DOING BUSINESS IN CHINA

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CHAPTER I INVESTMENT VEHICLES

If a foreign investor intends to establish a local presence in China, there are four types of investment vehicles available under the current PRC legal regime, including: a resident representative office (**RRO)**, an entity established by the foreign investor with no independent legal person status; a wholly-foreign owned enterprise (WFOE), a wholly-owned subsidiary of the foreign investor based in the PRC); a joint venture (JV), either a equity joint venture or a contractual joint venture, a company incorporated by a foreign investor and Chinese partners; and a Foreign Invested Partnership (or FIPE, a partnership entity formed by the foreign investor and its Chinese partners). This chapter will generally introduce the functions, formation and key operation matters of these investment vehicles.

1 Resident Representative Office (RRO)

1.1 General Introduction

A Resident Representative Office ("**RRO**") is one of the common business vehicles through which foreign investors can establish their first presence in China. The comparatively simply requirements and short time frame required to establish such an office are the main reasons for its popularity. RROs have no legal person status, which means the liabilities of an RRO are borne by its parent company. RROs cannot carry out actual business activities, but may engage in business liaison, product introduction, market research and technology exchange for its parent company.

As such, an RRO is a popular choice when the foreign investor has not decided whether to commit significant time and resources to China. Compared to an FIE (discussed below), there is no requirement to make any capital contribution when establishing a RRO. It is also an appropriate medium when the foreign investor has no need to conduct direct business, such as manufacturing or trading activities, in China. A RRO can help facilitate trade between the foreign parent company and its China -based entities, but an RRO may not directly invoice for services.

1.1.1 Introduction to the Governing Law

There are a series of regulations governing the establishment and operation of RROs in the PRC. The *Interim Provisions of the State Council of the People's Republic of China on Administration of RRO of Foreign Enterprises*, enacted by the State Council on 30 October, 1980, has set out principles for the establishment and operation of RROs in the PRC.

On November 11, 2010, The State Administration for Industry and Commerce ("**SAIC**") enacted the *Administrative Regulations on the Registration of RRO of Foreign Enterprises*, specifying the procedures for establishing, changing or terminating the registration of an RRO.

An RRO shall also be subject to other relevant laws and regulations addressing a variety of issues regarding the registration and administration of RROs, such as the *Circular of the State Administration for Industry and Commerce and the Ministry of Public Security on Further Strengthening the Registration Administration of Foreign Enterprises'* RROthat was issued on January 04, 2010 and etc.

1.1.2 Permitted Business Scope

As mentioned above, an RRO is not permitted to directly engage in business activities or generate income. RROs are permitted: (1) to engage in market investigation, displays, and publicity activities in connection with the products or services of foreign enterprises; and (2) conduct activities in connection with the products sales, services provision, domestic procurement and domestic investment of foreign enterprises.

1.2 Requirements for Investors

According to the relevant regulations, the parent company of a RRO must be legally registered in its home country and operate for more than two years.

1.3 Establishing an RRO

The SAIC and its authorized local industry and commerce administration bureaus ("**Local AIC**") are the authorities responsible for registering and administrating the Representative Offices. When establishing an RRO, the parent company shall appoint a representative or an agent to submit a registration application to the SAIC or competent Local AIC.

1.4 Representatives of an RRO

The foreign enterprise may appoint a certain number of representatives (usually no more than three persons) to the RRO, from which one shall be appointed chief representative. The chief representative may execute the registration application documents for the RRO and, within the written authorization scope of the foreign enterprise, act on behalf of the RRO.

1.5 Tax Issues for RROs

Pursuant to the *Circular on Printing and Distributing the Tentative Measures for the Administration on Taxation Collection of Resident RRO of Foreign Enterprises*, an RRO shall declare and pay enterprise income tax (EIT) for the income attributable to them and pay business tax (BT) and value-added tax (VAT) for their taxable income. The taxable income of an RRO refers to the proportion of the relevant income received by the RRO's parent company that could be attributed to the services provided by the RRO.

1.6 RRO Labor Issues

According to the relevant PRC laws and regulations, an RRO shall hire employees through a qualified local labor service agent.

2 Sino-Foreign Joint Venture (JV)

2.1 General Introduction

A Sino-Foreign Joint Venture ("**JV**") is a popular vehicle for those foreign investors who intend to conduct business in China with local partners, or to invest in certain business sectors where foreign shareholding is restricted by a threshold. There are two different types of JVs, namely the Sino-foreign Equity Joint Venture ("EJV") and the Sino-foreign Contractual Joint Venture ("CJV").

The major differences between an EJV and a CJV are as follows:

(1) While an EJV is always established as a legal person entity (a limited liability company), a CJV could either be established either as a non-legal person entity or as a legal person entity;

The registered capital contributed to an EJV may be made in cash, in kind and intellectual properties (not sure what "in kind and intellectual properties" means), while, in addition to the above contributions, the capital contribution of a CJV may also be made in other forms called "cooperation conditions", which may include provide market access assistants, distributing channels, etc.;

(2) The profits and liquidation proceeds of an EJV must be distributed to the shareholders according to their shareholding ratio, while the shareholders of a CJV can, upon mutual agreement, determine the ratio for distributing profits and liquidation proceeds;

(3) CJVs allow foreign investors to collect profits prior to the PRC shareholders under certain circumstances.

2.2 Supervisory Government Department

The establishment and operation of a JV is subject to the administration and supervision of several PRC authorities, including the National Development and Reform Commission ("**NDRC**"), Ministry of Commerce ("**MOFCOM**"), the State Administration of Industry and Commerce ("**SAIC**") and the State Administration of Foreign Exchange ("**SAFE**").

2.3 Introduction to the Governing Law ("**JV Laws and Regulations**")

The basic rules and requirements for the establishment and operation of a EJV are stipulated in the *Law of the PRC on Sino-Foreign Equity Joint Ventures*, as issued on July 1, 1979 and amended on March 15, 2001, and the *Implementing Regulations of the Law of the PRC on Sino-Foreign Equity Joint Venture*, as issued on September 20, 1983 and amended on July 22, 2001.

Similarly, the *Law of the PRC on Sino-Foreign Cooperative Joint Ventures*, issued on

April 13, 1988 and amended on October 31, 2000) and the *Implementing Rules of the Law of the PRC on Sino-Foreign Cooperative Joint Ventures*, issued on September 4, 1995) set out the general principles for CJVs' establishment and operations.

JVs are also subject to a number of administrative regulations or rules promulgated by the relevant supervising authorities. For instance, the payment to the registered capital and the amount of total investment of a EJV is governed by a series of regulations, such as the *Several Provisions on the Capital Contribution by Parties to the Sino-Foreign Equity Joint Venture*, jointly issued by the SAIC and MOFCOM on January 1, 1988), the *Tentative Regulations on the Proportion of the Registered Capital to the Total Amount of Investment of Sino-foreign Equity Joint Ventures* promulgated by SAIC on February 17, 1987). By virtue of relevant CJV regulations and the *Measures for the Examination and Approval of the Advance Recovery of Investments by Foreign Collaborators to Sino-Foreign Cooperative Joint Ventures*, the foreign investors of a CJV is allowed to collect distributions before its Chinese partner until the foreign investor has fully received the amount of its investment.

2.4 Shareholders and Capital Contribution

According to the JV Laws and Regulations, the foreign shareholder to a JV that established as green investments could be either a foreign entity or a foreign individual while its Chinese shareholder must be a PRC registered entity. However, the JV Laws and Regulations allow PRC individuals remain shareholders after his/her company be converted into a JV as a result of an acquisition.

The capital contribution by JVs' shareholders could be made in variety of forms including cash and contributions in kind, such as buildings and machinery, intellectual property rights and land use rights. The cash capital contribution shall be no less than 30% of the JV's registered capital.

2.5 Key Application Steps for Establishing a JV

The procedures for establishing a JV typically require the following steps:

- *Applying for Name Pre-Registration.* The investors shall file an application for the Name Pre-registration with the competent AIC either directly or through a designated agent.

- *Applying for Project Approval.* After received the Notice of Pre-registration of the Corporate Name issued by the AIC, the investors may then file an application with the competent NDRC for project approval[1].

- *Applying for Approval for the Establishment of the JV.* The investor shall, after obtained the Name Pre-registration and NDRC Project Approval (if required), apply for the certificate of approval from the competent MOFCOM[2].

[1] Depending on the amount of the total investment, the State Council, the NDRC its competent local counterpart at the provincial or municipal or district level is empowered to review the application and issue a approval.

[2] Depending on the amount of the total investment, MOFCOM or its competent local counterpart at the provincial

- *Applying for business registration of the JV.* The investors shall apply for registration with competent AIC and obtain its business license within a month after the date of the JV's certificate of approval.

- *File for Post-registrations.* After obtaining the business license, the JV shall apply for various operation licenses, such as a code certificate issued by the relevant AQSIQ (General Administration of Quality Supervision, Inspection and Quarantine) office, a foreign exchange registration card issued by the local SAFE office and a tax registration certificate issued by the relevant State Taxation Bureau and Local Taxation Bureau.

3 Wholly Foreign Owned Enterprise (WFOE)

A Wholly Foreign Owned Enterprise ("**WFOE**") is another popular type of FIE. Comparing to JVs, where at least one investor must be a PRC registered entity, a WFOE is fully controlled by one or more foreign investors. Similar to JVs, the establishment and operation of the WFOE are also subject to the approval and supervision of various government authorities, which mainly include the NDRC, MOFCOM, SAIC and SAFE, or their respective local offices.

The incorporation and operation of a WFOE is regulated by the *Law of the PRC on Wholly Foreign-owned Enterprises*, issued on April 12, 1986 and revised on October 31, 2000) and the *Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises*, as amended on12 April, 2001).

Although different application may be required, the application procedures for establishing a WFOE is the same as setting up JVs as described in the proceeding section.

4 Foreign-Invested Partnership (FIP)

4.1 General Introduction

Different from a "legal person entity" such as a wholly foreign owned enterprise (the "WFOE") or an equity joint venture (the "**EJV**") where the investors' liability in the entity is only limited to their respective subscribed contribution, a partnership is recognized as a "non legal person entity" and certain or all investors in a partnership should have joint and severe liability to the debts of the partnership. Nevertheless, partnership structure is commonly used by many investors, especially in fund formation and raising area due to its flexibility in capital contribution, management structure, profits and liquidation assets distribution, losses assumption and etc.

Foreign investment in the form of partnership is not practical in China until March 2010, when the long-await administrative measures of the State Council of the PRC

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or municipal or district level is empowered to approve joint venture contracts, articles of the association, and the establishment of an EJV.

(the "**State Council**"), i.e., the *Measures for Administration of Partnership Enterprise Established within the Territory of China by Foreign Enterprises or Individuals* (the "**FIP Administration Measures**") became effective. The FIP Administration Measures provides an alternative structure to invest in China, i.e. to set up a foreign-invested partnership (an "**FIP**").

4.1.1 Introduction on Governing Laws

The *Law of the PRC on Partnership Enterprises* (the "**Partnership Enterprise Law**"), enacted by the Standing Committee of the National People's Congress of the PRC on 23 February 1997 and amended on 27 August 2006, has set out principles for the formation and operation of partnerships, including FIPs, and authorized the State Council to promulgate special measures applicable to FIPs.

On 25 November 2009, the FIP Administration Measures was issued by the State Council, clarifying the supervisory government authority and additional conditions in connection with the formation of FIPs.

Later on 29 January 2010, the *Provisions on Administration for Registration of Foreign-invested Partnership Enterprises* (the "**Provisions on FIP Registration**") was issued by the State Administration for Industry and Commerce of the PRC (the "**SAIC**"), the FIP's supervisory government authority nominated by the State Council. The Provisions on FIP Registration, effective as of 1 March 2010, provides detailed instructions on the procedures for setting up FIPs as well as other procedural matters.

In addition, for matters not specified in the FIP Administration Measures and the Provisions on FIP Registration, the *Measures of the PRC for the Registration of Partnership Enterprise* (the "**Partnership Registration Measures**") shall also apply, which was enacted by the State Council on 19 November 1997 and amended on 9 May 2007.

An FIP shall also be subject to other relevant laws and regulations addressing a variety of issues regarding FIPs, such as the *Foreign Investment* Industry *Catalogue (2011 revision)* (the "**2011 Foreign Investment Industry Catalogue**"). In particular, setting up an FIP will not be allowed if it will result in any involvement in the Prohibited Industries or the Restricted Industries that are only admitted for purely domestic company or joint venture where the Chinese party is required to hold an absolute or relative controlling interest or where the foreign party is subject to a percentage interest cap pursuant to the 2011 Foreign Investment Industry Catalogue.

4.1.2 Types of Partnership

Under the PRC laws, investors may set up an FIP either in the form of a general partnership, where all the investors are general partners (each a "**GP**") with joint and several liability to the debts of the FIP, or in the form of a limited partnership, a combination of at least one GP and one or more limited partners (each an "**LP**") with liability limited to their capital contribution.

Special types of general partnership, known as special general partnerships, are

commonly used by professional services providers, e.g., accounting firms, law firms, architecture firms, etc. In a special general partnership, when debts were attributed to intent or gross negligence of one or more partners, the other partners will only have liability limited to their respective interest ratio in the partnership.

4.2 Investors and Capital Contribution

Generally, an FIP may be wholly owned by foreign enterprises or individuals or jointly owned by foreign investors and Chinese investors, which include Chinese individuals, legal or non legal person entities. Foreign investors are allowed to contribute in convertible foreign currencies as well as RMB from legitimate sources.

4.2.1 Requirements on Investors of an FIP

For an FIP in the form of a general partnership,

- there shall be at least two (2) partners;
- no partners are PRC state-owned enterprises, listing companies or government sponsored institutions or social group operating for the benefit of public interest; and
- individual partners, if any, shall have full capacity for civil acts.

For an FIP in the form of a limited partnership,

- the aggregated number of partners shall be no less than two (2) but no more than fifty (50), in which at least one (1) GP must be included;
- PRC state-owned enterprises, listing companies and government sponsored institutions or social group operating for the benefit of public interest may not act as the GP;
- if any of the GPs is an individual, he/she shall have full capacity for civil acts; and
- no LP shall be an executive partner of the FIP or otherwise engage in daily operation of the FIP.

4.2.2 Capital Contribution

For both general partnerships and limited partnerships,

- partners may make capital contribution in cash, or in kind, or with intellectual properties, labor service, land use rights or other lawful proprietary rights, but LPs are not allowed to contribute with labor service;
- no upper or lower limit or payment schedule of the capital contribution in an FIP

is required by law; and

- capital verification is not a requisite.

4.3 Establishing an FIP

4.3.1 Supervisory Government Department

When establishing an FIP, a representative or an agent designated by all partners may directly submit a registration application to the SAIC or its local branch (the "**AIC**") of competence, as the case may be, without prior approval from the Ministry of Commerce of the PRC or its local branches (the "**MOFCOM**"). In this respect, the FIPs are quite different from any other form of foreign invested entities in China, such as CJVs, EJVs, WFOEs and foreign-invested companies limited by shares, which requires a prior approval of the MOFCOM before registration with the AIC.

4.3.2 Brief Introduction on Procedures for Establishing an FIP

When establishing an FIP, the following steps are necessarily to be considered:

- *Determine the Form, partners, name and etc*. Before preparing application documents, the initial investors shall determine in what form, i.e., a general partnership or a limited partnership, the FIP will be operated; if the FIP will be a limited partnership, it is also advisable to identify its initial GP and LP candidates first.

Naming an FIP has no much difference from naming other foreign invested entities except for that such expressions as "general partnership" or "limited partnership", as the case may be, are required to be contained in its name.

- *Prepare AIC Application Documents*. The initial investors of an FIP need to prepare application documents as per requests of the FIP Registration Regulation and the AIC. Documents generally required to be submitted with the AIC include the following:

a) an application form for setting up the FIP signed by all the initial partners; in most cases, Chinese version of the template of the application form could be downloaded on the website of the AIC;

b) a partnership agreement executed by all the initial partners, which shall stipulate, among others, the name and the main operation premise of the FIP, the purpose and the business scope of the FIP, the name and address of the partners, the amount, method and term of contribution of each partner, the way to distribute profits and assume losses, operation of the FIP, participation in and exit from the FIP, dispute resolution, dissolution and liquidation of the FIP, and liability for breach of the partnership agreement;

c) certificates of identity of all the initial partners, which may include the certificate

of incorporation of a foreign enterprise partner, the passport of a foreign individual partner, the business license of the Chinese enterprise partner and the ID card of the Chinese individual partner;

d) certificate of main business premise of the FIP;

e) a power of attorney signed by all the initial partners to appoint a representative or agent to handle the procedures related to the FIP registration; Chinese version of the template of such power of attorney is also available on the website of the AIC;

f) a confirmation letter issued by all the partners regarding each partner's subscribed capital or paid-up capital;

g) a written declaration executed by all the partners expressing that the FIP will comply with the foreign investment industry policies of China;

h) a letter of creditworthiness in favor of each of the foreign partners issued by the bank having business relationship with the relevant foreign partner;

i) power of attorney for service of legal documents jointly executed by the foreign partners and the relevant domestic legal documents recipient; and

j) relevant prior approvals, if pursuant to PRC laws, the establishment of the FIP is required to be approved by relevant competent authorities in advance.

- *Name Pre-verification*. Pre-verifying name of the FIP before the registration application is also put in place to ensure that the proposed name does not duplicate the name of any existing partnership. This procedure may be initiated once a proposed name of the FIP has been figured out.

- *Registration with AIC*. A representative or an agent designated by all the initial partners may directly submit a registration application to the AIC after the application documents are ready. The AIC will issue a business license to the FIP if conditions and procedures set out by laws and regulations have been met. Upon the issuance of the business license, the FIP is duly formed.

- *Other Registration requirements*. A few other registrations are also required to be made with relevant government authorities, e.g., organization code registration, tax registration, foreign exchange registration, etc.

4.4 Tax Issues for FIPs

An FIP is a tax pass-through entity that does not pay income tax itself. Instead, partners of the FIP shall pay tax on income allocated to them. However, so far, the relevant rules are unclear regarding withholding tax on the income passing through to foreign partners.

4.5 Foreign Exchange Issues for FIPs

For quite a long period after the issuance of the FIP Administration Measures and the Provisions on FIP Registration, FIPs have practical barriers in foreign exchange registration and settlement due to lack of relevant supporting policies. However, since 17 December 2012, when the *Notice of the State Administration of Foreign Exchange* (the "**SAFE**") *on Issues Concerning the Foreign Exchange Administration of Foreign-invested Partnership Enterprises* (the "**SAFE Notice on FIPs**") came into effect, foreign exchange registration and settlement for FIPs has become doable. SAFE Notice on FIPs provided detailed rules for FIPs on registration with SAFE, opening and using foreign currency account, foreign capital injection and settlement, profit remittance, among other matters. Nevertheless, a new notice, *SAFE Notice on Distributing the Administration Rules on Foreign Exchange of Foreign Direct Investment and Several Related Documents* (the "**Circular 21**"), issued by SAFE on 10 May 2013, annulled the SAFE Notice on FIPs as of 13 May 2013. According to Circular 21, the existing foreign exchange administration measures have been equally applicable to both FIPs and other forms of foreign-invested enterprises, i.e. EJVs, CJVs and WFOEs.

4.6 Re-investment

An FIP may invest in other entities in China, but the investment in PRC entities shall be subject to restrictions on foreign investment under the PRC laws. A purely domestic PRC entity that accepts investment from an FIP will be converted to a foreign-invested enterprise regardless of how much equity interest in the portfolio company is purchased by the FIP. However, it remains unclear if such conversion would require approval/filing by/with MOFCOM (especially considering the formation of an FIP requires no such approval but only AIC registration) and registration with a competent AIC.

Additionally, the *Notice of the General Affairs Department of the SAFE on the Relevant Operating Issues Concerning the Improvement of the Administration of Payment and Settlement of Foreign Currency Capital of Foreign-invested Enterprises* (the "**Circular 142**"), issued by the SAFE on August 29, 2008, explicitly prohibits an foreign-invested enterprise from using any RMB converted from foreign capital to make equity investments in China, unless the equity investment is within the approved business scope of the foreign-invested enterprise and has been approved by the SAFE, or as has been "otherwise provided for". Considering the restrictive influence of Circular 142, except for some pilot FIPs (the "**Pilot FIPs**") formed according to the Qualified Foreign Limited Partner ("**QFLP**") pilot programs in pilot areas such as Shanghai, Tianjin, Beijing, Chongqing and Shenzhen, FIPs may not use any RMB converted from foreign capital to make equity investments in China. Consequently, it may be not doable for most FIPs to invest in China unless they have adequate RMB currency in hand.

4.7 Investment-type FIPs and Pilot FIPs

4.7.1 General Introduction on Investment-type FIPs

Investment-type FIPs are foreign-invested partnerships mainly focused on equity investment in China, e.g., foreign-invested PE funds structured as partnership

("**Investment-type FIPs**"). As per the FIP Registration Measures, rules applicable to Investment-type FIPs may be stipulated separately.

According to a notice of the SAIC, formation of Investment-type FIPs is required to register with AIC at the provincial level. Further, as required by the MOFCOM, Investment-type FIPs shall be treated as foreign investors and all portfolio companies of an Investment-type FIP will be deemed as foreign-invested enterprises. No other rules are observed being applied countrywide apart from the above.

In practice, AICs in most localities have not yet started processing registration of any Investment-type FIP; only a few Investment-type FIPs have been seen registered in QFLP pilot areas.[3] However, given the barriers in RMB conversion brought by the Circular 142, even if an Investment-type FIP is possible to be registered, it may still face a large obstacle in equity investment unless it is a Pilot FIP set up following the QFLP pilot programs.

4.7.2 General Introduction on Pilot FIPs and QFLP Programs

Pilot FIPs, including Pilot Foreign-invested PE Funds and Pilot Foreign-invested Fund Management Enterprises that are structured as limited partnership, can be set up following local QFLP pilot programs. So far, only Shanghai, Beijing, Tianjin, Chongqing and Shenzhen have launched their respective QFLP pilot program.

Seeing no regulations on Pilot FIPs are promulgated nationwide so far, summarised below are some of the requirements on and treatments of Pilot FIPs provided only in local QFLP pilot programs.

For Pilot Foreign-invested PE Funds:

(1) Special Requirements

- *Investors*. Foreign Investors in Pilot Foreign-invested PE Funds are normally subject to access restrictions. E.g., in Shanghai and Tianjin, it is provided, among others, that the assets of a foreign investor in a Pilot Foreign-invested PE Fund shall be no less than USD500 million or the assets under its management be no less than USD1 billion, that the foreign investor shall subscribe for at least USD10 million in the fund, and that the foreign investor or any of its affiliates shall have more than five (5) years of relevant investment experience.

- *Capital Contribution*. Investors in a Pilot Foreign-invested PE Fund are only allowed to contribute in cash. Further, a lower limit of capital commitment is often set forth, e.g., in Shanghai, Pilot Foreign-invested PE Funds with names including "equity investment fund" shall have a fund size no less than USD15 million; in Tianjin and Beijing, the minimum size is RMB500 million or an equivalent amount of foreign currency. In some localities, capital committed by foreign investors may also be limited to a fixed amount, e.g., Beijing requires that

[3] Even in the QFLP pilot areas, e.g., Shanghai, application for establishing an Investment-type FIP may still not be verified by AIC unless it is set up following the local QFLP pilot program.

capital contribution of foreign partners shall not exceed 50% of the fund size.

- *Formation Procedures*. Before submitting the initial registration application to AIC, the Pilot Foreign-invested PE Fund is generally required to be granted of a QFLP status, which may involve prior approvals from other supervisory government department such as the financial affairs office (e.g., in Shanghai), the financial affairs service bureau (e.g., in Beijing).

- *Custody of Fund*. Pilot Foreign-invested PE Funds are further required to put their funds under the custody of a qualified domestic bank.

- *Investment Industry Restrictions*. It is noteworthy that some of the local QFLP programs require that Pilot Foreign-invested PE Funds shall only invest in particular or encouraged industries. E.g., Beijing requires that Pilot Foreign-invested PE Funds shall primarily invest in seven strategic new industries (i.e., energy saving and environment protection, new-generation information technology, biology, manufacture of high-tech equipment, new energies, new materials and new energy automobiles).

- *Filing Requirement*. Pilot Foreign-invested PE Funds are generally required to be filed with the National Development and Reform Commission and its local branches (the "**NDRC**") as well as the other supervisory bodies such as the financial affairs office (e.g., in Shanghai), the financial affairs service bureau (e.g., in Beijing) or the filing supervisory office (e.g., in Tianjin).

(2) Special Treatment

- *Foreign Capital Settlement*. A Pilot Foreign-invested PE Fund is generally allowed to settle its foreign capital with its custodian bank according to applicable QFLP policy.

- *Tax Treatment*. A Pilot Foreign-invested PE Fund may also enjoy certain tax incentives (including local income tax refund) as well as subsidies pursuant to local regulations.

For Pilot Foreign-invested Fund Management Enterprises:

- *Special Requirements*. Pilot Foreign-invested Fund Management Enterprises are also subject to qualifications in many respects, i.e., investors, management personnel, capital, scope of business, etc.. For example, in Shanghai, a Pilot Foreign-invested Fund Management Enterprise with a name including "equity investment fund management" shall meet the following requirements: (i) at least one of the investors, or any of its affiliates, has a scope of business related to equity investment or equity investment management; (ii) at least two senior management personnel of the Pilot Foreign-invested Fund Management Enterprise are qualified for fixed conditions; and (iii) the aggregated capital commitment shall be no less than USD2 million and shall be contributed in cash only, 20% of which shall be paid within three (3) months after the issuance of the business license with the balance to be paid within two (2) years. Further, Pilot

Foreign-invested Fund Management Enterprises are also subject to filling requirements similar with Pilot Foreign-invested PE Funds

- *Special Treatment*. A Pilot Foreign-invested Fund Management Enterprise is allowed to settle its foreign capital with its custodian bank according to applicable foreign exchange regulations, and further to make capital commitments to the equity investment fund raised by it. Generally, an upper limit will be set on the amount of foreign capital to be settled by a Pilot Foreign-invested Fund Management Enterprise. In Shanghai, Beijing and Tianjin, the cap is 5% of the paid-in capital of the Pilot Foreign-invested Fund Management Enterprise. It is further stated in Shanghai and Tianjin that the capital contribution by Pilot Foreign-invested Fund Management Enterprise will not affect the nature of the fund invested by it, which means, if all other partners in the fund are domestic contributing with RMB currency, then the nature of the fund will be a purely domestic fund.

