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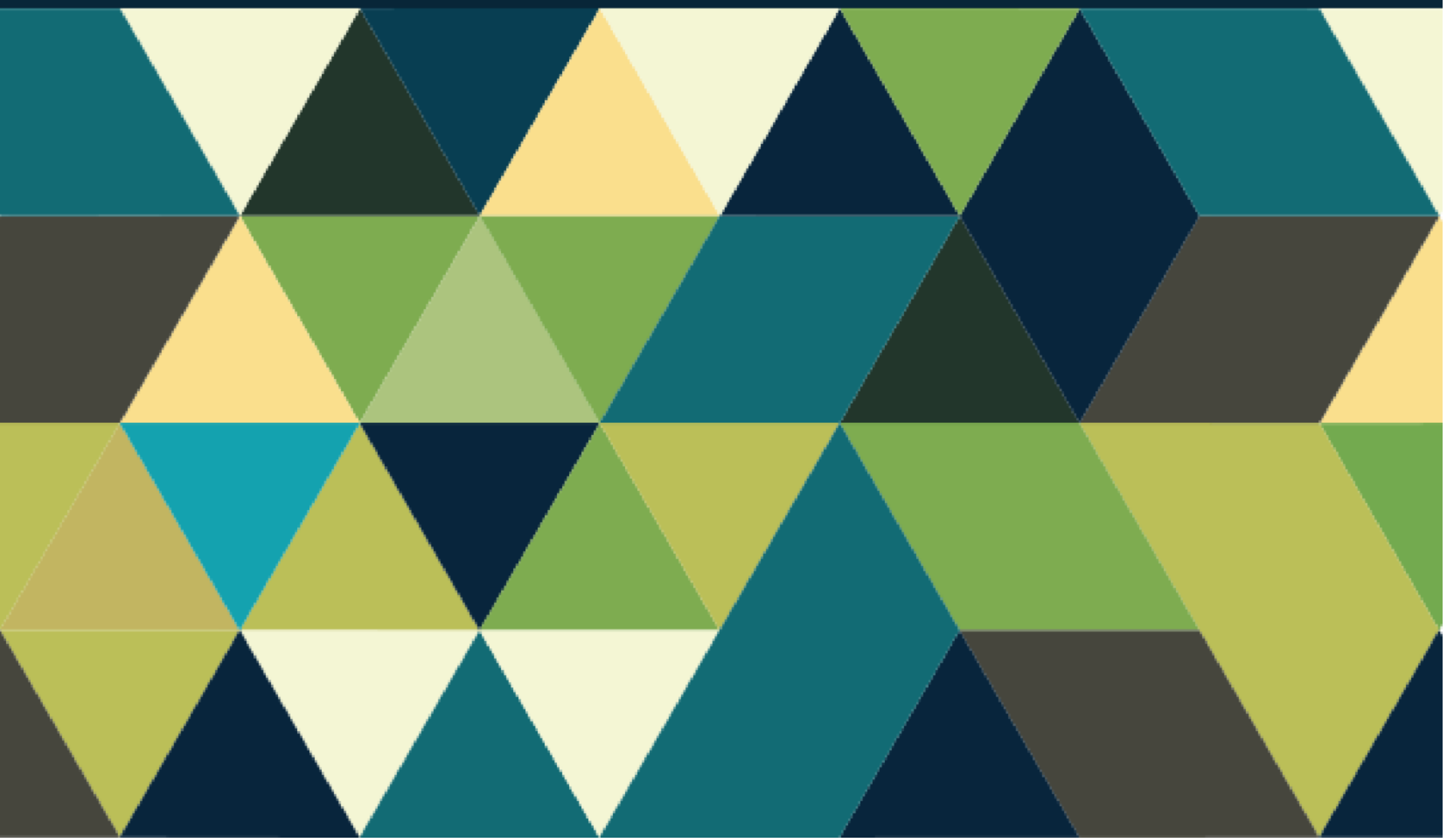

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专题文章

外商在华投资电子商务放松限制

Restrictions Relaxed on Foreign Invested E-Commerce Companies in China

Hari Sarang Nathan 熊佳佳

Recently, China's e-commerce industry has begun growing at an exceedingly fast pace and the Chinese government it is embracing it. One of the goals listed in China's 12th Five Year Plan (2011 – 2015) was to develop e-business and e-commerce. The Ministry of Industry and Information Technology's ("MIIT") detailed five year plan included plans to boost e-commerce by improving the legal regime around it. Earlier this year the MIIT announced that e-commerce companies in the Shanghai Free Trade Zone would no longer be subject to restrictions on foreign ownership[1]. More recently, on March 12, 2015 the State Council approved the creation of a cross-border e-commerce pilot zone in Hangzhou, the capital of Zhejiang and home to Chinese e-commerce giant Alibaba.

