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Newsletter

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Legal Updates

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Legal Updates

1. NDRC Amends Approval and Record-filing Requirements for Foreign Investment Projects (Authors: Wenyu JIN, Kaiying WU, Fanglu LIN)

On May 20, 2014, the National Development and Reform Commission, China's economic planning agency, released the *Administrative Measures for the Approval and Record-filing of Foreign Investment Projects* (the "Administrative Measures"). Concurrent with the release of the Administrative Measures, the previously effective law, the *Interim Administrative Measures for the Examination and Approval of Foreign Investment Projects* (the "Interim Measures") promulgated on October 9th, 2004 was repealed. The Administrative Measures will become effective on June 17, 2014.

The Administrative Measures implement the requirements of *Decision to Reform the Investment System* and the *Investment Project Catalogue Approved by the Government (2013 Version)* released by the State Council (the "Approved Catalogue"). Compared with the Interim Measures they contain significant revisions and adjustments with respect to regulatory oversight, administration and legal liabilities in order to further reform the regulatory structure for foreign investment. The main content in the Administrative Measures is as follows:

Which Foreign Investment Projects are subject to the Administrative Measures

The Administrative Measures apply to Sino-foreign equity joint ventures, Sino-foreign cooperative joint ventures, wholly foreign-owned enterprises, foreign-invested partnerships, mergers and acquisitions of domestic enterprises by foreigners, capital increases and reinvestments in foreign-invested enterprises and domestic investment projects made in Renminbi by foreign investors(each a "Foreign Investment Project" and collectively "Foreign Investment Projects"). Foreign Investment Projects are regulated by the *Catalogue for the Guidance of Foreign Investment Industries* (the "Foreign Investment Catalogue") and other sector specific laws and regulations. Under the Foreign Investment Catalogue, Foreign Investment Projects are categorized as either "encouraged," "restricted," "prohibited" or they are not categorized at all, in which case they are "permitted." Foreign investors cannot invest in "prohibited" sectors while they are allowed to invest in the sectors specified in the other categories. In the case of "restricted" or "permitted" sectors certain restrictions such as shareholding limitations apply.

Approval or Record-Filing of Foreign Investment Projects

Under the Administrative Measures, foreign investment projects are either subject to an approval requirement or merely a record filing. Whether or not a foreign investment project is subject to an advance approval depends on investment thresholds and requirements that have been updated by

the Administrative Measures, as follows:

Regulation of Foreign Investment Projects Under the Administrative Measures

Category Number	Foreign Investment Project Type and Amount(Classified according to the Foreign Investment Catalogue)	Approval or Record-filing	Supervisory Department
1	(1) "encouraged" projects whose controlling shareholder shall be (or effectively shall be) Chinese and whose total investment amount isUSD300 million or above; (2) "restricted" projects (excluding real estate projects) whose total investment amount is USD50 million or above	Approval Required	NDRC
2	(1) "restricted" real estate projects; (2) other "restricted projects" whose total investment amount is less than USD50 million	Approval Required	Provincial government (the approval authority may not be delegated to a lower governmental department)
3	"encouraged" projects whose controlling shareholder shall be (or effective shall be) and whose total investment amount is less than USD300 million	Approval Required	Local government (the approval authority may be delegated to a lower governmental department)
4	Foreign Investment Projects other than items 1-3 above that are listed in items 1-11 in the Approved Catalogue	Approval or record-filing depending on the requirements in the Approved Catalogue	In accordance with the provisions of the Approved Catalogue
5	Foreign Investment Projects other than those stated above	Record-filing	Competent investment department of the local government

[Note: When a foreign-invested enterprise applies to increase its capital, the total investment amount for the purposes of determining whether there is an approval requirement or a record-filing is the increased capital amount. For merger and acquisitions of domestic enterprises by foreigners, the total investment amount is the total transaction amount.]

For Foreign Investment Projects requiring advance approval from the NDRC, the Administrative Measures increased the investment threshold from USD 100 million to USD 300 million, with the additional condition that the Foreign Investment Project has a controlling shareholder who is or is effective Chinese. With respect to "restricted" real estate Foreign Investment Projects, the Administrative Measures delegate approval authority from the NDRC to the provincial governments. With respect to items 1-11 in the Approved Catalogue, approvals or record-filings are now handled by the competent governmental departments based on the conditions and requirements specified in the Approved Catalogue. Other than these specific requirements, other Foreign Investment Projects require only a record-filing with the local government.