5 Regional Headquarters

In recent years, more and more multinational corporations (the "**MNCs**") establish their regional headquarters in China and they normally choose major cities as their base camp to compete for more room in the market. The most significant factor they may take into consideration when they locate their regional headquarters is whether this place is investment friendly in terms of incentive policies, information accessibility, consumption levels, financing resources and government cooperativeness, among which, incentive policies seem to be the most important factor. In this regard, since 1990s, the PRC local government of certain cities has successively promulgated regulations and rules legislating preferential treatments for regional headquarters of MNCs. Currently, Shanghai, Beijing, Shenzhen, Jiangsu, Guangzhou, Tianjin and other major cities in China have respectively issued their own rules for regional headquarters of MNCs. However, Shanghai, Beijing and Shenzhen, as the widely recognized first tier cities in China attract most of MNCs to set up their regional headquarters, and as a matter of fact, such three cities are the first choices to be considered by MNCs when they intend to set up regional headquarters in China.

Given the above, this chapter will focus on the introduction of relevant rules and practices with respect to the establishment of regional headquarters of MNCs in Shanghai, Shenzhen and Beijing, in order that the MNCs can have an overall view in this regard.

5.1 Establishment of Regional Headquarters in Shanghai

5.1.1 Rules of Shanghai

In 2008, the People's Government of Shanghai Municipality issued the *Provisions of Shanghai City on Encouraging the Establishment of Regional Headquarters by Multinational Corporations (Hu Fu Fa [2008] No.28)*, the "**Old Shanghai**

Provisions"）and the *Several Opinions Regarding the Implementation of Provisions of Shanghai City on Encouraging the Establishment of Regional Headquarters by Multinational Corporations (Hu Fu Ban Fa [2008] No. 50)*, the "**Old Shanghai Implementing Opinions**"). The Old Shanghai Provisions were later repealed by the *Provisions of Shanghai City on Encouraging the Establishment of Regional Headquarters by Multinational Corporations (Hu Fu Fa [2011] No. 98)*, the "**New Shanghai Provisions**") in 2011. On August 8, 2012, the Old Shanghai Implementing Opinions was repealed by the *Several Opinions Regarding the Implementation of Provisions of Shanghai City on Encouraging the Establishment of Regional Headquarters by Multinational Corporations (Hu Fu Ban Fa [2012] No. 51),* collectively with the New Shanghai Provisions, the "**New Shanghai Rules**").

5.1.2 Threshold Requirements for Regional Headquarters Certification in Shanghai

According to the New Shanghai Provisions, a wholly foreign-owned investment companies registered in Shanghai are eligible to be certified as regional headquarter, and for a management company, whether existing or newly established, may be recognized as a regional headquarter if it meets the following requirements:

(1) The management company is a wholly foreign-owned enterprise registered in Shanghai;

(2) The total assets of its parent company are not less than USD400 million;

(3) The New Shanghai Provisions do not specify what entity can be regarded as the parent company. According to the telephone inquiry with the official of Shanghai Municipal Commission of Commerce, the parent company refers to any direct or indirect shareholders holding at least 50% equity interests in the management company;

(4) The total cumulative registered capital actually paid by the parent company in China is no less than USD10 million and the number of enterprises authorized to be managed by the parent company is no less than 3; or the number of enterprises authorized to be managed by the parent company is no less than 6. The municipal commerce commission may consider, at its own discretion, to certify management companies as regional headquarters if they basically satisfy the aforesaid conditions and have made prominent contributions to economic development of the local region; and

(5) The registered capital of the management company shall not be less than USD2 million.

5.1.3 Procedures for Regional Headquarters' Certification in Shanghai

Shanghai Municipal Commission of Commerce is the authority in charge of certifications of regional headquarters of MNCs in Shanghai. According to the Shanghai New Rule, the approving authority shall finish reviewing the application documents and make a decision whether it will approve the regional headquarter application or not within 10 working days after it receives the application documents,

however, according to the official of Shanghai Municipal Commission of Commerce, it usually takes about 20 working days to review and examine the application in practice. Once the application is approved, the company which makes the application will be issued with an approval of being certified a regional headquarter.

5.2 Establishment of Regional Headquarters in Beijing

5.2.1 Rules of Beijing

As early as January 29, 1999, People's Government of Beijing Municipality has promulgated *Measures of Beijing Municipality for the Recognition of Establishment of Regional Headquarters by Multinational Corporations in Beijing (Jing Zheng Fa [1999] No. 4 Appendix)* to promote the economic growth and society development of Beijing. Ten years later, for the purpose of attracting MNCs to set up regional headquarters in Beijing and specifying the detailed qualifications of a regional headquarter established in Beijing and the preferential policies enjoyed by it, People's Government of Beijing Municipality issued *Circular of the People's Government of Beijing Municipality on Printing and Distributing Several Provisions on Encouraging Multinational Corporations to Establish Regional Headquarters in Beijing (Jing Zheng Fa [2009] No. 15)* on May 21, 2009, immediately after that, Beijing Municipal Commission of Commerce, Beijing Reform and Development Committee, Beijing Public Security Bureau, Beijing Finance Bureau, Beijing Human Resources and Social Security Bureau, Beijing Local Taxation Bureau, Beijing Statistics Bureau and Beijing State Taxation Bureau jointly promulgated *Circular on Printing and Distributing the Implementing Measures for Several Provisions on Encouraging Multinational Corporations to Establish Regional Headquarters in Beijing (Jing Shang Wu Zi Zi [2009] No. 351)* (the "**Beijing Implementing Measures**") on June 24, 2009.

5.2.2 Threshold Requirements for Regional Headquarters Certification in Beijing

According to the Beijing Implementing Measures, a foreign-invested investment company established in Beijing upon approval is eligible to be certified as regional headquarter, and for a foreign-invested management company, it may be recognized as a regional headquarter if it meets the following requirements:

(1) Total assets of its parent company are not less than USD400 million;

(2) The Beijing Implementing Measures do not specify what entity can be regarded as the parent company of a multinational corporation. According to the telephone inquiry with the official of Beijing Municipal Commission of Commerce, the parent company refers to any direct or indirect shareholders holding at least 50% equity interests in the management company;

(3) The total cumulative registered capital actually paid by its parent company in China is no less than USD10 million, and the number of enterprises invested or authorized to be managed by the parent company is no less than 3; or the number of enterprises invested or authorized to be managed by the parent company is no

less than 6;

(4) The registered capital of the management company is no less than USD 2 million;

(5) The management company is the sole top operation and management organization of the parent company in China; and

(6) Requirements for internationally famous MNCs may be more generous when appropriate.

5.2.3 Procedures for Regional Headquarters Certification in Beijing

Beijing Municipal Commission of Commerce is the authority in charge of certifications of regional headquarters of MNCs in Beijing. According to the Beijing Implementing Measures, the approving authority shall finish reviewing the application documents and make a decision whether it will approve the regional headquarter application or not within 10 working days after it receives the application documents. Once the application is approved, the company which makes the application will be issued with an approval of being a regional headquarter.

5.3 Establishment of Regional Headquarters in Shenzhen

5.3.1 Rules of Shenzhen

Compared with Shanghai and Beijing, Shenzhen is late in the game to attract regional headquarters of MNCs from legislative and regulatory perspectives. Since joining the race, Shenzhen has adopted a regime with its own characteristics to regulate the regional headquarters, different from Beijing and Shanghai. The first legislation in Shenzhen (i.e., the *Measures of Shenzhen City on Recognition of Enterprise Headquarters (For Trial) (Shen Fu Ban [2008] No. 95)*, the "**Shenzhen Trial Measures**") was promulgated in late 2008. On August 31, 2012, Shenzhen Municipal People's Government issued the *Tentative Measures of Shenzhen Municipality on Encouraging the Development of Enterprise Headquarters (Shen Fu [2012] No. 104*, the "**Shenzhen Tentative Measures**"), repealing the Shenzhen Trial Measures.

5.3.2 Threshold Requirements for Regional Headquarter Certification in Shenzhen

According to the Shenzhen Tentative Measures, a corporate legal entity registered in Shenzhen may apply to be recognized as regional headquarter if it satisfies one of the following conditions:

(1) A newly established enterprise which has been operated for less than one year in Shenzhen may qualify as enterprise headquarter if (i) its paid-in registered capital is no less than RMB500 million; (ii) the total assets of its controlling parent company is no less than RMB10,000 million; (iii) the annual revenue of its controlling parent company in last year is no less than RMB10,000 million; and

(iv) its controlling parent company commits that the newly established enterprise will create no less than RMB5,000 million in annual revenue included in statistical accounting of Shenzhen city and contribute no less than RMB60 million as local financial resources in the next year of certification;

(2) A newly moved-in enterprise which has been operated for less than one year in Shenzhen may qualify as enterprise headquarter if (i) its paid-in registered capital is no less than RMB500 million; (ii) its annual revenue in last year is no less than RMB5,000 million; and (iii) it commits to create no less than RMB5,000 million in annual revenue included in statistical accounting of Shenzhen city and contribute no less than RMB60 million as local financial resources in the next year of certification;

(3) An established enterprise which has continuously operated for more than 1 year (including 1 year) in Shenzhen may qualify as enterprise headquarter if (i) its annual revenue in last year is no less than RMB2,000 million; and (ii) it contributes no less than RMB40 million as local financial resources in last year; and

(4) Subject to approval by the municipal government, enterprises which conform to the industry development strategy and industry policy of Shenzhen and take significant industry support role may qualify as enterprise headquarters.

According to the official of Shenzhen Municipal Department of Development and Reform (the "**Shenzhen NDRC**"), the requirements mentioned above are strictly applied in practice, and exceptions (i.e. situations under item (d) above) are only given to major projects introduced by Shenzhen Municipal Government.

Also, since the Shenzhen Tentative Measures are newly promulgated and some of its concepts and standards are not clearly specified, such as what entity can be regarded as controlling parent company, what enterprise can be considered as a "headquarter" (i.e. enterprise exercises functions of investment and control, operation and decision-making, centralized sales and financial settlement). According to the official of Shenzhen NDRC, all these uncertainty will be further clarified in the process of running the headquarter certification.

5.3.3 Procedures for Regional headquarter Certification in Shenzhen

The Headquarters Economic Development Leading Group is the authority in charge of certification of regional headquarter in Shenzhen, which is set under the Shenzhen NDRC. According to the *Notice on 2012 Shenzhen Regional Headquarter Declaration Work (Shen Fa Gai [2012] 1582)*, MNCs applying for regional headquarter certification shall first fill in relevant application information online, and then submit the application documents required to the Shenzhen NDRC. A newly established or newly moved-in enterprise may submit its application in working days all year round, while an established enterprise's application will only be accepted during certain period decided by the authority. However, since the declaration work of the certification of regional headquarters is newly issued, the specific time limit and required application documents for such approval are unclear, in this case, when

MNCs set up regional headquarters in Shenzhen, good communication with competent governmental authority is necessary.

5.4 Preferential Policies for Regional Headquarters

According to applicable regulations and rules of Shanghai, Beijing and Shenzhen, a certified regional headquarter will be entitled to various preferential policies, including but not limited to, (i) establishment subsidies awarded for newly established regional headquarter to facilitate its starting-up business; (ii) office subsidies awarded to newly set-up regional headquarter who lease or buy new offices; (iii) bonus reward based on the annual revenue of an regional headquarter as an incentive; and (iv) other preferential treatments (*please refer to Appendix I for details of the preferential policies that an regional headquarter in generally entitled in Shanghai, Beijing and Shenzhen respectively*).

5.5 Competitiveness Analysis of Beijing, Shanghai and Shenzhen

Specific policies for regional headquarters vary in different localities due to their geographic locations and economic profiles. Appendix I is a detailed comparison of the various local thresholds and incentive policies in Beijing, Shanghai and Shenzhen.

In the competition of attracting MNCs to establish their regional headquarters, Beijing, Shanghai and Shenzhen have its respective advantages. It is no doubt that Shanghai enjoys the leading place in headquarter economic development since so far it has the largest number of regional headquarters set up by MNCs (regional headquarters in Shanghai are among industries of finance, automobile, manufacturing, wholesale and retail, etc.). Shanghai's success is due to its economic strength and diversity, as well as its most favorable economic and administrative environment for regional headquarters to carry out their functions after the issuance of the New Shanghai Rules. Compared with Shanghai and Beijing, Shenzhen offers the largest amount of cash bonus to regional headquarters which however, are subject to the satisfaction of relatively high thresholds. Shenzhen may become a strong competitor if it gives more flexibility with respect to headquarter recognition and confers more tempting incentive policies. Beijing, as the capital of China, takes an important role in the race for headquarters due to its strongest capability of scientific research and development (most MNCs in IT industry, such as IBM, SAMSUNG, has chosen Beijing to place their regional headquarters), rich talent pool and prompt accessibility to information.

Appendix I

	Shanghai	**Beijing**	**Shenzhen**
Form of Organization	Regional headquarters certified in Shanghai shall be the wholly owned subsidiaries of the MNCs.	Regional headquarters certified in Beijing shall be generally a corporate legal entity. For well-known MNCs, regional headquarters can also be a non-corporate legal entity. Not necessary a wholly owned entity of its parent.	Regional headquarters certified in Shenzhen shall be a corporate legal entity. Not necessary a wholly owned entity of its parent.
Commitment in Operation Term	N/A	N/A	No less than 10 years
Authority Primarily in Charge	Shanghai Municipal Commission of Commerce	Beijing Municipal Commission of Commerce	Headquarters Economic Development Leading Group
Thresholds on Certification	Foreign invested investment companies are eligible to be certified as regional headquarters.		No distinctions on MNCs and domestic companies and no distinctions on companies with different functions (e.g., investment companies vs. management companies).
	Management company may qualify as regional headquarters in Shanghai if: (i) the total assets of its parent company are not less than USD400 million; (ii) the total cumulative registered capital actually paid by the parent company in China is no less than USD10 million and the number of enterprises authorized to	Management company may qualify as regional headquarters in Beijing if: (i) total assets of its parent company are not less than USD400 million; (ii) the total cumulative registered capital actually paid by the parent company in China is no less than USD10 million, and the number of enterprises	Newly established enterprise which has been operated for less than one year in Shenzhen may qualify as enterprise headquarter if: (i) its paid-in registered capital is no less than RMB500 million; (ii) the total assets of its controlling parent is no less than RMB10,000 million;

	be managed by the parent company is no less than 3; the number of enterprises authorized to be managed by the parent company is no less than 6; and (iii) the registered capital of the management company shall not be less than USD2 million.	invested or authorized to be managed by the parent company is no less than 3; or the number of enterprises invested or authorized to be managed by the parent company is no less than 6; (iii) the registered capital of the management company is not less than USD 2 million; (iv) the management company is the sole top operation and management organization of the parent company in China; and (v) requirements for internationally famous MNCs may be more generous when appropriate.	(iii) the annual revenue of its controlling parent in last year is no less than RMB10,000; and (iv) its controlling parent commits that the newly established enterprise will create RMB5,000 million in annual revenue included in statistical accounting of Shenzhen city and contribute no less than RMB60 million as local financial resources since the next year of certification. Newly moved-in enterprise which has been operated for less than one year in Shenzhen may qualify as enterprise headquarter if: (i) its paid-in registered capital is no less than RMB500 million; (ii) its annual revenue in last year is no less than RMB5,000; and (iii) it commits to create RMB5,000 million in annual revenue included in statistical accounting of Shenzhen city and contribute no less than RMB60 million as local financial resources since the next year of certification. Established enterprise which has continuously operated for more than 1 year (1 year included) in Shenzhen may qualify

			as enterprise headquarters, if: (i) its annual revenue in last year is no less than RMB2,000 million; and (ii) it contributes no less than RMB40 million as local financial resources last year. Subject to approval by the municipal government, enterprises which conform to the industry development strategy and industry policy of the Shenzhen city and take significant industry support role may qualify as enterprise headquarters.
Financial Support for Start-up	Office subsidy for regional headquarters established or moved in after July 7, 2008 and has more than 10 employees: (i) regional headquarters leasing offices are entitled to a three year subsidy of no more than RMB2.4/m^2/day for up to 1,000 m^2; (ii) regional headquarters buying or building offices can receive a lump-sum subsidy equal to the above three-year subsidy (i.e., up to RMB2,628,000); and Three-year installment (40%, 30% and 30%) establishment subsidy of RMB5 million beginning from the next year of its establishment or move-in for regional headquarters in the form of foreign invested investment companies established or moved	Office subsidy for regional headquarters established after January 1, 2009: (i) Regional headquarters leasing their offices (tentatively limited to Chaoyang District) are entitled to a three-year subsidy as 30%, 20% and 10% of each year's rental; and (ii) Regional headquarters buying or building their offices are entitled to a lump-sum subsidy up to RMB5 million; and Three-year installment (40%, 30% and 30%) establishment subsidy for Regional headquarters established after January 1, 2009: (i) if RMB100 million ≤ its registered capital < RMB500 million: RMB5 million; (ii) if RMB500 million ≤	Office subsidy for enterprise headquarters: (i) enterprise headquarters leasing their offices (not including ancillary facilities and buildings) are entitled to a three-year subsidy of RMB500/m^2/year with the total amount of subsidy per year no more than RMB1.5 million; (ii) enterprise headquarters buying their offices (not including ancillary facilities and buildings) are entitled to a lump-sum subsidy of 5% of the purchase price; (iii) enterprise headquarters may apply to individually or jointly build headquarters mansion subject to certain

	in after July 7, 2008 and has more than 10 employees.	its registered capital < RMB1 billion: RMB8 million; and (iii) if its registered capital ≥ RMB1 billion: RMB10 million.	criteria in its annual revenue and contribution to local finance. Establishment subsidies: (i) enterprise headquarters certified in accordance with the first and second scenario of the threshold on certification with an establishment subsidy of RMB10 million in the year of its certification; (ii) major enterprises which are introduced as key enterprises may agree on establishment subsidies by entering into cooperation agreement with municipal government.
Revenue-based Bonus for Regional Headquarters	As for foreign invested investment companies, (i) a three-year installment (40%, 30% and 30%) revenue-based bonus of RMB10 million when a regional headquarter certified by competent governmental authority after July 7, 2008 for the first time exceeds RMB1 billion in annual revenue after such certification; (ii) a three-year installment (40%, 30% and 30%) revenue-based bonus of RMB10 million when a regional headquarter certified by competent governmental authority before July 7, 2008 for the first time exceeds RMB1 billion in annual revenue since 2008; (iii) a three-year installment	A three-year installment (40%, 30% and 30%) revenue-based bonus: (i) if RMB100 million ≤its annual revenue < RMB500 million: RMB 1 million; (ii) if RMB500 million ≤ its annual revenue< RMB1 billion: RMB5 million; and (iii) if its annual revenue ≥ RMB1 billion: RMB10 million	Enterprise headquarters certified in accordance with first and second scenario of the threshold on certification may be awarded with a revenue-based bonus of no more than RMB50 million in total if the annual revenue for the 2nd year of certification exceeds RMB5,000 million. Enterprise headquarters, since the 3rd year of its certification, may apply for a contribution bonus up to RMB20 million.

	(40%, 30% and 30%) revenue-based bonus of RMB5 million when a regional headquarter certified after January 1, 2012 for the first time exceeds RMB1 billion in annual revenue after such certification; (iv) a three-year installment (40%, 30% and 30%) revenue-based bonus of RMB10 million when a regional headquarter certified before January 1, 2012 for the first time exceeds RMB1 billion in annual revenue since 2012; and As for management companies, (i) a three-year (40%, 30% and 30%) installment revenue-based bonus of RMB5 million when a regional headquarter certified after July 7, 2008 for the first time exceeds RMB500 million in annual revenue after such certification; (ii) a three-year (40%, 30% and 30%) installment revenue-based bonus of RMB5 million when a regional headquarter certified before July 7, 2008 for the first time exceeds RMB500 million in annual revenue since 2008.		
Bonus for Upgrading and Restructuring	Three-year installment (40%, 30% and 30%) establishment subsidy of RMB8 million for newly established regional headquarters of Asian-wide, Asian-pacific wide or worldwide whose employees are no less than 50 and the legal representative appointed by its parent and its key functional management work	N/A	N/A

	permanently in Shanghai. A lump-sum subsidy of RMB3 million for existing regional headquarters upgrading into Asian-wide, Asian-pacific wide or worldwide headquarters and whose employees are no less than 50 and the legal representative appointed by its parent company and its key functional management work permanently in Shanghai. Key regional headquarter in type of a foreign invested investment company may enjoy certain remuneration in terms of the costs and expenses incurred during its carrying out the internal equity restructuring, subject to the review of the municipal commerce commission, municipal financial bureau and other relevant departments.		
Bonus for Person in Charge	N/A	An annual cash bonus granted to one principal executive of the regional headquarter up to RMB500,000 in three successive years; A cash bonus granted to one principal executive of regional headquarter up to RMB500,000 if the incremental amount of locally retained enterprise income tax paid by regional headquarter is among the top 10 in the city; and A cash bonus up to RMB300,000 granted	N/A

		to regional headquarters' Beijing-based senior executives above the vice general manager level provided that such person take the position for at least two years.	
Preferential Treatments	(i) Preferential treatment in customs declaration and quarantine and inspection; (ii) Facilitate the administrative procedures of different functional departments for regional headquarters; (iii) Encourage investment companies to set up finance companies to provide centralized financial management services to enterprises in which they invest within China; (iv) Multiple preferential treatments or priority for expatriate employees to obtain their F visa, working permits, employment certificates and Chinese permanent residency certificates; (v) Preferential treatment in issuing the city's permanent residency certificates (i.e., hukou) to senior Chinese managers and technical staff.		Not in detail, and to be further stipulated
	Facilitate regional headquarters to use RMBs under current account; Encouraging commercial banks to provide more settlement and exchange services to regional headquarters.	The domestic working period restriction of regional headquarters' foreign employees when they intend to purchase self-used resident properties in Beijing has been waived.	

CHAPTER II INVESTMENT IN SPECIFIC INDUSTRIES

1 Information Technology Industry

1.1 General Introduction

The information technology industry in China is mainly regulated by the *Telecommunications Regulations of the People's Republic of China* ("**Telecommunications Regulations**"), which describes the information technology business using the term of "telecommunications activities," defining "telecommunications" as "the activity of using wired or wireless electromagnetic or optoelectronic systems to transmit or receive voice, text, data, images or any other form of information".

The telecommunications services are divided into two types of businesses according to relevant regulations. One is "basic telecommunications services", including: (i) fixed communication services, (ii) cellular mobile communication services, (iii) the first category of satellite communication services, (iv) the first category of data communication services, (v) cluster communication services, (vi) wireless paging services, (vii) the second category of satellite communication services, (viii) the second category of data communication services, (ix) network access services, (x) domestic communication facilities services, and (xi) network trusteeship services. The other is "value-added telecommunication services", including: (i) online data processing and transaction processing services, (ii) domestic multi-party communication services, (iii) domestic internet virtual private network services, (iv)internet data center services, (v) store-and-forward type services, (vi) call center services, (vii) internet data services, and (viii) information services. An enterprise may be required to meet multiple relevant requirements when it provides more than one type of the telecommunications service.

1.2 Introduction to Governing Laws

The Telecommunications Regulations, enacted by the State Council on 25 September 2000, set out principles for the operation of telecommunications business. On 21 February 2003, the Ministry of Industry and Information Technology ("**MIIT**") issued the *Classification Catalogue of Telecommunications Services* ("**Classification Catalogue**") to readjust the classification catalogue of telecommunication services attached to the Telecommunications Regulations.

On 25 September 2000, the *Administrative Measures for Internet Information Services* ("**IIS Measures**") was issued by the State Council, prescribing the requirements in connection with the internet information services.

The *Administrative Provisions on Foreign-Invested Telecommunications Enterprises* ("**Telecommunications FDI Provisions**"), enacted by the State Council on 11 December 2001 and amended on 10 September 2008, provides detailed instructions on the conditions and the procedures for establishing a foreign-invested telecommunication enterprise.

A foreign-invested telecommunication enterprise ("**FITE**") is also subject to other relevant laws and regulations addressing a variety of issues, such as the *Foreign Investment Industry Catalogue (2011 revision)* (the "**2011 Foreign Investment Industry Catalogue**"), which holds that the business of telecommunications services is "restricted". More specifically, the proportion of capital contributed by the foreign investor(s) in a foreign-invested telecommunications enterprise engaging in basic telecommunications services shall not ultimately exceed 49%, and the proportion of capital contributed by the foreign investor(s) in a foreign-invested telecommunications enterprise engaging in value-added telecommunications services shall not ultimately exceed 50%. Also, the following businesses are forbidden for foreign investment according to the 2011 Foreign Investment Industry Catalogue: news websites, network audio-visual program services, internet service sites, and internet cultural business (except for music).

1.3 Establishing an FITE

1.3.1 Minimum Registered Capital

For any enterprise operating throughout the country or across different provincial regions, the minimum registered capital shall be CNY1 billion if such enterprise provides basic telecommunications services, and CNY10 million if such an enterprise provides value-added telecommunications services; for any enterprise operating within a provincial region, the minimum registered capital shall be CNY100 million, if such an enterprise provides basic telecommunications services and CNY1 million if such enterprise provides value-added telecommunications services.

1.3.2 Major Foreign Investor's Qualifications

A major foreign investor[4] in a foreign-invested telecommunications enterprise providing basic telecommunications services shall (i) have the status of a legal person enterprise; (ii) have obtained a license for engaging in basic telecommunications business in the country or region where it is registered; (iii) have capital and professional staff commensurate with its business operations; and (iv) have a record of good performance and operating experience in basic telecommunications business; and the major foreign investor in a foreign-invested telecommunication enterprise providing value-added telecommunications services shall have a record of good performance and operating experience in managing value-added telecommunications business.

1.3.3 Examination Opinion and Approval Certificate:

To set up a foreign-invested telecommunications enterprise providing basic telecommunications services or value-added telecommunications in two or more provincial regions, the investors shall first apply to the MIIT for the Examination Opinion on Foreign Investment in Telecommunications, and then submit the proposed incorporation documents to the MOFCOM to obtain the Approval

[4] A "major foreign investor" hereby refers to the investor that makes the largest contribution among all foreign investors of the enterprise and has a share of 30% or more of the total amount invested by all foreign investors.

Certificate for the Establishment of a Foreign-Invested Enterprise; to set up a foreign-invested telecommunications enterprise providing value-added telecommunications services within a provincial region, the investors shall first apply to the MIIT's local counterpart for the Examination Opinion on Foreign Investment in Telecommunications MIIT's local counterpart at the provincial level, and then submit the proposed incorporation documents to MOFCOM's local counterpart to obtain the Approval Certificate for the Establishment of a Foreign-Invested Enterprise.

1.3.4 Telecommunications Business Operation License

After obtaining the above-mentioned Examination Opinion and Approval Certificate, the major Chinese investor of the proposed foreign-invested telecommunications enterprise shall submit those two documents to MIIT or its local counterpart to apply for a Telecommunications Business Operation License. With such a license, the proposed enterprise can go through the registration formalities for its establishment with the competent AIC.

