



漢坤律師事務所  
HAN KUN LAW OFFICES

# Newsletter

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## ■ ■ Insights & Ideas

1. Ministry of Health Issued Measures for Administration of Sino-foreign Equity Joint and Cooperative Joint Medical Institutions (Revision Draft for Comments)

## ■ ■ Legal Updates

1. State Administration for Industry and Commerce Issued Opinions on Strengthening the Administration of Business Activities with respect to Online Group Purchase
2. Implementing Opinions on the SAIC Opinions on Supporting Shanghai's Drive for Innovation and its Transition Development During the 12th Five-year Period

## ■ ■ Case Study

1. Legal Validity of Nominal Capital Contribution with Other Shareholders' Money

## Insights & Ideas

### **Ministry of Health Issued Measures for Administration of Sino-foreign Equity Joint and Cooperative Joint Medical Institutions (Revision Draft for Comments) (Authors: Huan WANG, Feng YAN)**

On April 13, 2012, the Ministry of Health published draft Measures for Administration of Sino-foreign Equity Joint and Cooperative Joint Medical Institutions (“**Draft Measure**”) for public discussion. The Draft Measure is published due to recent adoption of new Foreign Investment Industry Catalogue (2011), effective as of January 30, 2012, pursuant to which foreign investment to healthcare industry is no longer restricted. However, it appears that not only existing restrictions under the Interim Measures for the Administration of Sino-Foreign Equity and Cooperative Joint Venture Medical Institutions (“**Interim Measure**”) issued by the Ministry of Health and the Ministry of Foreign Trade and Economic Cooperation in 2000 are not reduced, but new restrictions will be added. A summary of the Draft Measure is as follows:

#### **1. Specifying the nature of business of foreign-invested medical institutions**

The Draft Measure clarifies that the nature of business of a foreign-invested medical institution can be profitable or non-profitable. In addition to prior approvals from provincial health administration and provincial commercial authority, while profitable medical institution shall be registered with local administration of industry and commerce, non-profitable medical institution shall be registered with local civil affair bureau. In the event a Chinese partner is a non-profitable healthcare institution, the foreign-invested medical institution to be established must be a non-profitable medical institution.

#### **2. Raising threshold for investment amount of foreign-invested medical institution**

Compared to existing threshold of investment amount of RMB20M for a foreign-invested medical institution under the Interim Measure, the proposed minimum investment amount of a foreign-invested medical institution under the Draft Measure has been sharply increased to RMB100M. With regard to a foreign-invested medical institution to be established in the central and western areas or in the old revolutionary-base, minority-inhabited, border/remote, or poor areas (老、少、边、穷地区) in China, the minimum investment amount may be adjusted to RMB 50M.

#### **3. Delegation of approval authority**

The approval authorities in terms of establishment of a foreign-invested medical institution will be delegated from the Ministry of Health and Ministry of Commerce to provincial health administration and commercial authority, which is consistent with a series of circulars issued by central government in 2011, and approval timeline will be adjusted from forty-five (45) working days to twenty (20) working days for each of health approval procedure and commercial approval procedure.

#### **4. Restriction on foreign ownership remains unchanged.**

Although foreign investment to healthcare industry is no longer restricted under the new Foreign Investment Industry Catalogue (2011), the Draft Measure obviously does not fully reflect such change. Foreign ownership in a foreign-invested medical institution will still be capped at 70%, and such limitation may be reduced from time to time under discretion of approval authorities, and establishment of wholly foreign-owned hospital may be gradually opened as well. It is interesting to note that the Ministry of Health indicates that only wholly foreign-owned hospital, instead of wholly foreign-owned medical institution, will be opened for incorporation gradually.

