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Legal Updates

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1. Revision Draft of the Chinese Anti-Monopoly Law – What to Expect

Authors: Chen MA | Da SHI | Jiahao GUO

Key takeaways from the Revision Draft:

1. Holds liable **undertakings organizing or assisting the reaching of a monopoly agreement** in the same manner as participants in the monopoly agreement.
2. Introduces the **indispensability test** in addition to other tests to qualify for a monopoly agreement exemption, could further increase the difficulty in applying for exemptions.
3. Grants SAMR the right to adjust **Merger filing thresholds** to adapt to market changes.
4. Highlights **Authenticity of submitted documents and materials**, fines rise substantially for fraudulent materials or information.
5. Introduces **Stop-clock rules** for merger reviews, which could replace the current practice of withdrawal and refiling upon expiry of the 180-day statutory time limit.
6. Increases maximum fines to **RMB 50 million** in cases where cartels are reached but not implemented and where cartels are reached but the member(s) had no sales revenue in the previous year.
7. Increases maximum **fines for industry associations** to **RMB 5 million**.
8. Substantially raises maximum **fines in gun-jumping cases** to **10% of the sales revenue of the previous year**, which is expected to encourage filings to be made in general (and, in particular, will force undertakings to file for VIE-related transactions and VCs to reduce their veto rights to avoid triggering merger filings).
9. Formally introduces **criminal sanctions** as a consequence of violations, subject to criminal law provisions.
10. Substantially raises fines for **refusal or obstruction of investigation and review**.

On January 2, 2020, the first working day of the third decade of this century, the State Administration for Market Regulation ("**SAMR**") issued for public comment a revision draft (the "**Revision Draft**") of the *Anti-Monopoly Law of the People's Republic of China* (the "**AML**"). Efforts to revise the AML formally began several years ago with the State Council releasing the Legislative Work Plan for 2015, and revising the AML was listed on the legislative work plan of the Standing Committee of the 13th National People's Congress (the "**NPC**") in 2018. Centering around these revisions, guided by the Anti-Monopoly Committee under the State Council, SAMR is soliciting public comments from a broad array of stakeholders so as to revise the AML pursuant to both local and international experience to address crucial and vexing problems facing practitioners. The Revision Draft is SAMR's first public step toward revising the AML. In principle, following this step, SAMR will modify the Revision Draft in response to public comments and submit it for review to the Ministry of Justice, which will further modify the submitted draft including

suggestions and opinions from stakeholders. Thereafter, the Ministry of Justice will submit its own draft to Legislative Affairs Commission of the NPC Standing Committee. Then, the NPC Standing Committee will also release consultation drafts and seek one or more rounds of public comments before finally adopting the revisions and amending the AML. The legislative process often takes years, making the timeline difficult to predict. At present, revising the AML is classified in the legislative work plan as a Category 2 priority. We therefore believe that it could take five years or more to revise the AML, from its initial inclusion in the legislative work plan in 2018 until adoption of the revisions. That said, the legislative process can in theory be simplified or expedited for the NPC Standing Committee to deliberate and pass the final revisions to the AML.

The Revision Draft proposes revisions that reflect the requirements of law enforcement in practice, which could have a profound impact on different industries and markets. The revisions are not complex and mostly concern revising wordings in relation to concentrations of undertakings. That said, the potential effect of these revisions on anti-monopoly enforcement may prove to be comprehensive. Here, we select several key points from the Revision Draft for the purpose of revealing the origins, possible considerations, and potential effects of such revisions.

Fair Competition Review System ("FCR System") and the fundamental position of competition policies

The State Council promulgated the *Opinions of the State Council on Establishing a Review System for Fair Competition in the Course of Building the Market System* in 2016, raising the curtain on the FCR System. Thereafter, five departments constituting or under the State Council circulated the *Rules for Implementation of the Fair Competition Review System (Interim)* in 2017, facilitating the establishment of the FCR System nationwide. With respect to the FCR System, the Revision Draft imposes active obligations on administrative departments and confirms the Anti-Monopoly Committee under the State Council as the coordinator, a move popular among various stakeholders.

At the end of 2018, the Central Economic Work Conference put forward for the first time the policy to "strengthen the fundamental position of competition policies," which is incorporated into Article 4 of the Revision Draft. While the Revision Draft does not contain the principle of "competitive neutrality," the fact that the "fundamental position" of competition policies may become a general provision of the AML suggests that competition policies and an institutional environment for fair competition are gaining more ground in the economic system.

Identification of monopoly agreements and abuse of dominant market positions

I. Monopoly agreements

Two changes proposed in the Revision Draft targeting monopoly agreements are particularly eye-catching. First, Article 17 adds that "undertakings are prohibited from organizing and assisting other undertakings to reach monopoly agreements." Further, Article 53 provides that the legal liability of undertakings in a monopoly agreement also applies to the undertakings which organize and assist those undertakings to enter into the monopoly agreement. Combined with the general definition of

monopoly agreements provided as a separate Article 14, complicated scenarios in practice may be addressed effectively which do not constitute traditional horizontal and vertical monopoly agreements (note, however, monopoly agreement exemptions provided in Article 18 of the Revision Draft do not explicitly apply to Article 14, which implies that regulators may not cite Article 14 alone in enforcement actions). For example, in dealing with hub-and-spoke cartels, competition authorities would have new enforcement tools and not be limited to proving vertical relationships; moreover, in addition to industry associations, conference organizers and market research institutions, etc. could also fall under the jurisdiction of the AML, provided that such entities have sufficient knowledge of the nature of the monopolistic conduct at issue.