On March 10, 2015 the National Development and Reform Commission ("NDRC") and Ministry of Commerce ("MOFCOM") issued "Catalogue for the Guidance of Foreign Investment Industries (Revised in 2015)"[2] ("2015 Catalogue") through which they announced numerous changes that, among other things, remove significant restrictions on foreign investment in the e-commerce industry. This change, which comes into force on April 10, 2015, removes the restriction that e-commerce enterprises must be at least half Chinese owned. In addition, depending on how approval authorities interpret the amendment, approval of foreign invested e-commerce enterprises might also be significantly easier.

Although there is currently no official definition for e-commerce (electronic commerce, also called "EC") in Chinese law it is usually defined narrowly as "trade and business activities, both local

[1]《关于在中国(上海)自由贸易试验区放开在线数据处理与交易处理业务(也称"经营类电子商务")外资股权比例限制的通告》Published on January 13th 2015.

[2] 外商投资产业指导目录(2015 年修订)

and global, conducted through the internet and other electronic means including, but not limited to, telephone, television, fax, and mobile technology.

This paper describes the certain changes in the new Catalogue, raises an important interpretive difficulty with them, and discusses the effects of these changes.

I. The Amendment of the Catalogue

The amendment to the Catalogue was a significant change to the previous version promulgated in 2011 ("**2011 Catalogue**") and affected a number of industries. In general (but not entirely) the amendment liberalized restrictions on foreign investment. This section gives an overview of the catalogue and describes the parts of the amendment relevant to e-commerce.

The Catalogue is a key document in the Chinese foreign investment legal regime. It categorizes all industries into one of four categories: (1) encouraged; (2) permitted; (3) restricted; and (4) prohibited. The catalogue explicitly lists industries in the encouraged, restricted, and prohibited categories. Industries not listed default to the permitted category. The category an industry falls into determines what hurdles, in terms of filing and approvals, must be cleared in order for a foreign party to invest in it. In addition, the Catalogue will state if foreign investment in a certain industry is limited in other ways such as by which type of entity can invest in it, what percentage (if any) must be held by Chinese parties, etc…

As stated above, the amendment affected many industries. As relevant to e-commerce, however, the amendment is as follows. The 2011 Catalogue listed the following in the ***restricted*** category:

> Telecommunication companies: value-added telecommunications services (with the proportion of foreign capital not exceeding 50%), basic telecommunication services (with the proportion of foreign investment not exceeding 49%)

The 2015 Catalogue also lists telecommunication companies as restricted, however, it makes an exception for e-commerce:

> Telecommunications companies: value-added telecommunications services (with the proportion of foreign investment not exceeding 50%, ***excluding e-commerce***); basic telecommunications services (with the proportion of foreign investment not exceeding 49%)

(emphasis added).

II. Interpreting The Amendment

The amendment discussed above leads to an interpretive question. On the one hand, it is clear that e-commerce commerce enterprises are no longer subject to the restriction that they must be 50% foreign owned. On the other hand, it is unclear if the e-commerce industry is still a restricted industry.

Under one interpretation (the more liberal interpretation) the words "excluding e-commerce" modifies "value-added telecommunications services." Under this interpretation, the e-commerce industry is removed from the restricted category (and because it is not listed anywhere else, defaults to the permitted category) and e-commerce industries need no longer be 50% or more Chinese owned.

In contrast, under another interpretation, the more conservative interpretation, the words "excluding e-commerce" modifies "with the proportion of foreign investment not exceeding 50%." Under this interpretation, e-commerce is still a restricted industry but e-commerce industries need no longer be 50% or more Chinese owned.

As of the time when this paper is published, no clarifying documents have been promulgated. As such, it is unclear which interpretation will be adopted by the approval agencies.

III. Company Approval

If the more liberal interpretation discussed above is correct i.e. if e-commerce is no longer in the restricted category, this will make it significantly easier to obtain approval for an e-commerce company. Establishing any company in China requires approval from MOFCOM or a local commerce authority. Obtaining approval from a local authority is both easier and faster. As per the *Circular of the Ministry of Commerce on Delegating Approval Authority over Foreign Investment to Local Counterparts*,[3] approval for the establishment of a company is delegated to the lower local counterparts if the total investment amount is below the following thresholds:

[3]《商务部关于下放外商投资审批权限有关问题的通知》商资发[2010]209 号

Category	Threshold
Encouraged	USD 300 million
Permitted	USD 300 million
Restricted	USD 50 million

If the e-commerce industry has been moved from the restricted to the permitted category, e-commerce companies of up to USD 300 million can, as of April 10, be established with local approval.

Note that the exact level of authority from which approval will be needed will depend on the way in which each province, autonomous region, and city directly under the central government delegates the authority granted to it.

