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# China News Alert Issue 88

## Headlines

### Public Offering "Passage" System Officially Abolished

The Securities Association of China has released a circular announcing the abolition (as of January 1, 2005) of the "passage" system for share issues and listings, whereby the China Securities Regulatory Commission (CSRC) granted qualified stock underwriters a number of listing passages or gateways through which they could assist companies list on the Shanghai or Shenzhen stock exchanges, effectively a quota system. The passage or quota system was initiated in 2001.

At the same time, the CSRC has provided a guidance on the implementation of the *Provisional Measures on the Sponsor System for Issuing and Listing of Securities Issuance and Listing Sponsorship*, which provides for the following:

* The CSRC will reject any application for listing recommended by a sponsor representative who is currently engaged in another pre-listing sponsorship;
* Persons applying to register as a sponsor must have a minimum of three years investment banking experience and the experience of acting as a sponsor on at least one completed public offering transaction on a domestic or overseas stock exchange during the year prior to the application to become a sponsor representative;
* The CSRC will strike off any sponsor who does not have the requisite investment banking experience as set out in Article 17 of the *Provisional Measures*. The investment banking experience in this case refers to continuous engagement in investment banking activities, playing a part in investment banking transactions, and participation in the training program for sponsor representatives organized by the Securities Association of China or other institutions authorized by the CSRC on an annual basis.

### State Council approves establishment of Investor Indemnity Fund

The State Council has recently approved the establishment scheme for a Securities Investor Indemnity Fund. The relevant authorities will attempt to complete the establishment of the fund in the first half of 2005.

In the preliminary period of Securities Investor Indemnity Fund, it is foreseen that financing from the Central Bank of China may be the main source of funding. Other sources if funding could include the MOF.

Although full details of the Investor Indemnity Fund have not yet been released, it is understood that the fund will be based upon similar principles to the newly established Insurance Indemnity Fund. The Insurance Indemnity Fund system, which came into force on January 1, 2005, utilizes various relief measures, including a combination of proportional compensatory limits and absolute compensatory limits. For example, the relief limit for a non-life insurance policy is RMB50,000. For losses within RMB50,000, 100% indemnity is provided; for the portion exceeding RMB50,000, individuals and institutions shall be indemnified up to 90% and 80% respectively.

In addition to the establishment of the Insurance Indemnity Fund and the Securities Investor Indemnity Fund, efforts are being made to accelerate the establishment of the Futures Market Investor Indemnity Fund. It is also expected that a risk reserves system for fund management companies and a deposits insurance system will also be established.

### CSRC to resume review of IPO applications

The China Securities Regulatory Commission (CSRC) has declared that it has resumed the examination and approval of new IPO applications as of January 14, 2005. The new IPO pricing system, which requires IPO applicants to inquire about share prices among institutional investors, will also come into effect as of the same date. Huadian Power International Corporation will be the first company to make an initial public offering in 2005. China International Capital Corporation Ltd will act as lead underwriter on the IPO.

### SAFE approves overseas investment quota for Ping An Insurance

The State Administration of Foreign Exchange (SAFE) has approved a US$1.75 billion overseas investment quota for Ping An Insurance Company (Group) of China. It is the first overseas investment quota granted by SAFE to a Chinese insurance company under the *Provisional methods for overseas investment of insurance foreign exchange*. The rules were issued in August 2004 to allow insurance companies to invest foreign currency overseas.

Chinese insurers held more than US$10 billion worth of foreign exchange as at the end of October 2004, mainly as a result of the overseas listings of PICC, China Life and Ping An. The US$10 billion also includes capital and working capital of foreign-funded insurance companies, foreign-owned stakes in domestically owned insurance companies and foreign exchange assets accumulated from foreign-currency insurance business.

## Corporate & Commercial

### CAS release trial guide for corporate valuations

The China Appraisal Society (CAS) has released the *Trial Guide for Corporate Valuations*. This follows the adoption by the Ministry of Finance of the *Asset Appraisal Rules - Basic Rules and the Asset Appraisal Professional Ethics Rules - Basic Rules* in 2004.

