. A direct seller may not advertise the sales remuneration nor make the payment of fees or the purchase of product a condition precedent when it recruits salespeople.\textsuperscript{28} They may not charge a fee for training that they are required to provide.\textsuperscript{29} Only certain employees can be trainers.\textsuperscript{30} Salespersons must leave a consumer’s house or apartment immediately upon request, and return policies must be explained in detail.\textsuperscript{31} Finally, the onus is on the direct seller to establish that the actions of its salespersons were unconnected with the enterprise, failing which, it is liable.\textsuperscript{32}

A number of foreign franchisors have expressed concerns about certain aspects of the Franchise Measures and in particular the requirement that two outlets have been in operation for at least one year. MOFCOM had said that it would release guidelines in the Fall of 2005, but at the time of this writing, a draft—Franchise Managerial Standard—was still being reviewed.\textsuperscript{33} The Chinese team that reviewed it, however, described it as very practical and as meeting the needs of China’s franchise development.\textsuperscript{34} If the needs of China’s franchise development bear much resemblance to the needs of its direct selling development, the restrictive aspects of the Franchise Measures are not likely to be loosened.

II. International Trade Regulation

In the last year, implementation of China’s World Trade Organizations (WTO) commitments has become less of a priority—the Chinese government calls it the end of the WTO transition period—while the administrative, legislative, and enforcement capacities developed in conjunction with implementation remain in place.\textsuperscript{35} The Chinese government agencies most related to international trade, including especially MOFCOM, have deployed the new capacities in ways that have improved transparency and international cooperation.

\begin{itemize}
\item \textsuperscript{25} Id. at art. 7.
\item \textsuperscript{26} See id. at arts. 29-34.
\item \textsuperscript{27} Id. at art. 10.
\item \textsuperscript{28} Id. at art. 14.
\item \textsuperscript{29} Id. at art. 18.
\item \textsuperscript{30} Direct Selling Regulations, supra note 2, at art. 19.
\item \textsuperscript{31} Id. at art. 22.
\item \textsuperscript{32} Id. at art. 27.
\item \textsuperscript{34} Id. This statement appears in the Chinese version only.
\item \textsuperscript{35} Wu Xiaoling fuhangzhang zai shoujie “Zhongguo jinrong luntan” shang yanjiang [Wu Xiaoling, Central Bank Vice-Governor, Speech at the Inaugural China Banking Conference], Nov. 4, 2005, available at http://www.gov.cn/gedt/2005-11/04/content_91042.htm. (“In November of 2006, China will reach the end of the transition period following accession to the World Trade Organization. Foreign investment will enter financial institutions in greater amounts and will bring us advanced financial products and management techniques, also bringing greater urgency to introducing new ideas in our financial system”).
\end{itemize}
while at the same time promoting and encouraging domestic industries. In the latter category, the international trade-related ministries have taken advantage of the granularity of the WTO commitments and of the many uncertainties of China's legal regime to develop policies that favor domestic industries and encourage technology transfer from foreign firms.

A. Textiles

On January 1, 2005, the thirty-year regime that had permitted WTO members (and Contracting Parties to the General Agreement on Tariffs and Trade (GATT) before 1995) to maintain quotas on textile products, ended. Developed countries, including the United States, ceased enforcing quotas protecting the textile industries, permitting low-cost producers like China to increase their exports. China, however, agreed to a textile specific safeguard in its WTO accession agreement that extends four years past the end of the expiration of global quotas. The safeguard permits another WTO member to initiate consultations with China on surging imports in particular categories. Therefore, when the Chinese government receives the request for consultations, it must impose an export limitation on products in that tariff line. China agreed to limit export growth to 7.5 percent based on the amount of such products that entered the WTO member seeking the safeguard in the first twelve of the preceding fourteen months.

The Chinese government attempted to discourage the imposition of safeguards on Chinese textile and apparel products directly after the expiration of the quota system by imposing an automatic licensing system on textile and apparel products in tariff lines with particularly high levels of exports to the United States and the European Union (EU).  


38. Id.

Nonetheless, the United States continued to accept safeguard petitions and impose safeguards on Chinese textile and apparel products throughout the year. In June 2005, China reached an agreement with the EU that suspended the use of the safeguard by reinstating quotas over a range of textile and apparel products. On November 8, 2005, after seven rounds of negotiation, the U.S. and Chinese governments reached an agreement that extends quotas over twenty-two tariff lines when it becomes effective on January 1, 2006. The agreement sets specific quotas for the twenty-two categories in each of the years remaining in the textile specific safeguard (2006, 2007, and 2008).

B. Antidumping and Countervailing Duty Investigations

Over the course of 2005, China remained one of the WTO members most often instituting antidumping investigations and imposing antidumping duties. According to the WTO, in the twelve months ending June 30, 2005, China initiated twenty-seven cases; only India and the European Union initiated more cases. The Chinese government also imposed duties or entered price undertakings in more cases during that period—a total of twenty-three—than any other WTO member. Chinese industries also remained a major target of anti-dumping investigations by other WTO members. During that same period, other WTO members initiated cases against Chinese exporters in forty-six instances and entered final measures in forty-three cases. No other WTO member's industries were targets of investigations in nearly as many cases.

