

CHINA LEGAL REPORT

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subject

The Measures for the Administration on Initial Public Offering and Listing of Stocks on the Second Board (Draft for Comments)

Introduction

The drafted Measures (hereinafter the “Draft”) was promulgated by China Securities Regulatory Commission (the “CSRC”) on 21 March 2008, and with its purpose of standardizing the behaviors of initial public offering (the “IPO”) and listing of stocks on the second board, promoting the development of those growth orientated enterprises especially those self-innovation enterprises, and protecting the lawful benefits of investors.

The Draft consists of 57 articles in 6 chapters, namely, General Rules, Requirements for Issuance, Procedures for Issuance, Information Disclosure, Supervision and Administration and Punishments, and the Miscellaneous.

A stock IPO and listing on the second board shall meet the requirements for issuance as set forth by the Securities Law, the Company Law as well as the present Draft.

The information as disclosed by an issuer according to law shall be authentic, accurate and integrate, and shall not carry any false record, misleading statement or major omission.

A recommender as well as the representative of recommendation thereof shall, according to the principles of due diligence and accountability as well as honesty and good faith, earnestly perform its obligation of scrutinized examination and tutorship and shall be responsible for the authenticity, accuracy and integrity of the Recommendation Letters of Issuance it has produced.

The securities trading service institutions and personnel that produce the relevant documents for securities issuance shall, according to the widely-accepted business standards as well as the moral criterion within the sector, strictly perform their statutory functions and duties and shall be responsible for the authenticity, accuracy and integrity of the documents they have produced.

Also worth of mentioning is that the CSRC shall carry out ratification on the stock IPO as made by an issuer and shall not make any material judgment or guaranty on the value of stock investment or on the proceeds as generated by investors. Where a stock is issued according to law, an investment risk as incurred from any change of the issuer’s business or proceeds shall be borne by the relevant investors themselves.

1. Introduction of Main Provisions of the Draft

The reasons why multinationals conduct transfer pricing are diversified. Profit allocation, minimization of taxable income in jurisdiction with high tax burden, reduction of customs duty, optimization of group overall tax burden, avoid restrictions on foreign exchange can be counted as the major advantages of transfer pricing. Furthermore, an increasing number of the multinationals choose transfer pricing to structure internal transaction at a price which they consider fairer than the market price. Finally transfer pricing is also a tool to correctly allocate costs within the various group companies of a multinational.

1.1. Requirements for Issuance

1. An issuer shall be joint stock limited company that has been legally established and lawfully exists and its business operation shall have lasted for three years or more;
2. The registered capital of an issuer shall have been fully paid in, formalities for transferring the property right of the assets contributed by the issuer or the shareholders shall have been concluded, and there shall be no material disputes over the ownership of the issuer's main properties;
3. An issuer shall operate solely one main business, and the issuer shall comply with the relevant industrial and environmental protection policies of the State;
4. There were no material changes to an issuer's main business, directors and senior managers in the last two years, and there was no alteration of the actual controlling party;
5. An issuer's business achievements shall not materially depend on tax preferences, and an issuer shall pay taxes according to law, for which all tax preferences shall meet the provisions of the relevant laws and regulations;
6. An issuer shall not have any major insolvency risk or be involved with any major contingent issue such as guaranty, litigation and arbitration that may negatively affect its business operations;
7. An issuer's equity is well-defined and there shall be no such dispute over the ownership of the issuer's shares as held by its controlling shareholders, or by the shareholders under the control of its controlling shareholders or the actual controller;
8. An issuer shall have integrated assets, and it shall have a complete set of operations and be capable of independently conducting market-based business operations;
9. An issuer shall not have any intra-trade competition or obviously unfair associated transactions with its controlling shareholder, actual controller or any other enterprise under its control;

10. An issuer shall have standardized accounting rules. The formulation of its financial statements shall satisfy the provisions on enterprise accounting standards as well as the relevant accounting rules, which shall, in all substantial aspects, reflect its financial status, business achievements and cash flows thereof at arm's length. An auditing report shall be produced by the certified public accountants, carrying an unreserved conclusion thereon;
11. An issuer's articles of association shall clarify the authority of examination and approval of its external guaranty as well as the relevant procedures for deliberation thereabout. There shall be no irregular guaranty as provided for its controlling shareholder, actual controller or any other enterprise under its control;
12. An issuer shall have strict rules for capital management and shall not be under any circumstance where its capital is embezzled by any controlling shareholder, actual controller or any other enterprise under its control by loaning, compensatory repayment, advance payment or any other way;

1.2. Procedures for Issuance

1. The board of directors of an issuer shall make a resolution on the specific plans of stock issuance, on the feasibility regarding the utilization of the raised funds as well as on any other item that shall be clarified, and shall submit them to the shareholders' assembly for approval;
2. An issuer shall, according to the relevant provisions of the CSRC, formulate its documents of application, which shall be recommended and reported to the CSRC by its recommender;
3. The CSRC shall, after receiving any application material, make a decision on whether to accept it within 5 workdays;
4. After the CSRC accepts any application document as reported by an issuer, the relevant functionary department thereof shall carry out a preliminary examination thereon and the Issuance and Verification Committee of the Second Board shall carry out an examination thereon as well;
5. As of the date when the CSRC approves an issuance, the relevant issuer shall make the stock IPO within 6 months. Where it fails to do so within 6 months, the relevant approval document shall be deemed as invalid and therefore it shall reapply for the CSRC's approval before any IPO is conducted.

