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CHINA Legal Bulletin



YOUR LEGAL ADVISORS IN CHINA

Executive Summary

Financing Your Business in China

The current financial crisis has made it even more important for our clients to arrange financing. However, in China strict foreign exchange regulations and active authorities make the transfer of capital in and out of extremely China complex. FDI consultant Phenix Zheng and tax expert Deng Yong have taken the time to lay out 4 straightforward strategies on how to manage the capital needs of your investments in China. These strategies include: overseas loans, domestic loans, increase of capital, and a loan between enterprises.

By Phenix Zheng and Deng Yong

Trends in Company Investigations in China

When we are asked whether or not a deal seems too good to be true, the first thing that we want to know is if the Chinese company even exists. Sadly, many overseas companies are defrauded into giving away thousands of dollars based on false websites and email promises. Senior Consultant Maarten Roos talks about how to investigate future business partners and what the future holds for the release of such information in China.

By Maarten Roos

Guidelines Issued for Grievances Against Runaway Foreign Employers

To cope with the consequences of the financial crisis, some foreign-invested companies are considering to simply abandon their China businesses and employees instead of going through the proper procedures to file for liquidation and bankruptcy. To counter this trend, the government has issued guidelines on how employees can file grievances in such a situation.

By Maarten Roos and Zachary Wortham

NEWS FLASH

Wang Jing & Co. Recognized by Chambers & Partners

Wang Jing & Co. is extremely proud to have been recognized as a Band 1 law firm in Chamber and Partners' 2009 survey of Chinese law firms, joining only a select number of law firms to receive this accolade. Chambers and Partners is widely recognized as providing one of the best-research law firms rankings around the world.

The survey quoted clients as saying that the firm as "a remarkably popular choice due to its undoubted prowess in shipping" and "technically strong, pragmatic and aggressive lawyers, who provide a consistently excellent service." Moreover clients found managing partner Wang Jing "well-rounded and polished shipping skills", and "highly affable, making the best of a situation for his clients", while senior partner Chen Xiangyong is "fine and specialized shipping practice, particularly for wet casualty and collision work."

The firm and individual partners were recognized as follows:
Wang Jing & Co. – Shipping: Band 1 and Insurance: Band 2.
Mr. Wang Jing – Shipping: Band 1 and Insurance: Band 1.
Mr. Chen Xiangyong – Shipping: Band 2

The China Legal Bulletin is produced by Wang Jing & Co. Law Firm

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Financing Your Business in China



A How to Guide for Financing a Foreign-Invested Enterprise in the PRC

In the midst of the global financial crisis, many foreign invested enterprises operating in the PRC are facing difficulties with capitalization. There are solutions and options available even in these lean times and our Senior FDI Consultant Ms. Phenix Zheng has teamed up with our tax and investment expert Mr. Deng Yong, to give an overview of four of the most common and easily accessible options for injecting funds into PRC registered, foreign-invested enterprises.

1. Overseas Loans

As compared to Chinese-invested enterprises, a foreign invested enterprise ("FIE") has the added option of resolving their financing problems through overseas loans. In accordance with the provisions of the Administration of Overseas Loan Tentative Procedures [Ref. No.28], FIEs may solicit overseas loans as long as the amount is not greater than the difference between the officially registered total investment for the project and the company's registered capital. If the loan exceeds that amount, the total amount of investment for the project will need to be re-verified by the original examination and approval authority. This practice of soliciting overseas loans for financing purposes is condoned by the State which further stipulates that FIEs may specifically include a difference between their registered capital and their total investment in order to solicit overseas loans, including from their (foreign) parent companies, other enterprises, and foreign financial institutions.

2. Increasing Registered Capital

Another option for an FIE to obtain financial support is by increasing its registered capital. However, a common misconception is that this can be done in much the same way as the contribution of capital during the establishment of the FIE. One major difference is that the timeframe for injection of any increase in registered capital is different from that of capital contribution: in accordance with the provisions of the Executive Opinions on Some Issues Concerning the Application of Law Governing the Examination, Approval and Registration of Foreign-Invested Companies (GSWQZ [2006] No.81), at least 20% of the increased registered capital must be transferred after obtaining an approval certificate from the BOFTEC but before registration with the AIC. The remainder of the increased registered capital must be injected according to the provisions of the Company Law and relevant laws concerning

foreign investment, as well as the Regulations on the Administration of Company Registration.

The newly increased registered capital can not be used by the FIE immediately. According to the provisions of the Circular of the SAFE on Relevant Business Operations Issues Concerning Improving the Administration of the Payment and Settlement of Foreign Exchange Capital of Foreign-Invested Enterprises (HZF[2008] No.142), where an FIE applies to a bank for settlement of foreign exchange (i.e. conversion of foreign currency into RMB for use), the funds must first go through capital verification procedures by an accounting firm. The accounting firm must then issue a capital verification report to the FIE. Banks are not permitted to handle the settlement of capital for which capital verification procedures have not been completed. Therefore an FIE can only convert the currency for use after it has taken care of the capital verification procedures. The documents and materials that an FIE must submit when applying for the settlement of capital with a bank are:

- A Letter of Payment Order for the RMB obtained from the settlement of capital;
- Documents certifying the intended use of the RMB to be converted from the settlement of capital;
- Relevant supporting documents concerning the payment which will be made with the converted RMB from the settlement of capital (these documents must support the Letter of Payment Order);
- A detailed list of how the funds will be allocated;
- A duplicate copy of all relevant vouchers, such as an invoice with the FIE's company stamp or financial stamp.