The WTO agreements require all WTO members, including China, to provide a judicial, arbitral, or administrative review mechanism for reviewing the final determinations in anti-dumping investigations. In 2002, the Supreme People's Court issued a decision pro-

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41. The agreement extends only to the end of 2007, one year before the special safeguard provision expires, and covers only ten tariff lines. Negotiations between the EU and China resumed in August because several of the agreed quotas had already filled and Chinese textile and apparel products were sitting on docks in European ports. The additional negotiations resulted in another agreement, signed September 9, 2005, to avoid impoundment of large quantities of Chinese textile products at European ports.
43. Id. at Annex I. The agreement raises quotas further than hypothetical safeguards in each of the twenty-two tariff lines in each of the next three years would have.
45. Id. at Annex C.
46. Id.
47. Id. India was the largest single source of initiations against China with eleven of the forty-six, while the United States led the way in final measures against China with eleven of the forty-three.
viding specific guidance on bringing final determinations to the people's courts. At this time, however, there are no reports of any of these cases being reviewed.

C. INDUSTRY DEVELOPMENT POLICIES

The Chinese government, acting through the National Reform and Development Commission, issued two major industry development policies in 2004 and 2005. These two policies—the Auto Industry Development Policy and the Steel Industry Development Policy—provide a clear picture of the long-term economic policy goals that lie at the end of the process of reform and opening up. The policies also show the concerns current policymakers have about the extent of the WTO accession commitments.

Both policies seek to create globally competitive domestic industries with a small number of large Chinese companies. By raising the minimum levels of foreign investment in each sector, and restricting foreign support for domestic industry growth by limiting foreign equipment imports in the steel sector to technologies that domestic enterprises cannot produce, the policy encourages technology transfer from foreign enterprises to consolidated domestic enterprises.

The policies also serve as the basis for other measures drafted to extend the domestic support effect of the underlying measure to related industries, such as distribution, in greater detail. Pursuant to the Auto Industry Development Policy, in February 2005, the General Customs Administration of China effectively reclassified complete knockdown ve-

49. Zuigao renmin fayuan guanyu shenli fanqingxiao xingzheng anjian yingyong falü ruogan wenti de jueding [Supreme People's Court Decision on Certain Questions about the Appropriate Law in Handling Anti-Dumping Administrative Cases], Nov. 21, 2002, available at http://www.law-lib.com/law/law_view.asp?id=42303. The Supreme People's Court later designated the Beijing No. 1 Intermediate People's Court as the appropriate court to hear these cases.

50. During the 2005 Transitional Review Mechanism on China in the Anti-Dumping Committee the United States asked whether "a judicial review of an anti-dumping measure [had] been heard under the Provisions of the Supreme People's Court on Certain Issues Concerning the Applicability of Laws in the Hearing and Handling of Anti-Dumping Administrative Cases? If so, for what measure and what was the outcome?" World Trade Organization, Committee on Anti-Dumping Practices, Questions from the United States concerning Anti-Dumping, G/ADP/W/446 (Sept. 26, 2005). The U.S. government also has not received notice of any cases filed or adjudicated under this mechanism.

51. Qiche chanye fazhan zhengce [Auto Industry Development Policy], June 1, 2004, available at http://gys.ndrc.gov.cn/zcfg/t20050707_27519.htm. As discussed, infra, the Ministry of Commerce and the General Administration of Customs have also issued related measures pursuant to each of these policies. See Qiche maoyi zhengce [Auto Trade Policy], Aug. 10, 2005 (on file with author); Goucheng zheng che tezheng de qichelingbujian jinkou guanli banfa [Management Measures for Imports of Auto Parts Having the Characteristics of a Complete Automobile], Feb. 28, 2005 (on file with author); Gangtie chanye fazhan zhengce [Steel Industry Development Policy], July 20, 2005 (on file with author). Reform and Opening up is the term given to the Deng Xiaoping-led process of economic development begun by the Communist Party and the Chinese government in 1978.

52. Current Chinese policymakers appear to fear that China's WTO market access commitments will allow globally competitive multinational companies to capture significant portions of the Chinese domestic market and prevent the development of globally competitive Chinese companies and brands.

53. See Steel Industry Development Policy, supra note 51, at art. 1 ("Steel's comprehensive competitive capacity to achieve an international advanced standard, and to make China become the great country of world steel production and the strong country possessing competitive power."); see also Auto Industry Development Policy, supra note 51, at art. 1.

54. See Steel Industry Development Policy, supra note 51, at arts. 18, 23.
vehicles as whole automobiles, making one source of competition for Chinese domestic automobiles more expensive. The Ministry of Commerce also issued an Auto Trade Policy that generally proscribes the import of used auto parts and secondhand cars, another source of competition for Chinese car producers.

D. Transparency

The Chinese government has made increasing use of mechanisms to promote broader participation in lawmaking in several areas of law. Several of China’s specific WTO accession commitments, as well as a number of generally applicable provisions of several WTO agreements, required greater openness and participation as prerequisites for WTO accession. As a first stage, the Chinese government has largely instituted the practice of enforcing only published trade-related measures, the subject of both a specific WTO accession commitment and a general requirement for all WTO Members. More significant, however, has been the more frequent publication of draft measures for comment, the increasing use of public hearings, and the use of the Internet to broaden the reach of both draft measures published for comment and hearings, particularly at the provincial level and below. As some recent examples have demonstrated, the introduction of an open government ideal has expanded beyond the arena of trade and commercial law, those areas of law on which WTO accession has a direct impact. At this point, general statements from the central and local governments about the importance of citizen participation in government are commonplace.