The *Trial Guide for Corporate Valuations*, which examines the current status and existing issues of the Chinese valuation industry and refers to International Appraisal Standards and appraisal theories and practices in the US and Europe, sets out some basic requirements for corporate valuations, valuation requirements, valuation methods and valuation disclosure.

### CAAC issues update rules for establishment of public air carriers

The Civil Aviation Administration of China (CAAC) has released updated *Rules for Operating Licences of Public Air Carriers*, which came into force on January 15, 2005. Under the new Rules, any enterprise meeting specific requirements, regardless of whether they are private enterprises or foreign-funded enterprises, may apply to set up public air carriers.

The new Rules apply the same qualification requirements for both private investors and state-owned investors seeking to establish public aviation transportation enterprises. No limitations will be imposed on private investors wishing to invest in public aviation transportation enterprises.

The establishment of a public aviation transportation enterprise must meet the following requirements:

* The enterprise must have at least three civil aircrafts which are purchased or leased and meet specified requirements;
* The principal officers of the enterprise must have the ability to manage a public aviation transportation enterprise and the legal representative of the enterprise must be of Chinese nationality;
* In order to prevent monopolization, certain enterprises or institutions, such as civilian airports, which may distort competition in the aviation transportation market, are not permitted to independently establish or illegally participate in establishing public aviation transportation enterprises;
* If foreign investors wish to invest in a public aviation transportation enterprise, the majority shares of the enterprise must be held by the State and the foreign holding may not exceed 25%.

It is understood that the CAAC approved the establishment of five airline companies in 2004: Jade Cargo International Company Limited, United Eagle Airlines, Huaxia Airlines Service Co., Ltd, Spring Airlines and Okay Airways Co., Ltd.

### New accounting rules come into force

On January 1, 2005, three new accounting systems, the *Small Business Accounting System*, the *Non-governmental Non-profit Organization Accounting System* and the *Village Collective Economic Organization Accounting System*, came into force.

The *Small Business Accounting System* applies to enterprises established within China that do not derive funding from overseas, and which operate on a relatively small scale. Specifically, these enterprises are small-sized enterprises which privately issue stocks or bonds and meet the corresponding definition in the *Provisional Rule for SMEs Criteria* formulated in 2003, excluding individual-funded and/or partnership type small businesses.

The *Small Business Accounting System* is a simplified version of the current *Enterprise Accounting System* with various deletions and modifications relating to preparation for asset reduction, valuation of long-term investments, valuation of borrowing costs, financed and leased fixed assets and financial statements.

The *Non-governmental Non-profit Organization Accounting System* applies to various non-governmental non-profit organizations established in China, including community organizations, foundations and private non-commercial institutions. These non-profit organizations must meet the following three requirements:

* They may not operate for the purpose of generating profits;
* Any institution or individual shall not, due to its contribution to a non-profit organization, have ownership of the organization and any balance of the organization shall not be distributed to its contributors;
* Once a non-profit organization goes into liquidation, the remaining property after liquidation must continue to be used for social benefits according to the relevant rules.

The *Village Collective Economic Organization Accounting System* applies to community-based collective economic organizations and must be implemented by village committees acting on behalf of corresponding village collective economic organizations.

### MOC issues new export and import licensing rules

The Ministry of Commerce (MOC) has issued three new regulations governing commodity export and import licences, as follows:

* *Measures for Administration of Commodity Export Licenses*;
* *Measures for Administration of Commodity Import Licenses*;
* *Measures for Administration of Automatic Import Licenses for Commodities*.

The three Measures came into force on January 1, 2005.

The *Measures for Administration of Commodity Export Licenses* provide that China shall implement a centralized commodity export licensing system within set quotas. The MOC shall, together with the Customs General Administration (CGA), release the *Catalogue of Commodities Subject to Export Licensing Administration*. The export license includes the export quota license and export license. Foreign trade operators must apply for the export license from issuing authorities nominated under the relevant regulations, prior to exporting commodities subject to the export licence administration. The export quota is valid up to December 31 of the year in question.

The *Measures for Administration of Commodity Import Licenses* provides that China shall implement a centralized commodity import license system with set quotas. The MOC, together with the CGA, will issue the *List of Commodities Subject to Import License Administration*. All foreign trade operators importing commodities subject to import license administration must apply for the import license with the issuing authorities nominated under the relevant regulations. The validity period of an import license is one year.

