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Update on Futures Regulations in China

Three important futures regulations were announced by the State Council and the China Securities Regulatory Commission (CSRC) in March 2007 and became effective on 15 April 2007. These were the Administrative Regulation on Futures Trading (the Regulation), the Administrative Measures for Futures Exchanges and the Administrative Measures for Futures Companies, together known as the New Futures Regulations. In addition, other relevant implementation rules and regulations have been or are about to be issued by the relevant government authorities. Under the Regulation, the categories of futures have been expanded to include commodity and financial futures contracts, and option contracts. Also, the subject matter of futures contracts has been expanded to include agricultural products, industrial products, energy, other commodities and the relevant index products thereof, as well as negotiable instruments, interest rates, foreign exchange rates, other financial products and the relevant index products thereof.

The Regulation warns that without the approval of the State Council's futures regulatory institution, any institution or market which conducts centralized trading on the basis of standard contracts and simultaneously adopts or bears the feature of either of the following trading mechanisms shall be deemed as conducting futures trading in a disguised form:

- Providing all buyers and sellers that participate in the centralized trading with a guarantee to perform the contracts
- Adopting the mark-to-market system and margin system, and simultaneously collecting a sum of margin which accounts for less than 20 per cent of the amount of the subject matter of each contract

The Regulation further provides that any institution or market which adopted or bore the feature of these trading mechanisms prior to the implementation of the Regulation shall make a rectification or remedy within the time limit as prescribed by the commerce administrative department of the State Council.

The Ministry of Commerce of the People's Republic of China also announced the Notice on Relevant Issues relating to Rectification of Bulk Commodities Trading Market Within a Time Limit (the Notice). The Notice required any institution or market conducting centralized trading on the basis of standard contracts without approval from the CSRC to complete the rectification of any disguised futures prior to 30 September 2007 in accordance with the Regulation. From 1 October 2007, any bulk commodities trading market shall not adopt the trading mechanisms of the disguised futures as provided by the Regulation. The said rectification mainly includes (i) the amendment of the articles of association of such markets (companies), (ii) the restructuring of the internal management system, (iii) amendments to the trading rules and (iv) the adjustment of the trading system.

In recent years, China has witnessed the emergence of the forwards trading market of stock-on-hand bulk commodities. Some of such markets are in the form of an exchange, such as the Shanghai Petroleum Exchange, and others are in the form of electronic trading, such as Shanghai Bulk Steel Electronic Trading Centre. The forwards market of stock-on-hand bulk commodities adopts the business model of a third-party e-business platform. It utilizes the risk-control mechanism of futures as a reference and conducts the trading under the mark-to-market system and margin system.

In the past, since there was no clear definition of “disguised futures” in the People’s Republic of China laws and regulations, the legality of such stock-on-hand forwards markets was hotly debated. Sometimes such stock-on-hand forwards markets could be deemed to be “disguised futures markets” and face the risk of being banned at any time.

The Regulation and the Notice provide the scope and features of the “disguised futures” and propose the requirements of the rectification process. Some of the main institutions and markets engaging in stock-on-hand forwards trading have completed their rectification according to the requirements of the Regulation and the Notice. Such rectification includes but is not limited to increasing the ratio of the margin, which shall be no less than 20 per cent of the amount of the subject matter of each contract. After the rectification, it is expected that such bulk commodities trading markets will not be subject to the legal risk of being deemed a “disguised futures market”.

According to the Regulation, the following Chinese citizens or corporate investors shall not trade futures transactions by themselves or through brokerage:

- Government-sponsored institutions or government agencies
- Staff of the futures regulatory institution of the State Council, futures exchanges, institutions monitoring the safe custody of futures margins, and futures associations
- Persons prohibited from entering into the securities and futures market
- Entities or individuals that fail to provide the required documents to open an account
- Other entities or individuals prohibited by the futures regulatory institution of the State Council from trading futures, including but not limited to individuals without civil capacity or with limited civil capacity, and the staff of a futures company and their spouses

In the New Futures Regulations, the concept of a “futures broker company” is replaced by a new term, “futures company”. For the first time, a futures company is explicitly defined as a financial institution. The New Futures Regulations also expanded the business scope of the futures company. Besides the domestic futures brokerage, the futures company may apply for engagement of overseas futures brokerage, futures investment consultation and other futures businesses as prescribed by the futures regulatory institution of the State Council.