III. Intellectual Property Rights

Responding to pressure from the United States and foreign and domestic industry, and in order to meet its obligations under the WTO Agreement on Trade-Related Aspects of

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55. Auto Industry Development Policy, supra note 51, at ¶¶ 55-57; Management Measures for Imports of Auto Parts, supra note 51, at art. 2. In the context of China’s 2005 Transitional Review Mechanism at the WTO, Japan asked China whether instituting this policy that values an import based on its assembled state even though it arrives in parts, violated art. II of the GATT. World Trade Organization, Committee on Market Access, China’s Transitional Review Mechanism: Communication from Japan, G/MA/W/72 (Sept. 7, 2005).

56. Auto Trade Policy, supra note 51, at art. 37.

57. See, e.g., World Trade Organization, Accession of the People’s Republic of China, pt. (1)(2)(C), WT/L/42 (Nov. 23, 2001) [hereinafter WTO Accession]; General Agreement on Tariffs and Trade, July 1986, art. X.

58. WTO Accession, supra note 57.

Intellectual Property Rights (TRIPS), the Chinese government took a number of steps toward a stronger and more transparent intellectual property rights (IPR) regime. As noted by the U.S. Trade Representative (USTR), however, IPR infringement in certain sectors (particularly Internet piracy of copyrighted materials) grew markedly in 2005 despite previous efforts to clamp down. Therefore, the efficacy of the government's new measures will be closely watched. Indeed, U.S. concern over the level of IPR infringement in 2005 was reflected in the USTR’s report on its out-of-cycle review (OCR) of China that announced that the United States would invoke the transparency provisions of article 63.3 of TRIPS, requiring China to provide specific information about its IPR enforcement regime and placing China on the Special 301 Priority Watch List.

The closing days of 2004 brought a significant new judicial interpretation (JI) from the Supreme People’s Procuratorate and Supreme People’s Court. The new interpretation—officially titled the Interpretation by the Supreme People’s Court and the Supreme People’s Procuratorate on Several Issues of Concrete Application of Laws in Handling Criminal Cases of Infringing Intellectual Property—resulted from an agreement between Deputy Premier Wu Yi and the U.S. government at the 15th annual meeting of the Joint Commission on Commerce and Trade (JCCT).60 Its provisions (1) lower the numerical thresholds determining the criminal status of infringing acts; (2) allow for accomplice liability for importers, exporters, landlords, and others who assist infringers; (3) permit goods produced in factories and/or kept in warehouses to be included in sales calculations; (4) authorize using the number of illegally duplicated disks or internet advertising revenue to satisfy the for-profit requirement; and (5) expand the definition of an infringing trademark.61 Lowering the bar for criminal enforcement is expected to increase the number of criminal cases brought and to serve as a stronger deterrent against infringement.62 The USTR welcomed the JI as a sign of serious commitment, but criticized certain key deficiencies, among them that the JI was promulgated without any prior public comment or consultation with the United States, that it eliminates three-strikes provisions for repeat offenders, and that it does not hold internet service providers (ISPs) liable for infringing material hosted on their networks.63 Other gaps in the JI involve the methods for calculating case values and the standard for proving knowledge.64

A gap in China’s compliance with TRIPS as it relates to copyright damages was filled in January by the Beijing Higher People’s Court that issued Guiding Opinions directing that


61. 2004 JI, supra note 60; see OCR Report, supra note 60, at 4 (listing key improvements contained in the 2004 JI).


63. See OCR Report, supra note 60, at 4 (discussing key deficiencies in the 2004 JI).

64. See Simone, supra note 62 (describing 2004 JI).
copyright holders be fully and adequately compensated for their losses, as required by article 45. 65 The Guiding Opinions also clarify the assessment of damages by courts in the capital, an issue that had caused much confusion and frustration for copyright litigants. 66

Also in January, the Supreme People’s Court issued a Ji titled Several Issues Concerning the Application of the Law in Trials of Copyright Disputes Involving Computer Networks. 67 This Ji directs courts to pursue joint or attendant liability claims against network service providers that allow third parties to infringe, or subscribers to infringe upon third parties, if there has been a substantiated warning or request from the copyright holder. 68

On May 30, 2005, the National Copyright Administration (NCAC) and the Ministry of Information Industry issued the Administrative Protection of Copyright on the Internet Procedures, China’s first administrative regulations governing the dissemination of copyrighted music over the Internet. 69 The regulations hold ISPs liable for fines if they knowingly transmit infringing material over their networks. 70

After the United States issued critical comments in its OCR, China agreed in the July 2005 JCCT meeting to take additional steps to strengthen its IPR enforcement. 71 China agreed to: (1) transfer more cases to criminal enforcement (and has issued draft guidelines to ensure timely referral of IPR violations for criminal prosecution); (2) issue regulations increasing prosecution of customs violations; (3) improve planning and coordination among national police forces; (4) establish a bilateral IPR law enforcement working group whose members will cooperate on enforcement activities to reduce cross-border infringing activities; (5) dedicate enforcement teams to more aggressively counter movie piracy; (6) ensure that state-owned enterprises and offices are using only legal, licensed software; (7) address software end-user piracy; (8) appoint an Intellectual Property Rights Ombudsman at the Chinese Embassy in Washington to serve as the point of contact for U.S. companies, particularly small and medium-sized businesses seeking to secure and enforce their IPR in China; (9) strengthen efforts to improve IPR enforcement at trade shows and issue new regulations to achieve this goal; and most importantly, (10) prepare a legislative package for accession to the World Intellectual Property Organization’s (WIPO) Internet Treaties. 72