The *Measures for Administration of Automatic Import Licenses for Commodities* provides that the MOC shall implement an automatic license administration for a portion of imports and shall, at least 21 days prior to the implementation, release the *List of Commodities Subject to Automatic Import License Administration*.

### MOF and MOC release circular on discounts for loans on contracted projects

The MOF and the MOC have released a circular on *Issues Related to Financial Discounts for Loans on Contracted Projects with Foreign Countries* in 2004. The circular specifies the conditions to be met by enterprises and projects applying for interest discounts, application materials and procedures and discount standards. Local enterprises must submit applications to the provincial finance and commerce authorities in the enterprises' place of business. The provincial authorities will review the applications on a preliminary basis and submit the relevant findings to the MOF and MOC by no later than March 31, 2005. The MOF and the MOC will jointly instruct subordinate departments to approve the respective discount applications. The MOC will pay the discount funds to enterprises within 15 days of approving the relevant applications.

## Insurance

### CIRC releases measures for administration of Insurance Indemnity Fund

The China Insurance Regulatory Commission (CIRC) has released the *Measures for Administration of the Insurance Guarantee Fund*, which came into force on January 1, 2005.

Under the Measures, an Insurance Indemnity Fund is to be formed by way of contributions made by insurance companies, and will be used to indemnify parties such as policyholders or policy transferees in the event of the discontinuance or insolvency of an insurance company.

The fund comprises both a Property Insurance Company Indemnity Fund and a Life Insurance Company Indemnity Fund. The property insurance fund will be financed by contributions made by property insurance companies, all-risks reinsurance companies and property reinsurance companies. The life insurance fund will be financed by contributions made by life insurance companies, health insurance companies and life reinsurance companies.

The Measures provide that insurance companies must contribute to the fund in the following proportions:

* For property insurance, casualty accident insurance and short-term health insurance: 1% of retention premium;
* For long-term life insurance and long-term health insurance with guaranteed interest rate: 0.15% of retention premium;
* For long-term life insurance without guaranteed interest rate: 0.05% of retention premium.

The Measures provide that Insurance Indemnity funds may only be invested in bank deposits and government bonds, and other investments specified by the CIRC. Funds may not be invested in equities, real estate or other kinds of industrial activities.

The Measures provide that if an insurance company is discontinued or becomes insolvent, and its liquidated property does not fully cover policy interest repayments, the Insurance Indemnity Fund shall indemnify policyholders of non-life insurance contracts according to the following rules:

* Policyholders whose loss does not exceed RMB50,000 will be indemnified in full;
* If the policyholder is an individual, for the part of his loss in excess of RMB50,000, the fund shall indemnify up to 90%;
* If the policyholder is an institution, for the part of its loss in excess of RMB50,000, the fund shall indemnify up to 80%.

The Measures stipulate that insurance companies shall contribute 50% of the Insurance Indemnity Fund to the special account for the fund opened by the CIRC within 3 months after the date of implementation of the Measures and pay off the remaining contribution within one year after the implementation of the Measures.

### CIRC releases circular on investing in subordinated fixed term debt

The CIRC has released a *Circular on Secondary Fixed Term Debt of Insurance Companies and Investment Insurance Companies Affiliated to Insurance Assets Management Companies*. In relation to subordinated fixed term debt of insurance companies and investment insurance companies affiliated to insurance assets management companies, the Circular provides as follows:

* Subordinated debt of insurance companies refers to subordinated fixed term debt which has been approved by the CIRC and meets the provisions of the *Provisional Measures Governing Secondary Fixed Term Debt of Insurance Companies*;
* Insurance companies with eligible investor qualifications must invest in secondary debt according to the specified proportions;
* The balance of invested secondary debt shall not exceed 20% of the net assets of the company at the end of the last month calculated on the basis of cost price;
* The accumulation of investment in secondary debt issued by an insurance company shall not exceed 4% of the net assets of the investor company at the end of the last month;
* The percentage of investment in secondary debt in one period shall not exceed 20% of the quantity of the secondary debt issued in that period.