IV. Restrictions on Ownership Removed

Under the 2011 Catalogue, e-commerce companies could not be more than 50% foreign owned. As such, they were limited to Equity Joint Ventures (EJVs) and Cooperative Joint Ventures (CJVs). Now that the cap on foreign ownership has been removed, foreign investors can own up to 100% of an e-commerce company. This section discusses some of the results that flow from this change.

Flexible Ownership and Profit Sharing

The most obvious benefit of this change is that enterprises are now free to choose their ownership structure in a way that makes the most sense for the company and the investors. This also leads to more flexibility with respect to profit sharing. Although e-commerce enterprises set up prior to the amendment could use the CJV form which allowed for some flexibility in profit sharing schemes, there are still limits as to what can be done with a CJV. The removal of this restriction in the 2015 Catalogue will give investors more options.

Wholly Foreign Owned E-Commerce Enterprises

Under the 2015 Catalogue, e-commerce companies can be Wholly Foreign-Owned Enterprises (WFOEs). WFOEs offer foreign investors a number of advantages, such as:

- The foreign partner(s) enjoy full managerial and operational control
- Greater flexibility with respect to the board of directors and management body
- No need to share profits with a local partner
- The intellectual property is under the control of the foreign investor

These advantages are significant and as a result WFOEs are, by an extremely wide margin, the preferred form of Foreign Invested Enterprise (“FIE”).

In particular, the protection of intellectual property will be of great interest to foreign investors in e-commerce as intellectual property with respect to code is notoriously hard to enforce. As a result, an e-commerce company with an innovative algorithm (for example, for recommending purchases) or website design might find it easier to protect these if there is no need for a local partner.

It is worth noting that a local partner can often bring advantages to a company such as local knowledge and experience in dealing with local employees. Thus, even though a WFOE is now possible, a company should carefully consider advantages and disadvantages of having a local partner.

Use of the VIE Stucture

Even prior to the 2015 Catalogue, foreign investors have wanted to invest in industries forbidden to them or be able to realize the entirety of the profits of companies where this was not possible. Investors often utilize the Variable Interest Equity (“VIE”) structure to do.

Briefly, the VIE structure generally has an offshore company creating a WFOE which has contractual arrangements (in the form of consulting fees, technical assistance, etc…) with PRC individual(s) and/or a domestic company. These contractual arrangements are designed such that the WFOE (and therefore the offshore company) is able to effectively realize (often imperfectly)

all of the profits of the PRC individual(s)/company. This allows foreign investors to, for example, effectively invest in prohibited industries by using a company without any foreign investors as an intermediary.

However, under the 2015 Catalogue, the VIE structure need no longer be used as a way to "work around" Chinese law. Investors can simply setup a WFOE, or a joint-venture with whatever proportion of share holdings they desire, and run their business in this way avoiding unnecessarily complex contractual arrangements and the related overhead costs. Those investors who wish to use a VIE for other purposes, such as those who wish to engage in an offshore IPO, can continue to do so without risking the ire of the Chinese government.

V. Other Issues

Despite the relaxation of restrictions on foreign investment in e-commerce, there are other hurdles and difficulties that must be considered:

- Because e-commerce involves telecommunications, companies may need to obtain certain licenses with the government before starting their business.[4]

- Some other related industries such as online publishing services and online audio-visual program services, which are not considered e-commerce, are still in the forbidden category.

In addition to the amendment discussed above, two other related amendments are worth noting:

- The online shopping industry, a sub-industry of e-commerce, was removed from the restricted category and is now a permitted industry.

- Development and application of IoT (internet of things) technology has been moved to the encouraged category.

VI. Conclusion

Although a small change in the text of Catalogue, the change discussed here has significant

[4] More information can be found in our article entitled *Approval and Supervision Procedures of Foreign Investment in the Telecommunications Industry* available at: http://chancebridge.com/english/cbw/wz/ (English) and http://www.chancebridge.com/cbw/wz/ (Chinese).

ramifications for existing foreign owned e-commerce enterprises as well as foreign individuals and companies considering starting an e-commerce enterprise in China. The (potentially) easier registration process and removal of ownership restrictions make foreign investment in an e-commerce enterprise a more attractive option than it was before.

2014 新规对外商投资的影响

2014 Changes Affecting Foreign Investors

Hari Sarang Nathan　熊佳佳

2014 was a year of significant change in Chinese law and policy and foreign direct investment was strongly affected by many of these changes. This paper summarizes a number of the changes that took place in 2014 in Chinese law that affect current and future investments.