1.3. Information Disclosure

1. An issuer shall, according to the relevant provisions of the CSRC, formulate and disclose a prospectus;

2. An issuer as well as all the directors, supervisors and senior managers thereof shall affix its seal and their signatures to its prospectus so as to ensure the authenticity, accuracy and integrity of the contents thereof;
3. The relevant recommender as well as the representative of recommendation thereof shall carry out an examination on the authenticity, accuracy and integrity of the prospectus and shall affix its seal and his signature to the opinions on examination;
4. The financial statements as cited in a prospectus shall be effective within 6 months upon expiration of the latest accounting term. Under any special circumstance, an issuer may apply for proper extension, which shall not exceed 1 month at most;
5. The effective term for a prospectuses shall be 6 months, which shall be calculated as of the last day of signature when the CSRS approves an application for issuance;
6. After an application document is accepted and before the Issuance and Verification Committee carries out an examination, an issuer shall disclose in advance its prospectus on the websites designated by the CSRC;
7. A prospectus as disclosed by an issuer in advance shall not include any information on price;

2. Main Characteristics of the Draft

2.1. Information Disclosure

1. The issuer shall have adequate capability of profit making.

With the purpose of ensuring a stable payoff model of the second board companies and decreasing market risk, the Draft requires the enterprises shall be able to make profits.

An issuer shall make profits successively within latest two years, the cumulative net profit of the latest two years shall not be less than RMB 10 million, and shall be increasing continuously; or it shall make profit within the latest one year and the net profit shall not be less than RMB 5 million and shall be increasing continuously, as well as the increasing rate of business income within the latest two years shall not be less than 30%. The net profit shall be calculated on the basis of the comparatively low net profits upon deduction of non-regular profits and losses;

Also according to article 13 of the PRC Securities Law, an IPO issuer shall have the capability of making profits successively as well as a sound financial status.

2. An issuer shall be in certain scale and holding period

According to article 50 of the PRC Securities Law, where a joint stock limited company applies for the listing of its stocks, its total amount of capital stock shall be no less than RMB 30 million.

The Draft requires an issuer have a total amount of net assets of not less than RMB 20 million before issuance; have no uncovered deficit in the latest period; and have a total amount of stock capital of not less than RMB 30 million after issuance.

The Draft also requires that an issuer shall be a joint stock limited company that has been legally established and lawfully exists and its business operation shall last for three years or more, and where any limited company is altered into a joint stock limited company by converting the entirety of its original net book value of assets, the term for its business operations may be calculated as of the day when the limited company is established.

3. The main business of an issuer shall be outstanding

Those growth orientated enterprises normally have a small business scale as well as a weak economic power. If they enter into too many businesses and have too scattered business scope, they are easily to lose their core competitive power. This is not in favor of valid risk control as well as development of competitive power.

The Draft therefore requests an issuer to focus all its energies on only one main business. The industrial policies and the environmental protection rules of the State shall be complied with. And the raised funds shall only be used to develop its main business. By doing so, the market risk of a stock IPO and listing on the second board would have been controlled and more market participation would have been attracted.

4. Strict requirements on corporate governance

An issuer shall establish perfect corporate governance structure, the shareholders' assembly, board of directors, board of supervisors, independent directors, secretary of the board of directors, and the auditing committee according to law. The relevant organizations and personnel shall be capable of performing their functions and duties according to law.

Establishment of auditing committee under the board of directors and duties of independent director has been strengthened.

The directors, supervisors and senior managers of an issuer shall have good knowledge of the relevant laws and regulations on the stock IPO and listing on the second board as well as the statutory obligations and duties of a listed company and the directors, supervisors and senior managers thereof.

The directors, supervisors and senior managers of an issuer shall meet the qualification requirements for holding their positions as prescribed by laws, administrative regulations and rules, and shall not be under any of the following circumstances:

- Having been banned from entering into the market by the CSRC and the ban is still valid;
- Having been given an administrative punishment by the CSRC within the latest three years or having been given a public reprimand by a stock exchange within the latest one year; and
- Being subject to a case investigation of the judicial organ for its involvement in a suspected crime or suspected violation of any law or regulation, and yet there being no clear conclusion.

An issuer shall have an improved and effectively implemented internal control system and shall ensure the reliability of its financial statements, legality of its business operations, and efficiency and efficacy of its business performances.

5. Improving the information disclosure as well as the transparency of the enterprises

The rules on the contents and format of the prospectuses prepared by CSRC shall be the minimum requirements for information disclosure. No matter whether there is any explicit provision in the said rules, any information that may have any major impact on the investors' decisions on investment shall be disclosed.

An issuer may publicize its prospectus (version for application use) on its enterprise website, on which the disclosed contents shall be identical to those as disclosed on the website designated by CSRC and the time of disclosure shall not be earlier than that on the website designated by CSRC.

A Recommendation Letter of Issuance as produced by a recommender as well as the relevant documents produced by a securities trading service institution shall

be deemed as reference to the relevant prospectus, which shall be disclosed on the websites as designated by the CSRC for public reference.

An issuer shall announce in an eye-catching position of its prospectus the following notice, which prepared by the Draft in advance, that “The CSRC has not granted an approval on the application for this issuance by our Company. This prospectus (version for application use) shall not be applied as a legal ground for stock issuance, and is merely used for advance disclosure. The relevant investors shall make their investment decisions on the basis of the full text of the Prospectus as officially announced”.

6. Strengthening education and warnings on risks

It is obviously that the second board is more risky than the main board. Therefore, the Draft clearly requires an issuer to announce the following warning in a unified format in an eye-catching position of its prospectus that “the issued stocks are intended to become listing on the second board, which has a comparatively high risk of investment. The second board has its characteristics of unstable performance and high risks, and investors subject to serious risk of market fluctuation. Investors shall fully understand the investment risk on the second board and the risky factors disclosed by our Company, and make your investment decisions diligently”.

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