Investment in secondary debt must be conducted by an insurance company's head office. Branches of insurance companies may not invest in secondary debt. However, foreign-funded insurance companies' first-level branches in China may invest in secondary debt issued in the Chinese territory according to the Circular.

## Foreign Investment

### MOC Further Regulates Foreign Investment in Road Transportation

The Ministry of Communications (MOC) has released the *Rules for Administration of Foreign Investment in Road Transportation (Supplementary Rules II)*. Based on the *Rules for Administration of Investment in Road Transportation Industry by Foreign Investors*, the new Rules include the following additional provisions:

* Enterprises, other economic organizations or individuals of WTO members will be allowed to establish wholly-owned road transportation enterprises within the Chinese territory and to engage in road cargo transportation, road cargo transportation terminal operations and motor vehicle maintenance;
* From January 1, 2005, passenger transportation companies specifically engaged in bus transportation in Hong Kong and Macao and non-specially operated bus companies engaging in Guangdong-Hong Kong or Guangdong-Macao "straight-through" passenger transportation will be permitted to establish joint ventures in Guangdong, Guangxi, Hunan, Fujian, Jiangxi, Yunnan, Guizhou and Sichuan provinces and to engage in "straight-through" road passenger transportation between Hong Kong or Macao and the aforesaid nine provinces;
* Passenger transportation will be allowed to engage in bus transportation in Hong Kong and Macao to set up individually funded enterprises in municipal cities in the Mainland and to engage in bus and taxi passenger transportation.

## Taxation

### Reductions on capital market business taxes

The MOF and the State Administration of Taxation (SAT) have jointly released a *Circular on Taxation on the Relevant Business Taxes in Capital Markets*. The Circular specifies that as of January 1, 2005, the relevant business taxes of stock exchanges, futures exchanges, securities companies and futures brokerage companies shall be reduced.

Currently, financial institutions operating funds collection and payment business must pay business tax at the rate of 5%. According to the Circular, certain securities transaction fees may be offset against business taxes as follows:

* Securities transaction supervision fees collected by the Shanghai Stock Exchange and the Shenzhen Stock Exchange may be deducted from the turnover upon which business tax is calculated;
* Futures market supervision fee collected by the two stock exchanges and the Dalian Commodities Exchange may be deducted from the turnover upon which business tax is calculated;
* The following three types of fees which securities companies collect as intermediaries may be deducted from the turnover upon which business tax is calculated:
  1. securities transaction supervision expenses collected for stock exchanges,
  2. stock exchanges' handling expenses collected as a result of trading securities as intermediary and
  3. shareholder account opening fees (including A shares and B shares), specially transferred stock account opening fees, account transfer fees, B Share settlement fees and transfer custody fees collected for CSDCC;
* Commissions collected by futures brokerage companies for futures exchanges may be deducted from the turnover upon which business tax is calculated.

It is expected that similar measures relating to stamp duty on securities transactions will also be adopted soon.

### SAT announces bumper tax receipts in 2004

Mr. Xie Xuren, the director of the SAT, announced at a press conference held by the State Council Information Office that tax receipts amounted to RMB2,571.8 billion in 2004, representing a year-on-year increase of 25.7%. Mr. Wang Li, deputy director of the SAT, also announced that following the introduction of measures to strengthen collection of individual income tax on foreigners and Hong Kong and Macao citizens, additional taxes of RMB0.7 billion had been collected.

In March 2004, the SAT printed and issued the *Circular on Strengthening Collection of Individual Income Tax on Foreigners*, which provided that foreigners and Hong Kong and Macao citizens paying overdue taxes incurred in the Mainland would incur a surcharge on the overdue tax payment but would escape further punishment. Many foreigners and Hong Kong and Macao individuals in the mainland took advantage of the tax "amnesty" to pay overdue individual income taxes.

## Capital Markets

### Rules on debt-for-stock swaps

The State Council has forwarded the *Opinion on advancing and regulating debt-for-stock swap of state-owned enterprises* to the Ministry of Finance (MOF), the State-owned Assets Supervision and Administration Commission (SASAC) and the China Banking Regulatory Commission (CBRC). The Opinion provides that debt for stock swaps shall be subject to approval by MOF.