Revisions to Project Approval Application Materials

Compared to the Interim Measures, the Administrative Measures simplify the content and documents required in a Foreign Investment Project's application report. For example, the following

documents that previously had to be submitted as part of the application are no longer required: i) explanation about the primary technology, workmanship, the number of employees and the consumption of main raw materials in a Foreign Investment Project; ii) letter of intent issued by a bank for a financing of a Foreign Investment Project; iii) environmental impact assessment stipulation and the approval document issued by the provincial or state administrative department of environmental protection; and iv) land prequalification for reconstruction projects within an area pre-approved for construction.

While simplifying the application materials for the approval of Foreign Investment Projects, the Administrative Measures strengthen the approval authority's investigation of a Foreign Investment Project's resource utilization, energy conservation, environmental protection, ecological safety and effect on the public interest. Foreign Investment Projects that may materially affect the public interest, the approval authorities are required to take appropriate measures to solicit for public comments during their evaluation, and for particularly significant projects, an expert review system may be adopted. The application for a Foreign Investment Project requiring prior requires the following: i) basic information about the Foreign Investment Project and its investor(s); other attached relevant materials such as evidence of an enterprise's registration, letter of intent for the investment and board resolutions on the capital increase and/or M&A projects of domestic and foreign investors. The competent investment department of the local authorities shall issue written comments and state the reasons within seven (7) working days for Foreign Investment Projects not to be filed.

Requirements for All Foreign Investment Projects

The Administrative Measures state that Foreign Investment Projects, whether they require advance approval or merely a record-filing, are required to comply with i) the relevant laws and regulations of the state; ii) national or regional development planning; iii) industrial policy and access criteria; iv) the Foreign Investment Catalogue and the Catalogues for Foreign-invested Leading Industries in Central and Western China. For Foreign Investment Projects subject to advance approval, the Administrative Measures further require the following during the construction process for a Foreign Investment Project: i) resources shall be developed reasonably and utilized efficiently; ii) there shall be no effect on national or ecological security and iii) the public interests shall not be materially affected.

Changes to a Foreign Investment Project

Where the Foreign Investment Project's location, investor, stock rights, or main construction content changes, the applicant is required to apply for the change with the original approval authority that approved the project or accepted a record-filing. If the projects approved fall into the scope of filing management after change, they shall be handled in accordance with the filing procedure; otherwise they shall be handled in accordance with the approval procedure.

New Chapters on Supervision and Legal Liability

The Administrative Measures add two new chapters, "Supervision" and "Legal Liability" in order to provide further specifics relating to the approval, record-filing, post approval/record-filing regulation and legal liabilities of Foreign Investment Projects. Compared to the Interim Measures, the Administrative Measures further emphasize perfecting the information sharing system amongst governmental agencies, and summarizing and reporting local information in order to synchronize the regulation of Foreign Investment Projects.

According to the Administrative Measures, related authorities such as the administrative authority for industry and commerce, tax department, customs department and so on, shall not handle the relevant procedures and financial institutions shall not provide loan support for Foreign Investment Projects that have not been approved or filed within the jurisdictional limits and procedures of approval authorities. When Foreign Investment Projects are approved or filed, the approval or filing documents shall have a stipulated validity period. Project applicants can apply for an extension of such validity period within thirty (30) working days following its expiration if the Foreign Investment Project has not commenced yet. The failure to do so will result in the approval or filing becoming null and void. If an applicant uses improper means, such as dividing the Foreign Investment Project or providing false materials, when applying for an approval or record-filing, the approval or record-filing authorities shall not accept the application or deny the application. Where the approval or record-filing authorities have already provided documentation allowing the Foreign Investment Project to proceed, and these circumstances are found to exist, such authorities shall revoke the approval or record-filing pursuant to law. Where construction has already started and these circumstances are found to exist, the authority shall order the construction to stop pursuant to the law. In these instances, the relevant approval or record-filing authorities and related departments shall cause the violators to have a poor credit record, and shall prosecute the legal liability of related persons who are liable pursuant to the law.

One interpretation of the Administrative Measures is that they will strengthen the independence of enterprises when it comes to making their investment decisions and impact in a positive way the transformation of government functions. We will continue to stay current with the development of policies, rules and practices relating to the regulation of foreign investment and share these updates with you.

2. SAIC Releases Draft Provisions on Prohibiting Intellectual Property Abuse to Eliminate or Restrict Competition(Authors: Estella CHEN, Qihui LI)

On June 11, 2014, the State Administration for Industry and Commerce (the "SAIC) released a draft of the *Provisions of the Administration for Industry and Commerce Prohibiting Intellectual Property Abuse to Eliminate or Restrict Competition* to the public for comments (the "Draft"). The Draft cites

the principal in Article 55 of the *Anti-Monopoly Law*, which states that the "Anti-monopoly Law shall apply where a business operator abuses intellectual property to eliminate or restrict competition." If formally promulgated, the Draft will regulate in detail, and provide guidance on, the implementation of Anti-monopoly Law in the area of intellectual property. The main content of the Draft is set forth below.