I. Project Approval

On June 17, 2014 the *Administrative Measures for Approval and Record-filing of Foreign Investment Projects* (外商投资项目核准和备案管理办法) ("Project Approval Measures") came into force and overhauled project approval in China. Project approval is a step prior to filing for approval for the establishment of a company that needs to be completed for all projects that involve fixed assets. Prior to the *Project Approval Measures*, almost all such projects had to file for approval with either the National Development and Reform Commission ("NDRC") or a provincial/local Development and Reform Commission ("DRC"). The *Project Approval Measures*, create a new system wherein only projects above a certain threshold (in terms of Total Investment Amount) need such approval, all other projects need only be filed for the record with the local DRC.　Four months later, on October 31, 2014, the *Catalogue of Investment Projects Subject to the Approval of the Government (2014 Version)* (国务院关于发布政府核准的投资项目目录（2014年本）) ("Project Approval Catalogue") was updated and the thresholds initially set were increased. The specific thresholds depend on the industry of the project and how that industry is categorized in the *Catalogue of Industries for Guiding Foreign Investment (Revised in 2011)* (外商投资产业指

导目录（2011 年修订））(“Foreign Investment Guidance Catalogue”).[5] As of February 6, 2015 the current thresholds are:

Category	**Threshold**	**Requirement**
Encouraged	Total investment is USD 1 billion or more and requires Chinese party to have a controlling share.	Requires approval from the NDRC. Note that if the total investment is above USD 2 billion, record-filing with the State Council is also needed.
	Total investment is less than USD 1 billion but requires Chinese party to have a controlling share.	Requires approval from the local DRC.
	All other.	Record-filing with the local DRC.
Permitted	All	Record-filing with the local DRC.
Restricted	Total investment is USD 100 million or more (excluding real-estate projects).	Requires approval from the NDRC. Note that if the total investment is above USD 2 billion, record-filing with the State Council is also needed.
	Total investment is less than USD 100 million or the project is a real-estate project.	Requires approval from the provincial level DRC.

[5] There are four categories: (1) encourages; (2) permitted; (3) restricted; and (4) forbidden. Unless listed in a different category, all industries are, by default, in the permitted category. The categories generally determine at what level approvals are necessary and other restrictions on foreign investment.

II. Companies

Registered Capital

On March 1, 2014 the *Company Law of the People's Republic of China (Revised in 2013)* (中华人民共和国公司法(2013 年修订）) ("Company Law") came into force and dramatically changed the registered capital requirements for companies in China. At the time this law was promulgated (December 28, 2013), however, it was unclear if these changes would affect FIEs. However, amendments to the implementing regulations for EJVs,[6] CJVs,[7] and WFOEs[8] as well as the *Circular of the Ministry of Commerce on Improving Foreign Investment Review Administration* (商务部关于改进外资审核管理工作的通知) (promulgated on June 17, 2014 with immediate effect) clarified that FIEs would also benefit from the looser restrictions on registered capital. As such, both FIEs and domestically owned companies can benefit from the cancellation of:

- General minimum registered capital requirements
- A minimum percentage of the registered capital that must be paid in upon registration.
- A minimum percentage of the registered capital that must be paid in cash.
- A specified a term within which all registered capital must be paid in.
- A review of the registered capital to ensure it is paid in accordance with the articles of association.

However, there are four points worth noting:

1. The requirement for registered capital, capital payments, etc… agreed upon in the articles of association must still should be followed;
2. There registered capital is still printed on the business license and is often used by

[6] *Implementing Regulations of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (Revised in 2014)* (中华人民共和国中外合资经营企业法实施条例（2014 年修订）) (effective March 1, 2014).

[7] *Implementing Rules of the Law of People's Republic of China on Sino-Foreign Cooperative Joint Ventures (Revised in 2014)* (中华人民共和国中外合作经营企业法实施细则（2014 年修订）) (effective March 1, 2014).

[8] *Implementing Regulations of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (Revised in 2014)* (中华人民共和国外资企业法实施细则（2014 修订）（律商网整理）) (effective March 1, 2014).

companies in China as one factor in judging a company's strength;

3. In certain industries and for some bidding projects, a minimum amount of paid-in capital is required;

4. If other laws or regulations have registered capital or paid-in capital requirements for particular industries, types of companies, etc… these restrictions will still apply.

Cancellation of Annual Inspections

Previously all enterprises in China had to go through annual inspections from the enterprise registration organs. However, since February 7, 2014 the *Circular of the State Council on Printing and Issuing the Reform Proposals for the Registered Capital Registration System* (国务院关于印发注册资本登记制度改革方案的通知) came into force, China started to move to a system of "enterprise annual self reporting and publicity" administered by the State Administration For Industry & Commerce (SAIC) and the Local Administration For Industry & Commerce below it.

Under the new system, companies must file two types of reports: (1) annual reports; and (2) periodic reports within 20 days of certain information being generated (e.g. changes in capital contribution subscriptions, administrative penalties, etc…). These reports are submitted through an online system and they are available to everyone. The accuracy of the reports is enforced through random inspections (which can lead to more in-depth reviews if something is found to be amiss) as well as through social supervision. A failure to accurately report as required can lead to blacklisting of the company, administrative penalties, compensation to harmed parties, and possible criminal liability.