Second, currently, two tests must be satisfied for monopoly agreements to be exempted under the AML: it must be proven that the agreements will “not substantially restrict competition in the relevant market” and that they will “enable the consumers to share the benefits derived therefrom.” The Revision Draft adds that “the agreements reached shall be indispensable for achieving the desired objectives,” further specifying the conditions for exemption for the purpose of ascertaining the indispensability of restrictive arrangements, but also making it more difficult to qualify for the exemption. That said, the indispensability test is not a new concept in China, it has been proposed indirectly by the National Development and Reform Commission in a public comment draft of the *Guidelines on the General Conditions and Procedures for Exemption of Monopoly Agreements (Draft for Comment)*, which provides in Article 7 that account must be taken of “(2) causation between the agreement and the circumstances realized; (3) the importance of the agreement to realizing the circumstance.”

II. Abuse of dominant market position

Certain revisions also deserve attention in the chapter on abuse of dominant market position. First, Article 20 of the Revision Draft adjusts the tests for differential treatment by deleting the “same conditions” test. “Same conditions” has always been a prerequisite for differential treatment in China’s antitrust rules; the *Interim Provisions on Prohibiting Abuse of Dominant Market Positions,* promulgated by SAMR, clarifies in Article 19 that the meaning of “same conditions” is “there are no differences that substantively affect transactions between the transaction counterparties in terms of transaction security, transaction cost, scale and capability, credit status, transaction process involved, duration of transaction, and other aspects.” That said, we expect that in practice, even without the “same conditions” test, undertakings holding dominant market positions could also rely on legitimate reasons to justify their transaction terms.

Second, in identifying dominant market positions under Article 21, factors are introduced regarding the dominant market positions of undertakings in the internet industry and other fields of the new economy, including but not limited to network effects, economies of scale, lock-in effects, and data resources. Such factors have been used in practice and are stipulated in Article 11 of the *Interim Provisions on Prohibiting Abuse of Dominant Market Positions*. Now, these factors may be confirmed in the form of law rather than merely in departmental rules.

Third, the Revision Draft makes no mention of “relative advantageous positions,” which may ease the concerns of some undertakings.

Merger control

Merger control is the big-ticket item of the Revision Draft. The corresponding revisions incorporate certain rules prescribed in supporting rules and regulations, and reflect the experiences of law enforcement in merger control. We find the following aspects to stand out among the revisions proposed in the Revision Draft:

First, Article 24 authorizes SAMR to adjust merger filing thresholds pursuant to the development of the economy, the scale of industries, and other factors, to keep pace with the times. Merger filings are currently subject to two fixed thresholds pursuant to the *Provisions of the State Council on Notification Thresholds for Concentrations of Undertakings*.

Second, the Revision Draft highlights the authenticity of documents and materials submitted for review. Article 26 adds a new clause providing that undertakings shall "be responsible for the authenticity of such documents and materials," and Article 51 further provides that SAMR may carry out an investigation pursuant to law and revoke the original review decision in the case of inauthenticity or inaccuracy of such documents and materials, either at the request of an interested party or ex officio. SAMR relies heavily on documents and materials submitted by filers in their merger control reviews, hence they champion authenticity of such documents and materials. Article 59 targets the submission of fraudulent materials and information by raising fines against entities from RMB 200,000 (normal violations) or RMB 1 million (serious violations) to no more than 1% of the sales revenue of the previous year or RMB 5 million (no sales revenue or revenue being difficult to calculate), and raises fines against individuals from RMB 20,000 (normal violations) or RMB 100,000 (serious violations) to between RMB 200,000 and 1 million. Article 59 of the Revision Draft increases fines substantially, which would increase the importance of compliance.

Third, Article 30 adds new stop-clock rules through prescribing three scenarios under which the elapse of time does not count toward the review period. These three scenarios are all necessary in practice: "upon application or consent by the notifying parties," "supplementary submission of documents and materials" and "consultation in relation to proposals for restrictive conditions." Currently, in the absence of stop-clock rules, it is common practice to withdraw and subsequently re-file transactions when the review period is running out. The establishment of stop-clock rules would predictably reduce the frequency of such practices, and we look forward to more detailed rules in this regard which support procedural transparency.

Fourth, for concentrations smaller in scale but which have the effect of potentially restricting or eliminating competition, Article 24 introduces that an investigation is to be carried out where a concentration of undertakings does not reach the merger filing thresholds but has or might have the effect of restricting or eliminating competition, a provision currently found in the *Provisions of the State Council on Notification Thresholds for Concentrations of Undertakings*. Article 34 further provides that such concentrations may be subject to unconditional or conditional approvals or prohibitions. For implemented concentrations, measures may be required to restore the status of competition prior to the concentration. Article 34 further confirms SAMR's power to initiate investigations against concentrations, and could prompt (or even normalize) the filing of transactions that fall short of merger filing thresholds but involve large market shares, while at the same time rendering uncertain certain deals that have closed.

Fifth, Article 55 increases the maximum fines in gun-jumping cases from RMB 500,000 to no more than

10% of the sales revenue of the previous year. The substantial increase in fines would partly unify with fines for monopoly agreements and abuse of dominant market positions. This revision could lead to a significant rise in the number of filings; but if combined with the potential adjustment of merger filing thresholds, SAMR may be more effective in its work while maintaining a stable workload. If the revisions are adopted in their current form, circumstances regarding VIE-related transactions and venture capital investments could be particularly interesting to watch. While SAMR has in the past shied away from VIE transactions, the regulator may finally have to tackle this issue head-on if market players make VIE-related filings en masse due to the enhanced fines. Venture capital funds that obtain important veto rights while neglecting the filing requirement could need to either make the filings or forgo such rights.

Investigations

With respect to investigations, we find the following aspects of the Revision Draft to be noteworthy. First, Article 44 provides that the public security departments will assist with investigative measures against suspected monopolistic conducts; this would assure the effective implementation of investigative measures such as investigating business premises, interviewing employees, reviewing and duplicating documents and materials, and seizing and taking custody of evidence.

Second, on commitments of undertakings, Article 50 of the Revision Draft forbids any suspension of investigations against cartels involving prices, quantities, and market partition, incorporating Article 22 of *Interim Provisions on Prohibition of Monopoly Agreements*.

