Charltons - China News Alerts Newsletter - 20 July 2005

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# China News Alert Issue 111

## Headlines

### Pilot companies involved in redesignation of non-tradeable shares introduce employee share options

Several companies selected by the CSRC to participate in its pilot scheme on redesignation of non-tradeable shares as shares that are tradeable on PRC stock exchanges, have introduced employee share option plans (ESOPs) as part of their share redesignation schemes. The companies include the privately-owned companies Jinfa High-tech and Hengsheng Electrical, and the state-controlled companies Sinochem International and Citic Securities

Under the share redesignation and ESOP plan of Citic Securities, the shareholders of non-tradeable shares will transfer 30 million shares (in proportion to their respective shareholdings) at a price calculated on the basis of the latest audited net assets per share. Sinochem International has adopted a slightly different scheme, under which the Sinochem Group will allocate 20 million shares from the shares remaining after paying consideration to shareholders of circulated shares to be used as the source of shares for the ESOP.

The subscription price of the ESOP is 0.5 yuan per share, its exercise price 5.00 yuan, and the exercise cost 5.5 yuan per share. Details of this plan will be developed and reviewed by the company's board of directors before adoption.

Sinochem International has adopted a "stimulation of share options" method, while Citic's proposal involving the using net assets as the consideration for the shares represents more of an actual rights transfer. The exercise cost of 5.5 yuan per share adopted by Sinochem International is close to the current market price. At the end of last year, net assets per share of Citic Securities stood at 2.17 yuan, and the average price in the 30 transaction days prior to June 17 was 5.40 yuan.

Article 2 of the Opinion on Rules on Employee Share Option Plans of Listed Companies (Draft) of the CSRC, states that "employee share option plans refer to the long-term stimulation by directors, supervisors, high-level management and other employees of a listed company using its own shares.

Article 16 of the Opinion provides that "any listed company conducting a share option plan may, according to its actual circumstances and through the following means, resolve the source of the shares to be listed:

1. reserve shares while publicly issuing new shares;
2. issue shares to stimulation targets; and
3. other means permitted by laws and administrative rules."

### State Council approves steel industry policy

The Development Policy for the Steel Industry has been approved by the State Council. It is the second national industry policy to be drafted by the State Development Planning Commission (SDPC) and approved by the State Council, following the Development Policy for the Automobile Industry.

The Development Policy for the Steel Industry will finalize some major issues, such as industry targets, development planning, technical policies, organizational structures and investment management.

China has thus been the top producer of steel in the world for many years. Technological modernisation and structural adjustments have been highlighted for future development. The steel industry aims to become internationally competitive through reducing energy and other resource consumption, placing greater emphasis on environmental protection and enhancing the integrated competitiveness of enterprises.

According to Luo Bingsheng, the standing vice-president and secretary-general of the China Steel Industry Association, China's steel capacity generally exceeds market demand. In 2004, China produced over 297 million tonnes of steel, accounting for 25% of total global steel production. This production amount is not only greater than the total production of the EU-25 countries (193 million tonnes), but also exceeds the aggregate production of Japan (126 million tonnes) and the USA (98.5 million tonnes). In addition, China imported over 29 million tonnes of steel in 2004, and domestic steel consumption amounted to over 312 million tonnes.

The Development Policy for the Steel Industry provides for the proper regulation and control of production for the steel industry. China's steel capacity is to be controlled on the basis of meeting domestic demand, while iron ore and rare alloy material, including nickel and chrome will be imported as required for the development of the steel industry. The State will restrict the export of primary processed products which necessitate high energy consumption and pollution, such as coke, ferroalloy and pig iron, and revoke the export tax rebate on such products.

Other measures for the steel industry include the promotion of joint restructuring of steel enterprises, improving industry concentration, reducing the number of steel manufactures, supporting the grouping of steel enterprises by the State, and supporting and encouraging competent large-scale enterprises to perform cross-region joint restructuring. However, there is no compulsory provisions for the scale of steel enterprises.

Conditions for entry into the market are to be applied evenly and without discrimination. Various social capital entities, including private capital entities, are encouraged to restructure existing steel enterprises through share subscriptions and mergers and acquisitions. Stricter provisions are to be set for enterprises failing to meet satisfactory standards of environmental protection, energy consumption and technical innovation.

Foreign steel enterprises developing in China are to be treated equally without discrimination, subject to WTO principles.

### SAT statement on income tax payable on creditors' rights

The State Administration of Taxation (SAT) stated on July 6 that individual income tax should be levied on earnings from creditors' rights in line with earnings from property transfers.