66. See id.
68. Id.
70. See id.
72. See U.S.-China JCCT, supra note 71 (listing Chinese commitments).
Joining the treaties will commit China to address what the USTR described as "the number one threat to the copyright industry"—Internet piracy of copyrighted works, which the USTR estimated as costing U.S. businesses between $2.5 billion and $3.8 billion each year. In early fall, the NCAC circulated draft Regulations on the Protection of the Right of Communication through Information Network. These draft regulations address the issue of Internet piracy by, among other things, requiring authorization and payment for uploading another person’s works, performances, or sound and video recordings, and imposing liability on persons who violate those regulations. Also in September, the State Administration of Industry and Commerce (SAIC) promulgated new Trademark Review and Adjudication Rules that (1) allow parties to a trademark dispute to settle the dispute privately; (2) restrict applicants to only one opportunity to file supplemental materials; (3) grants the Trademark Review and Adjudication Board the power to make decisions as to registrability on its own initiative; (3) removes the absolute requirement that foreign evidence be notarized and legalized; and (5) requires appellants to the People’s Court to send a copy of the appeal grounds to the Board within fifteen days.

With respect to enforcement measures—consistently the most oft-criticized aspect of Chinese IPR efforts—the government’s anti-piracy campaign, initially set to expire in August, was extended by Vice Premier Wu Yi through the end of 2005. Caught in the campaign were two Americans, who were convicted on May 19, 2005 and imprisoned for selling pirated DVDs over the Internet. In addition, the government conducted a three-month crackdown beginning in July targeting trademark violators. The results of the 2005 enforcement campaigns are not clear, however, and on October 26, the United States, joined by Japan and Switzerland, invoked article 63.3 of the TRIPS agreement that allows members to request information pertaining to judicial decisions or administrative rulings. The United States sought “detailed information concerning the application of criminal, administrative, and civil remedies for infringement cases that affect U.S. right holders.” Several high-profile IPR cases were initiated in 2005. On May 9, General Motors’ Daewoo subsidiary sued Chinese automaker Chery for unfair competition in Beijing No. 1 Intermediate People’s Court. GM Daewoo alleges that Chery’s QQ minicar is a copy of its Matiz and Spark automobiles. Along similar lines, Peugeot Citroen filed a patent infringement lawsuit in November against Shanghai Maple Automobile Co. in Wuhan.

73. OCR Report, supra note 60, at 2.
75. Id. at arts. 8. 13.
77. OCR Report, supra note 60, at 5.
81. Id.
termediate People’s Court, claiming that Maple used Peugeot Citroen’s core chassis technology in producing car models. Meanwhile, on September 28, Pfizer’s challenge to the State Intellectual Property Office’s decision revoking its Viagra patent was accepted on appeal by the Beijing No. 1 Intermediate People’s Court. Lastly, on August 15, a notable decision was handed down by the Beijing Second Intermediate People’s Court granting a pre-action injunction in a trademark case involving paint manufacturing. This was the first such injunction to be granted by a Beijing court since the revised patents, trademarks, and copyright laws were enacted—a case that could signal less cautiousness in granting preliminary injunctions by that important court.

China clearly has been motivated, in part, by an emerging internal recognition of the inherent economic value of a strong IPR regime. Indeed, the changing nature of China’s economy—evidenced by the growth of domestic consumer products giants like Haier and technology firms such as Lenovo—and looming copyright and trademark issues attached to the 2008 Summer Olympics in Beijing may ultimately do more to push China’s leadership to address IPR violations than external pressure from Washington. Foreign interests nevertheless must continue to zealously protect their intellectual property and plan carefully before entering the Chinese market.

IV. Biosafety and Biodiversity

In 2005, China continued to take the middle path on approval of agricultural biotechnology, with a research pipeline burgeoning with biotech sources of food and fiber but with a precautionary approach to biotech food that includes zero tolerance for biotech crops in non-GMO food, and zero tolerance for commingling of unapproved biotech crops in incoming shipments of commodities (e.g., China is the world’s largest soybean importer). With Biosafety Protocol parties like the EU nations imposing zero tolerance and traceability requirements for biotech crops that lack regulatory approval, China’s exporters will have to work harder to maintain markets for agricultural exports.

China ratified the Cartagena Protocol on Biosafety (Biosafety Protocol) on August 6, 2005. This international environmental agreement became law for environmental releases

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87. Lin Gu, Seeds of Ignorance, SOUTH CHINA MORNING POST, July 9, 2005 (on file with author).
of biotech crops and other living modified organisms (LMOs) in 2003.90 China attended
the second meeting of the parties (MOP 2) in Montreal from May 30 to June 3, 2003, and
a Chinese non-governmental organization provided a presentation on China's biotech in-
dustry (that has hundreds of biotech crops in research, some of which are entering com-
mercial production).91

The parties to the Biosafety Protocol reached deadlock on the documentation required
for commodities shipments (that now state May Contain LMOs on a commercial invoice).
The parties set a deadline—two years from September 11, 2003—to agree on what level
of additional disclosure would be required for biotech crops that may be contained in a
shipment of commodities to member nations. Brazil and New Zealand blocked consensus
on article 18.2(a), so the negotiations will resume at the third meeting of the parties (MOP 3)
on March 13, 2005, in Curitiba, Brazil.92

Until non-parties to the Biosafety Protocol negotiate bilateral and multilateral deals, the
grain shipping and agricultural biotech industries are bracing for a potential economic
impact that could be disruptive to trade flows (e.g., billions of dollars in annual trade dis-
ruption for U.S. products alone). China may feel impacts to its economy as well, given
the burgeoning biotech industry in China. With biotech crops originating in the United States
being approved by China (eight maize, two cotton, seven canola, one soybean, etc.) and
hundreds of Chinese biotech crops in the research pipeline (some leaking out into wide-
spread use) there will be considerable difficulties for Chinese exporters who are required
to list genetic events under article 18.2(a) or EU traceability directives.

