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China Law Deskbook Monthly: News & Views from Beijing

The following are a few new laws, regulations, and policy trends that I find of interest this month:

- *The release of the State Council's white paper on China's Judicial System and Reform Process*
- *The China Securities Regulatory Commission's measures opening up capital markets*
- *The CSRC's new rules on information security and privacy protection*
- *MOFCOM's rules regarding commercial franchising*
- *MEP's plan to control hazardous waste*
- *State Council's reduction and modification of administrative approval procedures*
- *NDRC's relaxing of investment procedures for outbound investment*
- *Corruption watch*

On October 9, 2012, the State Council's Information Office released a white paper on ***China's Judicial System and Reform Process***. The report reviews China's judicial system and reform process, and emphasizes the need for judicial institutions to maintain social justice, to improve judicial proceedings and supervision. The white paper also emphasizes the need to respect and protect human rights, and highlights that effective measures continue to be implemented to deter and prohibit confessions through torture, to better protect the rights of criminal suspects and defendants, and to protect the rights of attorneys in the course of performing their professional duties. *By the end of 2011, China had more than 3,600 legal assistance agencies, 14,000 full-time legal assistance personnel, 215,000 lawyers and 73,000 community-level legal services personnel. From 2006-2011 lawyers provided defense in 2.4 million criminal cases, which is an increase of 54% over the time period of 2001-2005. While the white paper generally mentions the need for the courts and prosecutorial institutions to exercise their authority "fairly and independently", the goal of reform is to establish a "just, effective and authoritative socialist judicial system with Chinese characteristics"; hence, China's version of judicial independence will still ensure that politics will continue to play a role. Please contact me if you would like an English or Chinese version of the Judicial Reform white paper.*

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The ***China Securities Regulatory Commission has made a number of policy changes to open the financial markets and ease restrictions on foreign investors***. On October 16, 2012, the China Securities Regulatory Commission issued a set of rules that allow overseas investors to hold higher stakes in China's securities firms. Under the new rules, foreign investors can now hold up to 49% interest in a joint venture securities firm. Previously, the CSRC imposed an investment cap of one-third foreign ownership. The rules also require that at least one domestic shareholder to hold no less than 49% in a JV securities firm (although this specific restriction does not apply to publicly-

traded securities firms). The CSRC also issued a notice that provides that securities firms, including joint ventures, are allowed to apply for permission to expand their business scope in two years after commencing operations in China, in contrast with the prior start-up period of five years. *These changes follow the CSRC's move in July to increase the threshold for qualified foreign institutional investors and increased the investment cap in listed companies from a previous 20% stake to a 30% stake. The CSRC has also expedited approvals for QFIIs this year and increased QFII quotas to \$80 billion from a prior quota of \$30 billion. As of September 2012, there were a total of 188 QFIIs in China.*

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Effective November 1, 2012, the CSRC issued a new set of measures designed **to enhance protection of information exchanged in the securities and futures industries**. The measures include obligations for operators to ensure information safety and privacy. In short, the new measures require that securities and futures firms must meet basic requirements in infrastructure, information systems, network isolation, safety protection and management rules, according to the measures. The new rules also set forth requirements for IT system upgrading and modification, data backup and storage. *China still does not have a national privacy law, and the CSRC's rules continue to refine the IT security and privacy standards to ensure that participant information is protected and that the IT infrastructure is insulated from disruption.*

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In August, MOFCOM issued the **Notice on Further Improving the Administration of Commercial Franchising**, which provides a package of policies to improve the filing process for commercial franchising, to further regulate franchising activities, to strengthen the publicity/marketing, and transparency for commercial franchising. *The bureaucracy involving franchising and approval for franchise operations is dismal. Most foreign companies avoid the franchising process and structure their arrangements as either direct ownership, JVs, or license arrangements to avoid the stringent and cumbersome franchising laws and regulations. MOFCOM's new policies are intended to provide more certainty in the process but they have a long ways to go before the system is more user-friendly.*

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The **draft amendment of the Law on Securities Investment Funds**, which is designed to protect investors' rights, has gone through a second review by the National People's Congress Standing Committee in October 2012. The first review took place in June. *(In order to become a law, a draft must typically go through three readings.)* The draft law provides standards for private equity funds, investment scope, and rules for fund managers, and seeks to control illegal fundraising activities and insider trading. The draft amendment requires managers of privately offered funds to register with the fund industry association, and that the association is thereafter required to report large scale private equity funds to the CSRC. *The private equity and venture capital sectors have been developing rapidly in China, and much fraud in the marketplace has been a challenge. There were more than 10,000 venture capital and private equity firms in China managing nearly RMB 2 trillion (US\$317.5 billion) in total assets. Once adopted, the new law will provide investors and fund managers with the statutory tools to tap the China market.*