Third, Article 53 raises the maximum fines from RMB 500,000 to RMB 50 million, which targets scenarios where monopoly agreements are reached but not implemented, and where monopoly agreements are reached but the undertakings had no sales revenue in the previous year. For industry associations, the maximum fines increase from RMB 500,000 to RMB 5 million. These revisions could increase the deterrent effect of the fines against such misconduct.

Legal liabilities

Legal liabilities are another important change in the Revision Draft. Particularly regarding maximum fines in gun-jumping cases, the tone from the antitrust community has been more or less the same – raise it up. We have mentioned above several revisions on legal liabilities, here we summarize the revisions on legal liabilities below for further analysis:

1. On reaching and implementing monopoly agreements, the Revision Draft maintains legal liabilities including ordering discontinuance of violations, confiscating illegal gains, and imposing a fine between 1%-10% of the sales revenue of the previous year. Where monopoly agreements are reached but not implemented, and where monopoly agreements are reached but the undertakings have no sales revenue in the previous year, the maximum fines increase from RMB 500,000 to RMB 50 million; for industry associations, the maximum fines increase from RMB 500,000 to RMB 5 million.

2. On abuse of dominant market positions, the Revision Draft retains the previous legal liabilities.

3. On merger control, Article 55 specifies that gun-jumping consists of (1) implementing a notifiable

concentration without filing; (2) implementing a notifiable concentration without obtaining clearance after filing is made; (3) violation of conditional approval decisions; and (4) implementing a concentration in violation of injunctions. Categories (1) and (3) are specified in the *Interim Measures for Investigation and Handling of Failures to Give Prior Notification of Concentrations of Undertakings* and the *Provisions on Imposing Additional Restrictive Conditions on Concentrations of Undertakings (for Trial Implementation)*, category (2) provides legal consequences for violating Article 24, and category (3) corresponds to Article 32.

4. On merger control, based on the four categories, the Revision Draft maintains legal liabilities including ordering discontinuance of concentrations, ordering disposal of shares or assets within a time limit, ordering transfer of businesses within a time limit, and adoption of other necessary remedial measures to return to the state prior to the concentration, and adds three new remedial measures based on restrictive conditions – imposing and changing restrictive conditions and ordering continued performance of restrictive conditions. More importantly, the Revision Draft raises the maximum fines in gun-jumping cases from RMB 500,000 to no more than 10% of sales revenue for the previous year. The substantially increased fines would partly unify with the fines for monopoly agreements and abuse of dominant market positions.

The approach to defining the sales revenue base used in determining fines awaits further clarification. We note there could be disparities among fines for different monopolistic conducts if SAMR were to impose fines in gun-jumping cases by calculating the sales revenue base by considering all products and all regions while continuing to limit geographic and product scopes when imposing fines for monopoly agreements and abuses of dominant market positions.

Another issue concerning administrative penalties is the retroactivity of the revised AML for deals closed prior to its effectiveness. Article 29 of the *Law on Administrative Penalty* provides that administrative penalties will not be imposed where the illegal conduct is not discovered by the authorities within two years of its commission, unless otherwise prescribed by law. The two-year period is considered to "be counted from the date the illegal conduct is committed; if the conduct is of a continual or continuous nature, it shall be counted from the date the conduct is terminated." SAMR (and its predecessor, MOFCOM) appear to view gun-jumping as of "a continual or continuous nature," because they have penalized transactions that have been closed for over two years. The *Law on Administrative Penalty* does not address how revisions of law apply to punishment of illegal conduct that is continual or continuous and exists both pre- and post-revision (*i.e.*, committed under the preceding AML, but extends to the period after the revised AML takes effect). In similar situations under the *Criminal Law*, however, the principle is to apply the revised law. As a result, filers of such gun-jumping cases closed under the preceding AML potentially face the risk of being penalized under the revised AML and thus subject to fines far higher than the current maximum amount of RMB 500,000. We expect transition rules or further guidance to be issued to address such circumstances.

Moreover, the Revision Draft adds "eliminate the consequences of the illegalities" among factors provided in Article 56 to determine the amounts of fines. In practice, this factor has been widely referenced and can also be found in penalty provisions in the *Guidelines on Recognizing the Illegal Gains Obtained by Undertakings from Monopolistic Conduct and Determining the Amounts of Fines (Draft for Comment)*.

Article 57 adds criminal sanctions in addition to existing civil liabilities – “[w]here a crime is constituted, the relevant undertakings shall be subject to criminal liabilities.” Currently, bid rigging, rigging prices of stocks or futures, and other monopoly-related conducts are already included in the *Criminal Law*. This provision in Article 57 reaffirms the position of regulators to criminalize certain monopolistic conducts.

For refusal or obstruction of investigations and reviews, Article 59 of the Revision Draft raises fines for enterprises from RMB 200,000 (normal violations) or RMB 1 million (serious violations) to no more than 1% of the sales revenue of the previous year or RMB 5 million (no sales revenue or revenue being difficult to calculate); and raises fines for individuals from RMB 20,000 (normal violations) or RMB 100,000 (serious violations) to between RMB 200,000 and 1 million. The proposed increase in fines should ensure the orderly handling of enforcement actions.

Investigations

Since its entering into force in 2008, the AML has gained more weight in the socialist market economy and civil life: the number of law-enforcement cases and the amount of fines are increasing, and market competition is protected by relying on these diligent efforts. Beginning in this new decade, the AML should and will play a bigger role in the market. The Revision Draft summarizes and addresses certain problems facing practitioners, but still needs to be perfected by taking into account the opinions of a wide spectrum of stakeholders both inside and outside the antitrust community. It remains to be seen how revisions to the AML will further take shape following the public comment period.

2. Highlights of the New PRC Securities Law

Authors: TieCheng YANG | Yang CHEN | Zhao ZHANG | Virginia QIAO | Zhenyu WANG | Shuozhu ZHENG

On 28 December 2019, the 15th Meeting of the Standing Committee of the 13th National People's Congress adopted revisions to the *Securities Law of the People's Republic of China* (the "**Securities Law 2019**"), which will become effective on 1 March 2020. Since China first officially adopted the *Securities Law of the People's Republic of China* (the "**Securities Law**") in 1998, the Securities Law has undergone three amendments and two revisions over the past 20 years. The Securities Law 2019 is widely regarded as unfurling a new chapter for the comprehensive implementation of the securities issuance registration system, marking a significant step for China's capital markets on the road to marketization, rule of law, and internationalization.