The WTO has yet to define the level of scientific evidence required to justify a precau-
tionary regulatory approach to biotech crops, but the United States, Canada, and Argentina
have served notice that they will challenge the EU’s invocation of the precautionary ap-
proach language in the Biosafety Protocol.93 In preparation for the Doha Round of trade
talks, slated for December 2005 in Hong Kong, China hosted a WTO Informal Ministerial
Meeting that discussed biotech issues as well as BSE-related beef bans and other agricultural
trade issues.

Pursuant to Biosafety Protocol article 27—Liability and Redress—the parties met in
May 2005 and submitted views on the elements of a regime setting standards for liability

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91. Dayuan Xue, Powerpoint Presentation, Biosafety Capacity Building in China, on behalf of State Environ-
mental Protection Administration of China (SEPA), at the Second Meeting of the Parties to the Cartagena
Protocol on Biosafety, Montreal (June 1, 2005) (on file with author).
92. Convention on Biological Diversity, Report of the Second Meeting of the Conference of the Parties to
the Convention on Biological Diversity Serving as the Meeting of the Parties to the Cartagena Protocol on
93. See Request for the Establishment of a Panel by the United States, European Communities-Measures
Affecting the Approval and Marketing of Biotech Products, WT/DS291/23 (Aug. 8, 2003); see also Aaron A. Ostroovsky,
The European Commission's Regulations for Genetically Modified Organisms and the Current WTO Dispute—
Human Health or Environmental Measures? Why the Deliberate Release Directive is More Appropriately Adjudicated
measures do not violate SPS nor TBT Agreements because international standards (precautionary approach)
was created the Biosafety Protocol). Cf. Terence P. Stewart & David S. Johanson, A Nexus of Trade and the
Environment: The Relationship Between the Cartagena Protocol on Biosafety and the SPS Agreement of the World Trade
preamble in Biosafety Protocol with precautionary approach and contrasting positions of parties to Biosafety
Protocol).
and redress for harm caused through transboundary movement of LMOs. The parties were divided on the proper scope of such a regime, with some calling for liability for harm not directly related to loss of protected biodiversity. Progress was made toward a possible text for consideration in 2006.\textsuperscript{94} China is one of the few nations to have ratified the Basel Convention's Protocol on Liability and it could have a significant voice in the negotiations of this liability element. The State Environmental Protection Administration of China held a meeting in late 2005 to establish its approach to defining damage to biodiversity.

While the parties to the Convention on Biological Diversity (CBD) did not meet in 2005, they will meet in March 2006 in Curitiba, Brazil, immediately following the meeting of the parties to the Biosafety Protocol.\textsuperscript{95} A "[g]roup of legal and technical experts on liability and redress in the context of [a]rticle 14(2)" met on October 12-14, 2005, in Montreal, Canada but made little progress toward setting liability standards.\textsuperscript{96}

The Subsidiary Body on Scientific, Technical and Technological Advice met twice to offer the CBD parties reports to consider, including reports on the Millennium Ecosystems Assessment report, as well as reports on climate change, genetic use restriction technologies, and agricultural biodiversity's role in food security.\textsuperscript{97} While the parties are making progress toward their 2010 objectives (reducing the rate of biodiversity loss) there is much work to be done. China has significant genetic resources to protect, ranging from pandas to wild soybeans, rice, and other native plants. China could play a leading role in defining the liability and regulatory standards for biodiversity protection.

V. Foreign Investment Regulation

The National Development and Reform Commission (NDRC and DRC at the provincial or local level) issued a regulation in October 2004 that added a layer of bureaucratic complication for the foreign investor establishing an enterprise in China. The Provisional Measures for Approving Foreign Investment Projects appear to require foreign entities interested in undertaking a new project (whether by forming a new entity or by investment in or acquisition of an existing entity) to seek approval from the NDRC or its local branches.\textsuperscript{98} The system that previously prevailed required, at the national level, MOFCOM approval, approval from the relevant ministry if the project were in a restricted category in the Catalogue of Foreign Investment Projects, and registration of the project with the appropriate level of government. Depending on whether the project is in the restricted or encouraged category, the investor should submit the project to the NDRC if its value is over $50 or $100 million respectively, and to the local Development and Reform Commission (DRC) if the value is under that threshold. \textsuperscript{id}