The SAT stated that, in accordance with the Individual Income Tax Law of the People's Republic of China and relevant provisions, individual income tax should be levied on earnings obtained through corresponding judicial or administrative procedures from creditors' rights, purchased by bidding, auction or other methods in line with earnings from property transfer.

In terms of "packaged" creditors' rights obtained by individuals through the above methods, only part of which are disposed, taxable income should be determined by means of levying taxes on income from creditors' rights each time complying with earnings from property transfer. Taxable income should be determined in line with the appraisal sum and market value of monetary and non-monetary assets acquired by individuals.

The costs of disposing creditors' rights (the original value of the property) should be calculated by the following formula:

* current costs of disposing creditors' rights = actual expenditure in purchasing packaged creditors' rights by individuals × current book value of disposing creditors' rights (or value publicized by auction authorities) ÷ book value of packaged creditors' rights (or value publicized by auction authorities).

The SAT has also stipulated that handling charges, costs for judicial proceedings, audit and evaluation fees and reasonable expenses of taxation such as paid taxes and duties incurred in the process of purchasing and disposing creditors' rights by individuals should be deducted in calculating individual income taxes.

## Capital Markets

### BOC and Shenhua Energy H Share listings reveal ambiguity on non-tradeable domestic shares

The effects of equity separation have spread to overseas markets. In June two large mainland enterprises, Bank of Communications (BOC) and Shenhua Energy, were listed on the Hong Kong Stock Exchange (SEHK) and must therefore face issues arising from equity separation.

The prospectuses issued by BOC and Shenhua Energy in relation to their respective listings on the SEHK both contain sections summarising the Share Redesignation Notice issued by the CSRC in April. In both cases, the relevant sections state that it is not clear under the Share Redesignation Notice whether it applies to non-tradeable shares of PRC companies whose shares are listed only on overseas stock exchanges (such as the SEHK), and not on any PRC stock exchanges. Both companies state in their prospectuses that they have no intention to seek redesignation of their non-tradeable shares under the Notice.

The respective prospectuses of BOC and Shenhua Energy do not refer to listings of H Shares on the SEHK prior to May of this year. For example, when China Telecom listed on the SEHK in October 2002, it did not refer to the issue of non-tradeable shares in its prospectus. Instead, the prospectus merely stated that "domestic shares are not listed on any securities exchange, nor traded or settled on any other recognized dealing institutions of China".

Whatever measures may finally be issued in respect of the non-tradeable shares of PRC companies with H-Share listings on the SEHK, the statements by BOC and Shenhua Energy indicate that trading of redesignated non-tradeable shares of PRC companies with listings on both the SEHK and a PRC stock exchange is likely to be on the relevant domestic PRC market rather than on the SEHK.

### SAC drafts Circular on sponsor involvement in redesignation of non-tradeable shares

The Securities Association of China (SAC) is drafting a *Circular* on Issues relating to Sponsors Engaged in the Pilot Scheme on Redesignation of Non-Tradeable Shares*. Among other things, the*Circular\* deals with sponsors' liability, standard charges, the submission of summary working reports, and disciplinary measures.

Regarding the issue of liability, the *Circular* provides that sponsors must carry out adequate due diligence on listed companies and their large shareholders and actual controlling entities.

Sponsors must carry out a full, broad and reasonable investigation as to the contents of the public announcements of a listed company and its shareholders of non-tradeable shares and which do not have documentary support from lawyers or accountants. The *Circular* requires sponsors to encourage related parties to make sufficient information disclosure, to set out and explain plans to redesignate non-tradeable shares and to assist listed companies in communication and coordination between shareholders of non-tradeable shares and tradeable shares.

The *Circular* also contains provisions regarding the implementation of related work following the adoption of pilot schemes. For example, the *Circular* provides that a sponsor should supervise and guide shareholders of non-circulated shares of listed companies in fulfilling related warranties. in share redesignation schemes. The sponsor should also supervise and guide listed companies to prevent large shareholders and other related parties misappropriating the assets of listed companies and supervise and to prevent high-level employees abusing their positions and from damaging the interests of listed companies.

In particular, the *Circular* emphasises the importance of sponsor independence.. Sponsors are required to ensure that they do not provide surety or financing for companies which they sponsor, and that in the performance of the sponsor's duties, there has been no instances in which the sponsor was involved in the pre-sale of a company yet to be listed. The *Circular* states that if a sponsor holds more than 7% of the shares of a listed company or is one of its five shareholders of the company, it should not be the sponsor of that company.