1.4 Special Requirements for Providing Certain Telecommunications Services

1.4.1 Internet Information Services

Under the IIS Measures, Internet Information Services ("**IIS**") refers to the provision of information services through the internet to online users. If such provision is compensated, it is further classified as commercial IIS; if such provision is not compensated, it is further classified as non-commercial IIS. Enterprises engaging in commercial IIS shall first obtain an Internet Contact Provider Permit ("**ICP License**") from the MIIT or its local counterpart, and enterprises engaging in non-commercial IIS shall file their records ("**ICP Filing**") with the competent authorities.

If the ISS to be provided involves certain aspects of news, publishing, education, medical treatment, health, pharmaceuticals or medical apparatus, the ISS provider shall first obtain the consent or approval of the relevant competent industry authority, before applying for an ICP License or carrying out an ICP Filing.

But in practice, an enterprise may not obtain an ICP License if such enterprise has foreign shareholders, even if the proportion of capital contributed by the foreign investor(s) is less than 50%.

1.4.2 Internet Cultural Products and Activities

If an FITE intends to produce internet cultural products, such as online music, online games, online shows (programs), online performances, online arts, or online cartoons, or to provide internet cultural products and services, it shall comply with the *Interim Administrative Provisions on Internet Culture* (**Internet Culture Provisions**), enacted by the Ministry of Culture on 17 February 2011. According to the Internet Culture Provisions, an entity shall obtain a "Network Cultural Business Permit" before conducting commercial internet cultural business; and in the event that such an

entity intends to conduct non-commercial internet cultural business, it shall report to the cultural administrative authorities of the people's government of the province, autonomous region or municipality directly under the central government with jurisdiction for recording within 60 days of its establishment.

1.4.3 Internet Publishing

If an FITE intends to conduct the activities of internet publishing, e.g., select, edit and process works created by the FITE or others and subsequently post the same on the internet or transmit the same to the users' end via the internet for browsing, reading, use or downloading by the public, then it shall obtain the approval from the General Administration of Press and Publication firstly.

In addition, according to the *Administrative Measures on Internet News Information Services*, promulgated by the State Council Information Office and the Ministry of Information Industry on 25 September 2005, no organization may establish a internet news information service provider in the form of a Sino-foreign cooperative joint venture enterprise, Sino-foreign equity joint venture enterprise, or wholly foreign-owned enterprise. Also, when an internet news information service provider cooperates with a Sino-foreign cooperative joint venture enterprise, Sino-foreign equity joint venture enterprise, or wholly foreign-owned enterprise either inside or outside the territory of China in any business involving internet news information services, it shall report to the Information Office of the State Council for safety evaluation.

1.4.4 Internet E-mail Services

If an FITE intends to provide an E-mail service on the internet, it should first obtain a business license for value-added telecommunication services or go through record formalities for non-commercial information services on internet, according to the laws.

Also, the provider for E-mail service on the internet shall register the IP address used for E-mail server on the internet in the MIIT or its local counterparts 20 days before an E-mail server is opened.

1.4.5 Internet Audio-Visual Program Services

To engage in internet audio-visual program services, one shall obtain the Permit for Spreading Audio-Visual Programs via Information Network issued by the competent department of radio, film and television, or handle the archive-filing formalities.

But as mentioned above, according to the 2011 Foreign Investment Industry Catalogue, an FITE is not currently allowed to conduct the network audio-visual program services.

1.4.6 Internet Games Business

According to the *Interim Administrative Measures for Internet Games* issued by the

Ministry of Culture on 03 June 2010, any entity engaged in internet game operating activities, such as the online operation of internet games or issuance and transaction services for virtual currencies used for internet games, shall obtain an Online Cultural Business Permit.

Since a internet cultural business (except for the music) is prohibited from foreign investment, an FITE may not conduct an online operation of internet games due to its inability to obtain the Online Cultural Business Permit.

1.4.7 Medicine Information Services

According to the *Administrative Measures on Internet Medicine Information Services*, issued by the National Food and Drug Administration on 08 July 2004, an enterprise shall apply to the local Food and Drug Administration for the Internet Medicine Information Service Permit to provide online information services about medicine and medicine devices.

1.4.8 Healthcare Information Service

According to the *Administrative Measures on Internet Healthcare Information Services*, issued by the Ministry of Health on 01 May 2009, an enterprise shall apply to the Health Department of local government for the Approval of Healthcare Information Service to provide the online information services of healthcare.

2 Healthcare Industry

2.1 Medical Institutions

2.1.1 General Introduction

Medical institution has been a heavily-regulated industry in China, and foreign investment to medical institution was first regulated by the Ministry of Health ("**MOH**") (currently known as the National Health and Family Planning Commission, or "**NHFPC**") and the Ministry of Foreign Trade and Economic Cooperation ("**MOFTEC**") (currently known as the Ministry of Commerce, or "**MOFCOM**") as early as 1989.

Right now, the main rule to regulate foreign investment to medical institution is the *Interim Measures for the Administration of Sino-Foreign Equity/Cooperative Joint Venture Medical Institutions* (the "**Interim Measures**") issued by MOH and MOFTEC on May 15, 2000, which sets out rules and procedures for establishment of Sino-foreign joint venture medical institutions in China.

Due to adoption of the *Mainland and Hong Kong Closer Economic Partnership Arrangement* and the *Mainland and Macao Closer Economic Partnership Arrangement* (collectively referred to as "**CEPA**") and its supplements, as well as the *Association for Relations across the Taiwan Straits and the Taiwan Straits Exchange*

Foundation signed the Cross-strait Economic Cooperation Framework Agreement (the "**ECFA**") and its supplements, qualified Hong Kong, Macau and Taiwan investors can capitalize on CEPA or ECFA to make investment to medical institution with certain preferential treatment, including, among other things, types of medical institution, investment amount, territory, and foreign ownership.

2.1.2 Types of Foreign-invested Medical Institutions and Foreign Ownership

Foreign investors can establish the following types of foreign-invested medical institutions in China, which could be either for-profit or non-profit:

- joint venture medical institutions;
- Wholly-owned medical institutions[5] by Hong Kong/Macau investors only.
- Wholly-owned hospitals by Taiwan/Hong Kong/Macau investors only.

The foreign ownership in a joint venture medical institution shall not be more than 70%[6].

2.1.3 Qualification Requirement of Foreign Investors

For a joint venture medical institution

- Shall be a legal person;
- Shall have experience directly or indirectly related to medical and healthcare investment and management;
- Shall be able to provide advanced hospital management expertise, as well as management and service models;
- Shall be able to provide advanced international medical technologies and equipment;
- Shall be able to compensate for or improve the inadequacy of local medical service capacity, medical technologies, funds, and medical facilities.

The requirement for establishment of a joint venture medical institution by Hong Kong/Macau investors shall follow the standards and requirements of medical institutions set up by Mainland Chinese institutions or individuals.

For a wholly-owned medical institution by Hong Kong/Macau investors

[5] Excluding wholly-owned hospital and nursing home

[6] It is unclear whether such upper limit of 70% has been abolished for joint venture medical institutions set up by Hong Kong/Macau investors

The requirement for establishment of a wholly-owned medical institution by Hong Kong/Macau investors shall follow the standards and requirements of medical institutions set up by Mainland Chinese institutions or individuals.

For an wholly Taiwan/HK/Macau-owned hospital

- Shall be a legal person;
- Shall have experience directly or indirectly related to healthcare investment and management;
- Shall be able to provide advanced hospital management expertise, as well as management and service models;
- Shall be able to provide leading international medical technologies.

2.1.4 Total Investment

For a joint venture medical institution

The total investment shall be no less than RMB 20 million, which may be appropriately reduced in under-developed regions such as ethnic minority areas, border regions, or poverty-stricken areas.

The requirement for establishment of a joint venture medical institution by Hong Kong/Macau investors shall follow the standards and requirements of medical institutions set up by Mainland Chinese institutions or individuals.

For a wholly-owned medical institution by Hong Kong/Macau investors

The requirement for establishment of a wholly-owned medical institution by Hong Kong/Macau investors shall follow the standards and requirements of medical institutions set up by Mainland Chinese institutions or individuals.

For an wholly Taiwan/Hong Kong/Macau-owned hospital

Taiwan/Hong Kong/Macau investors are only allowed to set up wholly owned hospitals of second or higher level.

- For a second-level hospital, the total investment shall be no less than RMB 20 million;
- For a third-level hospital, the total investment shall be no less than RMB 50 million;
- The total investment may be appropriately reduced in under-developed regions such as ethnic minority areas, border regions, or poverty-stricken areas.

2.1.5 Regulatory Approvals

2.1.5.1 NHFPC Establishment Approvals

In order to establish a foreign-invested medical institution, the establishment approval by competent health administrative authorities shall be first obtained.

- For a joint venture medical institution, the approval shall be granted by provincial-level health administrative departments;
- For a wholly Taiwan-owned hospital, the approval shall be granted by NHFPC;
- For a wholly HK/Macau hospital set up in Guangdong Province, the approval shall be granted by Department of Health of Guangdong Province, while the approval granted by NHFPC is need for that set up outside Guangdong Province.

2.1.5.2 MOFCOM Approval

Upon obtaining the approval for establishment from the competent health administrative authorities, approval together with the Approval Certificate for a Foreign-Invested Enterprise shall be obtained for a for-profit medical institution.

- For a joint venture medical institution, the approval shall be granted by provincial-level commerce departments;
- For a wholly -owned hospital by Hong Kong/Macau/Taiwan investors, the approval shall be granted by MOFCOM.

With respect to a non-profit wholly -owned hospital by Hong Kong/Macau/Taiwan investors, a recordation shall be filed the MOFCOM.

2.1.5.3 NHFPC Practicing Approvals

A foreign invested medical institution, following procurement of NHFPC establishment approval and MOFCOM approval, shall obtain a Medical Institution Practice Permit from the original NHFPC approval authority before commencing its healthcare business.

2.2 **Pharmaceutical Industry**

2.2.1 General Introduction

Pharmaceutical industry is another heavily regulated industry in China, and other than the Approval Certificate for a Foreign-Invested Enterprise and the business license applicable to all foreign-invested enterprises in all industries, different licenses or permits shall also be obtained in terms of manufacture and distribution of drugs. There is no general restriction on foreign investment to pharmaceutical distribution business, but certain restrictions are imposed on the manufacturing

activity based on classification of drugs.

The *Pharmaceutical Administration Law of the People's Republic of China* ("**Pharmaceutical Administration Law**"), which is a fundamental law governing pharmaceutical industry and is revised and reissued on February 28, 2001, regulates the research, production, trade, use, supervision and management of pharmaceuticals within the territory of China.

On August 5, 2004, the State Food and Drug Administration ("**SFDA**") issued the *Measures for the Supervision over and Administration of Pharmaceutical Production* to supervise and administrate the pharmaceutical production.

Foreign invested pharmaceutical enterprises shall also be subject to other laws or regulations addressing a variety of issues regarding pharmaceutical production and distribution, such as the *Measures on Administration of Pharmaceutical Registration*, the *Good Supply Practice for Pharmaceutical Products*, the *Administrative Measures on Foreign Investment in the Commercial Sector*("**Commercial Measures**") and the *Administrative Measures for Good Manufacturing Practice Authentication of Pharmaceutical Production*.

2.2.2 Pharmaceutical Manufacturing Enterprises

2.2.2.1 Types of Foreign-invested Pharmaceutical Manufacturing Enterprises

Manufacturing business is completely open for foreign investment, except for certain types of medicine listed in the *Foreign Investment Industry Catalogue* (2011 revision).

2.2.2.2 Conditions for Establishment of a Pharmaceutical Manufacturing Enterprise

In addition to meeting the pharmaceutical industry development plan and industrial policies of the State, the following conditions shall also be met:

- Having technicians in pharmacology, engineers and technicians and corresponding technical workers whose qualifications have been certified; and the legal representative or responsible person of the enterprise and the person in charge of quality are not disqualified by the Pharmaceutical Administration Law to take the relevant job position;

- Having workshops, facilities and sanitation environment fitting in with pharmaceutical production;

- Having institutions, personnel that are able to make quality control and inspection on the pharmaceuticals produced, and necessary apparatus and equipment; and

- Having rules and regulations that can ensure the pharmaceutical quality.

2.2.2.3 Brief Introduction on Licenses or Permits Necessary for Pharmaceutical Production

Pharmaceutical Production License

Prior to registration with the administrative department for industry and commerce, the establishment of a pharmaceutical manufacturing enterprise shall be approved and issued with a Pharmaceutical Production License by the food and drug administrative department of the province, autonomous region, or municipality directly under the Central government ("**provincial food and drug administrative department**") in which the enterprise is located.

The validity period of the Pharmaceutical Production License is 5 years and can be renewed before expiration.

Drug Approval Number

A pharmaceutical manufacturing enterprise can produce the following types of drugs:

- New drugs which have not been marketed within China; if the type of preparation or the route of administration of any drugs that have been marketed is changed, or if the range of indications thereof is newly expanded, the said drugs shall be treated as new drugs;

- Generic drugs, for which the SFDA has promulgated formal standards.

A new drug or generic drug can be put into production only after the SFDA has approved it and granted a Drug Approval Number, and in terms of new drugs, a New Drug Certificate shall also be obtained from the SFDA on or before the grant of the said Drug Approval Number.

GMP Authentication

Pursuant to the *Regulations for the Implementation of the Pharmaceutical Administration Law of the People's Republic of China*, any newly-established pharmaceutical manufacturing enterprise shall, within 30 days from the date it obtains the approval documents for manufacturing pharmaceuticals or from the date its formal production is approved, apply to the competent food and drug administrative departments for GMP Authentication as required.

2.2.3 Pharmaceutical Distribution Enterprises

2.2.3.1 Types of Foreign-invested Pharmaceutical Distribution Enterprises

The *Foreign Investment Industry Catalogue* (2011 revision) has lifted the restriction on foreign investment in pharmaceutical distribution (i.e. wholesale and retail) business. Distribution business is completely open for foreign investment.

However, according to the Commercial Measures, where the same foreign investor has opened accumulatively more than 30 stores in China to distribute pharmaceuticals which are of various brands and are from different suppliers, such foreign investment shall be conducted in the form of a joint venture and the proportional ratio of capital contribution of the foreign investor in the joint venture shall not exceed 49%.

Due to adoption of the CEPA and its supplements, qualified Hong Kong and Macau investors can enjoy certain preferential treatment. Pursuant to the supplements to the Commercial Measures, where the same qualified Hong Kong/Macau investor has opened accumulatively more than 30 stores in China to distribute pharmaceuticals which are of various brands and are from different suppliers, such Hong Kong/Macau investor is allowed to operate the business as a sole proprietor.

2.2.3.2 Conditions for Establishment of a Pharmaceutical Distribution Enterprise

A pharmaceutical distribution enterprise to be established shall meet the following requirements:

- Having legally qualified pharmaceutical professionals;
- Having the business operation premises, equipment, warehouses and hygienic environment required for pharmaceutical distribution;
- Having the units or personnel for quality control over the pharmaceuticals to be distributed; and
- Having rules and regulations to ensure the quality of the pharmaceuticals to be distributed.

2.2.3.3 Brief Introduction on Licenses or Permits Necessary for Pharmaceutical Distribution

Pharmaceutical Distribution License

Prior to registration with the competent administrative department for industry and commerce, the establishment of a pharmaceutical distribution enterprise shall be approved and issued with a Pharmaceutical Distribution License:

- For a pharmaceutical wholesale enterprise, the Pharmaceutical Distribution License shall be obtained from the provincial food and drug administrative department;
- For a pharmaceutical retail enterprise, the Pharmaceutical Distribution License shall be obtained from the local food and drug administrative department at or above the county level.

The validity period of the Pharmaceutical Distribution License is 5 years and can be

renewed before expiration.

GSP Authentication

Any newly-established pharmaceutical distribution enterprise shall, within 30 days from the date it obtains the Pharmaceutical Distribution License, apply to the food and drug administrative department which has issued such Pharmaceutical Distribution License for GSP Authentication as required. The GSP Authentication will be granted by the provincial food and drug administrative department.

2.3 **Medical Device Industry**

2.3.1 General Introduction

In China, medical devices are classified into three various categories, including Class I, Class II and Class III, depending on the degree of risk associated with each medical device and the extent of control needed to ensure safety and effectiveness.

Medical device industry has been completed opened to foreign investors. Different licenses or permits shall be obtained in terms of manufacture and distribution of medical devices and according to the classes of such medical devices.

Foreign invested enterprises engaged in the medical device industry are mainly regulated and supervised by the SFDA and its local branches. They are also subject to the laws and regulations applicable to medical device in general, such as the *Regulations on Supervision and Administration of Medical Devices* issued on January 4, 2000.

Other than the Approval Certificate for a Foreign-Invested Enterprise and the business license applicable to all foreign-invested enterprises in all industries, medical device enterprises are required to obtain production permits, distribution permits, product registrations, export registrations, etc. for their business operation.

2.3.2 Foreign-invested Medical Device Manufacturing Enterprises

A foreign-invested medical device manufacturing enterprise shall obtain the following permits or licenses:

Production Permit

Prior to obtainment of the business license, enterprises to be established for producing Class II and/or Class III medical devices shall be examined and approved by the provincial food and drug administrative departments and be issued a Medical Device Producing Enterprise License ("**Production Permit**") which is valid for five years and is renewable upon expiration.

Written Notification

A Production Permit is not necessary for the enterprises manufacturing Class I medical devices. Instead, pursuant to the *Measures for the Supervision and Administration of Medical Device Production*, such enterprises, within 30 days of obtaining the business license, shall complete the Form on the Registration of a Class I Medical Device Production Enterprise and inform the provincial food and drug administrative departments by written notification.

Product Registration & Clinical Tests

Before a medical device can be produced for commercial distribution, a Product Registration Certificate, which is valid for four years and is renewable upon expiration, is needed:

- For Class I medical devices, the Product Registration Certificate shall be granted by the food and drug administrative departments of the cities divided into districts;

- For Class II medical devices, the Product Registration Certificate shall be granted by the provincial food and drug administrative departments;

- For Class III medical devices, the Product Registration Certificate shall be granted by the SFDA.

Furthermore, clinical tests conducted for high-risk Class III medical devices shall be examined and approved by the SFDA before they are put into production.

Exportation Certificate

Pursuant to the *Provisions of the Administration on the Issuance of Certificate for Exportation of Medical Products* issued on February 12, 2004, before a manufacturer located in China can export any medical devices out of China, it must obtain from the SFDA a certificate for exportation of medical products ("**Exportation Certificate**") which would be valid for 2 years.

2.3.3 Foreign-invested Medical Device Distribution Enterprises

According to the *Measures for the Administration of Licenses for Medical Device Operation Enterprises* promulgated on August 9, 2004 and other related regulations, a foreign-invested medical device distribution enterprise shall obtain the License for the Medical Device Operation Enterprise ("**Distribution License**"), which is valid for five years and is renewable upon expiration, depending on the class of medical devices to be distributed:

- For Class I medical devices, no Distribution License is required;

- For certain Class II medical devices contained in the catalogue formulated by the SFDA, no Distribution License is required;

- For other Class II and/or all Class III medical devices, a Distribution License shall be obtained from the food and drug administrative departments of the cities divided into districts.

3 Foreign Investment in Commercial Sector

3.1 General Introduction

3.1.1 Definition of Commercial Enterprises

According to the *Law of the PRC on Sino-Foreign Equity Joint Ventures,* the *Law of the PRC on Sino-Foreign Cooperative Joint Venture,* the *Law of the PRC on Wholly Foreign-owned Enterprises),* the *Administrative Measures on Foreign Investment in the Commercial Sector*, and other laws and regulations, together with its implementing rules, foreign companies, enterprises and other economic organizations or individuals are allowed to make investments in commercial enterprises.

Generally, commercial enterprises in this section shall refer to enterprises that undertake the following business activities:

(1) Wholesale: the selling of goods to retailers, customers of industry, commerce and organizations, to other wholesalers or the providing of relevant attachment services;

(2) Retail: the selling of goods for consumption and use by individuals or groups or the providing of relevant attachment services in fixed places or through the use of television, telephone, mail order, internet and automats;

(3) Commission agency: agents, brokers, auctioneers or other wholesalers who sell goods owned by others and provide relevant attachment series through the collection of fees on the basis of contracts; and

(4) Franchising: vesting other people with the right of use of a given trademark, trade firm or mode of management through the signing of a contract in order to collect remunerations or franchising fees. Foreign investors must carry out the aforesaid business activities by establishing or the merger and acquisition of domestic companies into foreign invested enterprises in China.

Categorized by merchandise or items, foreign invested commercial enterprises shall be divided into general merchandise distribution business enterprises and special commodity distribution business enterprises. For the convenience of discussion, enterprises engaged in the aforesaid four different business activities shall be collectively referred to as Commercial Enterprises.

3.1.2 Regulatory Overview of Foreign Investment in Commercial Enterprise

3.1.2.1 ***Guidance Catalogue***. Investment activities in the PRC commercial industry by foreign investors are principally governed by the *Guidance Catalogue of Industries for foreign investment* (the "**Guidance Catalogue**"), which was amended on December 24, 2011, by the Ministry of Commerce ("**MOFCOM**")and the National Development and Reform Commission (the "**NDRC**"). The Guidance Catalogue divides industries into three categories: encouraged, restricted and prohibited. Industries not listed in the Catalogue are labeled as permitted and are generally open to foreign investment unless specifically restricted by other PRC laws and regulations. According to the Guidance Catalogue, foreign investment in wholesale commercial enterprises is listed as a restricted industry. In some particular circumstances, enterprises that engaged in the wholesale and retail industries are listed in the restricted category, which will result in stricter approval or filing procedures for the establishment a foreign invested commercial enterprise. Furthermore, for business activities labeled as restricted industry, it shall always mean that when setting up a foreign invested commercial enterprise, a Sino-foreign joint venture has to be adopted and domestic partner must hold majority of the shares. The particular business activities that are labeled as restricted industry are provided in the following:

(1) Direct sales, mail orders, and online sales;

(2) Purchase of grains; wholesale, retail, and distribution of grains, cotton, vegetable oil, sugar, tobacco, crude oil, agricultural chemicals, agricultural plastic film and fertilizers (in the case of chain stores having established more than 30 stores and selling products of different varieties and brands from multiple suppliers, the Chinese parties shall be the controlling shareholders);

(3) Construction and operation of a large-scale agricultural products wholesale market;

(4) Distribution of audio-video products (excluding movies) (limited to Sino-foreign cooperative joint venture operations);

(5) Vessel agencies (with Chinese parties as the controlling shareholders) and ocean shipping tally companies (limited to Sino-foreign equity/cooperative joint venture operations); and

(6) Wholesale of oil products, and construction and operation of gas stations (in the case of those having established more than 30 chain gas stations invested by the same foreign investors and selling product oil of different varieties and brands from multiple suppliers, the Chinese parties shall be the controlling shareholders).Foreign investors are not allowed to invest in industries in the prohibited category.

3.1.2.2 ***Trial Establishment Measures and the New Measures***. Prior to the PRC's

entry into WTO in December 2001, foreign investment in Commercial Enterprises in the PRC was highly restricted. On 25 June 1999，the PRC's State Economic Trade Commission and the Ministry of Foreign Trade and Economic Cooperation jointly issued the *Measures on the Trial Establishment of Foreign-Invested Commercial Enterprises* (the "**Trial Establishment Measures**"). According to the Trial Establishment Measures, foreign investors were permitted to set up Sino-foreign equity joint ventures or Sino-foreign cooperative joint ventures jointly with domestic companies or enterprises in the designated experimental areas within the PRC, which was greatly restricted. However, wholly foreign-owned enterprises were not allowed to be established in the commercial industry at that stage.

3.1.2.3 ***The New Measures***. However, to fulfill the PRC's WTO commitment in respect of the opening up of its distribution services sector, MOFCOM issued the *Measures on the Administration of Foreign Invested Commercial Enterprises* (the "**New Measures**") on April 16, 2004, which provided for the regulation of foreign investments in distribution services such as wholesale, retail, commission agency and franchising. The Trial Establishment Measures were abolished when the New Measures took effect from 1 June, 2004. There are a number of major changes against the prior Trial Establishment Measures in the New Measures, which include the permitting of foreign investors to engage in the operation of distribution services on a wholly-owned basis as of11 December 2004. The New Measures also gradually enlarged the geographic coverage of foreign-invested commercial enterprises and lowered the market entry threshold. In terms of requirements for foreign invested commercial enterprises to set up stores, it is stipulated in the New Measures that foreign investors can apply to set up both commercial enterprises and stores at the same time in accordance with a simplified procedure and clear guideline. The New Measures also stipulate responsible regulatory authorities, approval levels, conditions, application procedures, the documents to be submitted for establishment of Commercial Enterprises and/or the opening of new stores.

3.1.2.4 ***Follow up amendments of the New Measures***. After the New Measures were promulgated, MOFCOM continued to issue a series of notices or circulars from time to time to delegate matters concerning the examination and approval of foreign-invested Commercial Enterprises gradually. As stipulated in the aforesaid notices or circulars, the level of responsible government authorities for examination and approval has transferred from the central level to the provincial level, except for some particular business activities. Furthermore, MOFCOM has also promulgated some amendments to the New Measures, which offer more favorable terms to investors from Hong Kong and Macau who fall into the definition of "Service provider" in relation to investment in the PRC commercial industry.

3.1.2.5 ***Other Laws and regulation****s.* A foreign-invested commercial enterprise

must, when managing some particular commodities, abide by the regulations of the relevant industry in addition to the provisions of the aforesaid New Measures. For example, in situations where a foreign-invested commercial enterprise manages books, newspapers or periodicals, it must act in accordance with the *New Measures for the Administration of Foreign-invested Distribution Enterprises of Books, Newspapers, or Periodicals*. If a foreign-invested commercial enterprise manages a gas station and undertakes the retail of refined oil, it must have a stable supply channel for refined oil, conform to the construction plan of the local gasoline station. On situations where a foreign-invested commercial enterprise manages drugs, it shall conform to the relevant standards for the administration of drug sales. As described above, there are a number of other PRC laws and regulations promulgated to specially regulate some particular business activities.

3.2 Setting Up a Foreign-invested Commercial Enterprise

3.2.1 Investment Vehicles

3.2.1.1 General Introduction

Since foreign investors have been permitted to invest in Commercial Enterprises on a wholly-owned basis, foreign investment in Commercial Enterprise may take forms such as Sino-foreign equity joint ventures, Sino-foreign cooperative joint ventures, wholly foreign-owned enterprises and foreign-invested joint stock companies.