According to the Opinion, companies that are qualified for debt-for-stock swaps and whose debt-for-stock agreements and contracts were approved by the State Council before June 30, 2004 must complete registration of new companies prior to March 31, 2005. Companies whose debt-for-stock arrangements were approved after June 30, 2004 should complete registration of new companies within nine months. Failure to register the new companies will result in the automatic termination of the debt-for-stock swap.

In general, financial and asset management companies may openly transfer stakes in new companies to various investors at home and abroad in accordance with commercial principles. The transfer of stock rights of listed companies shall be subject to approval by the Ministry of Finance. Where purchasers buy stock options through bank financing, the financing banks must strictly abide by the loan examination and approval regulations to prevent new risks from arising.

Shareholders of new companies must actively advance and improve corporate governance measures. The new companies must be independent of the original state-owned entity in terms of organization, personnel, business operations and finance. Separate accounts must also be maintained. Commercial activities between new companies and original state owners must be conducted on an arm's-length basis. Financial and asset management companies should also provide consulting, asset and project assessment services and other services to new companies on commercial terms.

### New due diligence requirements for stock swaps of delisted companies

The Securities Association of China has released the *Provisional Guidelines for lead securities companies to conduct due diligence investigations*, which requires lead securities companies of delisted companies to form special project teams to conduct due diligence investigations on companies that plan to swap stocks with delisted companies. The scope of the investigation must include the companies' ability to operate as a going concern, financial status, soundness of accounting policies, corporate governance structure, compliance and other areas.

The Guidelines also provide that the project teams must consist of qualified staff of lead securities companies, including at least one qualified Certified Public Accountant, one qualified lawyer and one qualified industrial analyst. The above persons may not participate in more than two projects at the same time. The project team must release a due diligence report after completing the investigation. The report must include independent opinions on a number of matters, including corporate independence, corporate governance structure, legal risks and financial risks.

### CSDCC releases guidelines on portfolio asset management

The China Securities Depository and Clearing Corporation (CSDCC) has released *Guidelines for Depository and Clearing Business of Securities Companies' Portfolio Assets Management*.

The Guidelines provide that trustees of portfolio asset management plans must apply directly to branches of the CSDCC to open special accounts. In the event that portfolio asset management plans are terminated or dissolved, securities companies must cash assets in the special securities accounts, and entrust trustees to cancel the accounts.

Securities companies or trustees may conduct clearing of portfolio asset management business. If securities companies perform clearing, they must be approved by the CSRC. Trustees performing clearing must also be approved.

The CSDCC shall regard any overdraft incurred by a clearing participant's cash reserve account, or any overselling of the securities accounts of portfolio asset management plans as a breach of the stock acquisition and acceptance contract between the relevant clearing participant and the CSDCC, and the CSDCC will implement corresponding risk prevention measures.

### 116 foreign bank branches permitted to provide Renminbi services

According to recent data released by the CBRC, as of January 14, 2005, a total of 116 foreign bank branches have been permitted to provide renminbi services in China.

On December 1, 2004, the CBRC announced that China would open up renminbi business to foreign banks in Kunming, Beijing and Xiamen. Foreign banks are also permitted to provide renminbi services in Xi'an and Shenyang. Since that date, the CBRC has received applications to provide renminbi services from 14 foreign bank branches and one head office of a foreign bank, of which 10 are in Beijing, 4 Xiamen and 1 Xi'an. The CBRC has already approved 8 applications, including:

* Hong Kong and Shanghai Banking Corporation Limited Beijing Branch and Xiamen Branch;
* Standard Chartered Corporation Limited Beijing Branch and Xiamen Branch;
* Bank of East Asia Corporation Limited Xi'an Branch and Xiamen Branch;
* Bank of Tokyo-Mitsubishi Ltd. Beijing Branch;
* City Bank Corporation Limited Beijing Branch.

### CBRC releases rules on disciplinary measures

The CBRC has released the *Administrative Disciplinary Measures*, which will come into force on February 1, 2005. The Measures aim to regulate disciplinary actions taken by the CBRC and its appointed institutions.

The types of disciplinary actions that may be taken by the CSRC include warnings, fines, expropriation of illegal gains, ordering business suspension and reorganization, revocation of financial licences, and cancellation of eligibility qualifications of directors and senior managers.