III. Environmental Law

On April 4, 2014 the Standing Committee passed Environmental Protection Law of the People's Republic of China (Revised in 2014) (中华人民共和国环境保护法(2014 年修订)) ("Environmental Protection Law") which came into force on January 1, 2015. This momentous law is a massive update of the two and half decade old 1989 Environmental Protection Law. The new law adds 23 articles including a new Chapter, number V, on "Information Disclosure and Public Participation" and creates a stronger system of environmental protection. It also potentially creates new opportunities for enterprises.

The Environmental Protection Law

- Clarifies when environmental impact assessments are needed and specifies the consequences of not obtaining one when it is required.
- Creates obligations of public disclosure for both enterprises and the government and creates a government maintained list of entities that violate environmental protection rules.
- Allows for public oversight by creating whistleblower protection and by allowing qualified social organizations to bring cases against polluters.
- Creates stricter penalties for non-compliance for government agencies, enterprises, and individuals responsible for pollution.
- Opens the door for incentives for environmentally responsible/friendly institutions.

IV. Labor

A. Work Safety Law

On December 1, 2014 the *Work Safety Law of the People's Republic of China (Revised 2014)* (中华人民共和国安全生产法（2014 修订）) ("Work Safety Law") came into force. It made the following changes:

- It consolidates the responsibility for worker safety with the enterprises and gave trade unions the right to opine on new work safety regulations. It also requires certain types of enterprises to have full-time work safety management personnel and encourages all production and operation entities to hire full-time work safety management personnel.
- It expands the scope of the object which the work safety regulatory departments and other departments responsible for the work safety shall seal up or detain.
- It increases penalties for non-compliance and by creating new fines and increasing old fines. It also stipulates that if the main person-in-charge is liable for any serious or especially serious work safety accidents, he or she shall never be the main person-in-charge of any production or operation entities in the industry. Finally, it creates a "blacklist

system” for work safety violations.

Foreigners in China For Short-Term Work Assignments

On November 6, 2014 four authorities promulgated the *Circular on Relevant Handling Procedures for Foreigners Entering China for the Accomplishment of Short-term Work Assignments (For Trial Implementation)* (外国人入境完成短期工作任务的相关办理程序（试行）) which came into force on January 1, 2015. It relates to foreigners in China for 90 days or less for technical, scientific research, management or guidance work; training at a sports institution in China; shooting a film; fashion shows; engaging in a foreign-related commercial performance; and other circumstances recognized by the relevant human resources and social security department. The circular emphasizes that those who do not carry out the proper formalities or do not engage in the work they were authorized can be punished by the public security organs.

V. Intellectual Property

A. New Trademark Law

On May 1, 2014 the *Trademark Law of the People's Republic of China (Revised in 2013)* (中华人民共和国商标法（2013 年修订）) (“Trademark Law”) came into force. This amendment has the following significant changes:

- It added provisions making it illegal for trademark agents to aid in trademark privacy;
- Sound marks can be registered;
- A trademark application can cover multiple classes of goods and services;
- Shorter timelines for trademark cases;
- Stronger protection for well-known marks;
- If an opposition to a trademark registration fails, the trademark can proceed immediately to registration instead of waiting for appeals in courts; and
- Increased fines for violations.

On the same day, the *Implementing Regulations of the Trademark Law of the People's Republic of China (Revised in 2014)* (中华人民共和国商标法实施条例（2014 年修订）) came into force which, among other things, clarified certain issues and dealt with the international registration of trademarks in accordance with the *Madrid Agreement Concerning the International Registration of Trademarks*. A number of other regulations have been put out dealing with various issues related to the Trademark Law.

Intellectual Property Courts

On August 31, 2014 the *Decision of the Standing Committee of the National People's Congress on the Establishment of Intellectual Property Courts in Beijing Municipality, Shanghai Municipality and Guangzhou City* (全国人民代表大会常务委员会关于在北京、上海、广州设立知识产权法院的决定) which established intellectual property (IP) courts in Beijing, Shanghai and Guangzhou. These courts have jurisdiction over first instance of civil and administrative cases with respect to intellectual property with high level of expertise and technology such as patents, new varieties of plants, integrated circuit layout design, and technology secrets. The intellectual property courts in Beijing have jurisdiction over first instance administrative cases with respect to authorization and confirmation of intellectual property rights against the adjudication or decision of the administrative department of the State Council. Appeals from these cases go through the regular court system.

VI. Conclusion

This paper has attempted to summarize the key changes in Chinese law that took place in 2014 that will affect foreign investors. Any such summary is necessarily incomplete and there are a multitude of other changes that affect foreign investors, especially with laws and regulations that affect specific sectors. Nonetheless, two trends can be seen in 2014 that can be expected to continue in 2015.