#### **5. Whether Hong Kong and Macau service providers can continue to enjoy preferential treatment under CEPA?**

The Interim Measure has been amended and supplemented twice to incorporate terms under the Closer Economic Partnership Arrangement between Mainland China and Hong Kong/Macau (“CEPA”) and its amendments, pursuant to which Hong Kong and Macau service providers enjoy preferential treatment in terms of establishment of foreign-invested medical institution in China. As the Draft Measure will replace the Interim Measure, including its amendments, and the Draft Measure currently does not stipulate any preferential treatment applicable to Hong Kong and Macau service providers, it remains unclear whether Hong Kong and Macau service providers can continue to enjoy such preferential treatment under CEPA.

The following table reflects the difference between the Interim Measure and the Draft Measure in certain main aspects:

	<b>Interim Measure</b>	<b>Draft Measure</b>
Nature of Business	<ul style="list-style-type: none"> <li>• N/A</li> </ul>	<ul style="list-style-type: none"> <li>• Either profitable or non-profitable</li> <li>• Only non-profitable medical institution can be established where the Chinese partner to such foreign-invested medical institution is a non-profitable medical institution</li> </ul>
Registration Authority	<ul style="list-style-type: none"> <li>• Administration of Industry and Commerce</li> </ul>	<ul style="list-style-type: none"> <li>• Administration of Industry and Commerce for profitable foreign-invested medical institution</li> <li>• Civil affair bureau for non-profitable foreign-invested medical institution</li> </ul>
Qualification Requirements for Parties to a foreign-invested medical institution	<ul style="list-style-type: none"> <li>• Legal person</li> <li>• Having direct or indirect healthcare investment or management experience</li> <li>• Being able to provide international advanced management experience, modes, and service modes of medical institutions</li> <li>• Being able to provide international advanced medical technology and equipment</li> <li>• Being able to make up or improve the inadequacy of local medical service capacity, medical technology, funds, and medical facility</li> </ul>	<ul style="list-style-type: none"> <li>• Legal person</li> <li>• Having direct or indirect healthcare investment or management experience</li> </ul>
Incorporation Conditions	<ul style="list-style-type: none"> <li>• Minimum investment amount of RMB20M</li> <li>• maximum term of foreign-invested medical institution of 20 years</li> <li>• foreign ownership capped at 70%</li> </ul>	<ul style="list-style-type: none"> <li>• Minimum investment amount of RMB100M; for foreign-invested medical institution to be established in the central and western areas or in the old revolutionary-base, minority-inhabited, border/remote, or poor areas (老、少、边、穷地区) in China, minimum investment amount can be adjusted to RMB50M</li> <li>• Maximum term of foreign-invested medical institution of 30 years</li> <li>• Foreign ownership capped at 70%, but may be adjusted under discretion of approving authorities; establishment of wholly foreign-owned hospital will be opened gradually</li> </ul>
Approval Authority	<ul style="list-style-type: none"> <li>• Ministry of Health and Ministry of Commerce</li> </ul>	<ul style="list-style-type: none"> <li>• Provincial agencies of Ministry of Health and Ministry of Commerce</li> </ul>
Timeline	<ul style="list-style-type: none"> <li>• Forty-five (45) working days for each of health approval procedure and commercial approval procedure</li> </ul>	<ul style="list-style-type: none"> <li>• Twenty (20) working days for each of health approval procedure and commercial approval procedure</li> </ul>
Notarization and Legalization	<ul style="list-style-type: none"> <li>• No notarization and legalization requirement on application documents provided by foreign investor</li> </ul>	<ul style="list-style-type: none"> <li>• All application documents provided by foreign investor shall be notarized by local notary public and legalized by local PRC embassy or consulate</li> </ul>

## **Conclusion**

Right now the Draft Measure is soliciting public comments, and comments can be provided through <http://www.chinalaw.gov.cn/article/cazjgg/201204/20120400363197.shtml>. The deadline to respond is May 16, 2012, and the Draft Measure is expected to become effective within this year.