The Catalogue of Industries for Guiding Foreign Investment (the Updated Catalogue) was updated and published on 31 October 2007 and will become effective on 1 December 2007. According to the Updated Catalogue, foreign investors are allowed to jointly invest in futures companies in China with Chinese parties, but the Chinese parties must be the majority shareholders of such futures companies.

Major Amendments to the Civil Procedure Law

The Decision of the Standing Committee of the National People’s Congress on Amending the Civil Procedure Law of the People’s Republic of China (the Decision), adopted on 28 October 2007, shall come into force on 1 April 2008. The Decision focuses on amending difficulties inherent in the retrial process and enforcement actions.

Improvements to the Retrial System

The Decision specifies the legitimate circumstances for the filing of a petition requesting a retrial. Whereas the original Civil Procedure Law cited only five circumstances enabling a court to hear a petition for retrial, the Decision expands this number to 13. Moreover, the Decision provides an additional paragraph relating to violations of legal procedure and situations where adjudicating personnel have engaged in criminal conduct. These 13 circumstances are also applicable for the People’s Procuratorate to file a protest.

The Decision also clearly defines the circumstances where a petition for retrial can be legitimately filed after the standard time limit has elapsed. Even after two years, a retrial petition can be made within three months after the party knew or should have known that the legal document upon which the original judgment or ruling was made is cancelled or revised, or that any adjudicating personnel were involved in any embezzlement, bribery, practicing of favouritism of any nature or perverting the spirit of the law when rendering judgment.

Additionally, the Decision clearly defines which court may accept a retrial petition and the time limit of a retrial reviewing. The original Civil Procedure Law stipulates that a party may apply to the People’s Court which originally tried the case or to a People’s Court at the next level for retrial. Under the Decision, a party may only petition the People’s Court at the next level for

retrial. This limitation shall effectively prevent the repeated petition by a party or repeated hearing by the court. The Decision also stipulates: “The People’s Court shall review a retrial petition within three months after receiving it”.

Improvements to the Enforcement System

The original Civil Procedure Law stipulates that the enforcement officer shall send notification of enforcement to the party upon which a judgment is to be enforced. In practice, upon receiving notice some parties would take the opportunity to hide or transfer their property in order to avoid attachment procedures. In response to this abusive practice, the Decision further states that if a party fails to fulfil its obligations and hides or transfers property, enforcement officers may take compulsory enforcement measures against that party immediately.

The Decision increases the reporting obligations with respect to property. For the purpose of rectifying the problem that, in practice, a party may intentionally delay enforcement even when it owns sufficient property to fulfil its obligations, the Decision stipulates that a party that fails to fulfil its obligations shall report its current property status and the property status of one year previous to the receipt of the enforcement notice. If the party refuses to report or makes a false report, the People’s Court may, based on the circumstances, impose a fine or detain said party, its legal representative, the principal leading personnel or the directly responsible person of relevant unit.

The original Civil Procedure Law stipulates that the time limit for the application of an enforcement procedure shall be one year if one or both of the parties are citizens, and six months if both parties are legal persons or other organizations. The Decision extends both time limits to two years and stipulates that the suspension or termination of the time limit shall be governed by the provisions of the suspension or termination of the statute of limitations.

The Decision also specifies enforcement objection procedures, adding Article 202 to the new Civil Procedure Law. Article 202 stipulates that if the counterparties involved in the trial, other litigation participants or representatives, or even a party that is not involved in the case considers that the enforcement is in violation of legal provisions, it may raise a written objection to the People’s Court in charge of the enforcement procedure. Moreover, if the party that raises the objection is not satisfied with the ruling for the objection, it may apply for reconsideration to the People’s Court at the next level. In this manner, the Decision seeks to increase the probability that a judgment will be enforced by the lower level court because of reluctance to be overruled by a higher level court, and also to reduce the tendency of lower level courts to engage in local favouritism.

Finally, the Decision adds an enforcement linkage system. The Decision stipulates that the new Civil Procedure Law shall add Article 231, which states that the People’s Court may adopt, or notify relevant units to assist in the adoption of, measures such as discouraging an individual from fleeing the country if he or she fails to fulfil the obligations specified in a legal document.