\textsuperscript{98} Provisional Measures for Approving Foreign Investment Projects, October, 9 2004, available at http://www.law-lib.com/law/law_view.asp?id=87032. According to the Provisional Measures, the appropriate level of government for approving the project depends on the size of the investment. Depending on whether the project is in the restricted or encouraged category, the investor should submit the project to the NDRC if its value is over $50 or $100 million respectively, and to the local Development and Reform Commission (DRC) if the value is under that threshold. Id.
SAIC.99 The import of the Measures remains unclear as they delegate considerable authority to the local level DRCs for projects falling below certain investment levels. Therefore, if local DRCs do not adopt corresponding regulations to evaluate projects, effectively no extra level of review will be added; but if the local DRCs do adopt local regulations, then foreign investors face a separate or additional approval process for investment projects in that locality. In Beijing, for example, registering the project with the local Administration of Industry and Commerce has not required local DRC approval. The change potentially raises WTO concerns because it may add a layer of complication to the process of making an investment that does not exist for purely domestic investment.100 At this point, however, it is too early to tell whether the Measure's practical effect will cause a significant problem for foreign investors.101

VI. Regulation of Outbound Chinese Investment

In 2005, the State Administration of Foreign Exchange (SAFE) issued three notices relating to administration of outbound investment and foreign exchange registration by PRC domestic residents. The three notices are commonly known as: (1) Circular 75 (officially referred to as Hui Fa [2005] No.75) on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment Through Offshore Special Purpose Vehicles issued on October 21, 2005;102 (2) Circular 29 (officially referred to as Hui Fa [2005] No.29) on Certain Issues in relation to the Foreign Exchange Registration for Outbound Investment by PRC Residents and Foreign Exchange Registration for Merger and Acquisition by Offshore Entities on April 8, 2005;103 and (3) Circular 11 (officially referred to as Hui Fa [2005] No.11) on Certain Issues of Improving Administration of Foreign Exchange in Connection with Mergers and Acquisitions by Foreign Investors on January 24, 2005.104

Circular 11 and Circular 29 were issued early in the year by SAFE with the purpose of "maintaining the balance of international payments and ensuring the compliant and orderly flow of cross border capital."105 The two regulations imposed rigid requirements for PRC domestic residents including corporate persons and individual investors to register, disclose

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99. In cases in which the amount of the investment fell below a threshold, these official actions are completed at the provincial level instead of the national level by the relevant provincial level office associated with the appropriate Ministry.
100. General Agreement on Tariffs and Trade, supra note 57, at art. III.
105. See id.; Circular 29, supra note 103.
and obtain approval from SAFE and MOFCOM for cross-boarder capital flows prior to acquiring an equity interest in an offshore holding company. The two regulations significantly restrain the PRC domestic private enterprises obtaining venture capital and private equity investment from overseas and listing their companies on a stock market outside the PRC. Circular 75 repealed Circular 11 and Circular 29 when it took effect on November 1, 2005.

Circular 75 is the first law that permits PRC domestic residents to obtain offshore equity financing through special purpose vehicles (SPVs) and roundtrip investments in PRC companies. It also relaxes the approval requirements for foreign private equity funds and venture capital funds investing in PRC private enterprises. It imposes stricter requirements on Chinese domestic residents for registering and reporting their outbound investment activities compared with those required by Circular 11 and 29. It also requires approval certificates for both the source of foreign exchange (capital or assets) and the roundtrip investment by the SPV from the relevant PRC authorities in charge of foreign investment, which allows the PRC government to have more control of the offshore investment activities by PRC residents and thus makes it easier for the government to collect tax from PRC residents.

The main requirements for registrations set in Circular 75 are as follows: (1) PRC domestic residents are required to file six documents with local SAFE for foreign exchange registration before setting up offshore SPVs for obtaining offshore investment;106 (2) the PRC residents are required to provide information on how the PRC resident's equity in the SPV has changed;107 (3) the capital planned to be spent domestically according to the business plan must be transferred back to China after the completion of the offshore equity financing by SPVs;108 (4) PRC domestic enterprises are required to register and update the change according to the relevant foreign exchange regulations when a SPV makes roundtrip investments or provides shareholder loans and other loan capitals to domestic companies;109

106. Circular 75, supra note 102, at art. 2. The six documents required for such registration are: (1) application with the information about the domestic PRC company, the equity structure of SPV and the offshore financing arrangements; (2) registration document for legal persons or personal identification documents for individual residents; (3) business plan for obtaining offshore venture capital; (4) the approval certificate for the source of foreign exchange (capital or assets) and the proposed offshore investment by the domestic legal person (usually a company); (5) the standard forms for Registration Certificate for Foreign Exchange of Overseas Investment filled by domestic legal person or Registration Certificate for Foreign Exchange of Overseas Investment by Domestic Resident Individuals; and (6) other documents proving the legality. Id.

107. Id. at art. 3. Another set of six documents are required to be filed to amend the Offshore Investment Foreign Exchange Registration when a PRC resident contributes to a SPV with the assets or equity interest in a PRC company, or when the PRC resident undertakes an offshore equity financing after contributing the assets or equity interest to the SPV. The six documents required to be filed are: (1) Written application with detailed information on the change of equity interest and the change of capital and assets in the domestic PRC company and the SPV; (2) submitting the standard forms for Registration Certificate for Foreign Exchange of Overseas Investment by domestic legal person or Registration Certificate for Foreign Exchange of Overseas Investment by Domestic Resident Individuals; (3) the approval certificate for the roundtrip investment by the SPV from the relevant PRC authorities in charge of foreign investment; (4) With state-owned asset involved in SPVs, confirmation documents on the value of the assets or equity interest of the relevant PRC company is required to be first obtained by the state-owned asset administration and submitted to SAFE for verification; (5) the documents of SPV’s overseas registration, incorporation and license; and (6) other documents proving the legality. Id.