We understand the main purpose of revising the Interim Measure is to reflect the changes and spirit under the new Foreign Investment Industry Catalogue (2011), as well as several notices issued last year to simplify procedures on foreign investment to PRC healthcare industry, further reducing market entry obstacles. However, the Draft Measure indeed substantially raises thresholds in connection with entry of PRC medical industry by foreign investors, thereby potentially discouraging or restricting foreign investment to PRC healthcare industry, in particular investment to set up clinic, rather than full-service hospital, in China.

## Legal Updates

### 1. State Administration for Industry and Commerce Issued Opinions on Strengthening the Administration of Business Activities with respect to Online Group Purchase (Authors: Loretta LI, Amanda HU)

The State Administration for Industry and Commerce issued *Opinions on Strengthening the Administration of Business Activities with respect to Online Group Purchase* (Gong Shang Shi Zi [2012] No. 39) (hereinafter referred to as the “**Administration Measures**”) on March 12, 2012, which are the most detailed and targeted regulations issued so far after the *Notice of the Ministry of Commerce on Regulating Sales Promotion Behavior Relating to Online Shopping* (hereinafter referred to as the “**Notice on Regulation of Online Shopping**”) dated May 1, 2011 and *Notice of the Ministry of Commerce on Regulating Online Retail during the Holiday Seasons* (hereinafter referred to as the “**Notice on Regulation of Online Retail**”) dated December 23, 2011.

Under the Administration Measures, “Online Group Purchase” refers to “the business activities of gathering a certain number of consumers to form a group through the Internet channel and offering them a discount price for the purchase of the same type of goods or service.” The Administration Measures restate the relevant rules for online goods /services supplier (the “**Suppliers**”) to access the online group purchase market set out in the *Interim Measures for the Administration of Online Commodities Trading and Relevant Services* (Decree No. 49 of the State Administration for Industry and Commerce). An operator of a group purchase website (the “**Operator**”) shall duly register with the relevant administration for industry and commerce (“**AIC**”), acquire a business license and disclose the information set out in the business license or the electronic connection identifier of the business license at a conspicuous place on the homepage of its website. If a group purchase website establishes sub-sites in different regions, the matters relating to such sub-sites’ registration with the relevant AIC shall be handled in accordance with the relevant provisions of the prevailing registration laws and regulations. Failure to comply with the above requirements (and such phenomenon is not uncommon) can lead to a forced website shut down by the component AIC.

The Administration Measures impose the following seven (7) items of main obligations and duties on the Operators:

#### **Establish the approval system for the eligibilities of the Suppliers and the quality of the goods services for group purchase**

The Operator shall examine and register the subject identities of the Suppliers that apply to sell goods or provide services through the website and their eligibilities for operation, establish registration archives and verify and update them on a regular basis. The Operator shall conduct examination and record-filing in advance in a strict manner for the goods or services for group

purchase, guarantee the quality of such goods/services, check and confirm critical factors such as the inventory of goods, the speed of the delivery of goods, the logistics system and the service rules and prevent unreasonably high quotation.

Suppliers shall be legal persons, other economic organizations or individual businesses that have been registered with the relevant AIC and have obtained business licenses. If their businesses are subject to any pre-approval, the suppliers of goods/services shall acquire such approval in accordance with law.

The above requirement places a much heavier burden of examination on the Operators regarding the goods and services they are providing through website. To satisfy such requirement, the Operators need to have a stronger internal control and compliance department supervising the selection of Suppliers.

### **Specify the rights, obligations and responsibilities between the Operators and the Suppliers or consumers in the form of a contract**

The operator shall sign business contracts on website access with the Suppliers so as to specify clearly both parties' rights, obligations and responsibilities in aspects such as the trading entry and exit, the guarantee of the quality and security of the goods and services and the protection of consumer rights and interests. It is frequently discussed in practice whether online group purchase websites are better categorized as B2C platforms or as providers of the relevant goods and services which have no big difference with all the suppliers of goods and services. Practically, the courts usually assume the invoice issuer as the seller, while current laws and regulations are silent on who shall issue invoices for group purchase transactions. Therefore, when disputes do arise, consumers may find neither the group purchase website nor the supplier willing to resolve such disputes. If the business contracts between group purchase websites and the Suppliers or relevant laws and regulations can be more specific in this regard, consumers may enjoy better protection.