In relation to standard charges, the *Circular* states that a sponsor should levy charges on the basis of workload, estimated risks and principles of negotiation and agreement. The charges levied by a sponsor may in principle include financial consultation charges and sponsorship charges. Financial consultation charges relate to assistance given by a sponsor in the implementation of share redesignation schemes. Sponsorship charges relate to, for example, due diligence and other investigative work, sponsor opinions and continuing supervision and guidance.

Regarding financial consultation charges, the *Circular* states that these charges should be based primarily on the financial consultation workload of the sponsor, and, having regard to the complexity and risks of share redesignation work, should not be less than 1.5 million yuan.

The *Circular* also provides that sponsor charges should be between 1% and 3% of the total sum under consideration in the share redesignation scheme of the listed company.

The total sum should be calculated on the basis of consideration paid to shareholders of circulated shares by shareholders of uncirculated shares as stated in the opinions issued by the sponsor.

The *Circular* also provides that sponsors should submit sponsorship work summary reports to the Securities Association of China within 15 working days from the implementation of share redesignation schemes for listed companies. If any sponsor violates the provisions of the Circular, the Securities Association of China will investigate its liability and impose corresponding disciplinary measures depending on the nature of the violation.

### BOE becomes first A, B and H Share company

On 6 July 2005, the Beijing Orient Electronics Group Co., Ltd (BOE) announced approval of its plan to issue HKD2.5 billion H-shares outside China. thus became the first listed company in China to simultaneously issue A-shares, B-shares and H-shares.

On July 5, BOE issued an announcement concerning a bond issuance of BOEHydis, a wholly-owned subsidiary of BOE in Korea. This is the second time BOEHydis has issued a coupon-paying non-registered unsecured bond in Korea since April. The cumulative total of the two bond issues amounts to nearly RMB1.6 billion.

In March 2004, BOE's board of directors proposed 75% and 25% investments in Beijing BOE Optoelectronics Technology Co. Ltd., by BOE and its subsidiary company in Korea, BOEHydis, respectively. Beijing BOE Optoelectronics Technology Co. Ltd. is responsible for investing in the construction projects of TFT-LCD. At that time, BOE was considering applying for listing outside China in the name of BOEHydis. However, the company has altered its plan from an offshore listing of its Korean subsidiary to listing itself in Hong Kong by issuing H-shares due to regulations enacted by the China Securities Regulatory Commission (CSRC) which placed restrictions on a subsidiary company of a corporation being listed on the stock market.

In August 2004, the CSRC issued the Circular concerning relevant Issues on Regulating Affiliated to Listed Companies in China listed on Overseas Stock Markets. The Circular requires a subsidiary of a listed company seeking to list on an overseas stock market to meet the following conditions:

* it must not distribute capital for funding offshore listing within three years;
* net profits of the listed companies derived from distributed capital must not exceed 50% of the net profit of the listed company's as set out in its consolidated financial statements;
* net assets of the subsidiary must not exceed 30% of the total net assets of the listed company;
* management of the listed company must not carry out management functions in the subsidiary and vice versa.

Regarding the proposed issue of H-shares, BOE has stated that H-shares would account for no more than 35% of the total capital stock after the issue. If implementing over-allotment in accordance to international practices and market conditions, the scale of over-allotment shall be less than 15% of the aforementioned issuance scale. It is estimated that capital financed by issuing H-shares will be greater than HKD2.5 billion (excluding issuance expenses), of which HKD1.8 billion will be used to repay a bank loan necessitated by the establishment of the fifth generation TFT-LCD production line of the subsidiary company, Beijing BOE Optoelectronics Technology Co. Ltd. The remaining HKD0.7 billion will be used to increasing the registered capital of Beijing BOE Optoelectronics Technology Co. Ltd. in order to technologically upgrade the fifth generation TFT-LCD production line. According to statistics, BOE's assets-liabilities ratio in the first quarter of 2005 was 72.29%.

### Central Bank issue Circular on restructuring securities companies

On July 4, the Central Bank convened a Circular Meeting on the Restructuring of Securities Companies presided over by the director of the Financial Stability Bureau, Zhang Xin. At the meeting, participants reviewed the restructuring of securities companies this year and ideas on assisting securities dealers. They also put forward a programme of investment in nine securities companies, including Galaxy, Shenyin & Wanguo and Xiangcai Securities Co., Ltd, on the basis of changing refinancing policies.