Pursuant to the aforementioned stipulation, an FIE may convert foreign currency into RMB only if the transaction relating to the use of RMB is in the process of occurring and the obligation of payment can be proven to be performed in the near future, and at the same time there must be no problems or conflicts in respect to the allocation of the preceding settlement of capital. Should any of these occurrences be discovered by the authorities then the authorities have the power to refuse conversion into RMB even if the capital has been received and verified. Furthermore, the capital to be settled should only be used for the purpose as approved by the administration of foreign exchange.

Finally any remaining capital after the settlement is completed may not be used to repay an overseas loan, but can be used to repay loans given by Chinese banks providing that there are no outstanding balances. The FIE may also keep a reserve fund of no more than USD 50,000 (down from USD 200,000 under previous regulations).

WANG JING & Co. UPDATE:

Wang Jing & Co. Present to Chambers of Commerce

Client Service Manager Zach Wortham and Senior Consultant Maarten Roos have recently been invited to present to local chambers of commerce on legal matters in China.

Zach Wortham will speak for the Italian Chamber of Commerce on February 24th concerning Real Estate Purchases for Foreigners. Maarten Roos will give a presentation on the new business tax regulations for the Benelux Chamber of Commerce in Shanghai on March 12th.

Both presentations will be available on our firm's website at www.wjnco.com.

Wang Jing & Co. Selected Preferred PRC Law Firm for Top Interns

Wang Jing & Co. has been selected by several top law schools around the world to act as a preferred partner for receiving interns.

The Firm looks forward to receiving its first intern in the summer of 2009 from Georgetown Law, the law school of Georgetown University in Washington DC. Applications have also been received from Boston Law School and several other leading universities in the United States and Europe.

Interns receive first-hand experience working in a Chinese law firm and real life experience taking meeting notes, reviewing contracts and implementing marketing strategy.

Financing your Business in China cont.



3. RMB Loan

FIEs may also apply to receive a loan from a bank in China. In practice however, many banks are very cautious to approve applications for these types of loans, as the FIE may lack security in China. An overseas guaranty can help to relieve the bank's concern, from an overseas bank that the parent company deals with or from the parent company itself.

Do note that foreign guarantees of Chinese loans must be registered in China to be enforceable, and so this may bring further complications.

4. Loan between Enterprises

Lastly, when facing difficulties of capitalization, FIEs often consider borrowing money from other (affiliated) enterprises in China. However, under Chinese laws, no institution other than a financial institution may engage in any finance business involving the lending or borrowing of funds, and further the interest accrued thereby can not be deducted from any pre-tax profits. Note that the lending of funds is illegal, rather than the borrowing – the lending enterprise will face the legal risks including:

- confiscation of any loan interest
- administrative penalties for conducting business beyond the official business scope.

Conclusion

FIEs must decide how to obtain financing based on their specific circumstances and the timing of their projects. It usually takes several months to complete an overseas loan transaction, while the increase of registered capital also requires the company to go through various procedures. The source of financing will mostly depend on the size of the sums and the urgency of the capitalization.

by Phenix Zheng and Deng Yong

Trends in Company Investigations in China

Chinese Trends in Company Investigations

Common is the story of the foreigner who thought he was buying from a Chinese company, only to find out later that the company never existed – making any claim for repayment futile. This extreme example serves to illustrate the need to know one's Chinese business partner beyond the rituals of exchanging name cards and sharing food and drink; with cultural and language barriers clouding mutual perceptions, it is all the more important to understand whom you are dealing with.

How deep an understanding is appropriate depends on the transaction at hand. To acquire a Chinese target company and all its existing liabilities, an in-depth legal and financial due diligence is recommended, while for a simple commercial transaction a copy of the Chinese company's business license may be sufficiently re-assuring. In many cases, the middle way is to check a target company's Company File.

Company File

Every company registered and validly existing in China has a Company File. China does not have a central registrar; instead the Company File is kept with the Administration for Industry and Commerce (AIC) at the district or township, municipal, provincial or national level where the target company is registered. We generally distinguish the content of the Company File under two types:

(1) Basic information confirming the company's vitals, including its current shareholders, registered capital, legal address, legal representative and business scope.

(2) Extensive information, which usually includes the company's establishment files (e.g. Articles of Association, list of directors), annual inspection reports and penalties (if any), etc.

Access

An investigation of a target's Company File is by far the most direct and the least costly means to independently investigate a company's official legal status; however this is considerably complicated in that the level of access to the public and even lawyers varies greatly from place to place, as does the availability of extensive information.

