



MMLC Group – China Update

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Business News

Chinese Exporters Worry About Appreciating US Dollar

At the recent 2008 International Textile, Fabrics and Accessories Exhibition held in East China's Zhejiang Province, common amongst competitors, were concerns as to the effect of China's appreciating RMB. The RMB has appreciated around 24% since it was allowed to appreciate by the authorities, in 2005. For a simple item of clothing, like a T-Shirt, this has meant that the price has increased from US\$3 to US\$3.72. For more expensive items, such as machinery and electrical products, the increases have been very dramatic – adding to this, is inflation of around 8% across China and increasing production costs. Many manufacturers and exporters have absorbed some of the price increases, whilst some have been forced to breach long term supply contracts leading to litigation. Others have been looking at ways to make their operations more efficient and to reduce dependence on labor. These days, it is not uncommon to see international supply contracts using RMB as the currency, as well as materials price increase clauses.

Alibaba's Profits Rise

Alibaba.com's first-quarter net profit more than doubled year-on-year to US\$43 million from US\$20 million. Revenue increased 53% to US\$97 million from US\$64 million. The website, the listed unit of Alibaba Group, said revenue from its China Marketplace platform increased 81% to US\$31 million from US\$17 million a year ago. Alibaba's ecommerce platform is essentially a buyer/seller match making platform - aimed at introducing potential buyers to potential Chinese sellers/manufacturers. We have seen a dramatic reduction in sellers ads for counterfeits and "cheap copies" on Alibaba's sites, following its IPO and restructuring – interestingly, this has occurred as a precursor to profits having increased dramatically.

Fiat Aiming for New JV

Fiat plans on setting up a JV in the near future, to produce Fiat branded cars for sale within China. Such plans are not surprising given most other major brands, offer locally made cars to the local market, so that they are able to compete on price and service. Fiat last December pulled out of its ailing passenger car joint venture with

Nanjing Automobile. It transferred its 50 percent stake in the joint venture to Nanjing Automobile. Earlier in 2007, Fiat formed a tie-up with Chery, another Chinese brand.

CACC's First Commercial Jet Released

The Commercial Aircraft Corporation of China Ltd (CACC) released its first commercial jet in May, in the presence of representatives from Airbus and Boeing. The jet, known as a ARJ21, was made in China by CACC, adopting technology from Chinese and foreign entities. The ARJ21 will start commercial flights in Autumn this year. Plans for commercial production of larger aircraft, including 747s are under way.

China Sat 9 About to Launch

China's first direct broadcast satellite is due to start operation later this month. Chinasat 9, produced in France, is part of China's first generation DBS system, which will transmit signals covering 98 percent of the nation's territory. It's capable of transmitting up to 200 radio and TV channels to users throughout China, including Hong Kong, Macao and Taiwan. The 100 million euro satellite is to be operated and managed by China Direct Broadcast Satellite Co Ltd. The company then will have a total of five satellites servicing on orbits, with signals covering the whole Chinese territory. The Chinese mainland satellite operator also plans to add Sinosat-4 and Sinosat-6 to its lineup by 2010. China Direct Broadcast Satellite Co Ltd, which integrates all of China's civilian telecommunication satellite and direct broadcast satellite resources, debuted last December after an equity reform. The company, with a registered capital of 3.8 billion yuan (\$517 million) and total assets of seven billion yuan, now runs Chinastar-1, Sinosat-1, Sinosat-3, and Chinasat-6B satellites.

Xuzhou Construction Looks to Wind Power

Xuzhou Construction (XCMG) has had a joint venture with Germany's ThyssenKrupp Technologies Group to manufacture specialized large-diameter slewing bearings that are a major component of, among other things, wind turbines. Most of the major wind turbine producers in China buy the bearings from the XCMG joint venture. It is not too surprising to hear that XCMG is looking at vertically expanding in to wind turbine supply. Following an initial investment of US\$72m, a new factory will be built for the fabrication of wind turbines with capacity of 1.5 mW to 2 mW over the next 12 months. Production is expected to commence in the latter half of 2009. XCMG is looking at licensing technology from Windtec and Germany-based Aerodyn for around RMB100 million. Such an announcement comes at a time, when XCMG is undergoing significant restructuring of its operations, such as exiting its JV with Caterpillar and acquiring a national heavy duty truck manufacturer.

Legal News

Ferrero Rocher Successful in Supreme Court

For around 10 years, a Chinese entity, known as Montresor, has been selling throughout China, large quantities of products bearing striking resemblance to Ferrero Rocher's well known gold foil wrapped chocolates. These products have no doubt fooled many foreign visitors to China, as well as locals. Given problems with a trademark infringement action, Ferrero was forced to attack Montresor under the PRC Law Against Unfair Competition, in particular the provision that resembles the common law action for passing off. In 2005, a Tianjin court found that Montresor's products were more well known in China than those of Ferrero and therefore rejected the action. In 2006, this decision was reversed by a higher court in Tianjin. Montresor then appealed the decision to

the highest court in the country, the Supreme People's Court. In a well reasoned decision, the court found in favour of Ferrero, concluding that its products were well known in China, and that confusion was likely by Montresor copying the well known trade dress of Ferrero's chocolates. It ordered Montresor to stop these infringing activities and to pay damages of RMB500,000 to Ferrero. We note that the damages award could have been higher, however evidence as to damages suffered was limited.