Historical Review of the Securities Law

Key Revisions to the Securities Law

As compared to the currently effective version of the Securities Law last amended in 2014 (the "**Securities Law 2014**"), the key revisions in the Securities Law 2019 are as follows:

I. Comprehensive implementation of the "securities issuance registration system"

The comprehensive implementation of the "securities issuance registration system" is one of the highlights of the Securities Law 2019. On 27 December 2015, the Eighteenth Meeting of the Standing Committee of the Twelfth National People's Congress adopted the *Decision on Authorizing the State Council to Adjust the Application of Relevant Provisions of the Securities Law of the People's Republic of China during the Reform of the Stock Issuance Registration System* (the "**Authorizing Decision**"), authorizing the State Council to apply flexibly the provisions of the Securities Law in the stock issuance approval system based on the requirements for the reform of the stock issuance registration system, and to make flexible arrangements for the registration system. The Authorizing Decision, which came into effect on 1 March 2016, was renewed once in February 2018, and is slated to expire on 29 February 2020. After the Authorizing Decision was adopted, the registration system was first piloted on the STAR Board in March 2019. After nearly ten months of operation, the registration system on the STAR Board was considered fully practiced and tested.

Highlights of the registration system under the Securities Law 2019:

1. The registration system applies to all "public securities offerings". The Securities Law 2019 explicitly provides that **public securities offerings** are required to satisfy the criteria provided in the laws and administrative regulations, and be registered with **the securities regulatory authority under the State Council (i.e. CSRC)** or **other departments legally authorized by the State Council**. No organization or individual may publicly issue securities without registration in accordance with law.

2. Discretion remains for the design of specific systems within the registration system. The newly added Article 18 in the Securities Law 2019 provides for the requirements on application documents, and the addition of Article 9, which states in part "the specific scope and implementation steps of the registration system shall be formulated by the State Council" leave space for the issuance system of the STAR Board and the link between the issuance and the direct transfer-board systems of the National Equities Exchange and Quotations ("**NEEQ**"), which reflects more mature legislative skills.

3. Employee stock option plans ("**ESOPs**") will no longer be subject to the 200-investor limitation on a look-through basis. The Securities Law 2019 clearly provides that the number of employees in an ESOP implemented in accordance with the law is not counted within the scope of a "public offering" of securities to more than 200 specific investors. In combination with the *Q&A of the Shanghai Stock Exchange on the Review of the Issuance and Listing of Stocks on the Science and Technology Innovation Board* and the further clarification of relevant supporting rules, (i) ESOPs that follow the "closed loop principle"[1]; and (ii) other ESOPs that are legally established, normatively operated, have

[1] "Closed-loop principle": The ESOP shall not allow any transfer of any stocks at the time of IPO of the enterprise, with a lock-up period of at least 36 months from the date of listing promised. If an employee, during the lock-up period before and after listing of an issuer, intends to transfer and withdraw the relevant rights and interests he/she holds, he/she may only transfer such rights and interests to the employees in the ESOP or other eligible employees. If an employee, after the lock-up period, intends to transfer and withdraw the relevant rights and interests he/she holds, such rights and interests shall be dealt with in the way stipulated in the articles of association of the ESOP or the relevant agreement.

If an ESOP does not follow the "closed-loop principle", it shall be composed of employees of the enterprise, be established according to the law and be operated in a standardized manner, and shall have been filed for record with AMAC according to laws and regulations.

been filed with the Asset Management Association of China in accordance with the laws and regulations, or otherwise permitted under the applicable rules and regulatory framework, can be deemed to be an ESOP that will no longer be subject to the 200-investor limitation on a look-through basis provided by the Securities Law 2019.

4. The key of the registration system is to entrust the rights of choice to the market under a developed information disclosure system. Therefore, the Securities Law 2019 has correspondently revised the following conditions for initial public offerings:

   A. **From** "**sustainable profitability**" **to** "**sustainable operating ability**". Under the registration system, regulators are no longer concerned whether issuers are profitable, in the same manner as the profitability of high-tech innovation companies is not a necessary condition for initial public offerings under the STAR Board issuance system. The above revisions in the Securities Law 2019 also create space for other stock exchange boards other than the STAR Board to remove the financial requirements of "profitability" as a criterion for initial public offerings.

   B. **From** "**in good financial standing; no false entries in its financial and accounting documents for the preceding three years**" **to** "**audit report with unqualified opinion is issued on the financial and accounting documents in the preceding three years**". The Securities Law 2014 requires substantive regulatory review to determine whether an issuer is in "good" financial standing and has "no false entries". In contrast, the Securities Law 2019 is revised to require an "audit report with an unqualified opinion". While the responsibility of judging the issuer's financial standing is compressed into the work of intermediaries, regulatory reviews will be adjusted from subjective determinations to objective standards to meet the requirements of the registration system.

   C. **From** "**has not committed a major violation of law**" **to** "**its issuer, controlling shareholder and actual controller have not committed any crimes such as corruption, bribery, embezzlement of property, misappropriation of property or destruction of the order of the socialist market economy in the preceding three years**". The Securities Law 2019 refines the compliance requirements for IPO issuers, specifying types of crimes while also expanding the scope of applicable subjects to include the issuer's controlling shareholder and actual controller, which is more in line with practical regulatory standards.

5. Under the registration system, the requirements for public offerings of corporate bonds have been reduced. The requirements for the issuer's minimum net assets and the ratio of outstanding bond balances to net assets of the company have been replaced by "have a sound and well-functioning organizational structure". The Securities Law 2019 reflects a more market-oriented bond pricing mechanism by removing the previous requirements that: (i) the use of funds raised in the public offering be approved, and (ii) the coupon rate of the corporate bonds not exceed the coupon rate stipulated by the State Council.