The first trend is a liberalization of the economy. As China's economy develops, barriers to conducting business are being lowered. This can be seen, for example, in both China's liberalization with respect to project approval and the Company Law. If this trend continues, national barriers to entry in China will continue to decrease. However, it should be noted that: (1) it is not always advisable to take full advantage of the liberalizations; and (2) local regulations may not be as liberal as the national laws.

The second trend, however, is increased penalties for violating laws that protect the public interest. This can be seen, for example, with respect to safety laws for labor, environmental protection, and annual reporting. Thus, even as China reduces barriers to business, it is increasing penalties for violations.

In summary, the general trend of Chinese policy is towards allowing more business but ensuring that the business is conducted responsibly.

中国外商投资探索“新大陆”

China Looks to a Brave New World of Foreign Investment

熊佳佳　Hari Sarang Nathan

On January 19, 2015 the Ministry of Commerce (“MOFCOM”) promulgated the *Law of the People's Republic of China on Foreign Investment (Draft for Comment)*[9] (“Draft”). The Draft, if enacted, would represent a major change in the way China regulates and views foreign investment. It redefines what types of enterprises are considered foreign invested enterprises (FIEs), treats different types of FIEs in the same way, treats FIEs mores similarly to the way purely domestic enterprises are treated, reduces barriers to entry for FIEs, increases post-entry obligations such as information reporting obligations (including increasing the punishment for violating such obligations), and clarifies the scope and procedure for the national security review.

I. The New Definition of FIE

Under the current regime, an enterprise is an FIE if it has an investor that is foreign.[10] This definition is purely a matter of form, one can determine if an enterprise is an FIE by looking at the investors and checking their nationality. However, under the draft the definition is based on “actual control.” An enterprise that is controlled by foreign investors is an FIE and an enterprise controlled by domestic investors is domestic. The impact of this new definition can be seen in the Drafts definition of control. The definition includes not just greenfield investments or creating a legal entity in China but also control via mergers and acquisitions, medium and long term financing, concessions (for the exploitation of natural resources, infrastructure construction, or operation), real property rights, contracts, trusts, etc… As such, the classification of an enterprise as a FIE or purely domestic requires looking into the actual workings of the enterprise to see who is in control.

[9] 《中华人民共和国外国投资法 （草案征求意见稿）》

[10] Under both the current regime and the Draft, investors from Hong Kong, Macau, and Taiwan are considered foreign.

There are a number of implications of this change. First, determining if an enterprise is an FIE or not will become more complicated. This is especially true of companies with complex holding structures. Second, the Draft explicitly states that it has extraterritorial effect i.e. transactions that are purely offshore might be deemed to be foreign investments if they transfer control from a domestic party to a foreign party. Third, certain uses of the Variable Interest Entity (VIE) structure might come under scrutiny. VIEs are used by some investors to indirectly invest, through contractual arrangements, in industries in which foreign investment is restricted or prohibited. Under the current regime, these enterprises are domestic because there is no foreign investor. However, under the Draft these would be FIEs since foreign parties would exert actual control over the enterprise.[11]

II. The Treatment of Different Corporate Forms

Under the current regime there are two broad ways in which different corporate forms are treated differently that affect foreign investment. The first is that FIEs are treated differently from purely domestic enterprises. The second is that different types of FIEs are treated differently. Both of these differences are a result of the structure of the legislation governing foreign investment in China. The three main types of FIEs (Equity Joint Ventures (EJVs), Contractual Joint Ventures (CJVs), and Wholly Foreign Owned Enterprises (WFOEs))[12] are each governed by a separate laws and implementing regulations. Issues not governed by these laws are governed by the Company Law.[13] This has led to inconsistency and confusion.

However, the Draft would greatly change both of these distinctions. With respect to different types of FIEs, the Draft makes no distinction. As such, under the Draft, the distinction between EJVs, CJVs, and WFOEs, so important under the current regime, would be largely eliminated. This should make it easier to ensure compliance with laws and regulations. Second, the draft would largely eliminate distinctions between FIEs and purely domestic enterprises. The Draft does this by adopting a “negative list” method similar to that in the Shanghai Free Trade Zone. Under this method, FIEs will not need any special approval or be required to file any additional information for the record unless they invest in an area on the negative list. The negative list will contain those industries where approval is needed for foreign investment and those industries in which foreign

[11] Note however, that as discussed below, the list of prohibited industries might well change.

[12] As well as other types of enterprises.

[13]《中华人民共和国公司法》（2013 年底修订）

investment is forbidden. Outside of these two categories of industries, FIEs would not need any approvals, licenses, etc… that are not also needed by purely domestic companies. This equivalent treatment, known as “national treatment” or “NT,” would bring China much more in line with international norms. Note, however, that the Draft does not specify what areas would be on the negative list; this list would likely be promulgated by the State Council and updated as needed.