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On November 1, 2012, the Ministry of Environmental Protection and three other government ministries adopted an **action plan for the control of hazardous waste in China**. The objectives of the policy statement are to determine the exact amount and distribution of hazardous waste nationwide; to increase the level of management and control over hazardous waste; and to reduce the risks to the environment. Hazardous waste includes medical waste, chemical waste and heavy-metal waste, and is harmful if improperly processed, stored, or transported. The MEP anticipates that by

2015, the annual amount of hazardous waste generated in China will exceed 60 million tons, but the disposal capacity in China is currently limited to 23 million tons. The plan calls for completing the construction of over 300 centralized disposal facilities that were planned in 2004, and sets aside over \$4 billion in funds to complete 14 key programs. *Extreme environmental degradation has been caused by the improper handling of hazardous waste, including the chromium residue pollution incidents in the Yunnan province in 2011. As just one example, the MEP's Plan estimates the amount of soil polluted by chromium residue is roughly 15 million cubic meters of top soil and recognizes that much remedial work is necessary to reverse the degradation. Every year there are large-scale protests nationwide concerning the health risks and damages caused by pollution, and such protests are both a challenge to the government's legitimacy and a stability issue for the leadership. In response, the government has made environmental protection a top priority in its 12th Five Year Plan and other policy pronouncements.*

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On August 22, 2012, the **State Council issued a circular that removes or modifies 314 administrative examination and approval items** in order to further cut red-tape and bureaucracy, improve government efficiency, and to reduce the risk of corruption. Specifically, the circular provides that 184 administrative approval items are canceled, the power to approve 117 items will be handled by lower level government departments, and thirteen administrative tasks are merged into other items. The changes in 2012 are the sixth round of changes is the sixth since the State Council took steps to reform administrative approval in 2001. Specifically, the changes mainly cover investment and social projects. *Since 2001, a total of 2,497 administrative approval items, including those in the sixth round, have been rescinded or adjusted. This is good news for small business which has been hampered by the bureaucracy and unnecessary government intervention in the private sector. The government has also taken steps to better utilize online approval procedures to become more user-friendly and efficient.*

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On August 9, 2012, **the National Development and Reform Commission issued an announcement further relaxing the approval procedures for outbound investment**, specifically, the NDRC provides that applications will no longer be required for overseas resource development projects with an investment valued at less than \$30 million, or for non-resource development projects with an investment of less than \$10 million. The objective of the new rule is to encourage outbound investment by Chinese enterprises. In February 2012, the NDRC announced that applications for resource projects with an investment of up to \$300 million, and non-resource projects with an investment of up to \$100 million, may be approved by provincial and municipal-level authorities. Approval is not required at the national level. *Private investment in outbound M&A still remains small in comparison to the huge international investments by SOEs. In 2011, outbound investment by non-state owned enterprises increased to 44% of China's total outbound overseas investment. The NDRC's steps to relax outbound investments will encourage more privately held PRC companies to expand their brands in the international market and to acquire and integrate technology and resources from abroad.*

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Corruption Watch:

- The Ministry of Health adopted measures that require doctors and patients to sign agreements before treatment promising not to give or receive *bongbao* – cash filled red envelopes. The measures merely reemphasize the ban on *bongbao* is set forth in the Practicing Physicians Law, issued in 1999, which forbids doctors from asking for or illegally accepting money from patients. *Having said this, it is still a common practice in China for people to give cash to medical personnel before surgery and the practice will likely continue so long as doctors are underpaid. In the*

PRC, the government sets the fee schedule for services provided by public hospitals, and unfortunately the prices have been criticized for being too low for medical workers.

- Citizens are using the internet to raise awareness of corruption and abuse of powers by government officials by uncovering and publishing online information about illicit wealth accumulation by government officials. In October 2012, Cai Bin, a senior urban management official in Guangzhou was removed from his post and is under investigation after citizens reported online that he owned 22 homes – valued at US\$6.4 million – and lived a lifestyle which exceeded his government salary. Cai Bin is suspected of receiving large bribes during his tenure at the public security bureau and urban management bureau in Guangzhou. In September 2012, a senior work safety official in Shaanxi province, Yang Dacai, was fired due to a corruption scandal that was exposed after photos were posted online showing Yang wearing expensive wristwatches on multiple occasions. *The use of the internet has proven to be more effective than hotlines and formal administrative complaint procedures in raising awareness and accountability of the actions of government officials. PRC citizens are aggressively venting on the internet in ways unimagined several years ago, and the government recognizes that it needs to be more responsive to citizen complaints with respect to the misbehavior of government officials, or risk throwing the Party's legitimacy into question.*

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