Although it has stopped providing securities dealers with refinancing, the Central Bank has opened another "capital channel" for securities dealers. The only difference is that the gatekeeper of the channel is not the Central Bank but Central Huijin and Jianyin Investment Co., Ltd., the pioneer of restructuring state-owned financial assets. Other policies were defined at the meeting, such as putting Central Huijin and Jianyin Investment in charge of assisting securities dealers by investing in major securities dealers in order to implement the financial restructuring, which will be implemented in three months time.

Central Huijin will invest in Galaxy and Shenyin & Wanguo Securities Co., Ltd, while Jianyin will invest mainly in local securities dealers, such as Xiangcai, Zhongfu, Tiantong, Beijing, Huaan, Science and Technology and Huaxia securities Co., Ltd. It is hoped that by restructuring finance and introducing strategic investors securities dealers will be remodeled into modern financial enterprises with adequate capital, rigorous internal control and a complete governance structure.

## Funds

### CSRC approves first joint venture fund management company

Gongyin Ruixin Fund Management Company, the first joint venture fund management company approved by the CSRC and established by a state-owned commercial bank, was established in Beijing on July 5. The Industrial and Commercial Bank of China, Credit Suisse First Boston and China Ocean Shipping (Group) Company are the shareholders.

Gongyin Ruixin Fund Management Company received approval from the CSRC on June 4 and was registered at the State Administration of Industry and Commerce on June 21. The registered capital of the company is RMB200,000,000; held 55%, 25% and 20% respectively by the Industrial and Commercial Bank of China, Credit Suisse First Boston and China Ocean Shipping (Group) Company. Gongyin Ruixin is now preparing for public offerings of its first fund project.

The Industrial and Commercial Bank of China is presently the largest commercial bank in China. As at the end of 2004, it held total assets of RMB5,700,000,000,000 and accounted for 18% of the total assets owned by financial institutions in the banking industry in China. In April 2005, the joint stock reform system project was approved by the national authorities and Central Huijin injected USD15 billion worth of capital assets. The ICBC has now finished financial restructuring tasks such as national capital injection and the disposal of non-performing assets.

## Corporate & Commercial

### CCB introduces a new model for international investment

Following its investment agreement with the Bank of America on June 17, China Construction Bank (CCB) announced on July 1 that it would conclude an investment agreement with Singapore Temasek Holdings Co., Ltd (a state-owned holdings investment company based in Singapore, with a capital of SGD$ 90 billion). Temasek will invest $1.4 billion to purchase a 5.1% stake in CCB, becoming the second international strategic investor to invest in the CCB, alongside the Bank of America. Temasek has also undertaken to invest not less than $1 billion when initial public offerings (IPOs) of the CCB are launched.

Two successive foreign investors have been rapidly introduced within a single month, with the $2.5 billion equity participation by Bank of America breaking a record in terms of a single investment by an America-invested company in China. It has been noted that neither Bank of America nor Temasek have sought control of CCB or senior management positions. In addition, it is foreseen that this may provide a new model for introducing international strategic investors through China's four state-owned commercial banks.

Chairman of CCB, Guo Shuqing, has stated that CCB still plans to list during 2005. Following Bank of America's equity purchase, CCB submitted its initial listing application with to the SEHK on June 24. The successful listing of BOC on the SEHK (which was over 200 times over subscribed) has increased CCB's confidence in stock market listing.

During an interview with the Financial Economics magazine, Banker Chang Zhengming stated that in the future other strategic investors would be able to invest in the bank, in addition to the Bank of America, so that it is not particularly important for the CCB to acquire capital by listing. Their major goals were to accept public inspection and improve governance structure.

## Bonds

### Beijing Energy Investment Co., Ltd. (Group) issues RMB2 billion bonds

With the approval of the National Development and Reform Commission (NDRC), Beijing Energy Investment Co., Ltd. (Group) has issued bonds totaling RMB2 billion to the public from July 6 to 13.

These debentures take the form of 5- and 7-year fixed interest rate bonds. Interest is paid annually and capital will be repaid on a lump-sum basis upon maturity. the 5-year bonds total RMB1.5 billion with a coupon rate of 4.80%, while the 7-year bonds total RMB0.5 billion with a coupon rate of 4.95%. The minimum subscription amount is RMB1,000, and in multiples thereof. The Agricultural Bank of China will provide the capital guarantee for the debentures. These bonds have been endowed with a top credit rating (AAA) after assessment by the China Lianhe Credit Rating Co., Ltd. As the current major sales agent of bonds, Guotai Junan Securities Co., Ltd. will establish distribution outlets in Beijing, Shanghai and provinces such as Guangdong, Heilongjiang, Hubei and Zhejiang. Further information can be found at www.powerbeijing.com and www.gtja.com.