6. Clarification on the scope of duties of the regulators under the registration system. According to Article 21 of the Securities Law 2019, the registrar is the securities regulatory authority under the State Council (i.e. CSRC) or another department authorized by the State Council. The review bodies are

the stock exchanges. At the same time, Article 21 clarifies that the review bodies are mainly responsible for judging whether an issuer meets the issuance conditions and information disclosure requirements, and supervising and urging issuers to improve information disclosures. Based on the operation practices of the STAR Board, the review bodies reveal potential risks and problems of the issuers mainly by supervising and urging issuers and intermediaries to continuously improve disclosures of information. The core content of the registration system is that review bodies, issuers, and intermediaries each perform their duties, and issuers and intermediaries are fully accountable.

The Securities Law 2019 clarifies the principle of comprehensively implementing the registration system for public securities offerings, and the scope of the registration system has been expanded in legislation. However, public securities offerings may involve different securities markets, enterprises of different economic types, and diversified securities types. In practice, regulators will formulate and adjust supporting implementation rules in multiple stages and steps combined with the development stages of the securities markets and actual needs to support the real economy.

II. Provisions on the sale of shares

The Securities Law 2019 does not reflect the restriction, as provided in the third deliberation draft and the rules and implementation measures of CSRC and stock exchanges on the sale of stocks, i.e., the total shares sold by a shareholder of a listed company through centralized price competition within three months may not exceed 1% of the total shares of the company. Instead, the Securities Law 2019 adds Article 36, which states that:

"The sale of shares by shareholders holding more than 5% of the shares, actual controllers, directors, supervisors, senior management personnel, and other shareholders of listed companies holding shares issued before initial public offerings or shares issued to specific targets shall not violate regulations regarding such as the lock-up period, time, amount and method of sale, and information disclosure provided by the laws, administrative regulations and other regulatory requirements by the securities regulators, and shall comply with the business rules of the stock exchanges".

This revision leaves discretion for CSRC and the stock exchanges to adjust specific regulations regarding the lock-up period, and the requirements regarding time, amount, methods and disclosure obligations for sale of shares based on the needs of the capital markets. In addition, the Securities Law 2019 clearly provides punishments for illegal share sales, i.e. orders to correct, warnings, confiscation of illegal income, and fines below the equivalent value of securities traded, and providing a more direct legal basis for administrative punishments for illegal share sales.

III. Short-swing trading

The revisions in the Securities Law 2019 on short-swing trading mainly focus on the following aspects:

1. The rules for short-swing trading apply not only to listed companies, but also to companies whose shares are listed on other nationwide securities trading agencies approved by the State Council, such as NEEQ-listed companies.

2. Short-swing trading rules apply not only to stocks, but also to depositary receipts, convertible bonds,

and other equity-type securities recognized by the State Council in accordance with law.

3. The scope of restrictions on short-swing trading has been expanded. In addition to directors, supervisors, senior management personnel, and shareholders holding more than 5% of the shares as currently required, the revised Article 44 of the Securities Law 2019 also applies the short-swing trading rules to shares or other equity-type securities held by or held through others' accounts, including by spouses, parents and children of directors, supervisors, senior management personnel and natural person shareholders.

IV. Changes of equity interest

The Securities Law 2019 revises the rules on changes of equity interest mainly in the following aspects:

1. In determining reportable changes of equity interest, the Securities Law 2019 specifies that "voting shares" be considered the basis of an investor's equity interest in a listed company. This differs from the Securities Law 2014, which considers the investor's overall shareholding ratio as the basis for determining changes of equity interest. This change to "voting shares" supplements and improves the core element regarding changes of equity interest. Specifically, the revised Article 63 provides：

   A. When the shareholding of an investor reaches 5% of the **voting shares** issued by a listed company, the investor shall, within three days from the date on which such shareholding becomes a fact, report in writing to the securities regulatory authority under the State Council and the stock exchange, inform the said listed company of the fact and make an announcement thereof. The investor shall not continue to purchase or sell the shares of the said listed company within three days from the date on which such shareholding becomes a fact, unless otherwise stipulated by the securities regulatory authority under the State Council.

   B. When the shareholding of an investor has reached 5% of the issued **voting shares** of a listed company, for every 5% increase or decrease in such shareholdings thereafter, the investor shall, within three days from the date on which such shareholding becomes a fact, report in writing to the securities regulatory authority under the State Council and the stock exchange, inform the said listed company of the fact and make an announcement thereof. **From the date of occurrence of the fact until three days after the announcement**, the investor shall not further purchase or sell the shares of the listed company, unless otherwise stipulated by the securities regulatory authority under the State Council.

      The revisions to Article 63 cause the sensitive period for changes of equity interest to be more complete, rigorous and strict. The Securities Law 2019 changes the expression of the benchmark of the sensitive period from "during the period of report … and after the report and announcement" to "from the date of occurrence of the fact until the public announcement". This change means that the sensitive period is based on the occurrence of an objective fact, which makes determination of the sensitive period stricter and clearer. The revisions also extend the sensitive period from two days to three days, further extending the duration of the sensitive period.

   C. In case of purchase of voting shares of a listed company within the sensitive period in violation of the above two provisions, **the voting rights shall not be exercised for the shares in excess of**

the prescribed ratio within 36 months after the purchase.

This is a new requirement of the Securities Law 2019, the voting rights of shares purchased in violation of the sensitive period are restricted from being exercised for a period of up to 36 months.

D. When the shareholding of an investor has reached 5% of the issued voting shares of a listed company, for every 1% increase or decrease in such shareholdings thereafter, the investor shall notify the listed company on the day following occurrence of the fact and make an announcement thereof.

This is a new requirement in the Securities Law 2019. It should be noted that this provision only requires investors to perform a disclosure obligation and does not prohibit investors from buying or selling shares in the listed company during the sensitive period.