3.2.1.2 Restrictions on Shareholding

For enterprises engaged in the following business activities, foreign investors are not permitted to wholly own shares or are restricted to hold a majority shareholding stake of a commercial enterprise in the PRC:

<u>Refined Oil Distribution Enterprise</u>

According to the *Measures for the Administration of the Refined Oil Market*, issued by MOFCOM on December 4, 2006, if the same foreign investor engaging in the retailing of refined oil within the territory of China has at least 30 filling stations (including those set up with its investment, those in which it has a holding share and those it has rented), or if the same foreign investor sells different varieties and brands of refined oil from more than one supplier, the foreign party may not hold a controlling share.

<u>Video Product Distribution Enterprises</u>

According to the *Order on the Release of the Measures for the Administration of Sino-Foreign Cooperative Audio-video Product Distribution Enterprises*, issued jointly by MOFCOM and the Ministry of Culture on February 9, 2004, and its supplementary provisions promulgated from time to time, enterprises engaging in the

distribution of video products shall be set up in the form of a Sino-Foreign cooperative entity. Chinese investors shall own no less than 51% of the shares of such equity.

More Than 30 Stores

In the event that the same foreign investor accumulatively opens more than 30 stores within China, the goods it manages include books, newspapers, magazines, drugs, pesticides, agricultural films, fertilizers, refined oils, food, vegetable oil, sugar, cotton and other commodities, and the above commodities are of different brands and come from different suppliers, the proportion of capital contributions of the foreign investors must not exceed 49%.

Distribution of Salt or Tobacco

No wholesaling foreign-invested commercial enterprises may manage salt or tobacco, and no retailing foreign-invested commercial enterprises may manage tobacco.

3.2.1.3 Favourable Policies to Hong Kong and Macau Investors

For the purposes of promoting closer economic partnerships between Hong Kong and Macau and the Mainland and encouraging service providers from Hong Kong and Macau to establish businesses and enterprises in the Mainland, Mainland China has reached a series of partnership arrangements with both Hong Kong and Macau. Some of the aforesaid provisions have been adopted by PRC laws and regulations for specific industries that have been promulgated separately. Such provisions offer more favourable policies to investors from Hong Kong and Macau planning to make investments in the PRC commercial industry. The service providers from Hong Kong or Macau referred to herein shall fall under the definition of "service providers" of the relevant provisions in the *Mainland and Hong Kong Closer Economic Partnership Arrangement* and the *Mainland and Macao Closer Economic Partnership Arrangement*, and meet the requirements provided therein. In particular:

(1) For service providers from Hong Kong or Macau that have accumulatively established over 30 shops in the Mainland and sell books, newspapers and magazines or have accumulatively established over 50 shops in the Mainland: if the goods they operate include commodities such as medicine, pesticides, agricultural films, fertilizers, vegetable oil, sugar and cotton and, medicine, pesticides, agricultural films, fertilizers, vegetable oil, sugar and cotton and the aforesaid goods are under different brands and from different suppliers, the service providers will be allowed to hold a majority of the shares of such enterprises, but with a capital contribution of less than 65%.

(2) For service providers from Hong Kong or Macau that have accumulatively established over 30 shops in the mainland: if the goods they operate include commodities such as medicine, pesticides, agricultural films, fertilizers, vegetable oil, sugar and cotton and the aforesaid goods are under different brands and from different suppliers, such service providers will be allowed to

conduct their operations in the form of a wholly foreign-owned enterprise ("WFOE").

(3) For service providers from Hong Kong or Macau that have accumulatively established over 30 shops in the Mainland and sell food in different varieties and brands from multiple suppliers: they shall be allowed to run wholly-owned operations on a trial basis, and the aforementioned business operations shall be limited to Guangdong Province.

(4) For service providers from Hong Kong or Macau: they are allowed to provide distribution services for video products (including movie derivative works) in the form of a WFOE.

3.2.2 Business Term

Generally speaking, the maximum length of a business term for a foreign invested commercial enterprise is 30 years. In addition, the operating term of a foreign-invested commercial enterprise established in the middle and western areas must not exceed 40 years.

3.2.3 Business Scope

Upon approval, foreign-invested commercial enterprises may operate the following types of businesses:

3.2.3.1 For foreign-invested commercial enterprises in the retail business:

(1) Retailing of commodities.

(2) Importing of self-managed commodities.

(3) Purchasing of domestic products for export.

(4) Other relevant matching businesses.

3.2.3.2 For the foreign-invested commercial enterprises in the wholesale business:

(1) Wholesaling of commodities.

(2) General distributor or general agent for products that feature commission fees (excluding auctions).

(3) Importing and exporting of goods.

(4) Any other business activities relevant to those listed in items (1) to (3).

3.2.3.3 A foreign-invested commercial enterprise may authorize other parties,

including individuals or companies, to establish stores by way of franchising.

3.2.3.4 A foreign-invested commercial enterprise may, upon approval, undertake one or several types of sales businesses. The types of commodities it manages must be specified in the contents regarding the scope of business as prescribed in the contract or articles of association.

3.2.4 Conditions for Foreign Invested Commercial Enterprises

3.2.4.1 According to the New Measures, foreign-invested commercial enterprises are subject to the following conditions:

(1) its minimum registered capital must comply with the requirements of PRC company law (i.e. RMB30,000 for companies with two or more investors and RMB 100,000 for single investor companies);

(2) it must comply with the normal total investment and registered capital requirements for foreign invested enterprises; and

(3) in general, its operating term may not exceed 30 years, or 40 years in the western regions of the PRC.

3.2.4.2 Foreign-invested commercial enterprises are also subject to the following conditions for opening retail stores:

(1) if applying to open a store at the same time as applying to establish the enterprise, the proposed store must conform to the urban development plan and the commercial development plan of the city where it is located;

(2) if applying to open a store after the establishment of the enterprise, then in addition to satisfying the above requirement, the enterprise must also (a) have undergone an annual inspection on time and passed, and (b) have received all of its registered capital from its investors.

3.2.5 Approval Procedures

For the purpose of investment in the PRC commercial industry, foreign investors shall establish a new enterprise by foreign direct investment, or by the merger and acquisition of a domestic commercial enterprise. According to the relevant PRC laws and regulations, some approval procedures shall be applicable for setting up a foreign invested commercial enterprise.

3.2.5.1 Approval Levels for Investing in PRC Commercial Enterprises

The competent commerce departments of the state shall perform the supervisory and administrative duties concerning foreign investment in the commercial fields and the business activities of foreign-invested commercial enterprises in accordance with the

relevant laws and regulations MOFCOM at the central level and its competent departments at the provincial level shall be responsible for supervisory and administrative matters over foreign investment in PRC commercial enterprises.

Provincial Level Approval

(1) In the event that the applicant is a foreign-invested commercial enterprise engaging in retail business operations and opens stores at the provincial level of administration in its locality, the said competent commerce department of the province shall examine and approve such enterprise within the power of its examination and approval authority. The commerce department will then report it and file the result with MOFCOM, provided that the following conditions have been satisfied:

a. The area of business of an individual store does not exceed 3,000 square meters, the number of stores does not exceed three, and the total number of the similar stores established by foreign investors of such stores within China through the foreign-invested commercial enterprises they have established does not exceed 30.

b. The area of business of an individual store does not exceed 300 square meters, the number of stores does not exceed 30, and the total number of similar stores opened in China by foreign investors of such stores through the foreign-invested commercial enterprises they have established does not exceed 300.

c. Its business scope does not include sales via television, telephone, mail order, Internet, or automats, or any of the commodities as enumerated in Articles 17 and 18 of the Measures.

(2) This application for the establishment of foreign-invested enterprises as well as the opening of new stores shall be examined and approved by the competent commerce department at the provincial level where the enterprise is located if the following conditions have been satisfied:

a. the owners of a trademark or business name of a Sino-foreign equity joint venture or cooperative commercial enterprise are Chinese-invested enterprises or Chinese natural persons; and

b. the Chinese investors maintain the controlling shares in the foreign-invested commercial enterprise; and

c. the business scope of the foreign-invested commercial enterprise does not concern any of the commodities enumerated in Articles 17 and 18 of the Measures.

If a store is opened in a different province, the opinions of the competent commerce department at the level of the province where the planned store is located shall also be consulted.

(3) Foreign investment in the distribution of video products (excluding wholesale) shall be subject to provincial level approval.

(4) Any investment as delegated at the central level by MOFCOM.

(5) The competent commerce department at the provincial level shall not transfer the power for examination and approval to a lower level without the authorization from MOFCOM.

Central Level Approval

A commercial enterprise shall apply for central level approval from MOFCOM if such enterprise's foreign investment falls into any of the following situations:

(1) Such foreign invested enterprise conducts its operations via television, telephone, mail order, internet, or automats.

(2) Such foreign invested enterprise engages in the distribution of books, newspapers, magazines, medicines, automobiles, refined oil and the wholesale of video products.

(3) Where a foreign-invested commercial enterprise is to be established by means of an acquisition or merger, and the domestic and overseas enterprises are controlled by the same management staff or there is only one actual controller.

3.2.5.2 Application Procedures

In general, foreign investment in commercial enterprises shall be subject to the following procedures:

Distribution of General Commodities and Timeline Approval

(1) The project initiation, feasibility study report of the foreign-invested enterprise, and the report and verification on the establishment of the enterprise shall be submitted altogether at one time.

(2) The investors of foreign-invested commercial enterprises to be established and already established foreign-invested commercial enterprises that apply for opening stores or including distribution into existing business scope must submit the application documents to the competent commerce department where the foreign-invested commercial enterprise undergoes registration.

(3) The competent commerce department where the foreign-invested commercial enterprise undergoes registration shall, after conducting preliminary examinations of the documents submitted, report to the commerce department at the provincial level.

(4) The commerce department at the provincial level shall review and examine joint

venture contracts, articles of associations and other documents submitted, and make a decision on whether the new establishment of such commercial enterprise or the opening of new stores complies with the commercial network planning of the city.

(5) If a store is opened in a different province, the opinions of the competent commerce department at the level of the province where the planned store is located shall also be consulted.

(6) The commerce department at the provincial level shall make a decision on whether to approve the application within three months from the date of the receipt of all the application documents. If it approves the establishment, the Certificate of Approval for Foreign-invested Enterprises shall be issued. If the application is not approved, the reasons for the refusal will be thereby explained.

(7) If such investment is subject to approval from the central level commerce department, the provincial level commerce department will submit all the documents to the central level commerce department, within one month from the date of the receipt of all the application documents, after conducting preliminary examinations. MOFCOM shall make a decision on whether to approve the application within three months from the date of the receipt of all the application documents.

Additional Approval Requirement for the Operation of Special Commodities

For foreign investment in commercial enterprises engaged in the operation of special commodities, apart from approval from the competent commerce department, additional approval requirements shall be applied as follows:

(1) Distribution of Video Products. License for the Operation of Video Products shall be applied and issued from the competent responsible cultural authorities for foreign investment in the distribution and wholesale of video products.

(2) Distribution of Automobiles. Opinion and approval from the State of Administration of Industry and Commerce shall be obtained if such foreign invested enterprise engages in the distribution of Automobiles.

(3) Distribution of Medicines. Approval from the competent food and drug administration or a license for the operation of medicines shall be obtained if such foreign invested enterprise engages in the distribution of medicines.

(4) Distribution of Books, Newspaper and Magazines. Approval from the competent responsible press and publication administration authorities or a license for the operation of publications shall be obtained if such foreign invested enterprise engages in the distribution of books, newspapers and magazines.

(5) Online retailer. For enterprises engaged in online e-commerce, such enterprises

shall be subject to the *Administrative Rules for Foreign Investment in value-added telecommunications Industry*. According to the *Administrative Rules for foreign investment in Telecommunications Enterprises* issued by the State Council, which was effective as of January 2002 and amended in September 2008, a foreign investor may hold no more a 50% equity interest in a value-added telecommunications services provider in China.

3.2.5.3 Documents to be Submitted for Application

General Requirements for the Establishment of A New Entity

The following documents must be submitted upon application for the establishment of a foreign-invested commercial enterprise:

(1) Application letter.

(2) Feasibility study report jointly signed by all the investors.

(3) Contract, articles of association (for a foreign-invested commercial enterprise, only the articles of association should be submitted) and the attachment.

(4) Bank credit certificates of all investors, registration certificate (photocopy), certificate of the legal representative (photocopy), if the foreign investor is a legal individual, his/her identity certificate must be provided.

(5) The audit report of all investors during the past year, which has been audited by accountant firms.

(6) The evaluation report on state-owned assets invested into the Sino-equity joint venture or contractual joint venture commercial enterprises by Chinese investors.

(7) Catalogues of import and export commodities of the planned foreign-invested commercial enterprise.

(8) Name list of the members of the board of directors of the planned foreign-invested commercial enterprise and the power of attorney for directors of each investor.

(9) Notice of pre-approval of the enterprise name as issued by the administrative department for industry and commerce.

(10) The certificate documents (photocopy) of the right to use the land set aside for the planned store and (or) house lease agreement (photocopy), except when the business area of the store to be opened is less than 3,000 square meters.

(11) The documents of statement in conformity with the requirements for city development and urban commercial development as issued by the competent

commerce department of the government at the locality of the store.

In the event that the documents are signed by an individual who is not the legal representative, the power of attorney of the legal representative must be shown.

Special Requirements for the Establishment of Foreign Enterprises by Mergers and Acquisitions

If a foreign enterprise is to be established by the merger and acquisition of a domestic commercial enterprise, apart from the documents listed in the previous section, the following documents must be submitted upon application for the establishment of a foreign-invested commercial enterprise:

(1) Shareholders' resolutions by the domestic commercial enterprise on the merger and acquisition by foreign investors.

(2) Subscription agreement on the increase of capital or shares of the domestic company.

(3) Statement of entities or companies invested by such domestic company.

(4) Statement of settlement plan of employees of such domestic company.

Documents to be Submitted for Opening New Stores

Upon application, in situations where an already established foreign-invested commercial enterprise applies for opening a store, such enterprise must submit the following documents:

(1) Application letter.

(2) The revised contract or articles of association must be submitted in cases wherein amendments to the contract or articles of association are involved.

(3) Feasibility study report on the establishment of the store.

(4) Resolutions of the board of directors on the establishment of the store.

(5) The audit report of the enterprise during the past one year.

(6) The capital verification report of the enterprise (photocopy).

(7) Registration certificate (photocopy) of all the investors and the certificate of the legal representative (photocopy).

(8) Certificate documents of the right to use the land that has been set aside for the store to be opened and (or) house lease agreement (photocopy), except when the business area of the store opened is less than 3,000 square meters.

(9) The documents of statement in conformity with the requirements for city development and the commercial development of the city as issued by the government where the planned store is located.

(10) In the event that the document is signed by an individual who is not the legal representative, the power of attorney of the legal representative must be shown.

(11) The license contract for the use of a trademark or a business name, technology transfer contract, management contract and service contract signed by a foreign-invested commercial enterprise, and other legal documents shall be deemed as the attachment of the contract (for a foreign-invested commercial enterprises, it shall be deemed as the attachment of the articles of association) and must be submitted along with all the other relevant documents.

3.3 Relevant laws and regulations

Foreign investment in the commercial industry is subject to a number of laws and regulations. For your reference, we have provided a list of the major PRC laws and regulations on foreign investment in commercial enterprises.

- The *Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (Revised in 2001)*;
- The *Implementing Regulations of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (Revised in 2001)*;
- The *Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures*;
- The *Implementing Rules of the Law of People's Republic of China on Sino-Foreign Cooperative Joint Ventures*;
- The *Company Law of the People's Republic of China (Revised in 2005)*;
- The *Law of the People's Republic of China on Wholly Foreign-owned Enterprises (Revised in 2000)*;
- The *Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (Revised in 2001)*;
- The *Administrative Measures for Foreign Investment in Commercial Fields*;
- The *Supplementary Regulations for the Measures on the Administration of Foreign Investment in Commercial Fields*;
- The *Circular of the Ministry of Commerce on Printing and Distributing the Supplementary Provisions II on the Measures for the Administration of Foreign*

Investment in Commercial Fields;

- The *Supplementary Regulations III of Measures on the Administration of Foreign Investment in the Commercial Sector issued by the Ministry of Commerce*;

- The *Supplementary Provisions for the Administrative Measures for Foreign-invested Commercial Fields (IV)*;

- The *Supplementary Provisions to the Administrative Measures for Foreign-Funded* Commercial *Fields (V)*;

- The *Circular of the Ministry of Commerce on Delegating Matters Concerning the Examination and Approval of Foreign-invested Commercial Enterprises*;

- The *Circular of the Ministry of Commerce on Further Delegating Matters Concerning the Examination and Approval of Foreign-invested Commercial Enterprises and Including Distribution into the Business Scope of an Established Manufacturing Enterprise*;

- The *Measures for the* Administration *of the Refined Oil Market*;

- The *Procedures for the* Administration *of Commercial Franchising*;

- The *Order of the Ministry of Commerce and the Ministry of Culture on the Release of the Measures for the* Administration *of Sino-Foreign Cooperative Audio-video Product Distribution Enterprises*;

- The *Supplementary Provisions on the Measures for the* Administration *of Sino-foreign Contractual Video Product Distribution Enterprises (I)*;

- The *Supplementary Provisions on the Measures for the Administration of Sino-foreign Contractual Video Product Distribution Enterprises (II)*;

- The *Order of the State Administration of Press and Publication and the Ministry of Foreign Trade and Economic Cooperation on the Release of the Measures for the Administration of Foreign-Invested Books, Newspapers and Magazines Distribution Enterprises*;

- The *Circular of the General Administration of Press and Publication and the Ministry of Commerce on the Release of the Supplementary Provisions on the Measures for the Administration of Foreign-invested Books, Newspapers and Magazines Distribution Enterprises*.

4 Foreign Investment in China's Real Estate Industry

4.1 General Introduction

A foreign-invested real estate enterprise shall refer to a foreign-invested enterprise ("**FIE**") that engages in the construction and operation of all kinds of residences such as ordinary houses and apartments, hotels (and/or restaurants), vacation villages, office buildings, exhibition centers, commercial facilities, theme parks, etc., as well as the land development or tract development that aims for the construction of the above-mentioned projects[7].Since 2006, China has started to impose stricter regulations on foreign investment in the real estate market. Comprehensive restrictions were placed on market access, business scope, operation and management of development, inflow and outflow of foreign exchange, etc., following the promulgation of the *Opinions on Regulating the Market Access to and Administration of Foreign Investment in Real Estate* (Jian Zhu Fang [2006] No. 171,referred to as "**Circular 171**") and its supporting regulations. In recent years, China still follows the principles of restrictions and strict controls on foreign investment in the real estate industry in order to avoid a large influx of foreign capital into the market.

4.1.1 Related Laws and Regulations

Foreign investment in the real estate industry is mainly monitored by the following laws and regulations:

4.1.1.1 Laws and Regulations Related to the Formation of FIEs

Foreign investors mainly form Sino-foreign equity joint venture enterprises, Sino-foreign cooperative joint venture enterprises or wholly foreign-owned enterprises as investment vehicles to invest in the real estate market and operate their businesses. These investment vehicles are subject to the following laws and regulations: *the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (2001 Revision)* and the *Implementing Regulations of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (2001 Revision),*the *Law of the People's Republic of China on Sino-Foreign Cooperative Joint* Ventures *(2000 Revision)* and the *Implementing Rules of the Law of People's Republic of China on Sino-Foreign Cooperative Joint Ventures*, and the *Law of the People's Republic of China on Wholly Foreign-owned Enterprises (2000 Revision)*and the *Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (2001 Revision)* and the *Company Law of the People's Republic of China (2005 Revision)*.

4.1.1.2 Laws and Regulations Related to Real Estate Development

Laws and regulations supervising the acquisition of the land use rights for real estate development, incorporation of real estate enterprises, development and construction

[7]Please refer to Article 1 of the *Circular of the General Office of the Ministry of Commerce on the Relevant Issues Concerning the Implementation of the Opinions on Regulating the Access to and Administration of Foreign Investment in the Real Estate Market*. "Villas" are one kind of the residences that can be invested and developed by foreign investors according to the aforementioned notice. However, the *Catalogue for the Guidance of Foreign Investment Industries (2011 Revision)* has already prohibited the construction and operation of villas by foreign investors.

of real estate projects and real estate transactions mainly include:

(1) The *Law of the People's Republic of China on the Administration of Urban Real Estate (2007 Revision)* (promulgated by the Standing Committee of the National People's Congress on August 30, 2007 and effective thereon), the *Administrative Regulations on Urban Real Estate Development and Operation*(promulgated by the State Council on July 20, 1998 and effective thereon) and the *Provisions on the Administration of* the *Qualification for Real Estate Development Enterprises* (promulgated by the Ministry of Construction (now the Ministry of Housing and Urban-Rural Development) on March 29, 2000 and effective thereon);

(2) The *Land Administration Law of the People's Republic of China (2004 Revision)* (promulgated by the Standing Committee of the National People's Congress on August 28, 2004 and effective thereon) and its implementing regulations (promulgated by the State Council on December 27, 1998 and effective as of January 1, 1999), the *Interim Regulations on the Granting and Transfer of the Rights to the Use of State-owned Land in Urban Areas* (promulgated by the State Council on May 19, 1990 and effective thereon) and the *Provisions on the Granting of Rights to Use State-Owned Land by Tendering, Auctioning and Listing* (promulgated by the Ministry of Land and Resources on May 9, 2002 and effective as of July 1, 2002);

(3) The *Decision of the State Council on Investment System Reform* (promulgated by the State Council on July 16, 2004 and effective thereon), the *Interim Administrative Measures for the Verification and Approval of Foreign Investment Projects* (promulgated by the National Development and Reform Commission (the "**NDRC**") on October 9, 2004 and effective thereon), the *Notice of the National Development and Reform Commission on Further Reinforcing and Regulating the Administration of Foreign Investment Projects*(promulgated by the NDRC on July 8, 2008 and effective thereon) and the *Notice of the National Development and Reform Commission on Delegating Powers on Approval of Foreign Investment Projects to Authorities at Lower Levels* (promulgated by the NDRC on May 4, 2010 and effective thereon);

(4) The *Law of the People's Republic of China on Urban and Rural Planning* (promulgated by the Standing Committee of the National People's Congress on October 28, 2007 and effective as of January 1, 2008), the *Administrative Measures for the Site Planning of Construction Projects* (promulgated by the Ministry of Construction on August 23, 1991 and effective thereon) and the *Administrative Measures for the Preliminary Examination of Land Use for Construction Projects* (promulgated by the Ministry of Land and Resources on November 12, 2008 and effective as of January 1, 2009);

(5) The *Law of the People's Republic of China on the Evaluation of Environmental Effects* (promulgated by the Standing Committee of the National People's Congress on October 28, 2002 and effective as of September 1, 2003) and the *Regulations on Environmental Protection Management for*

Construction Projects (promulgated by the State Council on November 29, 1998 and effective thereon);

(6) The *Construction Law of the People's Republic of China (2011 Revision)* (promulgated by the Standing Committee of the National People's Congress on April 22, 2011 and effective as of July 1, 2011), the *Administrative Measures for the Construction Permit of Construction Projects (Amended)* (promulgated by the Ministry of Construction on July 4, 2001 and effective thereon) and the *Regulations on the Quality Management of Construction Engineering* (promulgated by the State Council on January 30, 2000 and effective thereon);

(7) The *Interim Provisions on the Completion Acceptance of Housing Construction Projects and Municipal Infrastructure Projects* (promulgated by the Ministry of Construction on June 30, 2000 and effective thereon), the *Fire Control Law of the People's Republic of China*(promulgated by the Standing Committee of the National People's Congress on October 28, 2008 and effective as of May 1, 2009) and the *Provisions on Fire Protection Supervision and Administration of Construction Projects (2012 Revision)* (promulgated by the Ministry of Public Security on July 17, 2012 and effective as of November 1, 2012); and

(8) The *House Registration Measures* (promulgated by the Ministry of Construction on February 15, 2008 and effective as of July 1, 2008).

4.1.1.3 Laws and Regulations Related to Foreign Investment in the Real Estate Industry

Such laws and regulations include two parts: the catalogue for the guidance of foreign investment industries, and the departmental rules jointly or solely promulgated by the supervisory authorities (mainly Circular 171 and its supporting regulations).

(1) The *Catalogue for the Guidance of Foreign Investment Industries (2011 Revision)* (the "**Industrial Guidance Catalogue**", jointly promulgated by the NDRC and the Ministry of Commerce ("**MOFCOM**") on December 24, 2011 and effective as of January 30, 2012): divides real estate projects in China into three types: permitted projects, restricted projects and prohibited projects. Only permitted projects and restricted projects are open to foreign investors.

(2) The *Opinions on Regulating the Market Access to and Administration of Foreign Investment in Real Estate* (Jian Zhu Fang [2006] No. 171, "**Circular 171**", promulgated by the Ministry of Construction, MOFCOM, the NDRC, the People's Bank of China (the "**PBOC**"), the State Administration for Industry and Commerce ("**SAIC**"), and the State Administration of Foreign Exchange ("**SAFE**)" on July 11, 2006 and effective thereon): provides the principles regarding the market access to and administration of foreign investment in real estate market.

(3) The *Circular of the General Office of the Ministry of Commerce on the Relevant Issues Concerning the Implementation of the Opinions on Regulating*

the Access to and Administration of Foreign Investment in the Real Estate Market (Shang ZiZi [2006] No. 192, "**Circular 192**", promulgated by MOFCOM on August 14, 2006 and effective thereon): provides more detailed rules regarding the approval and management of foreign-invested real estate enterprises.

(4) The *Circular on the Relevant Issues concerning Regulating the Administration of Foreign Exchange in the Real Estate Market* (HuiFa [2006] No. 47, "**Circular 47**", promulgated by SAFE and the Ministry of Construction on September 1, 2006 and effective thereon): provides more specific and detailed rules on the borrowing of foreign debts by foreign-invested real estate enterprises, and the foreign exchange administration of the mergers and acquisitions of domestic real estate enterprises and the acquisitions of Chinese shareholdings in joint venture enterprises by foreign investors.

(5) The *Circular on Further Strengthening and Standardizing the Approval and Supervision of Foreign Direct Investment in Real Estate Industry*(Shang Zi Han [2007] No.50, "**Circular 50**", promulgated by MOFCOM and SAFE on May 23, 2007 and effective thereon): provides the" project company" principle and strictly controls the mergers and acquisitions or investments in domestic real estate enterprises by means of round trip investments, and requires that approvals for the establishment of foreign-invested real estate enterprises should be filed with MOFCOM.

(6) The *Circular Concerning the* Distribution *of the List of the First Batch of Foreign-Invested Real Estate Projects Already Filed with the Ministry of Commerce* (HuiZongFa [2007] No. 130, "**Circular 130**", promulgated by the General Affairs Department of SAFE on July 10, 2007 and effective thereon): closes the channel for foreign-invested real estate enterprises which obtain approval certificates from the commercial authorities on or after June 1, 2007 to borrow foreign debts. Circular 130 also provides that foreign-invested real estate enterprises which failed to file with MOFCOM are not allowed to complete the foreign exchange registrations and the sale and settlement of foreign exchange in their capital accounts.