The Operator shall sign consumer contracts on website access (i.e. user registration agreements) with consumers. The Operator providing consumers with standard terms in electronic contracts shall comply with the provisions of the relevant laws, regulations and rules, determine the rights and obligations of both trading parties under the principle of fairness, adopt reasonable and obvious methods to request consumers to pay attention to terms that are materially related to consumer rights and interests and explain those terms as required by the consumers.

### **Protect trade secrets of the Suppliers and personal information of the consumers**

The Operator shall establish an information security protection system and take necessary measures to protect the security of the data and information involving the trade secrets of the Suppliers and the personal information of the consumers. Unless agreed by the parties concerned in the trading, information involving the trade secrets of the Suppliers or the personal information of

the consumers such as the name list of the parties concerned in the trading and the trading records shall not be disclosed, transferred or sold to any third party.

### **Prohibit unfair competition**

The Operator shall take necessary measures to protect the rights such as the exclusive license right and trade names. The Operator shall not commit infringement such as usurping, imitating or copying the domain names, names and logos of other websites by means of network technologies or carriers, or commit acts of unfair competition such as damaging the business reputation of other operators or the reputation of their goods.

### **Protect the lawful rights and interests of consumers**

The Operator shall issue a receipt to evidence the purchase of goods and service by consumers in accordance with the relevant provisions of the State or the business practices. With the consent of the consumer, such receipt may be issued in electronic form. An Operator shall issue evidence for the purchase of goods or service upon the requests of consumers.

The Operator shall comply with the relevant provisions of the Law for the Protection of Consumer Rights and Interests regarding the return of goods and refunds and shall not deprive consumers of their rights to return goods and receive refunds in accordance with law. The Operator that requires the receipt of advance payment for the sales of goods or services for group purchase shall not impose restrictions such as refusing to refund the advance payment if consumption is not made within a specified time limit or specifying that funds can only be refunded to the website accounts.

This requirement may have a fundamental impact on the operation model of the current group purchase websites, since the legality of various refund restrictions will be challenged, which may further impact the exclusive sales model adopted by many websites. With a good intent to protect consumer rights and eliminate relevant complaints, such requirement is not totally reasonable in practice -- where the advance payment is not timely consumed due to any neglect or fault by the consumer, unconditional refund may be unfair to Operators. Nevertheless, Operators shall be advised to strictly follow the Administration Measures, especially when they are negotiating business contracts with the Suppliers, the above new rules must be taken into account.

### **Record and maintain trading information**

The Operator shall examine, record and maintain the information relating to online group purchase that is published on its website and the time at which such information is published. The records of the information about the subject eligibilities of a Supplier shall be kept for no less than two (2) years from the consummation of the relevant online group purchase related to such Supplier.

### **Regulate the promotion activities for group purchase**



When engaging in sales promotion activities such as “second bidding” and “lucky draws”, the Operator shall comply with the provisions of the Anti-Unfair Competition Law and Several Provisions on Prohibiting Unfair Competition in Sales Activities Regarding the Offer of Rewards issued by the State Administration for Industry and Commerce in relation to sales activities involving the offer of rewards by lucky draws and prohibit deceptive sales acts involving the offer of rewards.

Based upon the above mentioned obligations and duties, the Administration Measures also set out the following five (5) measures to strengthen the regulation over online group purchase activities:

- a) Databases for the Operators shall be established.
- b) Online inspection shall be actively conducted and illegal online group purchase acts shall be investigated and punished.
- c) Templates of relevant contracts shall be prepared and promoted.
- d) Mechanism to protect the rights and interests of consumers shall be further improved.
- e) Group purchase websites shall be encouraged and supported to strengthen self-regulation.