2. The content of the public change of equity interest announcement includes:

A. Name and domicile of the shareholder;

B. Name and the amount of the shares held;

C. The date on which the shareholding or any increase or decrease in the shareholding reaches the statutory percentage, and the source of funds used to purchase the shares; and

D. The time and manner of the change in the voting shares of the listed company. Compared with the Securities Law 2014, the Securities Law 2019 imposes new requirements on the disclosure of the source of funds used to purchase the shares as well as time and manner of change in the voting shares.

V. Acquisition of listed companies

The revisions made to the relevant rules on the acquisition of the listed company by the Securities Law 2019 mainly include:

1. Prohibition on certain additional changes to the terms of an acquisition offer:

A. Reducing the purchase price;

B. Reducing the amount of the proposed acquisition shares in the acquisition offer;

C. Shortening the acquisition period; and

D. Other circumstance stipulated by the securities regulators.

2. In the event of the listed company issuing different share classes, the acquirer may put forward different acquisition conditions for different share classes.

3. Extension of the lock-up period. During the acquisition of a listed company, the shares in such company held by the acquirer may not be transferred for a period of 18 months following completion of the acquisition. The Securities Law 2019 lengthens the lock-up period compared with the 12-month period as stipulated in the Securities Law 2014.

VI. Information disclosure

The newly added Chapter V of the Securities Law 2019 contains provisions on the information disclosure system, and is intended to improve the information disclosure system in a systematic manner, impose higher requirements on information disclosure obligors, better protect the right to know of investors, especially small- and medium-sized investors, and lay a solid foundation for the implementation of the registration system reforms. The main points of the information disclosure system under the Securities Law 2019 are as follows:

1. Broadening the scope of information disclosure obligors from the issuers to other information disclosure obligors stipulated by laws, administrative regulations, and securities regulators.

2. Setting forth explicit quality requirements on information disclosure by law. Information disclosed is required to be true, accurate and complete, concise and clear, easy to understand, and shall not contain any false information, misleading representations or major omissions.

3. Information disclosed domestically required to be synchronized with that disclosed overseas. Where the securities are publicly issued and traded domestically and overseas at the same time, the information disclosed overseas by the information disclosure obligors shall be simultaneously disclosed domestically.

4. Specifying the content of information disclosure. Details are provided on the significant events that have a significant impact on stock and bond trading prices.

5. Substantiating the obligations of the board of directors, supervisors and senior management personnel of the issuer in the information disclosure process, and granting them the right to raise and disclosing their explicit objections to the content in information disclosures.

VII. Insider trading

The revisions in the Securities Law 2019 further improve the regulations regarding the scope of persons with access to insider information and the scope of insider information, and enhance the punishment for illegal insider trading. Any individual who engages in insider trading in violation of Article 53 of the Securities Law 2019 will be ordered to dispose of the illegally held securities in accordance with law; the illegal income shall be confiscated and a fine shall be concurrently imposed ranging from one to ten times the illegal income; where there is no illegal income or the amount of illegal income is below CNY 500,000, a fine ranging from CNY 500,000 to CNY 5,000,000 shall be imposed. For entities engaging in insider trading, the person-in-charge and other personnel who are directly responsible shall be issued a warning and be subject to a fine ranging from CNY 200,000 to CNY 2,000,000.

VIII. Investor protection

The newly added Chapter VI of the Securities Law 2019 significantly enhances the protection of investors, especially for small- and medium-sized investors:

1. Clarification of investor suitability management. For the first time at the legislative level, investors

are clearly distinguished into ordinary investors and professional investors. This revision provides that, in the case of any dispute between an ordinary investor and a securities company, the burden of proof shifts from the ordinary investor to the securities company. Where an ordinary investor submits a request for settlement, the securities company may not refuse such request.

2. Establishment of a new system for solicitation and exercise in proxy of shareholder's rights of a listed company. Qualified solicitors include the board of directors of the listed company, independent directors, and shareholders holding more than 1% of the voting shares or the investor protection institution established by the State. The rights of shareholders solicited to exercise include proposal rights, voting rights, etc. Meanwhile, paid solicitations or any other paid solicitations in disguised form are prohibited.

3. Setting up a new mechanism for advance compensation. Where an issuer causes losses to investors due to fraudulent issuances, fraudulent representations or any other significant illegal acts, the controlling shareholder, actual controller of the issuer, or the relevant securities companies may entrust an investor protection institution to enter into an agreement on compensation issues with investors who suffer losses and make compensation in advance. Upon making compensation in advance, recourse may be sought by the securities company against the issuer and other parties jointly held liable pursuant to law.

4. Improvement on the representative litigation mechanism of securities litigation:

   A. In case an investor protection institution (which refers to the investor protection institutions established in accordance with the laws, administrative regulations or the provisions of the securities regulators) holds the shares of the listed company, under two special circumstances, i.e., (i) any director, supervisor or senior management personnel of the issuer violates the laws, administrative regulations or the articles of association of the company during his/her performance of duties in the company and causes losses to the company, or (ii) any controlling shareholder or actual controller of the issuer infringes the legitimate rights and interests of the company and losses to the company are caused, an action may be brought to the people's court in his/her own name for the benefit of the company. The shareholding ratio and shareholding period of the investor protection institution is not subject to the restriction of "holding one percent or more of the company's shares individually or jointly for 180 or more days consecutively" in general shareholder actions.

   B. When an investor brings a securities-related civil compensation action such as fraudulent representation, if the subject matter of the action is of the same type and there are multiple litigants of one party, a representative action may be adopted. The investor protection institution may be appointed by more than 50 investors to participate in the action as a representative.