III. Shift Towards Post-Establishment Reporting

Under the current regime, every foreign investment is subject to approval before an FIE can be established. In contrast, as stated above, with the exception of investments in areas on the negative list, under the Draft, FIEs will no longer be subject to special pre-establishment approvals. As such this represents a significant decrease in the costs of entering the Chinese market.

This change is complemented by the increase in post-establishment obligation. For example, the Draft requires the creation of an information reporting system for the required reports. The Draft lists three types of reports that all FIEs must file: (1) an investment implementation report; (2) an investment amendment reports (for certain major changes); and (3) an annual report. In addition, large companies (those with total assets, sales, or revenue above RMB 10 billion or own more than 10 subsidiary companies) must file a quarterly report.

These new reporting requirements come along with strict punishments. Not meeting the reporting requirements, concealing information, or providing false/misleading information can lead not only to penalties for both the company (administrative as well as criminal) but also criminal penalties for the person in charge.

IV. National Security Review

Under the current regime certain foreign investments are subject to national security review. However, the Draft makes some significant changes to the national security review. First, under the current regime, national security review is limited to investments in certain (unpublished) areas whereas under the Draft, national security review is necessary whenever a foreign investment will or is likely to harm national security. Unfortunately, this criteria is not explained in detail. Second, the factors to be considered and the procedures are specified in greater detail. Third, a national security decision cannot be challenged either through administrative means or through the courts.

V. Other Points

The Draft, if enacted, would revoke the specific laws governing EJVs, CJVs, and WFOEs and bring them all under a single regime. As such, those FIEs that exist at the time would need to make a number of changes. MOFCOM has suggested that, if the Draft is enacted, the organizational form and structure of previously established FIEs at the time should come into compliance with the Company Law within three years.

The Draft adds protection for foreign investors in the areas of levy, expropriation, state compensation, property transfer, transparency and intellectual property protection.

VI. Conclusion

Chinese foreign investment law has been cautiously moving in the direction of liberalization for quite a while. Although a significant change, the Draft, if enacted, would be a natural culmination of these efforts. That being said, the release of a draft for comment is just the first of many steps. There are still many opportunities for the law to be amended and, although a significant change in direction is unlikely, various changes are possible.

商务部更新经营者集中附加限制性条件

MOFCOM Updates the Procedures for Restrictive Conditions on Mergers

Hari Sarang Nathan

On December 4, 2014 the Ministry of Commerce ("MOFCOM") promulgated the *Provisions on Imposing Restrictive Conditions on the Concentration of Undertakings (for Trial Implementation)*[14] ("2014 Provisions") which came into force on January 5, 2015 replacing the *Tentative Provisions on Implementing Divestiture of Assets or Business in Concentration of Undertakings*[15] ("2010 Provisions"). These new provisions significantly change the procedures related to restrictive conditions including adding new procedures for the determination and cancellation of restrictive conditions, updating the procedures for implementing and supervising the implementation of restrictive conditions, and adding legal liabilities for a failure to follow the procedures and duties properly. This paper summarizes those changes.

I. Background

In 2008 the *Anti-Monopoly Law of the People's Republic of China*[16] ("AML") came into force and, among other things, created a system of approvals for mergers based on whether or not a proposed merger would (likely) harm competition. Proposed mergers that were deemed "concentrations"[17] and met certain thresholds[18] must be submitted to MOFCOM for approval. If

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[14] 关于经营者集中附加限制性条件的规定（试行）

[15] 关于实施经营者集中资产或业务剥离的暂行规定

[16] 中华人民共和国反垄断法

[17] Concentration of operators refers to one of the following circumstances:

1. Operators merge;
2. One operator obtains controlling rights in another operator by means of equity or asset purchase; and
3. One operator, by means of contract, etc., obtains controlling rights in another operator or can exercise decisive influence on another operator.

[18] The thresholds are:

MOFCOM determines that the concentration will (likely) harm competition, it may either forbid the merger or, far more often, impose a restrictive condition to mitigate the harmful effects.

The basic steps in the procedure under both the 2010 Provisions and the 2014 Provisions are the same[19]:

1. Determine the restrictive conditions
2. **Self-Actuated Divestiture:** The declarer is given time to find an appropriate buyer under the supervision of a "supervising trustee."
3. **Entrusted Divestiture:** If the declarer fails to find a buyer, the "divestiture trustee" will find an appropriate buyer.
4. **Sale of Business:** The declarer sells the business to the buyer.

However, the 2014 Provisions significantly change all of these steps, add the possibility of later canceling restrictive conditions and create legal liabilities for the various parties for violating their duties.

II. Determination of Restrictive Conditions

Perhaps the most significant change in the 2014 is the creation of a formal process for the determination of restrictive conditions. The 2010 Provisions do not deal with this at all, the merely treat the restrictive conditions as a given in the Examination Decision handed down by MOFCOM.