The Draft prohibits business operators from reaching monopolistic agreements when using their Intellectual Property

Chapter two of the *Anti-monopoly Law* and the *Provisions by the Administration for Industry and Commerce Prohibiting Acts Relating to Monopolistic Agreements* stipulate in detail that business operators are prohibited from reaching monopolistic agreements when conducting economic activities. The Draft does not list in detail the types of monopolistic agreement that are prohibited in the area of intellectual property. Instead, the Draft only stipulates in general that business operators are prohibited from reaching monopolistic agreements when using their intellectual property and incorporates Article 13 and Article 14 of the *Anti-monopoly Law* for its application in practice.

Different from the provisions for economic activities in other areas, the Draft provides two specific acts involving the exercise of intellectual property that does not constitute monopolistic agreements: (i) the joint market share of the competing business operators in the relevant market affected by their acts does not exceed 20%, or there are least four other reasonably priced alternative substitutes of the technology available in the relevant market; (ii) the business operator and the counterparty's respective market share in the relevant market in the transaction does not exceed 30%, or there are least two other reasonably priced alternative substitutes of the technology available in the relevant market.

Based on these two exceptions described above, it may be concluded that the two factors the Draft takes into consideration when determining whether an act falls within the realm of these two exceptions. These two factors are: (i) market share in the relevant market of the business operator in question and (ii) the availability of reasonably priced alternative substitutes for the technology in the relevant market and the number of these alternatives that exist.

Acts involving the abuse of a market dominant position through the use of Intellectual Property

The Draft prohibits business operators with a dominant market position from abusing such position to eliminate or restrict competition. The Draft clarifies that the possession of intellectual property by business operators does not create the presumption that the business operators have a market dominant position (i.e. possession of intellectual property is not "per se" a violation of the *Anti-Monopoly Law*). Rather, the possession of intellectual property by business operators is merely a factor in determining the existence of a market dominant position.

The Draft specifically regulates in detail several common acts where business operators use intellectual property to abuse a dominant market position, as follows.

(1) Refusing to license intellectual property without providing valid reasons

While refusing to license its intellectual property is a lawful right of the business operator who owns a intellectual property, such refusal without valid reasons could strengthen the dominant market position of such business operator. In an attempt to create a balance between the need to encourage innovation and enforcing the *Anti-Monopoly Law*, the Draft stipulates that a business operator abuses its dominant market position only when it refuses to license intellectual property that is "indispensable" to the production and operation of counterparty. Article 7(2) of the Draft stipulates several factors that may be used to identify whether the intellectual property in question is "indispensable" to the production and operation of counterparty. The requirement that intellectual property be "indispensible" as a condition for determining abuse of market dominance with respect to the use of intellectual property may reflect a cautious attitude taken by the SAIC, which may have introduced this concept to avoid unnecessarily inhibiting innovation for competition reasons.

(2) Trade Restraints

Restraints on trade are commonly used to eliminate competitors. Consistent with the Provisions by the Administration for Industry and Commerce Prohibiting Acts Relating to Abuses of Dominant Market Positions, the Draft categorizes restraints on trade into the following categories: (i) limiting a counterparty to trading only with the business operator; (ii) limiting the counterparty to trading only with business operators designated by the business operator; (iii) requiring a counterparty not to trade with the business operator's competitors.

(3) Tying the sale of goods

The Anti-monopoly Law and the Provisions by the Administration for Industry and Commerce Prohibiting Acts Relating to Abuses of Dominant Market Positions both cover, in general terms, tying in connection with a sale of goods. Since in the field of intellectual property, tying is possible to produce technical and economic positive effects, the Draft sets forth comprehensive restrictions on tying from three perspectives: (i) intent of the counterparties, (ii) the nature of the tying good and the tied good and relationships associated with the tying good and the tied good, and (iii) the influence of the tying transactions for the relevant market of tying good. These three perspectives shed light on what types of tying transactions cannot be implemented in the area of intellectual property.

(4) Imposing Unreasonably Restrictive Conditions

Given that the intellectual properties and intellectual goods have special characteristics compared to normal goods, the Draft specifies six acts that constitute the imposition of

unreasonable conditions when business operators with a dominant market position exercise their intellectual property rights without providing valid reasons. The first four are specific to the field of intellectual property, and are as follows: (i) requiring counterparties to exclusively grant-back improvements to the intellectual property to the business operator; (ii) prohibiting counterparties from questioning the validity of the intellectual property; (iii) in the absence of an actual infringement by the counterparties, preventing counterparties from manufacturing, using, selling goods in competition with the business operator or developing, using technologies in competition with the business operator after the expiration of the license agreement; (iv) requiring counterparties to continue to pay royalties for intellectual property whose protection has expired or intellectual property that has been affirmed to be invalid.