IX. Legal liability

The Securities Law 2019 greatly enhances punishment for relevant securities violations. Where an issuer or any of its controlling shareholders, actual controllers or other related subjects obtains illegal income, such illegal income will be confiscated and the amount of administrative punishment imposed will be raised. Where the amount of the fine is calculated based on the amount of the illegal income,

the amount of such fine is raised from one to five times to one to ten times. Where an explicit range of fine is prescribed, the amount of fine is raised from CNY 300,000 to CNY 600,000, as generally prescribed in the Securities Law 2014, to respectively: CNY 2,000,000 to CNY 20,000,000 (such as fraudulent issuance), CNY 1,000,000 to CNY 10,000,000 (such as fraudulent representation, market manipulation, and public issuance without authorization), CNY 500,000 to CNY 5,000,000 (such as insider trading and alteration of the purpose of the funds raised through public issuance of securities without authorization), etc.

In addition, the Securities Law 2019 also enhances the legal liabilities of securities service intermediaries. For example, a sponsor who issues a sponsor's letter which contains fraudulent information, misleading representations or major omissions or who fails to perform other statutory duties shall be ordered to make corrections and be issued a warning; the business income shall be confiscated and the sponsor will be imposed with a fine ranging from one to ten times of the business income; where there is no business income or the amount of business income is below CNY 1,000,000, a fine ranging from CNY 1,000,000 to CNY 10,000,000 shall be imposed; where the case is serious, the business license for engaging in sponsoring shall be suspended or revoked. The person-in-charge and other personnel who are directly responsible shall be issued a warning and be subject to a fine ranging from CNY 500,000 to CNY 5,000,000.

X. Other important revisions

Other important and noteworthy revisions in the Securities Law 2019 also include:

1. Expansion on the applicable scope of the Securities Law. In order to adapt to the previous reform of the new rules on depository receipts, depository receipts are clearly defined as statutory securities. Asset-backed securities and asset management products are explicitly written into the Securities Law 2019. And the State Council is authorized to formulate the administrative measures for their issuance and trading under the principles of the Securities Law 2019. At the same time, in view of the realistic needs of cross-border regulations in the securities industry, the Securities Law 2019 specifies that securities issuance and trading activities outside China which disrupt the market order in China and damage the legitimate rights and interests of domestic investors will be subject to legal liability in accordance with the Securities Law.

2. Establishment of a multi-level capital markets system. The Securities Law 2019 divides securities trading platforms into three different levels, including stock exchanges, other nationwide securities exchanges approved by the State Council, and regional equity markets established according to the provisions of the State Council. The Securities Law 2019 defines the self-discipline management power of stock exchanges and other nationwide securities exchanges approved by the State Council, as well as specifies that the regional equity markets established according to the provisions of the State Council may only handle the issuance or transfer of securities in a non-public manner.

Supporting Rules for the Securities Law 2019

The revisions made to the Securities Law cover the issuance and trading of securities, acquisition of the listed company, information disclosures, securities registration and settlement, etc. Accordingly, we

expect to see revisions to be made in conformity with the Securities Law 2019 in administrative measures for initial public offering and listing, stock listing rules, stock trading rules, administrative measures for the acquisition of the listed company, information disclosure rules, administrative measures for the issuance and trading of corporate bonds, the corresponding rules of the NEEQ and other supporting rules. We will also pay further attention to the revisions of the supporting regulations of the Securities Law 2019 and share our views with readers in a timely manner.

3. Practice Guide: Applying to Mainland Courts for Interim Measures during Hong Kong Arbitral Proceedings

Authors: Xianglin CHEN | Yanyan WANG | Ying SUN

In 2019, one of the most important events in the field of China-related international commercial arbitration was the signing on April 2 and entry into force on October 1 of the *Arrangement of the Supreme People's Court of the People's Republic of China Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region* (the "**Arrangement**"). Supplementary to the Arrangement, the Research Office of the Supreme People's Court promulgated the *Understanding and Application of the Arrangement of the Supreme People's Court Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region* (the "**Understanding and Application**").

For your reference, we have summarized based upon our practice experience the key issues regarding applying to Beijing courts for interim measures by parties to Hong Kong arbitral proceedings under the Arrangement.

Which intermediate people's court should receive the application for interim measures submitted during a Hong Kong arbitral proceeding?

According to Article 3 of the Arrangement, applications for interim measures should be submitted to a single Mainland court having jurisdiction. Specifically, a party to a Hong Kong arbitral proceeding should submit the application to the "**Intermediate People's Court of the place of residence of the party against whom the application is made or the place where the property or evidence is situated**… If the place of residence of the [party] or the place where the property or evidence is situated fall within the jurisdiction of different people's courts, the applicant shall make an application **to any one of those people's courts but shall not make separate applications to two or more people's courts**" (emphasis added).

The above provisions are relatively straightforward. However, in practice, uncertainty remains whether the provisions on centralized jurisdiction applicable in Beijing municipality also apply to applications for interim measures made in overseas arbitral proceedings.

According to the *Provisions of the Beijing High People's Court on the Jurisdiction of Cases of the Fourth Intermediate People's Court of Beijing* (the "**Provisions**") promulgated in 2018 by the Beijing High People's Court, foreign-related arbitration judicial review cases in Beijing are subject to the centralized jurisdiction of the Beijing Fourth Intermediate People's Court. See Article 1, items 2, 3, and 4 of the Provisions:

"The Beijing Fourth Intermediate People's Court (Beijing Railway Transport Intermediate Court) has jurisdiction over the following cases: ... (2) commercial cases of the first instance where the subject matter under the jurisdiction of this municipal people's court is no more than 200 million RMB which are foreign-related or involve the Hong Kong Special Administrative Region, the Macao Special Administrative Region,

or the Taiwan Region; (3) cases under the jurisdiction of this municipal people's court which apply to confirm the validity of arbitration agreements, or to revoke arbitral awards (excluding cases applying for revocation of labor dispute-related arbitral awards); (4) review cases under the jurisdiction of this municipal people's court for applications to recognize and enforce foreign arbitral awards, or to recognize and enforce arbitral awards made by arbitral institutions in the Hong Kong Special Administrative Region, the Macao Special Administrative Region, or the Taiwan Region; review cases under the jurisdiction of this municipal people's court for applications to recognize and enforce judgments made by foreign courts, courts of the Hong Kong Special Administrative Region, the Macao Special Administrative Region, and the Taiwan Region; ..."