The 2014 provisions, however, create a procedure for determining the restrictive conditions. The declarer, the party declaring a concentration, files for antimonopoly review and MOFCOM decides if the concentration will (likely) harm competition. If so, the declarer can suggest possible

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1. The total amount of the global turnover realized by all the participating business operators of the concentration during the previous accounting year exceeds RMB 10 billion, with at least two of the business operators involved each achieving a turnover of more than RMB 400 million within China during the previous accounting year; or
2. The total amount of the turnover within China realized by all participating business operators of the concentration during the previous accounting year exceeds RMB 2 billion, with at least two of the business operators involved each achieving a turnover of more than RMB 400 million within China during the previous accounting year.

[19] Please note that, as with both provisions, this procedure will be discussed in terms of divestitures. The procedures apply analogously to other types of restrictive conditions.

restrictive conditions; if the declarer fails to suggest such conditions, MOFCOM will forbid the concentration. The conditions can also be recommended in advance of MOCCOM's decision to as to whether or not the merger will harm (likely) harm competition. If the suggested conditions are risky MOFCOM can require a set of alternative conditions. Once these suggestions are submitted, MOFCOM and the declarer will negotiate them and, in the end, MOFCOM will give a final decision. Thus, under the 2014 Provisions, the declarer is formally a necessary party in the determination of restrictive conditions.

III. Implementation of Restrictive Conditions

As stated in Section I, above, both the 2010 Provisions and the 2014 Provisions have a 2 step process in the implementation of restrictive conditions: (1) self-actuated; and (2) entrusted (if needed). The self-actuated divestiture is under the supervision of a supervising trustee and the entrusted divestiture is carried out by a divestiture trustee.

There are, however, a number of additions in the 2014 Provisions. In the beginning of the self-actuated divestment, the declarer must submit at least three candidates for buyers, supervising trustees and entrusted trustees to MOFCOM for approval. When submitting the three potential buyers, the declarer must also submit the sales agreements and other relevant agreements that have been concluded with the buyers.

With respect to the buyers, there are two new restrictions. The first is that buyers of the divested business cannot be using financing to buy it. The second relates to the question of whether the acquisition of the divested business by the buyer will itself harm competition. The 2010 Provisions stated that the purchase is allowed only if it "will not result in elimination or restriction of competition." The 2014 Provisions, however, take a broader view and requires that if the purchase of the divested business by the buyer is a concentration and meets the thresholds (see section I above), then a second MOFCOM anti-monopoly review is necessary.

Finally, with respect to the timing of the divestiture, under general circumstances the MOFCOM decision will provide a time period within which a sales agreement must be completed (if no time is provided, the default is six months). However, under certain circumstances, MOFCOM can require the declarer to "to find a proper buyer and conclude a sale agreement therewith before implementation of concentration."

IV. Supervision over Restrictive Conditions

The 2014 Provisions did not significantly change the supervision of restrictive conditions. It is the duty of the supervising trustee to oversee the self-actuated divestiture. However, the 2014 Provisions added an important provision regarding "whistle blowing." If a divestiture obligor fails to divest the business as required, entities or individuals may report this to MOFCOM. MOFCOM is required to keep the information about such informers confidential.

V. Change and Cancellation of Restrictive Conditions

Under the 2014 Provisions, restrictive conditions can be changed or canceled. A party can apply for a change or cancellation in the restrictive conditions or MOFCOM can unilaterally make the decision. In either event, MOFCOM will consider: (1) if the parties have changed a great deal; (2) if the market has changed a great deal; (3) if the conditions are impossible or unnecessary; and (4) any other factors.

VI. Legal Liabilities

The 2010 Provisions did not discuss legal liabilities at all, but the 2014 provisions create legal liabilities. If an operator participating in the concentration breaches the examination decision, MOFCOM shall order it to make corrections within a specified period. If the circumstances are serious, the MOFCOM shall order the operator to stop concentration, dispose of shares or assets within the specified period, transfer the business within the specified period and take other necessary measures to return to the status before concentration. MOFCOM may also impose a fine of up to RMB 500,000. If a trustee, fails to perform his/her obligations, with due diligence, MOFCOM may order the trustee to make corrections. If the buyer of the divested business violates the Provisions, MOFCOM shall order the buyer to make corrections.

VII. Conclusion

The 2014 Provisions changed the procedures for restrictive conditions. On the one hand, the 2014 Provisions create a higher burden in that the declarer must submit three possible buyers, supervising trustees and divestiture trustees to MOFCOM. What's more, sales agreements with all three possible buyers must be negotiated and submitted for approval. Finally, there are explicit penalties for a failure to comply with the restrictive conditions. On the hand, the 2014 Provisions

allow the declarer to suggest restrictive conditions to MOFCOM and negotiate with MOFCOM. This should allow the declares the ability to work with MOFCOM to craft the solution that works best for them while still mitigating the competition eliminating effects.

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