(7) The *Circular on Proper Handling of* Filings *for Foreign Investment in the Real Estate Industry*(Shang Zi Han [2008] No. 23, "**Circular 23**", promulgated by MOFCOM on June 18, 2008 and effective as of July 1, 2008): provides that provincial commercial authorities are delegated to review the application materials for filings. Circular 23also provides more detailed instructions for the preparation and review of such application materials.

(8) The *Circular on Business Operation Issues Concerning Improving Administration of the Payment and Settlement of Foreign Exchange Capital of Foreign-Invested Enterprises*(HuiZongFa [2008] No. 142, "**Circular 142**", promulgated by the General Affairs Department of SAFE on August 29, 2008 and effective thereon): provides that any FIE other than foreign-invested real estate enterprises shall not use RMB funds derived from its capital settlement to purchase domestic real estate properties for non-self-use purposes.

(9) The *Circular on Strengthening the* Administration *of Approval and Filings for Foreign Investment in the Real Estate Industry* (Shang Ban Zi Han [2010] No. 1542, "**Circular 1542**", promulgated by the General Office of MOFCOM on November 22, 2010 and effective thereon): curbs foreign-invested real estate enterprises' speculative investments and prohibits the establishment of investment companies involved in the business of real estate development and operation.

4.1.2 Main Regulatory Governmental Authorities

(1) MOFCOM and its local counterparts: in charge of approving the establishment, capital increase, share expansion, share transfer, merger of foreign-invested real estate enterprises, and handling the filings of such enterprises.

(2) SAIC and its local counterparts: in charge of registering foreign-invested real estate enterprises following the approvals of establishment, capital increase, share expansion, share transfer, merger of foreign-invested real estate enterprises by MOFCOM and/or its local counterparts.

(3) The NDRC and its local counterparts: in charge of approving foreign-invested real estate projects.[8]

(4) The Ministry of Land and Resources and its local counterparts: in charge of granting state-owned land use rights and issuing state-owned land use rights certificates.

(5) SAFE and its local counterparts: in charge of the foreign exchange flow of foreign-invested real estate enterprises.

(6) Planning department: in charge of planning construction lands and construction projects.

(7) Construction department: in charge of checking and ratifying the grade of qualifications of real estate enterprises and supervising the construction of real estate development projects.

(8) Environmental protection department: in charge of approving the environmental impact assessment of real estate development projects.

[8]The *Decision of the State Council on Reforming the Investment System* (promulgated by the State Council on July 16, 2004 and effective thereon) stipulates that foreign-invested real estate project shall be subject to the prior approval of the NDRC or its local counterparts with respective authority. Certain regulations, such as the *Interim Administrative Measures for the Verification and Approval of Foreign Investment Projects* (promulgated by October 9, 2004 and effective thereon), the *Notice of the National Development and Reform Commission on Further Reinforcing and Regulating the Administration of Foreign Investment Projects* (promulgated by July 8, 2008 and effective thereon), the *Notice of the National Development and Reform Commission on Delegating Powers on Approval of Foreign Investment Projects to Authorities at Lower Levels*(promulgated by May 4, 2010 and effective thereon), stipulate detailed regulations on relevant matters such as approval level in relation to the approval of foreign investment projects.

4.2 General Introduction to PRC Land System

4.2.1 Classification of Land Ownership

In accordance with the *Land* Administration *Law*, land in China is classified as state-owned land and collectively-owned land by ownership nature.

4.2.2 Access to State-owned Land Use Rights and Respective Terms for State-owned Land Use Rights for Different Uses

According to the *Law on the Administration of Urban Real Estate*, a land user can obtain state-owned land use rights from the state by two means: grants and the allocation of land use rights. Allocated state-owned land use rights can only be used for specific purposes as stated in the relevant laws and regulations, such as public welfare or key projects supported by the state. If such purposes cannot be satisfied, a real estate enterprise can only obtain state-owned land use rights by the way of grants. Land use rights may be granted by means of tenders, auctions, listings or bilateral agreements. Moreover, real estate enterprises can obtain land use rights from other land users by the transfer of land use rights.

According to the *Interim* Regulations *on the Granting and Transfer of the Rights to the Use of State-owned Land in Urban Areas*, the maximum term for granting state-owned land use rights from the date of the granting shall be determined in light of the purposes listed below:

(i) 70 years for residential purposes;

(ii) 50 years for industrial purposes;

(iii) 50 years for the purposes of education, science, culture, public health and physical education;

(iv) 40 years for commercial, tourist and recreational purposes; and

(v) 50 years for comprehensive utilization or other purposes.

4.3 Industrial Policy of Foreign Investment in Real Estate Development and Operation

4.3.1 Catalogue for the Guidance of Foreign Investment Industries

Pursuant to the Industrial Guidance Catalogue revised in 2011, foreign investments in the development and operation of real estate projects in China are divided into three types: permitted projects, restricted projects and prohibited projects. Only permitted projects and restricted projects are open to foreign investors, and foreign investors are prohibited to engage in the development of prohibited projects.

(1) Permitted projects include: the development and construction of ordinary

residences. However, commercial authorities are generally reluctant to approve the establishment of foreign-invested real estate enterprises or the addition of "real estate development and operation" into the business scope of FIEs, even if such foreign-invested real estate enterprises only engage in or such business scope of the FIEs only contains "ordinary real estate development project" (which is a permitted project).

(2) Restricted projects include: (i) the development of tracts of land, provided that foreign investors shall only adopt the forms of Sino-foreign equity or contractual joint ventures; and (ii) the construction and operation of high-class hotels, high-class office buildings and international exhibition centers.

(3) Prohibited projects include: construction and operation of golf courses and villas.

4.3.2 Strictly Control Foreign Investment in High-Class Real Estates; Prohibit Foreign Investment in Villas

According to Circular 50 promulgated in 2007, foreign investors' access to high-class real estate is strictly controlled by local commercial authorities. Further, the "construction and operation of villas" is moved from restricted projects in the *Catalogue for the Guidance of Foreign Investment Industries (2007 Revision)* to prohibited projects in Industrial Guidance Catalogue revised in 2011.

4.3.3 Require Foreign-invested Real Estate Enterprises to Pay off Land Grant Fees in One Year

Circular 171 provides that, a foreign-invested real estate enterprise shall be issued an FIE approval certificate and a business license with a validity period of one year. Only after the payment of land grant fees is made in full and the state-owned land use rights permit is obtained can a foreign-invested real estate enterprise apply for a formal FIE approval certificate and a business license with an operation term identical to that of the FIE Approval Certificate, and handle tax registration with the taxation authorities.

4.3.4 Prohibit Round Trip Investment

As early as in 2007, Circular 50provided that mergers and acquisitions of or investments in domestic real estate enterprises by means of round trip investment (including by the round trip investment made by the same actual controller)shall be strictly controlled and foreign investors shall not change the actual controller of a domestic real estate enterprise to evade the approval procedure for establishing foreign-invested real estate enterprises. Then in 2008, Circular 23 further provided that foreign-invested real estate enterprises applying for filings with commercial authorities shall submit materials to prove that none of their foreign shareholders is a company established overseas by a domestic company or individual. In 2010, Circular 1542 restated that foreign-invested real estate enterprises with round trip investments shall be strictly examined and controlled by local commercial authorities and local SAFE branches. Where a foreign-invested real estate enterprise is found

to be in non-compliance with the above provisions upon inspection, its foreign exchange registration shall be cancelled and its foreign investment statistics shall be removed.

4.3.5 Prohibit Affiliate Relationships between/among Shareholders

Circular 23 sets forth that, when a foreign-invested real estate enterprise applies for filing with commercial authorities in the event of its incorporation, increase in capital, increase in number of shares, equity transfer, merger and acquisition, etc., it shall submit materials proving that there are no affiliate relationships between/among its shareholders and its shareholders are not under the same actual controller. Where a foreign-invested real estate enterprise is found to be in non-compliance with the above provisions upon inspection, its foreign exchange registration shall be cancelled and its foreign investment statistics shall be removed.

4.3.6 Curb Speculative Investments in the Real Estate Industry

According to Circular 1542 issued in 2010, as a policy to curb speculative investment in the real estate industry, foreign-invested real estate enterprises are prohibited to engage in arbitrage by purchasing or selling real estate properties already built or under construction in China. In addition, Circular 1542 stipulate that MOFCOM will carry out strict examination over the filing materials of such projects in cooperation with the relevant departments such as the Ministry of Housing and Urban-Rural Development and SAFE.

4.3.7 Prohibit Foreign-Funded Investment Companies from Investing in the Real Estate Industry

Circular 1542 also provides that the applications for the establishment of foreign-funded investment enterprises shall be strictly examined. In addition, foreign-funded investment companies involved in real estate development and operation shall not be approved by the competent commercial authorities

4.4 General Conditions for Foreign Investment in Real Estate Development and Operation

4.4.1 Principle of Commercial Presence

Circular 171 sets forth that, foreign investors (including foreign institutions and individuals) who intend to engage in real estate development and operation in China shall apply for the establishment of FIEs following the principle of commercial presence, and conduct relevant business within the approved scope of business of the FIEs. Subject to certain restrictive provisions (e.g., as for the development of tracts of land, only Sino-foreign equity or contractual joint ventures would be available according to the Industrial Guidance Catalogue), generally, foreign-invested real estate enterprises may be established in all forms of FIEs. The main purpose of the principle of commercial presence is to prohibit the direct purchase of domestic properties by foreign investors.

4.4.2 Principle of Project Company

According to Circular 50, when applying to establish a foreign-invested real estate enterprise, land use rights and ownership of real estate buildings shall have be obtained, or a preliminary agreement for the granting or purchase of land use rights or building ownership rights shall have be signed with the relevant land administration department, land developer, or owner of the said buildings. Applications that do not meet the above requirements shall be declined by commercial authorities. Where an existing FIE intends to expand its business scope to include real estate development or management, or a foreign-invested real estate enterprise intends to engage in the development or management of a new real estate project, applications for an increase in business scope or business scale shall be filed with the competent commercial authorities.

Circular 23 further provides that a foreign-invested real estate enterprise shall only engage in a real estate project.

4.4.3 Difference Between Total Investment Amount and Registered Capital; Commitment in Capital Usage and Investment by Phases

The difference between the total investment amount and the registered capital of foreign-invested real estate enterprises shall be kept at a specified ratio. Pursuant to Circular 171 and Circular 192,where the total investment amount of a foreign-invested real estate enterprise is more than USD 3 million (exclusive), its registered capital shall not be less than 50% of its total investment amount. If the total investment amount is less than USD 3 million (inclusive), its registered capital shall not be less than 70% of its total investment amount. According to the review requirements for filings provided by Circular 23, foreign-invested real estate enterprises shall make commitments in capital usage, and make investments through phases based on the construction progress of the projects.

4.4.4 Filings with Commercial Authorities

Circular 50 requests that the local commercial authorities responsible for approving the establishment of foreign-invested real estate enterprises shall promptly file the approval records with MOFCOM. Circular 23 delegates the power to review the filing application materials from MOFCOM to the provincial commercial authorities, and specifies that the filing requirements shall be applicable to enterprise incorporations, increases in capital, increases in number of shares, equity transfers, mergers and acquisitions, etc.

4.4.5 Prohibit Round Trip Investment and Affiliate Relationships between/among Shareholders

Please see Section 4.3.4 above.

4.4.6 Prohibit Guarantee of Fixed Returns

Circular 171 provides that the Chinese and foreign investors of a foreign-invested real estate enterprise shall not conclude any clause in any form in any contract,

articles of association, equity transfer agreement and other legal documents to guarantee a fixed return directly or in a disguised form to any party. Any violation of the above restriction will result in the failure to complete the initial registration or change registration of foreign exchange and the failure to complete the filings with MOFCOM.

4.4.7 Prohibit Making Capital Contribution by Equities of Foreign-Invested Real Estate Enterprises

In accordance with the Interim *Provisions of the Ministry of Commerce on Capital Contribution in the Form of Equity by Foreign Investment Enterprises*, the equities of foreign-invested real estate enterprises shall not be used for making capital contributions.

4.5 Main Approaches for Foreign Investment Real Estate Development and Management

4.5.1 Establishment of A New Foreign-Invested Real Estate Enterprise

In addition to satisfying the conditions required by the laws and regulations regarding the establishment of a new FIE and anew non-foreign-invested real estate enterprise, a newly established foreign-invested real estate enterprise shall also satisfy the "General Conditions for Foreign Investment in Real Estate Development and Operation" stated in Section 7.4.

4.5.2 Acquisition of Domestic Real Estate Enterprises

In addition to satisfying all the conditions stated in Section 7.5.1, foreign investors shall also satisfy the following conditions in order to acquire a domestic real estate enterprise:

(1) Submit a guarantee letter in relation to the performance of state-owned land use rights grant contract, construction land planning permit, construction project planning permit, the certificate of the land use rights, the filing certificate for change of construction (or real estate) supervision department, and the relevant certificates for tax payment issued by the tax authorities;

(2) properly handle affairs about employees and debts owed to banks;

(3) pay the transfer price in lump sum using their own capital within three months from the date of the issuance of the new business certificate of the foreign-invested real estate enterprise (since after the acquisition, the domestic real estate enterprise has become an FIE).According to Circular 47, if the foreign investors fail to pay such transfer price, SAFE shall not handle the foreign exchange registration for the transfer of shares[9]; and

[9]For more detail, please refer to Circular 171, Circular 192 and Circular 47.

(4) the foreign investors shall not have any adverse records.

4.5.3 Domestic Reinvestment via Existing FIEs

If foreign investors have established FIEs in China, such existing FIEs may be used to act as "direct investors" to set up real estate enterprises and the foreign investors shall become the "indirect investors". Such investment approaches can be labeled as "domestic reinvestment via existing FIEs". So far, there is no specific regulation for such investment approach, thus, consultations with local commercial authorities may be necessary for each project.

Indirect investment in domestic real estate via domestic reinvestment may be subject to the following restrictions: (i) the investment amount made by an existing FIE shall not exceed 50% of its net assets; (ii) in the event that the foreign investors propose to provide funds for the existing FIEs for reinvestment by capital increase or shareholder loan, it would be difficult to settle such foreign capital in the name of an investment; (iii) in the event that the proposed investment program falls within the foreign investment restricted area, such investment shall be subject to the approval of the higher level commercial authorities(such as the provincial level) where the target enterprise is located.

4.5.4 Expansion of the Business Scope of Existing FIEs

If foreign investors have already established FIEs in China, they may add "real estate development and management" to the business scope of the FIEs in order to invest in the real estate development and management industry. We understand that if a foreign-invested non-real estate enterprise becomes a foreign-invested real estate enterprise by expanding in its business scope, it shall also satisfy the filing requirements with MOFCOM.

4.6 Exit Strategy for Foreign Investment in the Business of Real Estate Development and Management

4.6.1 Sale of Real Estate Projects ("Project Exit") vs. Sale of Real Estate Project Companies ("Equity Exit")

(1) Procedures. For an Equity Exit, foreign investors may need to execute equity interests transfer agreements to transfer their equity interests in their real estate project companies. They also may need to handle the relevant approval procedures and AIC change registrations in accordance with the competent laws and regulations. As a result, foreign investors may no longer be the shareholders of the real estate project companies. A Project Exit is subject to more restrictions, such as in the event that the land use rights are obtained by a grant, certain conditions must be satisfied. A Project Exit also involves multiple approvals and registration matters in relation to the land use rights, transfer of the title of house ownership, or project changes, which make the transaction more complicated and time-consuming.

(2) Continuing Operation of a foreign-invested real estate enterprise after an Equity Exit or Project Exit. For an Equity Exit, most licenses held, commercial contracts and labor contracts executed by the foreign-invested real estate enterprise shall remain unchanged, which minimizes the risks of operation interruptions. As for a Project Exit, provided that the transfer of the project is legally permitted, licenses, commercial contracts and labor contracts must be changed, renewed and re-signed by the acquirer of the project, and this process may impact the continuance of operation.

(3) Transaction Cost. For an Equity Exit, sellers only need to pay the capital gain taxes, while both sellers and buyers need to pay their stamp duties respectively. As for a Project Exit, sellers need to pay income taxes, business taxes, land value-added taxes and stamp duties, while buyers need to pay deed taxes and stamp duties.

(4) Profit by Resell. According to Circular 1542, foreign-invested real estate enterprises shall not engage in arbitrage by purchasing or selling real estate properties already built or under construction in China.

4.6.2 Wind-up and Dissolution

In addition to the satisfaction of certain procedures and conditions required by the relevant laws and regulations in relation to the wind-up and dissolution of FIEs, there is no specific procedure or condition for the wind-up or dissolution of foreign-invested real estate enterprises. However, it is worth noting that, as stated above, real estate development and management by foreign investment must satisfy certain conditions. Therefore, for foreign investors who obtain real estate development projects in the proposed distributed dissolution assets, in order to conduct the real estate development and management business, they shall still satisfy the respective conditions.

4.7 Main Financing Methods of Foreign-Invested Real Estate Enterprises

Since foreign investment in real estate is greatly restricted, for instance, China has explicitly forbidden foreign debts[10], the China Securities Regulatory Commission (the "**CSRC**") issued a notice on October 15, 2010. This notice suspended the acceptance of applications for reorganization plans of real estate enterprises, and made the CSRC seek the comments from the Ministry of Land and Resources regarding reorganization plans that have been submitted to the CSRC. Currently, foreign-invested real estate enterprises may consider obtaining financing by loans from domestic banks, domestic real estate trusts, private equities or outbound bonds. However, all financing methods come with certain conditions. For example, in order to obtain funds from domestic bank loans or domestic real estate trusts, foreign-invested real estate enterprises shall have obtained a land use rights certificate, a construction land planning permit, a construction project planning permit and a construction permit. Moreover, the use of proceeds of such capital is greatly restricted (i.e. the proceeds cannot be used to pay land grant fees).

[10]For more detail, please refer to the introduction of "Foreign Debt" in Section 7.8.3 below.

4.8 Foreign Exchange

4.8.1 Proceeds of Foreign Exchange

Except for foreign-invested real estate enterprises, FIEs shall not purchase non-self-use domestic real estate through RMB capital settled by contribution capital. Capital in the up-front fee account (formerly called "specific foreign exchange account"[11]) opened by the foreign institutions and individuals in the domestic banks are not allowed to be used for real estate development and management.

4.8.2 Foreign Exchange Registration

(1) Where foreign institutions or individuals acquire domestic real estate enterprises by share transfer or other methods, or purchase domestic shares in joint capital ventures, but fail to pay all of the transfer payments at one time using their own capital, SAFE shall not handle foreign exchange registration for such share transfer;

(2) Where the domestic and foreign shareholders of a foreign-invested real estate enterprise provide direct or indirect fix return for either party in contracts, articles of association, share transfer agreements or other documents, SAFE shall not handle foreign exchange registration for the foreign-invested real estate enterprise or change registration.

(3) SAFE shall not handle foreign exchange registration (or change registration) and capital account settlement as well as the sale of foreign exchange for foreign-invested real estate enterprises that obtained approval certificates from local commercial authorities after June 1, 2007, but failed to file with MOFCOM.

(4) SAFE shall not handle foreign exchange registration for illegally established foreign-invested real estate enterprises.

4.8.3 Foreign Debts

For foreign-invested real estate enterprises that obtained approval certificates from local commercial authorities and filed with MOFCOM after June 1, 2007, SAFE shall not handle foreign debts registration and foreign debts settlement approval procedures. For foreign-invested real estate enterprises that obtained approval certificates from local commerce authorities and filed with MOFCOM before June 1, 2007, but failed to fully pay the registered capital, failed to obtain state-owned land use certificates, or their developing project capitals that have been invested are less than 35% of the total investment of the projects, foreign debts should not be the legal financing approach. Moreover, SAFE shall not approve the relevant foreign debt

[11] According to the *Circular of the State Administration of Foreign Exchange on Further Improving and Adjusting the Direct Investment Foreign Exchange Administration Policies*, an up-front fee account is used to deposit all types of up-front fees relating to direct investment activities carried out by foreign investors within the territory of China.

settlement[12];

As of June 14, 2012, foreign-invested real estate enterprises may not borrow outbound RMB capital.[13]

5 Foreign Investment in the Education Industry

5.1 General Introduction

The fundamental education systems of the People's Republic of China (the "**PRC**" or "**China**") include a school system of pre-school education, primary education, secondary education and higher education, a system of nine-year compulsory education and a system of education certificates. The PRC government formulates plans for educational development, and establishes and operates schools and other educational institutions. In addition, the PRC government encourages enterprises, social organizations and individuals to operate schools and other types of educational organizations in accordance with the relevant PRC laws and regulations. Moreover, no non-public organization or individual may establish or operate a school or any other educational institution for profit-making purposes. However, such private schools may be operated for "reasonable returns", as described in more detail below.

The school system of the PRC can also be divided into public schools, domestic-invested private schools and Sino-foreign cooperative schools based on the identity of the sponsors. In this article, we will primarily introduce the regulations and requirements on Sino-foreign cooperative schools.

5.2 Introduction on Governing Laws

The principal regulations governing private education in China consist of the *Education Law of the PRC* promulgated by the National People's Congress on March 18, 1995, the *Law for Promoting Private Education* promulgated by the Standing Committee of the National People's Congress on December 28, 2002 and the *Implementation Rules for the Law for Promoting Private Education* promulgated by the State Council on March 5, 2004.

In addition, regulations have been promulgated by PRC authorities, such as the *Regulations on Sino-foreign Cooperative Education* and the *Implementing Measures for the Regulations on Sino-foreign Cooperative Education*, to regulate Sino-foreign cooperative educational activities and encourage foreign investors to engage in the Chinese education business.

The Ministry of Finance and the State Administration of Taxation promulgated the *Circular on Education Tax Policies* on February 5, 2004, and the National Development and Reform Commission, the Ministry of Education, and the Ministry

[12]For more detail, please refer to Circular 171.

[13]For more detail, please refer to the *Notice of Detailed Operation Procedures in Clarifying Foreign Direct RMB Investment Business* (Yinfa [2012] Circular 165, promulgated by the PBOC on June 14, 2012 and effective thereon).

of Labor and Social Security jointly issued the *Interim Measures for the Management of the Collection of Private Education Fees* on March 2, 2005.

5.3 Regulations and Requirements on Foreign Investment in the Chinese Education Business

PRC laws and regulations encourage substantive cooperation between overseas educational organizations with the relevant qualifications and experience in providing high-quality education and Chinese educational organizations to jointly operate various types of schools in China, with such cooperation in the areas of higher education and occupational education being encouraged. However, foreign investors are not permitted to establish wholly foreign-invested schools in the PRC. Moreover, Sino-foreign cooperative schools are not permitted to engage in compulsory education and military, policy, political and other kinds of education that are of a special nature in the PRC.

5.3.1 Regulations on Sino-foreign Cooperative Schools

a. General Requirements on Sino-foreign Cooperative Schools

In general, a Sino-foreign cooperative school shall be a legal person[14]and meet the same basic conditions as domestic private schools. Therefore, the requirements on private schools as introduced hereinafter shall apply to Sino-foreign cooperative schools automatically.

b. Requirements on Sponsors

Each of the foreign party and the Chinese party that jointly establish a Sino-foreign cooperative school shall be an education institution and be a legal person. Other investors, such as social organizations and individuals, may fund a Sino-foreign cooperative school and participate in its management by entering into an agreement with such school, but shall not act as its chairman of the council, chairman of the board, or chief executive, nor shall they participate in its educational activities.

c. Requirements on Capital Contributions

A sponsor of a Sino-foreign cooperative school may make its capital contribution in cash, in kind, or in the form of land use rights, intellectual property rights or other forms of property, among which, the value of intellectual property rights shall not exceed one-third of such sponsor's total capital contribution. However, a foreign educational institution invited by the Chinese government to engage in cooperative educational activities in the PRC is not subject to the above limitation.

d. Approvals and Licenses

[14]However, such legal person requirement does not apply to a Sino-foreign cooperative school providing higher education jointly established by a foreign education institution and a Chinese higher education institution providing diploma-based education.

The establishment of a Sino-foreign cooperative school providing higher diploma-based education at the undergraduate level or above is subject to approval by the Ministry of Education. The establishment of other types of Sino-foreign cooperative schools is subject to approval by the local provincial, regional or municipal government and shall be filed with the Ministry of Education. Sino-foreign cooperative schools engaging in occupational qualifications training and occupational skills training shall be subject to approvals from the authorities in charge of labor and social welfare. A duly-approved Sino-foreign cooperative school will be granted a *Sino-foreign Cooperative Education License* and shall be registered with Ministry of Civil Affairs or its local counterparts as a privately-run non-enterprise institution.

e. Requirements on Dividend Distribution

Private schools, including Sino-foreign cooperative schools, can be divided into three categories: private schools established with donated funds, private schools that distribute reasonable returns and private schools that do not distribute reasonable returns. In the case of private schools that distribute reasonable returns, sponsors of these schools may choose to seek the distribution of "reasonable returns" from the annual net balance of the school after deduction of costs, donations received, government subsidies, if any, the reserved development fund and other expenses as required by the relevant PRC laws and regulations. A private school that distributes "reasonable returns" to its sponsors must be permitted to do so through explicit provisions in its articles of association. However, none of the current PRC laws and regulations provides a formula or guidelines for determining what constitutes "reasonable returns". In addition, none of the current PRC laws and regulations is responsible for the business operations of private schools that distribute reasonable returns any differently than those that do not.

At the end of each fiscal year, every private school is required to allocate a certain amount to its development fund for the construction and maintenance of the school or procurement or upgrade of education equipment. In the case of a private school that distributes reasonable returns, this amount shall be at least 25% of the annual net income of the school, while in the case of a private school that does not distribute reasonable returns, this amount shall be at least of 25% of the annual increase in the net assets of the school, if any. Private schools that do not distribute reasonable returns are entitled to the same preferential tax treatment as public schools, and the preferential tax treatment policies applicable to private schools that distribute reasonable returns are formulated by the relevant PRC authorities. However, currently, no such regulations have been promulgated.

f. Requirements on Tuition and Fees

According to PRC laws and regulations, the types and amounts of fees charged by a private school providing certifications shall be approved by the governmental pricing authorities and be publicly disclosed. A private school that does not provide certifications shall file its pricing information with the governmental pricing authorities and publicly disclose such information.

5.3.2 Regulations on Sino-foreign Cooperative Education Projects

Besides establishing and operating Sino-foreign cooperative schools, a foreign investor can also choose to engage in education business in China by launching a Sino-foreign cooperative education project. The "Sino-foreign cooperative education project" refers to educational activities targeted mainly at Chinese citizens carried out jointly by Chinese and foreign education institutions without establishing any independent educational entity. Each of the foreign party and the Chinese party of a Sino-foreign cooperative education project shall also be an education institution.