108. Id. at art. 4. This permits PRC domestic residents to use SPVs to attract venture capitals from the overseas markets without a time limit for the transfer.

109. Id. at art. 5.
(5) article VI permits the PRC domestic residents to pay SPVs for profits, dividends, and sale of equity interest after the registration of the foreign exchange for overseas investment, but it requires the foreign currencies obtained from the above payment to a SPV to be remitted back to China within 180 days of receipt thereof; (6) PRC domestic residents are required to amend the foreign exchange registration upon the occurrence of changes that may substantially change and affect the capital structure of SPVs; and (7) the retrospective registration is imposed with a local SAFE before March 31, 2006, if PRC residents established or obtained control of an offshore SPV before November 1, 2005, and completed the roundtrip investment but have not fulfilled the required foreign exchange registration for offshore investment. In addition, Circular 75 defines the four key terms: (1) special purpose vehicle, (2) roundtrip investment, (3) domestic residents, and (4) control.

The stated purpose for Circular 75 is to encourage the efforts by Chinese private companies and high technology companies to obtain offshore financing. The Circular is generally considered a positive development, permitting the domestic PRC residents to obtain the venture capital from the overseas markets as well as allowing foreign equity funds and venture capital funds to invest in PRC fast-growing private enterprises. The more rigid and comprehensive registration requirements set forth in Circular 75 for SPVs and offshore financing help improve the transparency of the registration procedure; however, it also creates uncertainty on whether the documentation-oriented process will impose hardships for PRC residents to be in compliance of the rule and obtain the overseas venture capitals efficiently at the same time.

VII. Real Estate Regulation

In order to maintain the continuous and healthy development of the real estate market, further strengthen the guidance and control of that market, and impede the overheating real estate investment, a series of regulations and policies have been formulated. The Ministry of Construction, the National Development Reform Commission, the Ministry of Finance, the Ministry of State Lands and Resources, the People's Bank of China, the State Administration of Taxation, and the China Banking Regulatory Commission jointly issued the Opinion on Doing a Good Job of Stabilizing House Prices on April 30, 2005. The Opinion's main objectives are to (1) enhance planning control to improve the structure of residential property supply; (2) strengthen the macro-control of land supply and land administration; (3) adjust the sales tax of residential property; (4) transfer and strengthen tax collection; (5) enhance the management of real estate loans to prevent finance risks; (6) specify the standards for common houses that enjoy favorable policies; (7) increase the supply of economically-affordable houses; (8) rectify and regulate real estate market order

110. Id. at art. 6.
111. Id. at art. 7. Such change includes an increase or decrease of capital, transfer or swap of equity interest, consolidation or a split, long term equity or debt investment, or guarantee provided for a third party with no involvement of the roundtrip investment. The amendment to registration is required to be made within 30 days of the occurrence of the above events. Id.
112. Circular 75, supra note 102, at art. 8.
113. Id. at art. 2.
and strictly punish illegal sales conduct; and (9) strengthen market monitoring and improve the market information disclosure system.\(^{116}\)

With respect to land management, the Opinion emphasizes that it is forbidden to transfer the lands used for real estate development without complying with laws and regulations. Illegal speculative trading of land is prohibited. In addition, the opinion stipulates that the assignee of land will be subject to vacant land tax if he fails to begin the project within one year from the time agreed in the assignment contract. If the assignee fails to begin the project within two years, the land will be withdrawn without payment.

Subsequently, on May 9, 2005, the State Council implemented the Opinion by issuing the Circular of General Office of State Council on Forwards the Opinion of Doing a Good Job of Stabilizing House Prices by Ministry of Construction and Other Ministries (Guo Fa Ban [2005] No. 26).\(^{117}\) The Ministry of Construction also emphasized the spirit of stabilizing the house price and advancing the continuous and healthy development of the real estate market in the Notice on the Implementing ‘Circular of General Office of State Council on Forwards the Opinion of Doing a Good Job of Stabilizing House Prices by Ministry of Construction and other Ministries (Jian Zhu Fang Dian [2005] No.33).\(^{118}\)

Furthermore, the Notice of the State Administration of Taxation, the Ministry of Finance and the Ministry of Construction on Intensifying the Administration of Real Estate Taxes (Guo Cui Fa [2005] No.89) was issued on May 27, 2005.\(^{119}\) The Notice further implemented the Opinion’s tax policies. The Notice specifies that after June 1, 2005, any individual who purchases a house and resells it within two years will be charged the total sales tax according to the earnings derived from the housing sale; any individual who purchases the common house and holds it for a period exceeding two years and subsequently exercises switch operation will be charged the sales tax according to the balance of the earnings derived from housing sale deducting the payment for housing purchase. The Notice further provides local real estate administration is required to calculate the average house transaction prices on the same class of land and publicize such statistics twice a year to provide an accurate basis for carrying out favorable polices to common houses. Moreover, the local real estate administration should also report to the taxation administration the list of house projects with plot ratios lower than 1.0. Such practice is to establish reliable files and database for tax sources.

On May 18, 2005, the Notice of the State Administration of Taxation about Further Strengthening the Administration of Real Estate Taxes (Guo Shui Fa [2005] No.82) (Taxation Administration’s Notice) was issued.\(^{120}\) The Taxation Administration’s Notice estab-

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116. Common houses (i.e., economically affordable houses) mean small houses with low prices that meet the following requirements: (1) plot ratio is more than 1.0; (2) the building area is less than 120 square meters; and (3) the consummation price is more than 1.2 times lower than the average house price on the same class land.