According to our consultations with the Beijing Fourth Intermediate Court, the court's centralized jurisdiction in connection with foreign-related arbitration is limited to case types as described above, including cases applications to revoke arbitral awards, applications to recognize and enforce arbitral awards made by foreign arbitral institutions, and applications to recognize and enforce arbitral awards made by arbitral institutions in Hong Kong, Macao, and Taiwan. Applications for interim measures made in overseas arbitral proceedings do not fall into the scope of centralized jurisdiction of the Beijing Fourth Intermediate Court, but are governed by the competent court designated according to the methods stipulated in the Arrangement.

Are applications for interim measures to be submitted directly to a Mainland court or forwarded by the overseas arbitral institution?

According to Article 3, paragraphs 2 and 3 of the Arrangement, applications for interim measures are divided into two types.

Type one – the application is made to the Mainland court before the arbitral proceeding commences in Hong Kong. In this case, the application may be submitted directly to the Mainland court, provided that a letter certifying acceptance of the case by the Hong Kong arbitral institution is submitted to the court within 30 days.

Type two – the application is made to the Mainland court during an ongoing arbitral proceeding in Hong Kong. In this case, the party should first submit the application for interim measures to the arbitral institution or its permanent office, which will in turn forward the application to the Mainland court.

However, the Understanding and Application points out that the forwarding of an application through the arbitral institution or its permanent office will prolong the application process, considering the relevant arbitral institution or its permanent office is located in Hong Kong. Therefore, it would appear strict application of Article 3, paragraph 2 of the Arrangement prevents the full effectiveness of interim measures. Thus, the Understanding and Application further stipulates that "the parties to an arbitral proceeding in Hong Kong shall be permitted to submit an application for interim measures together with a transmittal letter from the arbitral institution or its office to the people's court of the Mainland; the people's court of the Mainland may confirm the circumstances by contacting the relevant arbitral institution or its office according to the contact information provided by the Department of Justice of the Hong Kong Special Administrative Region."

Based on our practical experience, Beijing courts recognize the methods described above in the Understanding and Application. That is, applications for interim measures can be filed directly with the Beijing courts without first submitting them to the arbitral institution or its permanent office in Hong Kong for forwarding, even if arbitral proceedings have been initiated in Hong Kong.

What serves as proof that the Hong Kong arbitral institution has accepted an arbitration case once the case is instituted and underway?

Based upon our practical experience, the arbitral institution needs to issue a separate certification letter to certify acceptance of the case. Requirements will differ among arbitral institutions in terms of information required to be submitted, how long it will take the arbitral institution to issue the letter, and the specific contents of the letter issued by the arbitral institution. In practice, parties should directly confirm with the arbitral institution when handling the application.

The arbitral institution will issue a letter certifying formal acceptance of the case after it receives a notice of arbitration and the registration fee. The certification letter can be submitted to the Mainland court as supporting evidence together with the application to prove that the arbitral institution has accepted the case.

According to our experience, the above-mentioned certification letter and supporting materials need not be notarized and authenticated. However, it is necessary to obtain overseas notarization and authentication where a Mainland lawyer submits the application to the Mainland court on behalf of a party. In addition, the certification letter issued by the arbitral institution must be written in Chinese.

What support will arbitral institutions provide to facilitate applications?

According to information disclosed in the Understanding and Application, as confirmed by the Supreme People's Court and the Government of Hong Kong Special Administrative Region, the following Hong Kong arbitral institutions may apply for interim measures with Mainland courts under the Arrangement: the Hong Kong International Arbitration Centre ("**HKIAC**"), the China International Economic and Trade Arbitration Commission, Hong Kong Arbitration Center, International Court of Arbitration of the International Chamber of Commerce – Asia Office, Hong Kong Maritime Arbitration Group, South China International Arbitration Center (HK), and eBRAM International Online Dispute Resolution Centre.

Based upon our practical experience, arbitral institutions all proactively assist parties to apply for interim measures, including assisting in the issuance of letters certifying acceptance of the case, and maintaining confidentiality of the applicant's application. For example, we have been deeply impressed by HKIAC for its responsiveness in cases where we have applied for interim measures with Mainland courts.

Once the Mainland court has accepted the application for interim measures, are there any procedural differences with ordinary interim measures?

After the Beijing courts have accepted an application for interim measures, the basic procedures for handling the interim measures are the same as those for Mainland courts in litigation and arbitration. These include requiring the relevant parties to provide a guarantee (the most commonly used method is

to provide a property security guarantee letter issued by a qualified insurance company) and requiring information about the property to be preserved, etc.

Based upon our practical experience, one slight difference is that, according to Article 5, paragraph 3 of the Arrangement, the court may require the relevant parties to submit "an explanation of the urgency of the circumstances so that if interim measure is not taken immediately, the legitimate rights and interests of the applicant may suffer irreparable damage or the enforcement of the arbitral award may become difficult, etc." We do not ordinarily encounter this requirement when applying for interim measures in Mainland litigation and arbitral proceedings.

The court's practices and requirements may change as more experience is accumulated with the implementation of the Arrangement. Our analysis above is merely intended to serve as a reference and we will continue monitor issues that may arise during implementation of the Arrangement.

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.

If you have any questions regarding this publication, please contact:

Beijing	**Wenyu JIN**	**Attorney-at-law**
	Tel:	+86 10 8525 5557
	Email:	wenyu.jin@hankunlaw.com
Shanghai	**Yinshi CAO**	**Attorney-at-law**
	Tel:	+86 21 6080 0980
	Email:	yinshi.cao@hankunlaw.com
Shenzhen	**Jason WANG**	**Attorney-at-law**
	Tel:	+86 755 3680 6518
	Email:	jason.wang@hankunlaw.com
Hong Kong	**Dafei CHEN**	**Attorney-at-law**
	Tel:	+852 2820 5616
	Email:	dafei.chen@hankunlaw.com