A Sino-foreign cooperative education project providing higher diploma-based education at the undergraduate level or above is subject to approval by the Ministry of Education. Other types of Sino-foreign cooperative projects are subject to approval by the local provincial, regional or municipal government and shall be filed with the Ministry of Education. A duly-approved Sino-foreign cooperative education project will be granted a *Sino-foreign Cooperative Education Project Permit*. Except for the above requirements, there are no other requirements, such as capital contributions, tuitions and fees, for a Sino-foreign cooperative education project.

6 Foreign Investment in the Energy and Mineral Resources Industry

6.1 General Introduction

*The Implementing Rules of the PRC Mineral Resources Law (the "**Implementing Rules**")* stipulates that the PRC shall allow foreign companies, enterprises and other economic organizations as well as individuals to invest in the exploration and exploitation of mineral resources within the territory of China and the sea areas under its jurisdiction pursuant to the relevant PRC laws and regulations. Such provision provides that, in general, foreign investors shall enjoy the same legal rights and privileges as domestic entities would have regarding investment in the exploration and exploitation of mineral resources.

In 2000, *the Opinions on* Further *Encouraging Foreign Investors to Invest in the Exploration and Exploitation of Non-oil and gas Mineral Resources (the "**2000 Opinions**")* promulgated by the Ministry of Land and Resources *(the "**MLR**")*, the State Development and Planning Commission, the State Economic and Trade Commission, the Ministry of Finance, the Ministry of Foreign Economic and Trade Cooperation and the State Administration for Industry and Commerce stipulates that:

- Foreign investors are encouraged to invest in the exploration and exploitation of non-oil and gas mineral resources within the territory of China according to *the Law of the PRC on Mineral Resources*, other relevant laws and regulations and *the Catalogue of Industries for Guiding the Foreign Investment (the "**Catalogue**")*.

- Foreign investors are permitted to engage in the venture exploration of non-oil

and gas mineral resources within the territory of China in the form of exclusive investments or joint ventures with a Chinese party.

- Foreign investors are permitted to hold shares for engaging in the exploration and exploitation of non-oil and gas mineral resources by advanced technology or equipment, and are also permitted to purchase exploration rights and exploitation rights to non-oil and gas mineral resources of large or medium-sized state-owned enterprises, unless otherwise prohibited by the relevant laws and regulations.

- The exploration rights or exploitation rights to non-oil and gas mineral resources obtained through the investment of foreign investors may be transferred in accordance with the relevant laws and regulations.

However, according to Article 4 of *the Administrative Measures for the Block Registration of Mineral* Resource *Prospecting*, Article 3 of *the Administrative Measures for the Registration of Mineral Resources Exploitation*, and the 2000 Opinions, in the event of foreign investment in the exploration and exploitation of the mineral resources, the foreign investor shall apply for the respective mining rights licenses with the MLR. In 2005, *the Circular on the Regulation of the Terms of Reference of Exploration License and Mining License (the "**Circular**")* was promulgated by the MLR, providing the level of application authority for the mining rights certificates of foreign investors. In addition, the Circular stipulates that foreign investment in the exploration and exploitation of the mineral resources shall be in compliance with the relevant provisions of the Catalogue, and the mining rights license for foreign investors shall be issued in accordance with the terms and references on the exploration and exploitation by domestic investment provided for in the Circular.

Therefore, subject to the compliance of the Catalogue, foreign investors do not need to apply for mining rights licenses with the MLR, but shall only apply with the authorities as provided in the Circular, most of which are local authorities.

According to the PRC Mineral Resources Report in 2012, by the end of 2011, hundreds of foreign investors from over 20 countries had invested in the exploration and exploitation of the mineral resources in China, and had obtained more than 500 exploration and mining licenses, and the foreign investment in the exploration and exploitation of the mineral resources in China in 2010 is RMB 6.04 billion in total.

6.2 Foreign Investment in the Exploration and Exploitation of the Mineral Resources Industry Policy

According to the Catalogue, foreign investments in the exploration and exploitation of the mineral resources are catalogued as:

Catalogue	Items
Catalogue of Encouraged Foreign Investment	Prospecting, exploitation and utilization of coal-bed gas (limited to equity joint ventures and contractual joint ventures)

Industries in Relation to Energy	Venture prospecting and exploitation of petroleum, natural gas (limited to equity joint ventures and contractual joint ventures)
	Exploitation of oil and gas deposits (fields) with low osmosis (limited to equity joint ventures and contractual joint ventures)
	Development and application of new technologies that can increase the recovery factor of crude oil (limited to equity joint ventures and contractual joint ventures)
	Development and application of new technologies for prospecting and exploitation of petroleum, such as geophysical prospecting, well drilling, well-logging and downhole operations, etc. (limited to equity joint ventures and contractual joint ventures)
	Prospecting and exploitation of conventional oil resources such as oil shale, oil sand, heavy oil and super heavy oil (limited to equity joint ventures and contractual joint ventures)
	Prospecting and exploitation of unconventional natural gas resources such as shale gas and submarine natural gas hydrate (limited to equity joint ventures and contractual joint ventures)
	Exploration, mining and selection of iron mines and manganese mines.
	Development and application of new technologies on improving the utilization of mine tailings, and the comprehensive application of technologies on the ecological restoration of mines.
	Exploration and development of shale gas, submarine gas hydrates and other unconventional natural gas (limited to equity joint ventures and cooperative joint ventures)
Catalogue of Restricted Foreign Investment Industries in Relation to Energy	Exploration and mining of special and scarce coal (Chinese partners shall hold the majority of shares)
	Barite prospecting, mining (limited to joint ventures and cooperation)
	Exploration and mining of precious metals (gold, silver, platinum families)
	Exploration and mining of diamonds, high-alumina refractory clay, wollastonite, graphite and other natural gems
	Mining of phosphate, lithium, sulfurous iron ore and beneficiation
	Mining of szaibelyite and szaibelyite ironstone
	Mining of Celestine
	Mining of ocean manganese nodules and sea sand (Chinese

	partners shall hold the majority of shares)
Catalogue of Prohibited Foreign Investment Industries in Relation	Exploration and exploitation of Tungsten molybdenum, tin, antimony and fluorite
	Exploration, mining and selection of rare-earth metals
	Exploration, mining, mineral processing of radioactive minerals

As indicated in the Catalogue, China adopts a policy that encourages foreign investment to invest in the oil-and-gas-related industry, of which the demand is increasing while the exploration and exploitation require sophisticated technologies that are overwhelmingly possessed by western giant oil enterprises such as Shell Group and Exxon Mobil. In addition, China restricts foreign investment in certain precious and scarce mineral resources or resources that may be strategic, such as the rare-earth metals and radioactive minerals.

6.3 Examination and Approval System for Foreign Investment in the Exploration and Exploitation of the Mineral Resources Industry

According to *the Tentative Measures for the Administration of Examining and Approving Foreign* Investment *Projects*, subject to the classification of the Catalogue, the application report of a project of encouraged and permitted industries with a total investment amount (including the increased amount of capital, similarly hereinafter) of 100 million U.S. dollars or above, or a project of restricted industries with a total investment of 50 million U.S. dollars or above shall be subject to the examination and approval of the National Development and Reform Commission (the "**NDRC**") at central level. Moreover, the application report of a project of encouraged and permitted industries with a total investment amount of 500 million U.S. dollars or above, and a project of the restricted industries with a total investment amount of 100 million U.S. dollars or above shall be subject to the examination and approval of the NDRC at central level, and then be reported to the State Council for verification. A project of encouraged and permitted industries with a total investment amount of 100 million U.S. dollars or less, and a project of restricted industries with a total investment amount of 50 million U.S. dollars or less shall be subject to the examination and approval of a development and reform department at provincial level. A project of permitted industries shall be subject to the examination and approval of a development and reform department at provincial level, and the power to examine and approve such projects shall not be delegated to a lower-level department.

Upon obtaining approval from the NDRC authorities, the foreign investor shall obtain the foreign investment enterprise certificate from the Ministry of Commerce ("**MOFCOM**"). According to the 2000 Opinions, in the event a foreign investor intends to engage in venture exploration or establish a mining enterprise, it must obtain approval from MOFCOM at central level. However, in 2005, *the Announcement on Relevant Issues concerning Delegating the Administrative Authorities over the Record Filing and Issue of Approval Certificates of Foreign Investment Enterprises to and Further Simplifying the Examination and Approval Procedures*, as promulgated by MOFCOM, stipulates that, under the authorization of

the State Council, where competent departments of the State Council have approved the establishment or modification of foreign investment enterprises, the approval documents (including the original applications materials such as JV contracts and articles of association) shall be filed with the competent provincial commerce authorities where the enterprise locates. The approval certificate for such enterprise with foreign investment shall be issued by people's governments at the provincial level.

It is worth noting that, *the Administrative Measures for Foreign-invested Mineral Exploration Enterprises* promulgated by MOFCOM and MLR in 2008 have adjusted the approval authority for the establishment of exploration enterprise by foreign investment, stipulating that MOFCOM shall be responsible for the approval and administration of exploration enterprise that fall in restricted area in the Catalogue, and provincial commercial departments shall be responsible for the approval and administration of other exploration enterprises.

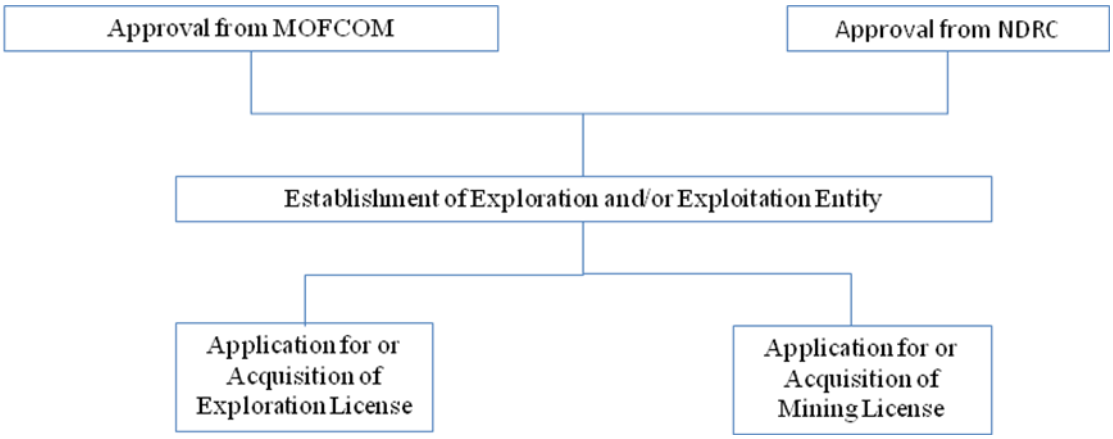
The approval level of respective governmental authorities for foreign investment in the exploration and exploitation of mineral resources industry is summarized as:

<table>
<tr><th rowspan="2">Catalogue</th><th rowspan="2">Investment Amount</th><th colspan="2">Approval Level</th></tr>
<tr><td>NDRC</td><td>MOFCOM</td></tr>
<tr><td rowspan="3">Encouraged and Allowed</td><td>500 million U.S. Dollar or above</td><td>At central level, but subject to the report of the State Council for verification</td><td rowspan="6">Generally at provincial level, except that in the event a foreign investor intends to engage in venture exploration or establish a mining enterprise, it must obtain approval from MOFCOM at central level.</td></tr>
<tr><td>100 million to 500 million U.S. Dollar</td><td>At central level</td></tr>
<tr><td>100 million U.S. Dollar or less</td><td>At provincial level</td></tr>
<tr><td rowspan="3">Restricted</td><td>100 million U.S. Dollar or above</td><td>At central level, but subject to the report of the State Council for verification</td></tr>
<tr><td>50 million to 100 million U.S. Dollar</td><td>At central level</td></tr>
<tr><td>50 million U.S. Dollar or less</td><td>At provincial level</td></tr>
</table>

In practice, generally, the merger and acquisition of domestic mineral resources by foreign investment follows the regular approval approach and level as same as that for other industries. However, it is worthy noted that, for restricted catalogue, the approval authorities would have a broad discretion to decide whether a foreign investment is allowed to acquire the respective domestic mineral resources interest. For example, Gan Su has explicitly indicated that gold exploration and exploitation are prohibited for foreign investment, although gold is catalogued as restricted but not prohibited in the Catalogue.

6.4 Flow Chart for Foreign Investment in the Exploration and Exploitation of the

Non-oil-and-gas Mineral Resources



After the duly establishment of a legal entity in China, a foreign investor may obtain the respective exploration license or mining license. In China, to obtain an exploration license or mining license, subject to the Catalogue, an foreign-invested enterprise may either apply with MIR or acquire from other licensee.

6.5 Tax and Financial Preferences for Foreign Investment in the Exploration and Exploitation of the Non-oil-and-gas Mineral Resources

According to the 2000 Opinions, foreign investment in the exploration and exploitation of non-oil and gas mineral resources may enjoy the following tax and financial preferences:

- In the event a foreign investor explores and recycles coexisting minerals other than the main minerals of non-oil and gas mineral resources, it can enjoy the policy of paying half of the mineral resource compensation fees for the coexisting minerals. In the event the foreign investor makes use of gangue, it may enjoy exemption from the mineral resource compensation fees. In the event the foreign investor makes use of advanced technology and makes the mineral resources that are difficult to be exploited by current domestic technology available for development and use, it may enjoy the policy of paying half of the mineral resource compensation fees for three years.

- In the event a foreign investor and a Chinese holder of prospecting rights and mining rights cooperate in the exploration and exploitation of non-oil and gas mineral resources, and the foreign investor, through the use of advanced technology, makes the mining recovery ratio, dressing recovery ratio and the comprehensive utilization ratio higher than the level of similar domestic enterprises, it may enjoy the policy of paying half of the mineral resource compensation fees for three years. With respect to the amount of mineral products mined due to the higher level of mining recovery ratio, dressing recovery ratio and the comprehensive utilization ratio than similar domestic enterprises, it may enjoy exemption from mineral resource compensation fees.

- In the event a foreign investor explores and exploits non-oil and gas mineral resources in the western region of China by way of exclusive investments, joint

ventures with a Chinese party or cooperation with a Chinese party, it may, in addition to relevant preferential policies of the State, enjoy the policy of exemption from exploration rights and exploitation rights fees for one year, and enjoy the policy of paying half of the exploration rights and exploitation rights fees for two years

- In the event a foreign investor exploits the non-oil and gas mineral resources encouraged in the Catalogue in the western region of China by way of exclusive investments, joint ventures with a Chinese party or cooperation with a Chinese party, it may enjoy the policy of exemption from mineral resource compensation fees for five years.

- In terms of the import and export of exploration facilities and equipment, foreign investors may enjoy equal treatment with exclusively foreign-invested enterprises, Chinese-foreign cooperative joint ventures and Chinese-foreign cooperative legal person enterprises

In addition to the 2000 Opinions, the authorities of certain provinces, such as Hainan, Yunnan and Sichuan, have adopted certain local tax and financial preferences policy for foreign investment in the exploration and exploitation of non-oil and gas mineral resources.

6.6 Regulation and Policies for Foreign Investment in the Exploration and Exploitation of the Oil and Natural Gas

According to the Catalogue, venture exploration and exploitation of oil and natural gas is catalogued as an encouraged item but is limited to being in the form of equity joint ventures and contractual joint ventures. According to our consultation with MOFCOM, such "equity joint ventures and contractual joint ventures" shall not be interpreted as the establishment of EJVs or CJVs in China by foreign investors, but shall refer to the contracts on the cooperative exploration of oil and gas resources executed by a designated Chinese oil company and a foreign oil company stipulated in *the Regulations of the People's Republic of China on Sino-Foreign Cooperation in the Exploration of Offshore Petroleum Resources* and *the Regulations of the People's Republic of China on Sino-foreign Cooperation in Exploration of Onshore Petroleum Resources*, where both parties contract respective rights and obligations regarding the exploration and exploitation of oil and natural gas. Such cooperative exploration is the only legal approach for foreign investors to invest in the exploration and exploitation of the oil and natural gas in China.

According to *the Regulations of the People's Republic of China on Sino-Foreign Cooperation in the Exploration of Offshore Petroleum Resources* and *the Regulations of the People's Republic of China on Sino-foreign Cooperation in Exploration of Onshore Petroleum Resources*, foreign investment in the exploration and exploitation of oil and natural gas in China shall subject to the following restrictions:

- Only specific Chinese oil companies are allowed to cooperate with foreign investors;

- The contract on the cooperative exploration of oil and gas resources executed by a designated Chinese oil company and a foreign oil company is subject the approval of MOFCOM at central level;

- Only areas that are permitted and approved by the State of Council are allowed to be explored and exploited for cooperation by foreign investors.

CHAPTER III MERGERS AND ACQUISITIONS

1 Overview

Mergers and acquisitions of a PRC domestic company by foreign investors can be realized through either equity M&As or asset M&As. Equity M&A means the purchase of equity, or the subscription to the increased capital, of a non-foreign-invested enterprise in China as to convert it into a foreign-invested enterprise. Asset M&A typically takes the form of establishing a foreign-invested enterprise to purchase the assets of a domestic enterprise or purchasing assets from a domestic company to establish a foreign-invested enterprise. Both equity M&A and asset M&A are subject to foreign investment restrictions and substantive government review. This part provides an overview of the main regulations governing mergers and acquisitions of PRC entities by foreign investors.

2 Investment Restrictions

Investment activities in the PRC by foreign investors are principally governed by the *Guidance Catalogue of Industries for Foreign Investment* (the "**Catalogue**"), which is promulgated and amended from time to time by the Ministry of Commerce ("**MOFCOM**") and the National Development and Reform Commission (the "**NDRC**"). The Catalogue divides industries into three categories: encouraged, restricted and prohibited. Industries not listed in the Catalogue are generally permitted to receive foreign investment unless specifically restricted by other PRC regulations. The establishment of wholly foreign-owned enterprises is generally permitted in encouraged and permitted industries. Certain restricted industries, such as value-added telecommunications businesses, are limited to equity or contractual joint ventures, while in some cases PRC partners are required to hold the majority interests in such joint ventures. In addition, restricted category projects may also be subject to higher-level government approval. Foreign investors are not allowed to invest in industries in the prohibited category.

3 Approvals from MOFCOM and NDRC

3.1 Approvals by the NDRC for foreign-invested projects

The industrial classifications and the investment amount together determine the level of the authority from which approval shall be obtained, the details are as follows:

Governmental Authority	Investment Amount and Industries
State Council	• a project of the encouraged or permitted industries with a total investment of 500 million U.S. dollars or more • a project of restricted industries with a total investment of 100 million U.S. dollars or

Governmental Authority	Investment Amount and Industries
	more
National Development and Reform Commission	• a project of encouraged or permitted industries with a total investment of 300 million U.S. dollars or more • a project of restricted industries with a total investment of 50 million U.S. dollars or more
Development and Reform Commission at provincial or lower level	• a project of encouraged or permitted industries with a total investment of less than 300 million U.S. dollars • a project of restricted industries with a total investment of less than 50 million U.S. dollars（shall be approved only by the Development and Reform Commission at the provincial level）

A project application report which is required to be submitted to the NDRC by the investors mainly contains the following: the name of project, term of operation and fundamental conditions of an investor; the scale of a construction project, main construction projects and products, main technologies and techniques adopted, target market of products and planned number of workers; the construction sites of project, demands of such resources as land, water and energy, and amount of main raw materials consumption; the evaluation about impacts on the environment; the prices of involved public products or services; and the total investment amount of project, registered capital and amount of contribution of each party, mode of contribution and financing schemes, and equipments which need to be imported and the price thereof.

The NDRC is required by the relevant regulations to make a decision of approval or disapproval or report to the State Council within 20 working days. However, the specified period can be extended for 10 working days, and it does not include the period for assessment conducted by an entrusted consulting organization designated by the NDRC. If an ultimate approval from the State Council is required, the approving period is uncertain and may be relatively longer.

3.2 Approval by MOFCOM

The most significant approval required for acquiring PRC entities is the examination and approval by MOFCOM and its competent local counterparts, which involves full review of all of the definitive agreements for the transaction, including, but not limited to, transaction agreements and resolutions. The transaction documents shall be governed by Chinese Law, and all documents to be submitted for approval shall have a Chinese language version. The primary governing legislation is the *Regulations on the Merger and Acquisition of Domestic Enterprises by Foreign Investors* (the "**Foreign M&A Regulations**"), which were last revised in June 2009 and are supplemented by a myriad of departmental rules governing specific industries or target groups.

Investment in foreign-invested enterprises of encouragement and permission with a

total investment of 300 million U.S dollars and foreign-invested enterprises of restriction with a total investment of 50 million U.S. dollars shall be approved by the competent commercial department at the provincial level.

It usually takes 30 days for the approval authorities to make a decision of approval or disapproval. In practice, the approval period may vary depending on the levels and locations of authorities.

Foreign investors wanting to acquire a PRC company should pay attention to the "affiliated acquisition" concept under the Foreign M&A Regulations. These Regulations provide that if the domestic companies or individuals use offshore companies they establish or control to acquire their affiliated domestic companies, approval from MOFCOM is required. However, in most cases, it is almost impossible to obtain such approval from MOFCOM.

4 AIC Registration and Other Registrations

After receiving MOFCOM's approval, the target company shall register with the competent administration of industry and commerce (the "AIC") for the issuance of a new business license within 30 days. The target company shall, within 30 days upon receipt of its new business license, go through the registration formalities with the tax, customs, land administration and foreign exchange administration authorities, etc.

5 Equity Acquisition vs. Asset Acquisition

A foreign investor may acquire a PRC entity's equity or assets to complete the acquisition of such PRC entity. For an equity acquisition, the foreign investor may acquire the equity of such PRC entity directly through the offshore entity of such foreign investor. For an asset acquisition, the foreign investor is required to establish another PRC entity to acquire and operate the target assets.

A foreign investor may take into account the following aspects when choosing between these two acquisition approaches:

5.1 Liability assumption. Generally speaking, an asset acquisition is more favorable to the investor in terms of liability assumption. An asset acquisition allows a foreign investor to select and purchase specific assets that it deems valuable while it generally does not need to assume any obligations and liabilities of the selling company. On the contrary, in the case of equity acquisition, all historical liabilities of the target company shall be assumed by such target company itself regardless of whether or not the foreign investor becomes the shareholder of such target company.

5.2 Contract assignments under asset acquisition. A typical asset acquisition involves the transfer of business contracts and employee contracts, and such transfer will normally make the acquisition process more complicated. An assignment of business contracts requires consent of the counterparty and it could

be time consuming and costly to obtain such consent in practice, especially in regard to the case of retailing enterprise, where many sales and supply contracts are involved. In terms of transfer of employees, it is noteworthy that such a step may be regarded as an early termination of the labor contract with the employee, and thus gives rise to the compensation obligation of the seller to its employee under the relevant PRC laws. Under that circumstance, the seller may want to negotiate with the investor on reimbursement for such compensation and the cost for acquisition would be therefore increased.

5.3 Tax consideration. Subject to the categories of target assets, an asset acquisition may involve various taxes and thus requires a more complex tax planning. In comparison, the major taxes related to an equity acquisition are more straightforward, namely income tax and stamp duty. In particular, subject to a case-by-case analysis, an asset acquisition is normally deemed as tax disadvantaged from the seller's perspective because its ultimate income from the sale of target assets will be subject to double taxation at the company's level and its shareholder's level. In contrast, the seller's income from the sale of equity in the case of an equity acquisition will be subject to only one layer of taxation at the shareholder's level.

5.4 Others. Before the foreign investor chooses the approach for acquisition, it is suggested that the investor carefully review the existing loan agreements of the seller, especially facility agreements with banks, because such agreements normally provide that any change of the borrower's shareholding structure and/or the borrower's disposition of any material assets shall be subject to the prior consent of the lender. In that case, the foreign investor should check with the seller on the necessity and feasibility of obtaining such consent in order to assess which acquisition approach is more practicable and safer.

6 Merger Control

6.1 General Introduction

Where a foreign investor acquires a PRC domestic enterprise and competition issue is involved, an anti-trust review may be conducted. Merger and acquisitions that constitute concentration of undertakings and meet the regulatory turnover thresholds must submit premerger notification to the PRC Ministry of Commerce ("**MOFCOM**") and be cleared by MOFCOM prior to consummation of such transactions.

According to publicly available data, since the *Anti-Monopoly Law of People's Republic of China* (the "**Anti-Monopoly Law**") went into effect in August 2008 to the first quarter of 2013, MOFCOM has closed 571 notifications, among which only the acquisition of Huiyuan, a fruit juice producer, by Coca-Cola was blocked, eighteen cases were cleared subject to conditions, and 552 cases were unconditionally cleared (over 90% of the closed cases).

6.2 Governing Legislations

The Anti-Monopoly Law enacted by the Standing Committee of the National People's

Congress of the PRC on August 1, 2008 sets out the ground rules for the current Chinese merger control regime.

Since the Anti-Monopoly Law came into effect, a body of implementing rules and guidelines have been actively developed, including:

- *Provisions of State Council on Notification Threshold for Concentration of Undertakings*, effective on August 3, 2008;
- *Calculation Methods of Turnovers for the Concentration of Financial Undertakings*, issued by MOFCOM, the People's Bank of China, China Securities Regulatory Commission, China Banking Regulatory Commission and China Insurance Regulatory Commission and effective on August 15, 2009;
- *Measures on Notification of Concentration of* Undertakings, issued by MOFCOM and effective on January 1, 2010;
- *Measures on Review of Concentration of Undertakings*, issued by MOFCOM and effective on January 1, 2010;
- *MOFCOM Interim Provisional on Assets or Business Divestiture in Connection with the Implementation of Concentration of Undertakings*, effective on July 5, 2010;
- *MOFCOM Interim Provisions on Assessment of Impact of Concentration of Undertakings on Competition*, effective on September 5, 2011;
- *Interim Measures on Investigation on Concentrations not Notified*, issued by MOFCOM and effective on February 1, 2012;
- *State Council Anti-monopoly* Commission *Guidelines for the Definition of Relevant Markets*, effective on July 6, 2009;
- *MOFCOM Guidance on Notification of Concentration of Undertakings*, effective on January 5, 2009;
- *MOFCOM Guidance on* Notification *Documents and Materials*, effective on January 5, 2009.