117. See http://finance.sina.com.cn/g/20050512/10121581229.shtml. Such implementation by the State Council raises the level of regulation. The Opinion is only a ministry regulation and the Circular issued by State Council is a state regulation.


119. See id.

lishes following objectives: (1) payment of real estate tax before the issuance of title documents; (2) mastery of tax source information; (3) utilization of information obtained from deed tax collection; and (4) establishment of tax source database. By virtue of such tax regulations, the government will control the speculative investment in real estate and effectively collect real estate taxes.

To ensure the healthy and steady development of real estate industry, the People's Bank of China issued the Circular on People's Bank Adjusts House Loan Policy of Commercial Bank and Lowers the Interest Rate of Excessive Reserve of Financial Institution (PBOC Circular) on March 17, 2005. The PBOC Circular raises the lowest limit of individual real estate interest loans from 5.31 percent to 5.51 percent. Moreover, for the cities or regions where the real estate market is overheated, the proportion of minimal down payment is increased from 20 percent to 30 percent. As a result, some speculative investors are forced to retreat from the real estate market.

With the implementation of the above macro-control policies, the overheating real estate investment is under control to a certain extent. The State still supports the development of the real estate industry. The recent statements of policy just focus on the speculative factors therein and make the corresponding adjustments. In the long run, the statements will play a guidance role for the development of Chinese real estate industry. The government has taken steps to enhance the capital cost of real estate, thereby impeding speculative trading in houses. There is no doubt that such macro-control on real estate will engender the cooling-off of real estate development in China. These measures lower the financial risks of the bank industry but also indirectly extend the financing channels. As a result of measures to enhance the credit management of banks, bank loans will represent a rapidly decreasing share of capital invested in the real estate market, while the share of other sources development capital will increase direct finance, project finance, shares finance, fund, trust and mortgage. In this regard, the macro-control on the real estate will advance the development of real estate of China. Last but not least, macro-control policies drive out small or inefficient real estate developers and create great opportunities for foreign real estate developers to enter China's real estate market.

VIII. Company Law Reform

On October 27, 2005, the Chinese government announced the latest major revisions to its Company and Securities Law. These become effective January 1, 2006. Reforms include lowering the threshold for domestic initial public offerings (IPO) and strengthening corporate governance. In addition, provision is made for formation of a single-person limited liability company. Changes were made in registered capital requirements, lowering the

\[121. \text{See http://www.e521.com/cjlx/redian/0317111141.htm.}\]

\[122. \text{ABA members of the International Law Section and China Committee along with many colleagues were pleased to offer comments and to contribute to China's study of U.S. corporate law and practice as well as adjudication and enforcement of corporate law in the U.S., including the Sarbanes-Oxley Law. Georgetown University Law Center Professor and Committee member James Feinerman and Vice Chair, Ann Marie Plubell of the Plubell Firm, made arrangements for a senior delegation from China including legislative draftsmen and securities enforcement officials to learn about U.S. securities and corporate law including a visit to Delaware and the Chancery Court as well as the Office of the Secretary of State and to meet with senior corporate attorneys from in-house offices as well as law firms for a frank and detailed exchange of views related not only to drafting but also to what it is like to live with a law once enacted.}\]
thresholds and rules concerning profits, thereby making it easier to start a business and to merge existing businesses. In particular, thresholds were lowered for joint stock companies to approximately US $617,000 (from approximately US $1.2 million). Further, the requirement for three years of profitability to qualify for an IPO was eliminated. An individual limited liability company is now required to hold approximately US $12,000 of registered capital.

Other new provisions not previously contained in the previous version of the Company Law include provisions for (1) senior executive and board member liability for violating the company charter or law and causing loss to the company; (2) direct suit by shareholders; (3) inspection of documents and records of the company including records of the board of directors and the board of supervisors; (4) withdrawal and compensation of minority shareholders; (5) provision for shareholder proposals; (6) piercing the corporate veil in the event of shareholder abuse of the corporate form; (7) the power to hire independent directors when a company intends to engage in an IPO; (8) director and senior executive liability for improperly appropriating opportunities that belong to the company; (9) shareholder power stockholders to hire an independent accounting firm and a requirement that the company produce true, certified financial and accounting reports; (10) shareholder power to dissolve the company; (11) a liquidation committee; (12) requirements that the company perform in good faith, obey social morality, and carry out its social responsibility; and (13) liability in the event of fraudulent valuations.

In addition, the new Company Law cancels limits specified in the old law on issuing company bonds, eliminates the requirement that a company create a statutory welfare reserve fund from its profits, provides simplified notice procedures for mergers and liquidations, and modifies the percent and method of selection of representatives of the employees to the company’s board of supervisors.

IX. Conclusion

This article has reviewed developments in eight important legal areas, franchising and direct selling; international trade regulation; intellectual property rights; biosafety and biodiversity; foreign investment regulation inbound to China; outbound foreign investment from China; real estate markets; and company law reform. The year 2005 was an active one for legal development in China. The year 2006 promises to be at least as active, as there are potential amendments to China’s Company Law in the pipeline with the possible promulgation of China’s first Anti-Monopoly Law. In addition, China’s Bankruptcy Law is currently being drafted for action in 2006. Stay tuned.