Beijing Energy Investment Co., Ltd. (Group) is a wholly state-owned enterprise, which is under the direct control of the Beijing State-Owned Assets Supervision and Administration Commission. The Group primarily invests in electric energy, with 70% of the power supply for Beijing supplied by electric power plants under its control. The funds raised by the bond issue will be used for the construction of 5 electric power infrastructures, such as the electricity generation project which will make use of natural gas from the Beijing Third Thermo-electric Plant in order to ease pressure on the electricity supply of the capital and to guarantee supply for the 2008 Beijing Olympic Games.

### NGC Issue debenture of RMB4 billion bond issue

The National Grid Company (NGC) issued RMB4 billion worth of bonds on 8 July.

The bonds were to be issued on a 10 year basis with interest paid annually. Fixed interest rate bonds total RMB3 billion with a coupon rate of 4.98%, while floating interest rate bonds total RMB1 billion with a coupon rate of 2.25% added to the benchmark interest rate. The benchmark interest rate is the fixed-deposit interest rate for a term of one year as published by the Bank of China, which is applicable from the first day of issuance and any other start date for the year in which interest accrues.

The Beijing Branch of the Bank of Communications will provide the capital guarantee for the bonds. The credit rating of these debentures is Grade AAA, with China Galaxy Securities Co., Ltd. serving as the major sales agent. Funds collected from the bond issue will be used for the construction of 22 projects, such as nation-wide networking, sending electricity to the east and networking in local areas of the NGC. The NGC owns 5 local grids in the north, northeast, east, centre and north west of China, covering 26 provinces.

### Bank of China approves issue of financing bills by Haitong Securities Co., Ltd.

Haitong Securities Co., Ltd. has received approval from the Bank of China to issue short-term financing bills. The maximum sum of money authorized for issuing short-term financing bills is RMB2 billion.

Haitong Securities will issue the bills on an ad hoc basis, based on its requirements for business development and market capital.

## WTO

### The MOC issue Catalogue of textiles exports subject to temporary regulation

The Ministry of Commerce (MOC), the Customs General Administration (CGA) and the General Administration of Quality Supervision, Inspection and Quarantine (GAQSIQ) have jointly issued the Temporary Managing Commodity Catalogue of Textiles Exports, in accordance with Article 8 of the Measures on Temporary Management of Textiles Exports and the EU Memorandum of Understanding on Partial Textiles Exports and Clothing of China, setting out the following provisions:

#### 1. Product scope

Textile exports under temporary management include the following 10 categories of products exported to the EU:

**Category 2**: tatting cotton cloth, excluding cotton cloth weaved from etamine, pile loop, narrow breadth, knop and Xueni'er as well as malines lace;

**Category 4**: shirts with knitting or fancywork, T-shirts, thin knitted overalls, pullovers with curling necklines or round turn-down collars (non-wool or non-fine animal hair), underwear and similar products;

**Category 5**: sweaters, pullovers, jackets without sleeves, twinsets, cardigans, short upper outer garments and slip-ons (excluding jackets and blazer coats), thick jackets with funnel caps, outdoor jumpers, waist-length jackets with knitting or fancywork and similar products;

**Category 6**: tatting breeches, short pants (excluding bathing trunks) and trousers (including casual trousers) of wool, cotton or man-made fiber for men and boys; tatting and casual trousers for women and girls; upper tracksuits made of cotton, chemical fibers from categories 16 and 29;

**Category 7**: shirts, underwear or short shirts with knitting, fancywork or tatting wool, cotton and man-made fibre for women and girls;

**Category 20**: bed sheets with no knitting or fancywork;

**Category 26**: wool, cotton and man-made one-piece dresses for women and girls;

**Category 31**: bras with knitting, tatting or fancywork;

**Category 39**: Tablecloths, Turkish towels and kitchen cloths with no knitting or fancywork, excluding cotton or similar wool loop textiles;

**Category 115**: flax or ramie yarn.

#### 2. Date of implementation and time range

The implementation period for the temporary management of textiles exports will be from 20 July 2005 to 31 December 2007. Commodities declared to customs and exported to member states of the EU during this period will be processed by customs according to the procedures for declaration and examination and released with a temporary export license. Customs will also deal with procedures for the examination and release of textiles, which are required by law to be inspected, with the Clearance Form for Exported Goods issued by the inspection and quarantine authorities.

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