Penalties for Contravention of Environmental Regulations

Given SEPA's new teeth as a ministry, we are finding that it is becoming more willing to at least threaten entities and individuals under its environmental protection legislation. It is worthwhile to remind ourselves of the following potential enforcement regulations – both the Environmental Protection Law (EPL) and the General Principles of the Civil Law, state that polluters are responsible for eliminating illegal pollution and compensating entities and individuals that suffer direct loss from the polluting activities. The EPL sets the time limit for bringing an action at 3 years from the date that the damage occurred. The EPL also allows SEPA (now known as MEP) to impose fines and orders on polluters – in serious cases, managers and directors of companies can be held criminally responsible for the polluting actions of an entity, under the EPL and Criminal Law. Regular environmental impact audits are now a must for many FIEs in China, so as to ensure that these enforcement provisions are not triggered, or if triggered are manageable.

Transfer Pricing and Comparables

The new Corporate Income Tax Law briefly touched on transfer pricing, with the concept of contemporaneous documentation being introduced in the implementing regulations. A dedicated transfer pricing regulation is due to be enacted within the next 12 months, although we

note that the drafts continue to be heavily revised each time that they are issued. There is little doubt however, that the Chinese taxation authorities (as well as Customs offices) are spending increasing amounts of time looking at transfer pricing involving FIEs. It is therefore vital, that FIEs maintain a database of comparables for setting of prices and defense of those prices if queried. It is worth noting, that the State Taxation Administration (SAT) uses the OSIRIS database basically on an exclusive basis. Subscription to this service is not cheap, but given SAT's dependence on it, it might well be worth tapping that data from time to time.

Advance Filing for Service Fee Payments

Pursuant to State Administration of Taxation Circular 219 and Circular 258, foreign currency payment of service fees in Tianjin, Shanghai, Jiangsu, Sichuan, Fujian and Hunan, above US\$50,000, are now subject to advance filings of the relevant services agreement, with the local tax authorities. It is claimed that this system will allow for faster payment of service fees abroad, and may be rolled out on a national basis in 2009 or 2010.

Extradition Treaties with Australia and France

In early April, the National People's Congress approved two new extradition treaties with Australia and France. China's legislature is under pressure to locate and bring back to China, hundreds of former government officials that are wanted for embezzlement and similar crimes. Figures from the Ministry of Public Security released in 2006 show more than 800 suspects accused of embezzling some US\$10 billion) worth of property and cash had fled abroad, 500 of whom were still at large. But experts estimate the actual number to be much larger.

MEP and its New EIA Legislation

In March this year, the State Environmental Protection Administration was converted into a ministry – it is now known as the Ministry of Environmental Protection. This is indeed a promotion for the agency, illustrating the increased importance being placed on environmental issues in China. It continues to offer information in Chinese and English, under its old website though – www.sepa.gov.cn. Given concerns with how environmental impact assessments are being carried out for major projects, MEP has tabled new EIA assessment regulations, aimed at ensuring that wider concerns are taken into account when local EIAs are carried out – further, they will mean that EIAs are carried out at earlier stages of a project’s approval – in some cases these days, EIAs are not carried out in any form, until a potentially damaging project is up and running.

Arrested Suspects See Greater Rights

From 1 June, the rights of those arrested to see a lawyer and have their lawyer review the police files, have been clarified and strengthened. The new regulations make it clear that an arrested suspect has the right to meet with their lawyer, after they have been interrogated by the police –

however, unfortunately no such right will exist in relation to cases involving State secrets – this limitation could well be exploited by the authorities unfortunately. The law confirms that discussions between an arrested suspect and their lawyer, can not be monitored and that defense lawyers have the right to carry out full prehearing discovery. It remains to be seen how the new regulations are interpreted and followed throughout China, especially in rural areas.

China Visa Processes Tightened

The Public and Security Bureau has confirmed that it has officially tightened procedures regarding tourist and business visas leading up to the Olympics. Although the regulations have not changed, official policies appear to have changed in relation to persons wishing to travel to China from places that are considered high risk in relation to terrorism activities. Applicants from many African and Middle Eastern nations are advised to commence the visa application process weeks prior to departure, in order to avoid disappointment.

This update is aimed at keeping our clients informed of developments in Greater China. Whilst every care has been taken to ensure the accuracy of this update, it should not be relied upon before individual advice is obtained. The MMLC Group is an international legal and corporate advisory group.