6.3 Notification of Concentrations

6.3.1 Definition of Concentration of Undertakings

Anti-trust review provisions only apply to mergers and acquisitions that qualify as "concentration of undertakings" or "concentrations". Under the Anti-Monopoly Law and *Measures on Notification of Concentration of Undertakings*, "concentration of undertakings" that may trigger the merger review by MOFCOM refer to any of the following circumstances:

(a) mergers;

(b) acquisition of control over another entity through acquisition of equity or assets; and

(c) acquisition of control or decisive influence over another entity by contract or by other means (other means that are not specified above include, without limitation, contracts, licensing of intellectual property rights, and control of the supply of raw materials. The establishment of a joint venture is also treated as concentrations by MOFCOM).

6.3.2 Notification Thresholds

If a merger qualifies as a concentration, it must be notified to MOFCOM if any of the following turnover thresholds, as provided in the *Provisions of State Council on Notification Threshold for Concentration of Undertakings*, are met:

(a) the combined worldwide turnover of all the participating undertakings in the preceding financial year is more than RMB 10 billion Yuan, and the nationwide turnover within China of each of at least two of the participating undertakings in the preceding financial year is more than RMB 400 million Yuan; or

(b) The combined nationwide turnover within China of all participating undertakings in the preceding financial year is more than RMB 2 billion Yuan, and the nationwide turnover within China of each of at least two of participating undertakings in the preceding financial year is more than RMB 400 million Yuan.

In addition to the above general thresholds, the *Measures on Notification of Concentration of Undertakings* has provided detailed rules on calculation of the turnover figures.

6.4 Review Procedures

6.4.1 Notification Documents and Materials

All parties participating in a concentration have a duty to notify, and are notifying parties for purpose of the Anti-Monopoly Law and its implementing rules. Notifying parties may file a notification only after providing all materials required under the Anti-Monopoly Law and *MOFCOM Guidance on Notification of Concentration of Undertakings*, including but not limited to:

(a) notification application form (indicating the name, domicile and business scope of the participating parties, and the estimated effective date of the proposed concentration, together with the identification or certificate of incorporation of the notifying parties;

(b) a statement analyzing the impact of the concentration on the relevant market, which shall, *inter alia*, provide the general information about (i) the transaction, (ii) definition of the relevant market(s), (iii) market shares and control in relevant markets of the participating parties; (iv) key competitors and their market shares, (v) the degree of market concentration, (vi) ease of market entry, (vii) the development stage of the industry, (vii) analysis of the impact of the proposed concentration on market structure, industrial development, technological

advancement, national economic development, consumers and other business operators, (viii) assessment of the influence of concentration on relevant market competition and the basis thereof and (ix) opinions from relevant authorities, such as local governments and competent departments.

(c) concentration agreement and relevant documents, including all forms of agreements, contracts and the supplements thereto, and various reports that support the concentration agreement, such as feasibility study report, due diligence report, etc.

(d) audited financial and accounting reports of all parties participating in a concentration for the preceding fiscal year, and

(e) other documents and materials required by MOFCOM.

6.4.2 Timeframe for Anti-trust Review

Following receipt of the complete notification materials, MOFCOM shall preliminarily review the notification within 30 days, and then decide whether to proceed to an in-depth review and inform the notifying parties in written. If MOFCOM decides to further review the proposed concentration, it shall complete such review within 90 days as of the date of decision. However, under the following circumstances, MOFCOM may extend the time limit for review, provided that such extension shall not exceed 60 days:

(a) the participating parties agree to extend the review time limit;

(b) the documents and materials submitted by the notifying parties are inaccurate and further verification is required; or

(c) relevant circumstance changes substantially after filing of notification.

Therefore, the whole process of the anti-trust review can be extended to 180 days at most. If MOFCOM fails to adopt a decision before the expiry of the regulatory review period, the transaction is deemed cleared and the participating parties may consummate the transaction.

6.5 Substantive Assessment

The *Interim Provisions on Assessment of Impact of Concentration of Undertakings on Competition* elaborates on the factors listed in the Anti-Monopoly Law for the assessment of the impact of mergers on competition. When determining whether a concentration results in or may result in the effect of eliminating or restricting market competition, MOFCOM primarily focuses on (i) the market shares and market control of the merging parties, and (ii) the concentration level of the relevant market(s).

In respect of the former, MOFCOM will incorporate the following factors into its comprehensive assessment of market control and market power: (i) the market shares of the participating parties in the relevant markets; (ii) the degree of substitutability of the products or services of the participating parties; (iii) the production capability of other competitors in the relevant market and the degree of substitutability of their products or services; (iv) the ability of the participating parties to control the sales

market or the raw material purchasing market, (v) the capability of the buyers for commodities of the participating parties to change suppliers; (vi) the financial resources and technical conditions of the participating parties (vii) the purchasing power of the downstream customers of the participating parties, and (vii) other factors that shall be considered.

As to the latter aspect, MOFCOM will look at market concentration indices such as the Herfindahl–Hirschman Index ("HHI") and the combined market shares of the top market players ("CRn") as relevant indications of the level of market concentration.

Besides the above two key elements, MOFCOM will also analyze the market entry, ask whether the concentration impacts technological development, consumers or other undertakings, or the national economy, and balance the negative impact against possible efficiencies generated by the proposed transaction.

6.6 Review Decisions

In accordance with the Anti-monopoly Law and the *Measures on Review of Concentration of Undertakings*, the MOFCOM may decide to (1) approve unconditionally, (2) prohibit, or (3) approve conditionally the concentration. The restrictive conditions may include the following types:

(a) Structural conditions, such as divestiture of partial assets or business of the merging parties;

(b) Behavioral conditions, such as granting access to such infrastructure as networks or platforms, licensing of key technologies (inclusive of patents, know-how or other intellectual property rights) and termination of exclusive agreements by the merging parties; or

(c) Hybrid conditions, a combination of structural conditions and behavioral conditions.

To date, detailed rules related to divestiture of assets or business have been provided in the *Interim Provisional on Assets or Business Divestiture in Connection with the Implementation of Concentration of* Undertakings. On March 27, 2013, MOFCOM published draft *Regulations Relating to Imposing Restrictive Conditions on Concentrations of Undertakings* seeking public comments by April 26, 2013. The *Regulations Relating to Imposing Restrictive Conditions on Concentrations of Undertakings* aims to provide increased transparency by setting out uniform standards for the proposal, implementation and supervision of restrictive conditions, and it will replace the *Interim Provisional on Assets or Business Divestiture in Connection with the Implementation of Concentration of Undertakings* after becoming effective.

Based on the current practice of MOFCOM, only the cases prohibited or cleared with conditions are published by MOFCOM. Except for the establishment of joint venture between General Electric (China) Ltd. and China Shenhua Coal to Liquid and Chemical Co., Ltd., all the merging parties in the concentrations cleared subject to conditions are offshore companies.

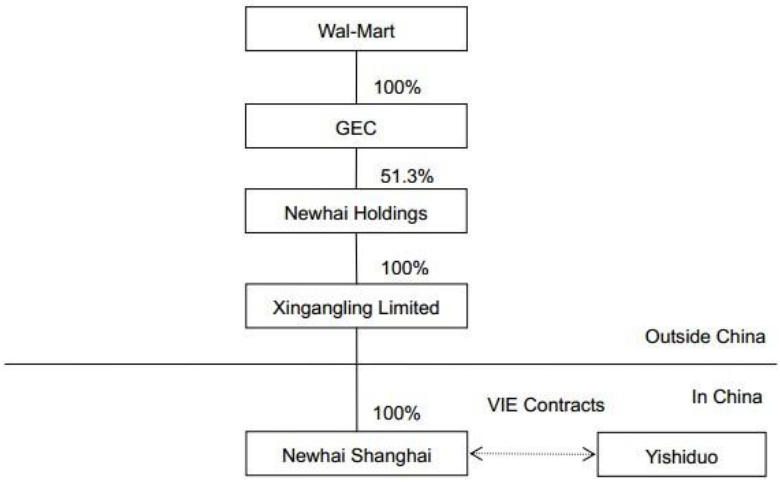
6.7 Sanctions and Remedies

The Anti-Monopoly Law and the *Interim Measures on Investigation on Concentrations not Notified* set out the legal consequences of failure to notify a reportable concentration and the procedural framework under which MOFCOM will investigate and sanction reportable transactions implemented prior to seeking anti-trust review. If the merging parties wish to challenge a decision by MOFCOM to prohibit a concentration or impose restrictive conditions, they have to first apply for administrative review, and may further bring a law suit and institute a judicial review.

6.8 Case Study: Wal-Mart/Yihaodian

On August 14, 2012, MOFCOM cleared the acquisition by Wal-Mart Stores Inc. ("Wal-Mart") of a controlling interest in the largest Chinese online supermarket, Yihaodian, subject to certain conditions. It has been the first published anti-monopoly review announcement regarding a transaction involving variable interest entity ("VIE") structures and could shed some light on future notifications involving VIE structures.

Wal-Mart proposed to acquire 33.6% of the equity interest of Niuhai Holdings Co., Ltd. ("Niuhai Holdings") via its holding company GEC 2 PTE ("GEC") and immediately after the closing of the transaction, Wal-Mart will be the beneficial owner of 51.3% of equity interest of Niuhai Holdings. Niuhai Holdings is the sole beneficial owner of Niuhai Information Technology (Shanghai) Co., Ltd. ("Niuhai Shanghai", a wholly foreign owned enterprise located in Shanghai) which controls Shanghai Yishiduo E-commerce Co., Ltd. ("Yishiduo", a domestic PRC company running the online shopping platform "Yihaodian") through VIE contracts. The post-closing corporate structure of the transaction is as follows:



MOFCOM raised the concern that Wal-Mart might seek to leverage its advantages in physical retail supermarket stores (procurement, storage, product lines, store networks, services, logistics, and brands) into Yihaodian's online retail supermarket and its third-party online sales platform, potentially strengthening its control of bargaining power against online platform users and gaining the ability to eliminate or restrict competition in that platform.

Consequently, MOFCOM conditionally approved the transaction with three restrictive

conditions, i.e.: (i) this acquisition of Niuhai Shanghai shall be limited to the online direct sales business carried out with its own online platform; (ii) without obtaining the ICP License, Niuhai Shanghai shall not use its own online platform to provide network services for other transaction parties subsequent to the completion of the transaction; and (iii) upon closing of the transaction, Wal-Mart is not allowed to engage in the value-added telecommunications business currently operated by Yishiduo through its VIE structure.

According to the first condition, MOFCOM will probably approve an FIE using VIE structures to engage in businesses permitted to be conducted by foreign investors in accordance with PRC relevant laws and regulations, unless the transaction itself would cause eliminative and/or restrictive effects in the relevant market. As indicated by the third restrictive condition, Wal-Mart is prohibited from engaging in the value-added telecommunications business currently operated by Yishiduo via its VIE structure and the rationale of elaborating the reasons for such condition was based on an unprecedented methodology. We could infer that for a future notification involving VIE structures used by in restricted and/or prohibited businesses, MOFCOM would take much more prudent steps than VIE structures involving non-restricted businesses.

7 National Security Review

7.1 Legal System

The national security review system in the PRC was launched in 2011 and was implemented in accordance with the following regulations:

7.1.1 Notice No. 6

On February 3, 2011, the General Office of the PRC State Council promulgated the *Notice of the General Office of the State Council on Launching the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* ("**Notice No.6**"), which is deemed as the guidelines of the PRC national security review system. Notice No.6 includes five chapters which mainly stipulate the scope, the content, the mechanism and the procedures of security review in the mergers and acquisitions (the "**M&A**") projects.

7.1.2 Regulations on the Implementation of Notice No.6

In order to further implement Notice No.6, the PRC Ministry of Commerce ("**MOFCOM**") promulgated the *Regulations on the Implementation the* Implementation *of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (the "**Regulations on Implementation of Notice No.6**", together with Notice No. 6, the "**National Security Review Laws**") on August 25, 2011.

7.2 Transactions Subject to Security Review

Foreign investors who purchase the equity interests or assets of domestic enterprises shall file an application with MOFCOM. In the case that such domestic enterprises are

i) military industry enterprises or military industry related supporting enterprises, enterprises located near key and sensitive military facilities, and other entities relating to national defense security; and ii) conducting business in the fields of important agricultural products, important energy and resources, important infrastructure, important transport, key technologies, important equipment manufacturing, etc., and the foreign investors might acquire actual control over such domestic enterprises after the M&A transaction, MOFCOM shall submit such M&A transaction to a joint session initiated by the NDRC and MOFCOM together with the relevant departments who are responsible for the administration of the industries involved, under the leadership of the State Council for examination ("**Joint Session**").

The M&A transactions of domestic enterprises by foreign investors shall mean: (i) a foreign investor's purchase of the equity of a non-foreign-invested enterprise in the PRC, or subscription of the increased capital of a non-foreign-invested enterprise in the PRC, which will transform such non-foreign-invested enterprise into a foreign-invested enterprise; (ii) a foreign investor's purchase of the equity held by Chinese shareholders in a foreign-invested enterprise in the PRC, or a subscription of the increased capital of such foreign-invested enterprise in the PRC; (iii) a foreign investor establishes a foreign-invested enterprise in the PRC so as to purchase by agreement and then operate the assets of a domestic enterprise through such foreign-invested enterprise, or purchase the equity of a domestic enterprise through such foreign-invested enterprise; or (iv) the foreign investor directly purchases the assets of a domestic enterprise and uses the purchased assets to invest and establish a foreign-invested enterprise for the operation of such assets.

In addition, "foreign investors acquir[ing] actual control over domestic enterprises" shall include the following circumstances: (i) a foreign investor or its parent company or subsidiary holds 50% or more of the equity interests in the target company after the M&A transaction; (ii) several foreign investors hold 50% or more of equity interest in the target company in aggregate after the M&A transaction; (iii) foreign investors hold less than 50% of equity interest in the target company after the M&A transaction, but the voting rights actually held by such foreign investors is sufficient to have major impact on the resolution of the shareholders' meeting, general meeting of shareholders, or the board of directors of such target company; or (iv) other circumstances that may result in the transfer of actual control over the target company to the foreign investors in terms of its business decision-making, financial affairs, human resources, technologies, etc.

Please note that pursuant to the Implementation of Notice No.6, a foreign investor shall not substantially circumvent the national security review by any means, including but not limited to holding on agency basis, trust, multi-tier reinvestment, leasing, loan, contractual control, overseas transactions, etc.

7.3 Content

The content of M&A transaction subject to the national security review includes: (i) the impact of the M&A transactions on national defense and security, including the domestic product manufacturing capacity, domestic service provision capacity, and relevant equipment and facilities required by national defense and security; (ii) the impact of the M&A transactions on the stable operation of national economy; (iii) the impact of the M&A transactions on the basic social order; and (iv) the impact of the

M&A transactions on the capacity of research and development for key technologies related to national security.

7.4 Procedures

7.4.1 Submission and Acceptance

The foreign investors (collectively the "**Applicants**") who will purchase the equity interests or assets of domestic enterprises shall file an application with MOFCOM. In the event that the M&A transaction is required to be reviewed by a Joint Session, MOFCOM shall notify the foreign investors whether or not such M&A transaction shall be subject to the security review within fifteen (15) working days after it accepts the foreign investors' application. If yes, MOFCOM shall submit such M&A transaction to a Joint Session for examination within five (5) days thereafter.

Please kindly note within fifteen (15) working days after the Applicant is notified by MOFCOM with its acceptance of the application in writing, the Applicant shall not carry out the M&A transaction, and the local counterpart of the MOFCOM shall not approve such M&A transaction. If MOFCOM doesn't notify the applicant in writing after fifteen (15) working days, the Applicant may go through the appropriate procedures according to relevant PRC laws and regulations.

7.4.2 Review

After receiving the relevant documents submitted by MOFCOM, the Joint Session shall do a general review over the M&A transactions firstly, and then shall special review over those failing to pass the general review. Parties to the M&A transactions shall cooperate with the Joint Session's security review, provide materials and information necessary to the Security review and answer the questions of the Joint Session.

During general review procedure, the Joint Session shall, within five (5) working days upon its receipt of MOFCOM' request of security review over the M&A transaction, solicit written opinions from the relevant departments. If all relevant departments believe that the M&A transaction will not impact national security, it becomes unnecessary to conduct a special review and the Joint Session shall give review opinions within five (5) working days upon its receipt of all written opinions and inform MOFCOM in writing.

If any department believes that the M&A transaction may incur impact on national security, the Joint Session shall initiate a special review procedure within five (5) working days upon its receipt of the written opinions. After the special review procedure is initiated, the Joint Session shall arrange a security assessment over the M&A transaction and examine the transaction based on the assessment opinions. If the opinions are mostly consistent with the assessment opinions, the Joint Session shall issue the review opinions. If such opinions are not consistent with the assessment opinions, the Joint Session shall submit such transaction to the State Council for decision. A special review procedure shall be completed within 60 working days after MOFCOM initiates such procedure. The Joint Session shall notify MOFCOM of the special review opinions in writing.

7.5 Results

After receiving the written review opinions of the Joint Session, MOFCOM shall, within five (5) working days and in writing, notify the applicant (or the parties concerned) and the local counterpart of MOFCOM of the review opinions.

7.5.1 In the event that the M&A transaction will not have an effect on national security, the applicant may go through the procedures for the M&A transaction with the relevant government authorities according to PRC laws and regulations.

7.5.2 In the event that the M&A transaction, which has not been carried out, may have an effect on national security, the parties thereto shall terminate the transactions. The applicant shall not carry out the M&A transaction until such M&A transaction and the application documents concerned have been adjusted and reviewed again.

7.5.3 If the M&A transaction caused or has threatened to cause significant impact on national security, MOFCOM together with the relevant departments shall terminate such M&A transaction, or take any other necessary actions to eliminate the impact on national security.

8 Consideration Payment

8.1 Acquisition by Foreign Investors

8.1.1 Fixing the Consideration

Acquisition of a Domestic Enterprise

When a foreign investor acquires equity interest or assets of a domestic enterprise, the consideration for such acquisition should be based on the appraisal value of the relevant equity interest or assets. The appraisal should be carried out by a Chinese appraisal firm in accordance with internationally accepted appraisal methods. The consideration must not be substantially lower than the appraisal value.

Acquisition of a Foreign Invested Enterprise ("**FIE**")

There are less restrictions regarding the consideration where a foreign investor acquires an FIE. In general, no appraisal is required unless stated owned assets are involved in the acquisition. However, if the acquisition is conducted between related parties, the transaction should be carried out on an arm's length basis. In case the transactions between the related parties are not carried out in accordance with the arm's length principle and result in a reduction of the taxable income in China, the PRC tax authorities shall have the power to make a reasonable adjustment to the price.

8.1.2 Timing of Consideration Payment

A foreign investor that acquires equity interest in a domestic enterprise must pay the

consideration in full within three (3) months following the issuance of the business license to the resulting FIE. In special circumstances where a time limit extension is required, the foreign investor should, upon approval by the approval authorities, pay more than 60% of the total consideration within six (6) months as of the issuance of the new FIE's business license, and pay off the balance within one (1) year. The foreign investor should only share the profit of the FIE to the extent of its paid-in investment.

In asset acquisitions where an FIE is established as the acquisition vehicle, the amount of the foreign investor's capital contribution equivalent to the asset acquisition price should be paid in compliance with the above payment schedule.

8.1.3 Types of Consideration

Although cash is the most common means of payment, a foreign investor can use qualifying shares in payment for equity acquired from a domestic company. Qualifying shares refer to (i) shares listed on an overseas stock exchange, the trading price of which has been stable in the most recent year; or (ii) shares of a offshore special purpose vehicle directly or indirectly controlled by a domestic company or Chinese resident(s) for the purpose of making the equities of its actual owned domestic company to be listed abroad.

8.1.4 Foreign Exchange Procedures

In equity acquisitions, if the consideration is fully remitted by the foreign purchaser in cash, the foreign exchange confirmation of the capital injection by the foreign purchaser would be conducted automatically through a system establishment between the bank and the foreign exchange authorities. Where the payment is made in other non-monetary means, the target Chinese enterprise should apply to the local foreign exchange authorities for confirmation of the foreign purchaser's capital injection.

8.2 Selling FIE Equity Investments

The transfer of an FIE's equity interests or assets is not highly restricted under PRC law, so most of investors acquire FIEs through the purchase of its equity interest.

8.2.1 Selling to Another Foreign Investor

In principle, the purchaser and the seller are free to negotiate the purchase price as well as the timing and method for the payment. However, please note that the seller is liable to an enterprise income tax in China for any capital gain arising from the sale of equity interest in a Chinese enterprise. The tax should be filed and paid by the seller or its designated agent to the in-charge tax authorities where the target company is located. In addition, if the direct shareholders of such FIE are changed as result of such sale, such sale is still subject to the approval of the PRC approval authorities.

8.2.2 Selling to Chinese Investors

The target company, after the equity transfer has been approved by the approval authorities, should apply to the in-charge foreign exchange authorities at its place of incorporation for the amendment to its foreign exchange registration. The purchase of foreign exchange and payment of the consideration by the Chinese purchaser are

handled directly by banks.

One of the key documents the banks will review before authorizing the payment is the tax certificate evidencing the payment of applicable PRC taxes or exemption thereof. A tax certificate is however not necessary for any batch of payment that is no more than USD 30,000 (or the equivalent in any foreign currency). The PRC taxes arising from the equity transfer will generally be withheld and paid by the Chinese buyer. The tax certificate can be issued either by the in-charge tax authorities where the target company is located, or by the tax authorities where the taxes are actually paid (if different from the first-mentioned tax authorities).

Technically speaking, the consideration can be paid after the amendment to the foreign exchange registration is completed. However, the buyer may only want to pay after the amended business license is issued to the target company, whereas the seller could require a payment before amending the foreign exchange registration. An escrow arrangement is often adopted to solve such disagreements in respect of payment.

9 Acquisition of State-Owned Enterprises by Foreign Investors

9.1 General Introduction

9.1.1 Introduction to the Governing Laws

Mergers and acquisitions of state-owned enterprises shall follow some special regulations and rules regarding the supervision of state-owned assets in China. The main rules are as follows:

- *The Provisional Regulations on the Administration and Supervision of State-owned Assets in Enterprises* (the "**Supervision Regulations**") promulgated on May 27, 2003 by the State Council, stipulates the competent supervision authorities and the principles of the supervision of the state-owned assets in enterprises.

- *The Provisional Measures for the Administration of the Transfer of State-owned Assets and Equity in Enterprises* (the "**Transfer Measures**"), promulgated on December 21, 2003 and came into effect on February 1, 2004, stipulates the general rules of transferring state-owned assets in non-financial enterprises.

- *The Provisional Regulations on Reorganizing State-owned Enterprises with Foreign Investment* (the "**Regulations on Foreign Investment in State-owned Enterprises**"), promulgated on November 8, 2002 and came into effect on March 1, 2003, stipulates the rules on foreign investment in state-owned enterprises.

- *The Provisional Regulations on Reorganizing the Assets of the State-owned Enterprises with Foreign Investment* promulgated on September 14, 1998, regulates the approval and procedure of the asset reorganizations of state-owned enterprises with foreign investment.

- *The Operational Rules on the Transactions Related to the State-owned Assets in Enterprises* issued on June 15, 2009, regulates the operational measures of the transactions related to state-owned assets in enterprises. The Implementation Measures for the Transfer of State-owned Assets in Enterprises by Way of Auction, the Implementation Measures for the Transfer of State-owned Assets in Enterprises by Way of Biding and other implementation measures regarding additional ways of transferring state-owned assets in enterprises provides more specific rules regarding the procedure of transferring state-owned assets.

The term "assets" mentioned in these regulations refers not only to tangible assets, but also to intangible assets and equity interests. Moreover, since there is no specific rule regarding the procedure of capital increase of state-owned enterprises, unless otherwise defined, the following discussion only focuses on the acquisitions through share transfers.

9.1.2 Supervisors and Jurisdiction

The State-owned Assets Supervision and Administration Commission of the State Council (the "**SASAC**") and the Ministry of Finance of the People's Republic of China (the "**MOF**") are the two major supervisors of state-owned enterprises. The SASAC and its local branches are responsible for non-financial enterprises. Enterprises contributed and established by the SASAC are known as central enterprises ("**Central Enterprises**") and shall be subject to special rules issued by the SASAC regarding Central Enterprises. Enterprises contributed and established by the local SASAC branches are known as local enterprises ("**Local Enterprises**") and shall comply with the rules and regulations issued by the local SASAC branches. The MOF and its local branches are responsible for financial enterprises.

Generally, important issues of state-owned enterprises, such as share transfers, increases or decreases of registered capital, shall be determined by the state-owned enterprises. However, important issues of material subsidiaries shall be subject to the approval of the state-owned asset supervisors.

The following introduction focuses on only non-financial and non-listed state-owned enterprises. The transfer of state-owned assets in listed enterprises shall be also subject to the rules regarding the listed companies as will be explained in a later chapter.

9.2 Preparation for Transfer

9.2.1 Approvals and Competent Authorities

The SASAC and its local branches can determine whether to approve or reject the transfer of state-owned assets in enterprises established or contributed by them or material subsidiaries. State-owned enterprises shall determine whether to approve or reject the transfer of state-owned assets in their subsidiaries (other than material subsidiaries).

The transfer of state-owned assets shall be approved internally with a written resolution. With respect to enterprises wholly-owned by the state, the transfer shall be reviewed and approved by the board of directors or a meeting of general manager's

office if there is no board of directors. If the transfer may affect the legitimate rights of the employees, the opinions of the employees' representatives' meeting shall be obtained and the allocation of employees shall be discussed and approved by such meeting.

9.2.2 Asset Check and Audit

Once the transfer has been approved in accordance with the relevant laws and regulations, the transfer shall check its assets (the "**Assets Check**"), structure the financial statements to be based on the Assets Check's results, and engage an accounting firm to conduct a complete audit.

If the transfer will result in the transferor losing its majority control, the Assets Check shall be organized by the competent SASAC branch and performed independently by a social intermediary agent.

9.2.3 Asset Evaluation

Based on the results of the Assets Check and auditing, the transferor shall engage an assets evaluation institution with the relevant qualifications to conduct an evaluation of the state-owned enterprise's assets in accordance with the relevant laws and regulations. With respect to some enterprises, the evaluation result shall be approved, while with respect to other enterprises of lower levels, the result shall be filed with the competent authorities and need not to be approved. The transfer price shall be determined based on the result.

It should be noted that the sticker price of the assets to be transferred in the first notification shall be no less than the evaluation result. If no potential transferee is attracted after the publication of the first notification, a sticker price in the amount of no less than 90% of the evaluation results can be reset in the following notifications. However, if the transfer price is lower than 90% of the evaluation results, the transaction shall be suspended and submitted for approval， and such transaction shall be resumed only after being duly approved by the approval authorities of such transfer.

9.2.4 Applying for Transfer and Publication of the Notification

Pursuant to the Transfer Measures, unless otherwise provided under the relevant laws and regulations, the transfer of state-owned assets in enterprises shall be conducted in a legally established equity exchange institution publicly, which shall not limited by regions, industries, capital contribution or subordinations.