We believe the SAIC identified these acts as restricting competition due to the SAIC's belief that they strengthen the dominant market position of business operators and because they inhibit technical innovation and are antithetical to intellectual property protection.

(5) Discriminatory Treatment

The Provisions by the Administration for Industry and Commerce Prohibiting Acts Relating to Abuses of Dominant Market Positions already contains stipulations on discriminatory treatment. The Draft does not add much additional detail in this regard, only generally stipulating that business operators with dominant market positions are prohibited from discriminating equivalent counterparties when exercising their intellectual property rights without providing valid reasons.

The Draft's regulation of four other particular acts pertaining to Intellectual Property

In addition and as a complement to regulations on monopolistic agreements and abuses of dominant market positions, the Draft also contains regulations on four other acts pertaining to intellectual property, which involve (i) patent pools, (ii) the formulation and implementation of patent standards, (iii) the activities of collective copyright management organizations, and (iv) arbitrary issuances of cease and desist letters pertaining to intellectual property rights.

(1) Patent consortiums, namely patent pooling may give rise to monopolistic agreements or abuses of market dominant positions during the course of their operation. Article 12 of Draft stipulates that where members of a patent pool exchange sensitive information with each other regarding competition such as price, production volume, market division, then such acts may constitute a monopolistic agreement prohibited by Article 13 and Article 14 of the Anti-monopoly Law. In addition, the following acts constitute an abuse of a market dominant position if such acts are done by members in a patent pool with a dominant market position or by the administration of a patent pool without providing valid reasons: (i) restricting members of the patent pool from licensing patents independently to any third parties outside the patent pool, (ii) restricting members of the patent pool or licensees from conducting research on technology that competes

with the patents in the patent pool, either independently or jointly with any third parties, (iii) requiring licensees to conduct exclusive grant-backs of improvements in the technology to members of the patent pool, (iv) prohibiting licensees from questioning the validity of patents in the patent pool, or (v) imposing discriminatory treatment on members of the patent pool or on licensees.

In practice, patent pools may be the most likely component in the field of intellectual property to raise competition issues. In addition to the specific regulations on patent pools described above, the patents in the pool and their relationship with each other, the judgment of whether a patent is necessary for the pool by independent experts and the determination of license fees may all influence the analysis of whether a patent pool will raise competition issues. However, the Draft does not address these additional issues more specifically. Presently, patent pooling is not common in the Chinese market. The few patent pools that do exist were established with policy support from the Chinese government. Accordingly, it remains to be seen how often the Draft will be applied to patent pools.

(2) Article 13 of the Draft introduces the international "FRAND" principle, which stands for "fair, reasonable and non-discriminatory" for patents. Specifically, business operators who have a dominant market position are deemed to have conducted acts restricting competition in violation of competition laws where they prevent other business operators from using standard essential patents under reasonable conditions, or they license standard essential patents with unfair conditions, or they conduct tying transactions when licensing patents.

(3) Article 14 of the Draft prohibits collective copyright management organizations from abusing their intellectual property and gives several examples when such abuse occurs. They include imposing unreasonable limits on membership or territorial reach through monopolistic agreements and other acts relating to dominant market positions such as refusing to issue licenses, imposing discriminatory treatment, requiring licensees to adopt unwanted licenses, or restricting members from exiting the organization.

(4) Article 15 of the Draft prohibits business operators who have a dominant market position from issuing cease and desist letters pertaining to purported intellectual property infringement where the intellectual property in question has expired or be affirmed as invalid, or if others have provided sufficient evidence showing that the targeted party has not infringed on the intellectual property in question.

Steps used to analyze and identify Intellectual Property abuses that eliminate or restrict competition, the procedures and legal consequences associated with such acts

Different levels of Administration for Industry and Commerce are the enforcement agency for intellectual property abuses that eliminate or restrict competition, and they are entitled to launch investigations of suspicious acts associated with such intellectual property abuses.

Article 17 and Article 18 stipulate the procedures the enforcement agency is required to follow and the factors it is required to consider when analyzing and identifying intellectual property abuses that eliminate or restrict competition. Article 19 of the Draft stipulates the legal consequences associated with reaching monopolistic agreements and abusing dominant market positions in the field of intellectual property. These legal consequences correspond with the relevant stipulations in the *Anti-monopoly Law*.

The Draft provides substantial guidance on the standards used to evaluate whether acts in the field of intellectual property eliminate or restrict competition as stipulated in the Anti-monopoly Law. We will keep track of further modifications or updates of the Draft, as well as its formal promulgation into law.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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