By listing the above obligations and duties of the Operators, the Administration Measures restate the relevant requirements under Notice on Regulation of Online Shopping, which says, “online shopping stores are encouraged to explain to the consumers in advance the key information such as the names, types, quantities, quality, prices, freight, distribution methods, payment methods, and the return and exchange methods of goods or services, to adopt safety protection measures, to ensure that the sales promotion behavior is safe and reliable and to provide goods or services as promised”, and “shall not engage in fraudulent pricing acts, false sales promotion, offer of discounts on the basis of false original prices, or lowering the standard of the after-sales services for goods (including the prizes and gifts in sales with giveaways), refuse to provide return or exchange services or set up barrier for such services by ‘reserving the right of final interpretation’.” Under the Notice on Regulation of Online Retail, all local commercial authorities shall “coordinate with relevant authorities to supervise the online retail market”, with the focus on “false promotion, intellectual rights protection, sales of forbidden items, product and service quality and deceptive pricing by third party transaction platform, group purchase websites and etc.”, and “online retailers and third party transaction platforms are encouraged to adopt the “compensation-in-advance” mechanism” to enhance the protection available to consumers.

We understand that the promulgation and implementation of the Administration Measures may increase the operational costs for group purchase websites and further promote the re-shuffle and consolidation of the group purchase business. In the long run, however, the Administration Measures will play a positive role in regulating large-scale group purchase websites as well as in protecting consumers’ rights and interests.

## **2. Implementing Opinions on the SAIC Opinions on Supporting Shanghai's Drive for Innovation and its Transition Development During the 12th Five-year Period (Authors: Kelvin GAO, Li ZHANG, Xin LI)**

On February 16, 2012, the State Administration for Industry and Commerce (“SAIC”) and Shanghai Municipal Government jointly held a policy release conference in Shanghai and issued the “SAIC Opinions on Supporting Shanghai's Drive for Innovation and its Transition Development During the 12th Five-year Period (Gong Shang Ban Zi (2012) No.: 17) (the “Opinions”). The Opinions carried out eighteen supporting measures for Shanghai's drive for innovation and its transition development during the 12th Five-year period. Thereafter, Shanghai counterpart of the SAIC (“Shanghai AIC”) issued the “Implementing Opinions on the SAIC Opinions on Supporting Shanghai's Drive for Innovation and its Transition Development During the 12th Five-year Period (Hu Gong Shang Ban (2012) No.: 131) (“Shanghai AIC Implementing Opinions”) on March 21, 2012, further elaborating and refining the supporting measures provided under the Opinions.

The Shanghai AIC Implementing Opinions mainly sets out Shanghai AIC's policy guidance and role during the 12th Five-year period in the following four aspects:

### **Support to accelerate the establishment of the modern market system; and efforts to speed up the establishment of "four centers"**

In order to facilitate Shanghai's efforts to establish itself as an international economy center, international finance center, international shipping center and international trade center, the Shanghai AIC Implementing Opinions carried out eight service principles for the industries of finance, shipping, E-Commerce, international trade, and etc.

According to the Shanghai AIC Implementing Opinions, actions will be taken to support the development of new-type financial institutions such as equity investment, venture capital investment, small business loans, credit guarantee and rural banks, while studies should be made for the rules and regulations with respect to the market entrance and development of such industries as factoring and financial leasing. It is reported that Shanghai AIC is ramping up the SAIC registration measures for financial leasing companies in Shanghai together with other departments, and will carry out the pilot program for registration of both domestic and foreign-invested financial leasing companies in Yangshan Bonded Port Area, Waigaoqiao Free Trade Zone and Pudong Airport Free Trade Zone.