Prior to imposing significant disciplinary measures (such as the imposition of large fines, the suspension of businesses or the revocation of licences) the CBRC (or its appointed institutions) shall inform the parties concerned of their right to request an evidentiary hearing.

The *Administrative Review Measures* will be implemented in conjunction with the *Administrative Disciplinary Measures*. The Review Measures provide that banking, financial and other institutions and individuals may submit adminstrative review applications to the relevant authorities if they are of the view that the CBRC has exceeded its powers or infringed legal rights and interests.

### CBRC adopts rules on internal controls and risk management systems of commercial banks

The CBRC has adopted the *Provisional Measures for Assessment of Commercial Banks' Internal Controls and the Guide on Market Risk Management of Commercial Banks*, which will come into force on February 1 and March 1, 2005 respectively.

The Provisional Measures on internal control establish a framework to assess the efficiency of the internal control systems of commercial banks, based on the Framework for Internal Control Systems in Banking Organisations designed by the Basle Committee.

The CBRC will assess the business activities, management and support systems of commercial banks according to the new framework. Measures to deal with inadequacies in internal control systems, including business suspensions and disqualification of responsible officers, will also be adopted.

The Guide on market risk management of commercial banks is also based on risk management guidelines issued by the Basle Committee. The Guide provides that an effective risk management system should have the following four basic elements:

* Effective supervision of directors and senior management;
* Adequate risk management policies and procedures;
* Effective risk identification, measuring, monitoring and control procedures;
* Adequate internal control and independent external audit.

Domestic commercial banks should implement the required systems and controls within the next three to four years. Within the transitional phase, commercial banks should establish and improve their market risk management systems as soon as possible in accordance with the requirements of the Guide.

## Bonds

### MOF approves foreign-funded institutions to issue RMB bonds

The MOF has approved the Asian Development Bank, International Finance Corporation (affiliated to the World Bank), and the Japan Bank for International Cooperation to issue RMB 4 billion in bonds within the Chinese territory. This represents the first time that foreign-funded institutions have been approved to issue renminbi bonds in the Mainland. The renminbi bonds will be issued mainly to institutional investors.

## Other

### Rules on copyright collective administration to come into force in March

The recently adopted *Rules on Collective Administration of Copyright* will come into force on March 1, 2005. Under the Rules, upon being granted permission by a copyright owner, a copyright collective administration organization may exercise the rights held by the copyright owner and may conduct the following activities:

* Execute contracts with either the user or holder of the copyright or related rights;
* Charge users for using the copyright;
* Pay charges for use to the copyright owner;
* Commence litigation or request arbitration regarding the copyright or related rights.

Rights that the copyright owner may have difficulty in enforcing, such as performance rights, screening rights, broadcasting rights, leasing, the right to transmit information on the internet and the right of reproduction, may be administrated collectively by the copyright collective administration organization.

The Rules also include provisions on the establishment and supervision of copyright collective administration organizations.

The Rules provide that the copyright owner may execute a written contract on copyright collective administration with the copyright collective administration organization, accrediting the organization to administer the copyright or rights related thereto which the copyright owner shall enjoy according to the relevant laws. Foreigner companies may, through services provided by overseas counterparts which have executed mutual representative agreements with China's copyright collective administration organizations, accredit the latter to administrate the copyright or related rights.

### Bank of China increases exit and entry domestic currency limits

The People's Bank of China has adjusted the exit and entry domestic currency limits. As of January 1, 2005, the maximum renminbi amount that a Chinese citizen or a foreigner exiting or entering China may carry has been increased from RMB6,000 to RMB20,000.

### Law on polluting wastes adopted

China has recently adopted an amended *Law on Preventing Solid Wastes from Polluting the Environment*, will come into force on April 1, 2005.

The Law provides that product manufacturers, importers, distributors and users shall be responsible for preventing solid wastes caused by the products from polluting the environment. The Law also incorporates provisions relating to construction of dangerous waste disposal facilities, limiting storage time, emergency response measures and the establishment of a maintenance fund. In order to facilitate victims of pollution in taking action in environmental pollution compensation cases, the Law includes provisions reversing the traditional burden of proof, use of litigation proxies and the reduction of legal expenses.

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