This can be illustrated with some examples.

- In Suzhou and Fuzhou, a member of the public (with ID card) can access both the basic file and the more extensive information.
- In Shanghai and in Binzhou (in Shandong), a target company's basic information is open to the public, while the combination of a lawyer's license and law firm introduction letter will give direct access to the extensive information.
- Recently, Hangzhou, Wenzhou and Shenzhen have adopted more restrictive internal policies on access: applications from lawyers for extensive information are no longer entertained

unless accompanied by a court filing or the consent of the target company.

The extended information can be difficult (or impossible) to access but could include "treasures" on the target company's health, and as such can be useful in making decisions on whether to do business with this target company, whether filing a lawsuit against it would be worthwhile, etc. Basic information is often less valuable, but at least confirms the existence of the target company, and tells of the activities that it may engage in.

Recent Trends

The recent adoption of more restrictive policies in Wenzhou, Hangzhou, Shenzhen and some other localities seems to counter the trend of increasing transparency of China's legal and business environment, by effectively cancelling the option to check on Chinese-registered companies without their knowledge and for a reasonable price. In some cases, it may be feasible to ask a company for permission to check, but Chinese businessmen often see this as a sign of mistrust – not the best way to start a business relationship. At the same time, many other AICs are adopting less restrictive policies, with an increasing number opening their full registry to the public. It will be interesting – and important to foreign investors doing business with Chinese counterparts – to see which trend will persist.

by Maarten Roos

Guidelines for Grievances Against Runaway Foreign Employers



Guidelines Issued on How Workers File Grievances Against Abandoning Foreign Employers

Under existing laws and regulations, those workers at foreign-invested factories who are owed wages because the factory owners have fled, have the right of claim. Senior Consultant Maarten Roos elaborates: "As exports suffer due to the current financial crisis, there have been many cases of improper divestment by foreign companies operating in the Pearl River Delta. This sudden – and illegal – abandonment of factories, equipment, debt, and non-payment of employees' wages is causing high anxiety among factory workers, and in some cases even unrest."

Mr. Roos further notes that the Ministry of Commerce, the Ministry of Foreign Affairs, the Ministry of Public Security and the Ministry of Justice recently issued a notice establishing guidelines as to how employees may file grievances against fleeing foreign investors.

"According to this notice, as soon as signs of illegal divestment become apparent, Chinese employees or other debtors should quickly move to file a case with the relevant People's Court or file a report with the Public Security Bureau".

Client Service Manager Zach Wortham: "even though the foreign party may have fled abroad, the Chinese authorities can move to have the offending foreign parties extradited to China or have a civil judgment completed, which can then trigger the agreements signed between China and foreign countries concerning judicial judgments."

According to some foreign investors, one of the reasons that they flee illegally is because the Labor Contract Law that became effective on January 1st, 2008 put too high a burden on them, increasing labor costs unfairly. According to others, the changes in the Labor Contract Law have simply brought labor standards in line with international expectations and those companies who cannot meet those standards should review their business model. China is simply becoming less attractive to businesses that pay low wages and adversely effect the environment.

If companies do run into difficulty, they should instigate liquidation or bankruptcy proceedings as required under law. For companies that seek a future in China, this is the best way to ensure that they will be allowed back in when the business environment improves.

By Maarten Roos and Zach Wortham

Wang Jing & Co. receives high rankings in 2009 CLP Survey

The head office in Guangzhou has received word that in the 2009 China Law Profiles annual survey the results indicate that the Guangzhou office has come out on top in the following categories;

Leading Guangzhou Corporate / M&A Firm
Leading Guangzhou Intellectual Property Firm

The China Law Profiles annual survey is an annual publication providing benchmark rankings for legal service providers in China.

<http://www.chinalawandpractice.com>

Chinalaw Profiles is a fully bilingual (English and simplified Chinese) guide to Greater China's law firms and legal markets. It combines an extensive directory of domestic and foreign law firms in Mainland China, Hong Kong and Taiwan with expert editorial overviews of the legal environment in each jurisdiction. Chinalaw Profiles is consulted by corporate counsel and senior executives at many domestic and international organizations with activities in the Greater China region.

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This newsletter is published by the Corporate & Commercial Group of Wang Jing & Co, a PRC law firm assisting Chinese and multinational clients in business operations in China and abroad.

WANG JING & Co. UPDATE

Wang Jing & Co. honored as one of the top 5 Employers in the Chinese Legal Market

For the second year in a row, Wang Jing & Co has been voted by Chinese Legal Professionals as one of the best law firms in China to work for.

The Employer of Choice Awards will be given out by the legal publication China Law and Practice and Wang Jing & Co. has been notified of their recognition.

Shenzhen Office moves to Larger Office

Following in the footsteps of our Shanghai office, the Shenzhen office has recently moved to more spacious accommodations in the Futian district of Shenzhen.

Below are the newly updated details for our Shenzhen Branch office. We look forward to receiving your visit and welcome you all.

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