Meanwhile, the Shanghai AIC Implementing Opinions further set up the new rules for the company registration services in Shanghai. For example, an enterprise with more than fifty branches now is generally allowed to file the registration with the SAIC office where such parent enterprise is located. Prior to the promulgation of the Shanghai AIC Implementing Opinions, registration of domestic enterprises' branches is governed by the principle of territorial jurisdiction. In other others, each

branch will file the registration with the SAIC office where such branch is located. Therefore, as to such enterprises as supermarket or convenience stores, it will need to proceed with the alteration registration with the SAIC office where its branches is located in the event of any change of its business scope or legal representative. With the issuance of the Shanghai AIC Implementing Opinions, it is much easier to proceed with the alteration registration and can thus save the cost for enterprises.

In addition, the Shanghai AIC Implementing Opinions supports qualified commercial and service enterprises to establish group companies in order to further enhance the ability of industry chain integration as well as the market competition. Under applicable existing SAIC rules and regulations, if an enterprise wishes to establish itself as a group company, its registered capital should be at least RMB50 million and should have at least five subsidiaries, while the total registered capital of both the parent company and its subsidiaries should reach at least RMB100 million. After the release of the Shanghai AIC Implementing Opinions, the above-mentioned requirements have been lowered to at least RMB30 million for the parent company's registered capital, at least 3 for the number of the subsidiaries that such parent company has established, and at least RMB50 million for the total registered capital.

It is expressed in the Shanghai AIC Implementing Opinions that Shanghai AIC will take an active role to help enterprises to expand their financing channels by improving its registration services, including processing registration of equity pledge and property mortgage in a short time period, carrying out the trademark right pledge registration, participating in and promoting the restructuring of non-listing companies, and introducing non-listing companies to make their equity interests under the custody by Shanghai Equity Exchange.

### **Promotion of strategic adjustment of Shanghai's industrial structure; acceleration of the formation of industrial structure focusing on services**

Besides the general support for the development of service industry in Shanghai, some innovative policies in certain areas are mentioned in the Shanghai AIC Implementing Opinions. For example, it is provided under the Shanghai AIC Implementing Opinions that capital contribution by means of equity, debt, trademark, patent, domain names, and etc. should be supported and should be introduced for the industries of modern services and advanced manufacturing. As a matter of the PRC Company Law and practice, shareholders are allowed to make in-kind contribution by using properties, intellectual property rights, or land use rights that can be appraised and transferred only. However, the Shanghai AIC Implementing Opinions further broadens the scope of the in-kind contribution for a limited liability company.

It is noteworthy that the Shanghai AIC shows its efforts in the Shanghai AIC Implementing Opinions to study the practical methods for the transformation of individual businesses into small enterprises as well as to support such form transformation by qualified individual. This policy guidance will provide clear direction for the specific procedures for the form change of individual businesses into

enterprises. It is reported that Shanghai AIC are studying the detailed operational methods in this regard and it has also decided that the enterprises that have been identified as small and tiny enterprises shall be exempted to pay the annual inspection fees for the year of 2012.

It is also required under the Shanghai AIC Implementing Opinions that the Shanghai AIC will need to take an active role to explore the existing problems in the area of alteration registration and de-registration and try to solve them, to simplify the procedures in the case of merger and reorganization, and to allow the establishment of a parent group company by means of equity investment.

### **Support of comprehensive pilot reform in Pudong; enhancement of level of open economy and city internationalization**

The Shanghai AIC Implementing Opinions further set up the requirements to improve the development of cultural industry on the basis of summarizing and promoting the supporting reform pilot program in Pudong.

It is provided under the Shanghai AIC Implementing Opinions that the following matters shall be studied: form change registration, separated registration for the domicile and place of business of an enterprise which does not involve pre-registration, and application of establishment of domestic enterprises by PRC citizens living abroad and holding Chinese passport.

Meanwhile, the Shanghai AIC Implementing Opinions also lowered the qualifications to set up the headquarter in order to encourage multinational companies to establish such functional institutions in Shanghai as regional headquarters, sales center, purchasing center, settlement center, R&D center, and brand center. Further, it is proposed that based on the experience gained in Pudong, the approach for the individuals to set up Sino-foreign equity joint venture and Sino-foreign contractual joint venture should be expanded to the full territory of Shanghai.

Besides, the Shanghai AIC Implementing Opinions supports the reform of cultural system reform as well as the form change of operating culture institutions and makes studies to solve the registration problems incurred during the form change of state-owned art troupes, non-political newspapers and news websites. Also, operating culture institutions are allowed to add the enterprise form on the basis of their original names. As introduced by the Shanghai AIC on the press conference on March 27, 2012, the following measures will be taken to solve the reform problems for operating culture institutions: (i) Shanghai AIC will actively seek authorization from SAIC to be responsible for the preliminary approval of the name change registration originally under SAIC's supervision, which will be easier for the restructuring enterprises to declare their names in Shanghai and avoid traveling. At the same time, it is allowed for the operating culture institutions to add the word such as "Limited Liability Company" or "Limited Liability Company by Shares" into the existing name directly as the changed name upon restructuring, which maintains the continuity for the enterprises names and can keep the intangible value for such name; (ii) it is allowed to make capital contribution by using the

appraised net asset value upon restructuring, which will provide a smooth form change and save the cost for form change due to appraisal; and (iii) operating culture institutions are allowed to retain their original scope of business activities which will ensure the continuity of their business operation.

It is also creatively put forward in the Shanghai AIC Implementing Opinions that the innovative culture enterprises can use the premises located in a municipal cultural industry park as their domicile, which will likely help such entrepreneurs to save the rental cost by leasing the office buildings or shops and will promote the growth of small and medium-sized innovative culture enterprises.

### **Further improvement of market supervision mechanisms; protection and improvement of people's livelihood and promotion of social harmony**

The Shanghai AIC Implementing Opinions puts forward the new policy guidance and requirements in the areas of market order, market environment, consumer environment, construction of the market credit information system and the integrated development of the urban and rural areas, which aims to provide a friendly external environment and supporting conditions to carry forward the policies mentioned above.

Overall, the Shanghai AIC Implementing Opinions has granted Shanghai many priority rights in many areas, which is significantly meaningful in innovation and guidance of laws and policies. Further, it has set up the polity foundation for Shanghai to further promote its drive for innovation as well as its transition to develop services as its pillar industry.

## Case Study

### **Legal Validity of Nominal Capital Contribution with Other Shareholders' Money (Authors: Eric LIU, Guanglei ZHANG)**

We recently noticed a case reheard by the Supreme People's Court. In this Case, Company A and Company B entered into a contract to establish Company C, stating that Company A shall be responsible for collecting all the registered capital in the amount of RMB10,000,000, and Company B shall be obliged to contribute its education resources necessary for the operation of Company C; the procedures of their contributions shall be that Company A transfers RMB5,000,000 to Company B who will then transfer such amount to the account of Company C for capital verification purpose. As agreed, the two parties completed capital contribution, capital verification and registration procedures of Company C with local administration for industry and commerce. Afterwards, a dispute happened between Company A and Company B, and Company A filed a lawsuit against Company B, claiming that given that Company B had never made its capital contribution actually, all the equity interest of Company C should belong to Company A. Through the trial of the court of first instance, the court of second instance and the Supreme People's Court, Company A failed in the case and its claims were rejected.

The core legal issues of this case are: in case that the education resources owned by Company B cannot become capital contribution recognized by law, is the nominal capital contribution made by Company B with the money provided by Company A valid? What remedies does Company A have after payment of such capital contribution for Company B?

#### **Is the capital contribution made by Company B in currency with Company A's Money valid?**

Through the trial of the court of first instance, the court of second instance and the Supreme People's Court, Company B's capital contribution with Company A's money was recognized to be valid.

In accordance with Article 27 of the *Company Law*, a shareholder may make capital contributions in currency, in kind, intellectual property right, land use right or other non-currency properties that can be accessed on the basis of currency and transferred in accordance with the law, excluding the properties that shall not be treated as capital contributions according to laws and administrative regulations. According to Article 14 of the *Regulations on the Administration of Company Registration*, a shareholder shall not make capital contributions in labor, credit, name of a natural person, goodwill, franchise or properties to which any guarantee has been made. In this case, education resources owned by Company B are similar to labor or credit and may not be assessed on the basis of currency or be transferred according to the law, so they may not become the capital contribution paid to Company C. In order to make the capital contribution of Company B satisfy legal requirements, Company A transferred the amount corresponding to the capital contribution of

Company B to the account of Company B in advance, and then Company A and Company B respectively transferred the money in their accounts to the capital verification account of Company C. Through such procedures, Company A and Company B both made their capital contributions in currency, which was confirmed by capital verification and registration, so the form and procedures of its capital contribution are legitimate and valid.

Company A, the plaintiff of the case, claimed that even though the capital contributions of the two shareholders are both made in currency, however, Company B actually made its capital contribution in education resources, so the contract between the two shareholders should be invalid by reason of a concealed illegitimate purpose under the guise of legitimate acts. The Supreme People's Court held the opinion that the registered capital subscribed and paid by shareholders were the basis of company capital, but the efficient operation of a company sometimes still needed other conditions and resources. Thus, under the laws of the PRC, shareholders are not forbidden to make agreements on actual capital contribution amount and percentage of equity interests they owned, and the agreements between Company A and Company B did not affect the registered capital performing its guarantee for creditors' rights and other basic functions. These agreements did not circumvent the laws and should be governed by the autonomy of the shareholders. Therefore, the contract between Company A and Company B and the capital contribution procedures are valid, and the claims of Company A should not be supported.

### **How does Company A protect its rights in case that the nominal capital contribution of Company B is valid?**

In case that the nominal capital contribution of Company B is valid, Company B legally owns the equity interest of Company C corresponding to its capital contribution. However, in the event that Company B fails to perform its obligations according to the contract, Company A may still claim other civil rights based on the contract. For example, Company A provided Company B with the amount for its capital contribution, because Company B promised to contribute its education resources to Company C as a consideration. If Company B never actually owned the education resources as it said, or failed to contribute them to Company C according to their agreements, Company A may claim its rights based on the following legal privities:

1. Donation Subject to Collateral Obligations. Company A's payment for the nominal capital contribution of Company B may be deemed to be a donation subject to collateral obligations. Company A donated to Company B RMB5,000,000 as the capital contribution made by Company B, who, however, should contribute education resources that Company C needed. In accordance with Article 192 and Article 194 of the *Contract Law*, the donator may rescind the donation in case that the donee fails to perform its contractual obligations, and requires the donee to return the donated properties. Therefore, in case that Company B failed to contribute the education resources in accordance with the contract, Company A may require Company B to return the RMB5,000,000.



2. Investment Contract. Investment contract is not explicitly addressed in the *Contract Law*. Company A and Company B agreed on their rights and obligations in the investment contract, and should bear liabilities if breaching of the contractual obligations. Therefore, if Company B failed to contribute the education resources in accordance with the contract, it should be liable for breach of contract.

### **How to protect Company A's rights beforehand?**

As analyzed above, where the capital contribution by Company B is held valid, Company A is unable to directly obtain the equity interest owned by Company B in Company C. Where dispute arises and cooperation cannot continue between Company A and Company B, it is unlikely to fully protect Company A's rights and interest even if Company A could request Company B to undertake liabilities for breach of contract according to the contract. Therefore, in order to prevent and mitigate these risks, any matters which may potentially arise shall be clearly specified in the contract when executed. For example, Company A may enter into an equity pledge agreement with Company B and complete the pledge registration procedures. Moreover, the equity pledge agreement may provide that Company A is entitled to accept the equity interest of Company C owned by Company B without consideration, in the event of breach of agreement by Company B or upon the fulfillment of certain conditions, and Company B is obliged to cooperate with Company A in this regard.



## **Important Announcement**

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