Therefore, the transferor shall choose an equity exchange institution to conduct the transfer. Since the transfer shall be carried out publicly, the transferor shall entrust the equity exchange institution to publicize a notification of such transfer on a published economic or financial magazine and the website of such institution, disclosing the information related to the transfer to attract potential transferees. The publication period of the notification shall last for 20 business days.

The transferor may set up some standards regarding the transferee with respect to its qualifications, credits, operations, financial conditions, management capabilities, scale

of assets, etc.

9.3 Procedure of Transfer

Based on the number of potential transferees attracted, the transfer may be conducted mainly in one of the following three ways: bidding, auction or agreement.

9.3.1 In the event of Two or More Potential Transferees

If there are two or more potential transferees, the transferor shall consult with the equity exchange institution and determine the proper way of transfer. Besides the two ways listed below, price competition through the Internet and other new ways are also available options in some equity exchange institutions.

9.3.1.1 Transfer by Way of Bidding

If the transfer is conducted by way of bidding, the transferor shall engage a bidding institution to chair the bidding. An aggregate of no more than 30% of the sticker price of the assets to be transferred shall be paid by the bidders as a deposit. Normally, the deadline for the bidding documents shall be no later than 10 days after the issuance of the bidding invitations. Bidding documents failing to respond to the bidding invitations substantively, the bidding price being lower than the base price or upon the occurrence of any other circumstances which may cause the bidding documents to be invalid, the bidding documents will be considered invalid. The bidding evaluation shall be carried out confidentially by a committee consisting of experts and representatives from the transferor. The number of the committee shall be an odd number and higher than 5, and no more than 1/3 of which shall be the transferor's representatives. Upon the completion of the auction, the deposit paid by the successful bidder shall be deducted from the transfer consideration, and the deposits paid by the other bidders shall be returned. Within 3 business days after the issuance of the notification of the result of the bidding, the transfer agreement shall be signed with both the bidding invitation and the bidding documents attached as the transfer agreement's exhibits.

9.3.1.2 Transfer by Way of Auction

If the transfer is conducted by way of an auction, the transferor shall engage an auction institution to hold the auction. An aggregate of no more than 30% of the sticker price of the assets to be transferred shall be paid by the tenderers as a deposit within 3 business days after its identity has been confirmed. Upon the completion of the auction, the deposit paid by the successful tenderer shall be deducted from the transfer consideration, and the deposits paid by the other tenderers shall be returned. The confirmation of the auction shall be executed by the successful tenderer and the auction institution, and the tenderer shall sign the transfer agreement with the transferor and complete any other registration in connection with the transfer.

9.3.2 In the Event of One Potential Transferee

If after the notification period, there is only one potential transferee, the equity exchange institution shall organize the parties to sign the contract and the transfer price shall be the higher of the sticker price and the price offered by the potential

transferee.

9.4 Notes for Foreign Investors

Apart from the aforementioned requirements on the transfer of state-owned assets in enterprises, the following special rules and regulations are worth noting in the acquisition of state-owned assets in enterprises by foreign investors.

9.4.1 Qualification of Foreign Investors

Foreign investors shall meet the following requirements: (1) having the operating qualifications and techniques required for the business of the target enterprise; (2) having good credit and management capabilities; and (3) having good financial conditions and economic competence. Foreign investors shall also provide their audit reports of the most recent 3 years issued by a certified accounting firm and an explanation on the foreign investors' market shares in the PRC through their subsidiaries and/or enterprises actually controlled by them.

9.4.2 Submission of Reorganization Plan

The foreign investor shall provide a reorganization plan regarding the improvement of the corporate governance of the enterprise and the promotion of the enterprise's continuous development after the transfer. The reorganization plan shall contain measures related to the development of new products, restructuring of technology and its related investment plans and enhancement of the corporate management.

9.4.3 Approval of the Transfer Agreement by the SASAC

The transfer agreement between the transferor and foreign investors shall be approved by the competent authorities in accordance with the Provisional Measures for the Administration of State-owned Assets in Enterprises and the Finance of the Enterprises issued by the MOF on April 28, 2001. The transfer agreement shall come into effect only after it has been duly approved. The transfer agreement shall be submitted to the commerce committee for approval and shall be submitted to the State Administration for Industry and Commerce for change of registration.

9.4.4 Approval of the Transfer by the Committee of Commerce (the "COC")

The transfer shall be approved by the competent COC. With respect to Central Enterprises, enterprises wholly-owned or controlled by Central Enterprises or enterprises directly or indirectly holding any equity interests in listed companies or enterprises whose total assets after the transfer are no less than USD 30 million, the transfer shall be approved by the Ministry of Commerce.

9.4.5 Ways of Transfer

Transfer by way of price competition shall be considered with having a priority in transferring state-owned assets to foreign investors. Even if the transfer is conducted by way of an agreement, it shall be conducted publicly.

9.4.6 Payment of Transfer Price

The transfer price shall be paid within 3 months upon the issuance of the new business license after the transfer. If the transfer price cannot be paid within the time limit, an aggregate of 60% shall be paid within 6 months upon the issuance of the new business license and the appropriate security shall be provided for the remaining amount that shall be paid within 1 year. Moreover, in the event that the transferor has lost control over the enterprise by transferring all of the material assets to the foreign investor, before the foreign investor has fully paid the transfer price, the transferor shall have the right to inspect the operation and financial conditions of the target enterprise. The foreign investor and the target enterprise shall provide corresponding assistance.

9.4.7 Employment Issues

If all of the assets of the target company or the material assets of the target company are be transferred to the foreign investors, the transferor and the foreign investor shall stipulate a plan to allocate the employees properly and such plan shall be approved by the representatives of the employees. The target company shall pay the salaries owed to the employees, unreturned collected funds, due but unpaid social insurance fees and any other fees with its assets. Both the target company and the employees shall have the right to decide whether to continue the employment contracts. Compensations shall be paid to the employees to be dismissed and the social insurance fees of the employees who will be transferred to the social insurance institutions shall be paid up in a lump sum. The capital needed shall be deducted from the net assets of the target company or paid by the gains of the transferor from the transfer of the state-owned assets.

10 Investment in Listed Companies by Foreign Investors

10.1 General Introduction

There are currently two markets now accessible to foreign investors intending to invest in Chinese listed companies, the A-share market and the B-share market. Investment in A-share listed companies by foreign investors has two main ways: i) the strategic investment in and joint development with specific listed companies, or ii) the direct investment in domestic securities markets.

10.2 Strategic Investment in A-share Listed Companies

10.2.1 Governing laws

Investment in the Chinese A-share market by foreign investors is subject to: i) the *Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies*[15] (the "**Administrative Measures**"), which specify the requirements, procedures and supervisory departments for strategic investment in A-share listed companies by foreign investors. ii) The *Administrative Measures* for *the Takeover of Listed Companies*, promulgated on September 1, 2006 and revised and announced on

[15] The Administrative Measures were jointly promulgated on December 31, 2005 by the State Administration of Taxation, the State Administration for Industry and Commerce, the State Administration of Foreign Exchange, the Ministry of Commerce and the CSRC and came into effect on January 31, 2006.

February 14, 2012 by the China Securities Regulatory Commission (the "**CSRC**"), stipulates the disclosure obligations, reports, record-filing and approval procedures in the acquisition of listed companies. iii) The *Interim Administrative Measures for the Transfer of Shares of Listed Companies by State-owned* Shareholders[16] (the "**Interim Measures**") and the *Several Opinions on Regulating the Activities of State-owned Shareholders of Listed Companies*[17] (the "Opinions") stipulate the approval procedures regarding the transfer of state-owned shares in listed companies. In addition, where strategic investors acquire the state-owned shares in listed companies, the state-owned shareholders shall go through the relevant examination and approval procedures, which is a prerequisite to the validity of the acquisition. Investment in A-share listed companies by foreign investors is also subject to industry policy regarding foreign investments, and shall acquire project approval and approval from the competent commerce departments.

10.2.2 Requirements on Strategic Investments

Strategic investments shall meet the following requirements: i)by means of contract transfer, regularly issue new shares by A-share listed companies or otherwise prescribed by the relevant national laws and regulations; ii) Investment may be conducted in stages, with the proportion of shares obtained after the initial investment being no less than 10% of the shares issued by the company, unless special provisions for certain industries or approval by the competent authorities provides otherwise; iii)A-shares obtained by listed companies shall not be transferred within three (3) years.

10.2.3 Qualified Strategic Investors

The strategic investor shall meet the following requirements: i) foreign legal person or other organization established and operated lawfully, with steady finance, sound credit and experienced management; ii)the total amount of abroad real assets shall be no less than USD 100 million or the total amount of real asset under supervision shall be no less than USD 500 million. In addition, the total amount possessed by its parent company shall be no less than USD 100 million or the total amount of real asset under supervision shall be no less than USD 500 million; iii) good governance structure, sound inner control systems, and standardized operations; iv) having received no penalties from abroad supervision organs within the last three years (including its parent company).

10.2.4 Supervisory Government Department

10.2.4.1 the Ministry of Commerce

In accordance with the *Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies*, strategic investment in listed companies by foreign investors shall be subject to the approval from the Ministry of Commerce ("MOFCOM"). MOFCOM shall give tentative approval within 30 days upon receipt

[16] The Interim Measures were jointly promulgated on June 30, 2007 by the State-owned Assets Supervision and Administration Commission of the State Council and the China Securities Regulatory Commission and implemented as of July 1st, 2007.

[17] The Opinions were promulgated and implemented on June 16, 2006 by the State-owned Assets Supervision and Administration Commission of the State Council.

of all the documents, and the period of validity for the tentative approval shall be 180 days.

The foreign investors shall, within 15 days after the settlement of the exchange, begin the strategic investment and, within 180 days after receiving the tentative approval from MOFCOM, complete the strategic investment[18]. Upon the completion of the strategic investment, the listed company shall, within 10 days, go to MOFCOM to obtain the approval certificate of foreign invested enterprises. MOFCOM shall, within five (5) days after the receipt of all the required documents, promulgate the approval certificate for foreign invested enterprises and identify any "foreign-invested joint-stock companies" (A-share acquisition and merger). Where the investor has obtained 25% of one listed company and claims shareholding of no less than 25% continuously for 10 years, MOFCOM shall make note of the "foreign-invested joint-stock company (no less than 25% of A-share acquisition and merger)" in the approval certificate issued for the foreign-invested company.

10.2.4.2 CSRC (merger and acquisition of shares in listed companies of more than 30%)

Tender offers

On the basis of the *Administrative Measures for the Takeover of Listed Companies*, when the shares held by a purchaser in a listed company, through a securities trading on a stock exchange or an indirect takeover, exceed 30% of all the shares issued by the listed company, for the part in excess of 30%, the takeover shall be made by general or partial offer, for which a general offer or a partial offer shall be made.

When the takeover is conducted by an offer, the strategic investors shall deliver a tender offer report to the CSRC. If the CSRC, within 15 days after the receipt of the tender offer report, raises no objections, the investor shall announce the tender offer report and perform all the obligations thereof.

Exemptions from mandatory tender offers

Under any of the following circumstances, the purchaser may apply to the CSRC for exemption from making an application for increasing the holding of shares by a tender offer:

(a) where the purchaser and the transferor can prove that the transfer will not result in any change of the actual controller of the listed company;

(b) where the listed company is in serious financial difficulties, the reorganization scheme for saving the company proposed by the purchaser has been approved by the general shareholders' meeting of the company, and the purchaser has warranted to not transfer its equities in the company within 3 years;

(c) where upon approval by the non-affiliated shareholders at the general shareholders' meeting of the listed company, the acquisition of new shares issued by the listed company by the purchaser makes the total shares held by the

[18] This procedure shall also include completing the CSRC approval procedures (if necessary) as well as registering transfer procedures in securities registration and clearing institutions.

purchaser in the listed company exceed 30% of the shares issued by the company, the purchaser shall warrant not to transfer the new shares issued to it this time in three (3) years, and the general shareholders' meeting shall agree on the exemption.

The CSRC shall, within 20 days after the acceptance of the exemption application, determine whether to grant exemption with respect to the specific issue applied for by the purchaser. Where exemption is granted, the purchaser shall complete the increase of holding of shares directly instead of making a tender offer.

Where the shares to be purchased by strategic investors in the listed company is in excess of 5% and no more than 30%, the transaction will not be subject to CSRC approval.

10.2.4.3 Foreign Exchange Administration

The strategic investor, within 15 days after the receipt of the tentative approval by MOFCOM, shall open its foreign exchange account under the relevant provisions on foreign capital mergers and acquisitions. The foreign exchange capital for strategic investment received from overseas, shall, in accordance with the relevant provisions of foreign exchange administration, be put into a special foreign exchange account (acquisition type) for foreign investors. This account shall be situated in the local foreign exchange administration authority where the registration office for the listed companies locates and settlement of exchange of capital in the account, and its cancellation procedures shall be conducted accordingly.

The listed company shall, within 30 days after the issuance of the business operation license for foreign-invested companies, handle related procedures regarding the foreign exchange registration certificate with the foreign exchange administration. The administrative authorities of foreign exchange shall note in the foreign exchange registration certificate any "foreign-invested joint limited companies (A-share mergers and acquisitions)" or "foreign-invested joint limited companies (no less than 25% of A-share mergers and acquisitions)". Based on whether the strategic purchaser has acquired no less than 25% of the shares issued by the single listed company and warranted to continue holding no less than 25% of the shares of the listed company herein for 10 years.

10.2.4.4 The state-owned asset supervision and administration department (where state-owned assets are involved in the listed company)

When state-owned assets are involved in the listed company to be invested in, after the internal decision-making procedure for the general manager's office meeting or board of directors to pass the relevant resolutions goes through, the state-owned shareholders shall report on the transaction in writing to the state-owned asset supervision and administration authorities at the provincial level in accordance with relevant procedures. After receipt of tentative approval from the state-owned asset supervision and administration authorities at the provincial level, the state-owned shareholder shall notify the listed company to disclose the relevant information on the transfer and collection of transferees. The transferee with purchase intentions shall file an application by the announced deadline, and the state-owned shareholder is

authorized to make a preferential selection as the final transferee after analysis[19], and execute the share transfer agreement[20].

Following the execution of the share transfer agreement, where local state-owned enterprises transfer the shares in listed companies and no longer hold the controlling stake in the listed company, the state-owned asset supervision and administration authorities at the provincial level shall report to the people's government at the provincial level for approval and then to the State-owned Asset Supervision and Administration Commission of the State Council for examination and approval.

10.2.5 Procedures for Strategic Investment

10.2.5.1 Strategic investment through private offering of new shares

Strategic investment conducted through private offering of new shares by A-share listed companies shall be undertaken in accordance with the following procedures:

(a) Resolution on the private offering of new shares by the board of directors of the listed company to investors and on the revised draft of the articles of association;

(b) Resolution on the private offering of new shares by the corporate shareholders of the listed company to investors and on the revised draft of the articles of association;

(c) Private offering contract signed by the listed company and investor(s);

(d) Application documents submitted by the listed company to MOFCOM for approval;

(e) After the receipt of the approval from MOFCOM, private offering application documents submitted to the CSRC and subsequently obtain its approval;

(f) After the completion of the private offering, the listed company shall obtain the approval certificate of foreign invested enterprises by MOFCOM, and thereby register the alteration with the administrative authorities of industry and commerce.

10.2.5.2 Strategic Investment through Contract Transfer

Strategic investment by means of a contract transfer shall follow the same steps as mentioned in items a), b) and f) with strategic investment through the private offering of new shares, but steps c) through e) are as follows:

(a) Stock transfer contract signed by the transferor and the investor;

(b) Related application documents submitted by the investor to MOFCOM for approval;

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[19] At the same time, a financial advisor shall be engaged in conducting due diligence with the potential transferees.

[20] Before the execution of the share transfer agreement, the board of directors and shareholder's meeting in the listed company shall also conduct internal decision-making procedures.

(c) After having received approval, the investor shall handle the confirmation procedures of the stock transfer in the concerned stock exchange, conduct registration transfer procedures in securities registration and clearing institutions, and submit them to the CSRC for filling.

10.2.6 Investment in A-share Listed Companies by Hong Kong, Macau and Taiwan Residents

The *Circular on Revising the Administration Rules on the Securities Account of the China Securities Depository and Clearing Corporation Limited (2013)* (the "**Administration Rules on Securities Account**") was promulgated on March 9, 2013 and implemented on April 1, 2013 by the China Securities Depository and Clearing Corporation Limited, and was approved by the CSRC. The Administration Rules on Securities Account removes the limit for Hong Kong, Macau and Taiwan residents working and living in mainland China to open A-share accounts. In addition, as of April 1, 2013, Hong Kong, Macau and Taiwan residents working and living in mainland China are authorized to open A-share accounts and invest in A-share listed companies accordingly.

According to the Administration Rules on Securities Account and the *Guidelines of the China Securities Depository* and *Clearing Corporation Limited Shanghai Branch on Securities Account Management* promulgated on March 14. 2013, the required documents for Hong Kong, Macau and Taiwan residents to open an account in agencies are as follows:

(1) An application form for the registration of securities account for individuals;

(2) A Mainland travel permit for Hong Kong and Macau residents or a Mainland travel permit for Taiwan residents and the photocopies;

(3) The resident identity card for Hong Kong, Macau or Taiwan residents and the photocopies;

(4) Certificate of registration for temporary stay issued by the local police station of the place of lodging and the photocopies;

(5) When the procedure is handled by a transactor, an authenticated authorization contract, the resident identity documents and the photocopies shall be delivered.

The investment scope and eligibility management for an A-share account of Hong Kong, Macau or Taiwan residents are the same as that of domestic individual investors. The securities account shall become effective on the first trading day after its opening and shall not start any transactions before handling the designated transaction.

The authority to open A-share accounts and invest is limited to Hong Kong, Macau or Taiwan residents working and living in mainland China and Hong Kong, Macau or Taiwan residents not working and living in mainland China are not able to open A-share account and invest temporarily.

10.3 Domestic Securities Investment by QFII

A Qualified Foreign Institutional Investor QFII is an overseas fund management institution, an insurance company, a securities company or any other asset management institution. After being approved by the CSRC and obtaining an investment quota from the State Administration of Foreign Exchange ("**SAFE**"), A QFII can trade A-shares on the Shanghai Stock Exchange and Shenzhen Stock Exchange.

10.3.1 Governing Laws

(1) The *Administrative Measures for Domestic Securities Investments by Qualified Foreign Institutional Investor* (the "QFII Measures"), enacted by the CSRC, the People's Bank of China (the "PBOC") and SAFE on 24 August, 2006 and effective as of 1 September, 2006, has set out the conditions and applying procedures for QFIIs.

(2) The *Provisions for the Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors* (Revised in 2012) promulgated and implemented by SAFE on November 7, 2006, has stipulated the investment quotas, opening of foreign exchange accounts and exchanges.

(3) The *Measures for the Pilot Program of Domestic Securities Investment by RMB Qualified Foreign* Institutional *Investors* (Revised in 2013) promulgated and implemented by the CSRC on March 6, 2013, has stipulated the qualifications and approval issues for RMB QFIIs.

(4) The *Circular of the State Administration of Foreign Exchange on Issues Concerning the Pilot Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* was promulgated and implemented by SAFE on March 11, 2013.

10.3.2 Requirements of Qualified Foreign Institutional Investors

10.3.2.1 Brief Introduction on the Requirements of QFIIs

A QFII shall meet the following requirements:

(1) The QFII shall be in sound financial conditions and good credit standing, and satisfy the requirements provided by the CSRC on assets size and other conditions;

(2) All employees satisfy the relevant requirements on professional qualifications provided by the country or region;

(3) The QFII shall have a sound governance structure and perfect internal control system with all business activities being in compliance with the relevant laws and regulations, and has not been imposed with any substantial penalty by the supervision organization over the last three years;

(4) The country or region where the QFII is located has a well-established legal and regulatory system. In addition, its securities regulatory authority has signed the regulatory cooperation memorandum of understanding with the CSRC and is

maintaining a relationship of efficient regulation and cooperation.

According to the QFII Measures, in order to encourage medium and long-term investments, the applicant of an institution managing long-term funds such as pension funds, insurance funds, mutual funds and charity funds will receive preferential approval.

10.3.2.2 Asset Management

A QFII shall meet the following requirements with regard to asset management:

- For a fund management institution: it should have conducted asset management business for more than two years and the securities assets under its management in the latest accounting year should not be less than USD 500 million;

- For an insurance company: it should be established for more than two years and the securities assets held in the latest accounting year should not be less than USD 500 million;

- For a securities company: it should have conducted securities business for more than five years, the net assets should not be less than USD 500 million, and the securities assets under its management in the latest accounting year should not be less than USD 5 billion;

- For a commercial bank: it should be in operation in the banking business for more than 10 years, with the tier one capital not less than USD 300 million, and the securities assets under its management should not be less than USD 5 billion in the most recent accounting year;

- For other institutional investors (such as pension funds, charity funds, endowment funds, trust companies, government investment management companies, etc.): they should be established for more than two years, and the securities assets under its management or held by it in the latest accounting year should not be less than USD 500 million.

10.3.3 Supervisory Government Department

CSRC

The CSRC has the authority to review applications and approve qualification as a QFII.

To apply for qualification as a QFII, the applicant may submit the relevant documents to the CSRC through its custodian bank (a domestic commercial bank).

The CSRC shall determine whether to grant approval or not after having examined the application materials and consulted with SAFE. The determination should be made within 20 working days from the date of its receipt of the full set of application documents. If it determines to grant the approval, the CSRC shall issue a permit for engaging in securities investments business, or give a written notice to the applicant.

SAFE

SAFE is in charge of approving investment quotas, opening a foreign exchange accounts or a RMB special accounts and remittance of funds to or from China.

To apply for qualification as a QFII, the applicant shall submit an application to SAFE through their custodian banks for an investment quota within 1 year after having obtained the permit for engaging in securities investments business.

10.3.4 Investment Quota

Investment Quota

The investment quota applied for by a QFII on any one occasion shall be no less than the equivalent of USD 50 million and the cumulative value of all investment quotas shall not exceed the equivalent of USD 1 billion.

SAFE may adjust such limits in accordance with economic and financial conditions, supply and demand in the foreign exchange market and the international balance of payments.

The investment quota limit of sovereign wealth funds, central banks or monetary authorities shall exceed the equivalent of USD 1 billion.

The QFII shall not apply for an increase in its investment quota within one year after the investment quota is approved.

Investment Quota Adjustment

A QFII shall remit the investment principal to China within 6 months after each investment quota is approved. No remittance may be made beyond this period unless approval has been granted. In the event that the investment principal is not remitted in full within the specified period but exceeds the equivalent of USD 20 million, the amount actually remitted shall be deemed to be the investment amount.

Lock-up Period of Investment Principal[21]

The investment principal lock-up period for QFIIs that are pension funds, insurance funds, mutual funds, charitable funds, donation funds, or government and currency administrative departments, as well as for open-ended Chinese funds[22] sponsored and established by QFIIs, shall be three months.

Other QFIIs shall be subject to an investment principal lock-up period of one year.

The investment principal lock-up period for a QFII shall commence from the date on which the principal has been remitted in full. Where the principal has not been remitted in full within the specified period, it shall commence within six months after the investment quota is approved.

10.3.5 Custody, Registration and Clearing

[21] "Lock-up period for investment principal" refers to the period during which the QFII is prohibited from remitting the investment principal out of China.

[22] "Open-ended Chinese funds" refer to open-ended securities investment funds sponsored and established overseas through public offerings, which invest no less than 70% of their funds in China.

A QFII shall appoint a domestic commercial bank as its custodian bank to manage its assets. Each QFII can only entrust one custodian bank, and any QFII may dismiss and replace its custodian bank. A QFII may apply to a securities registration and clearing agency for opening securities accounts, which may be either a real-name account or an account under the name of a nominee. A QFII shall entrust an institution that has obtained qualification as a participant of the securities registration and clearing agency to make the capital clearing.

10.3.6 Investment of a QFII

Investment Field

A QFII can invest in RMB financial instruments approved by the CSRC within the approved investment quota. A QFII can entrust investments management institutions such as the securities company established in China to conduct the management of securities investments within the territory of China.

Information Disclosure

A QFII shall compute the consolidated amount of the domestically listed shares and the overseas listed shares by the same company for fulfilling the duty of information disclosure.

10.3.7 Domestic Securities Investment by RMB Qualified Foreign Institutional Investors

Different from QFII, a RQFII is a foreign legal entity that conducts domestic securities investment through RMB funds from foreign countries. Besides being supervised by the CRSC and SAFE, a RQFII is also supervised by the PBOC on opening RMB bank accounts within China. For investment in China by RQFIIs, a domestic commercial bank with QFII custodian qualifications shall also be entrusted to conduct asset management, and a domestic securities company shall also be entrusted to sell and purchase securities as an agency.

Requirements of RQFIIs

An RQFII should meet the following requirements: i)Strong financial condition, good credit standing, with registration place and business qualifications meeting the requirements of the CSRC; ii) Effective corporate governance and internal controls, with practitioners meeting the relevant professional qualification requirements of the residential country or region; iii) Compliant manner with its business, and has no serious penalties meted out by the local regulator in the latest three years or since its establishment.

Supervisory Government Department

The CSRC is in charge of supervising and administrating domestic securities investments and SAFE is responsible for supervision and administration of investment quota and capital remittance, which are the same with regard to QFIIs. However, the decision-making periods for the CSRC and SAFE are 60 days, which are longer than those for QFIIs.

In addition, the PBOC manages the domestic RMB bank accounts opened by RQFIIs, and works with SAFE to supervise and manage the capital remittance. RQFIIs shall report RMB capital remittance issues to the cross-border RMB receipts and payments information management system of the PBOC through the domestic custodian.

Investment Field

The investment field of an RQFII includes the investment of RMB financial instruments within the approved investment quota, which is the same with QFII. This investment field also includes investing in interbank bond markets under the relevant regulations by the PBOC.

10.4 Investments in B-share Listed Companies by Foreign Investors

10.4.1 Governing Laws

(1) The *Provisions of the State Council on Foreign Currency Stocks Listed in the Domestic Stock Markets by Limited Companies* (the "**Provisions on B-share**") promulgated and implemented by the State Council on November 25, 1995, has stipulated the issuance and trade of foreign currency stocks listed in the domestic stock markets (hereafter the "**B-shares**") in principal.

(2) The *Circular on Issues* Concerning *Investments by Individual Domestic Residents in Foreign Currency Stocks Listed in the Domestic Stock Markets*, promulgated and implemented by the CSRC and SAFE on February 21, 2001, has stipulated the income and expenditure range of non-residential B-share capital accounts.

(3) The *Circular of the Shenzhen Securities Exchange on Measures for Opening Securities Accounts of* Foreign *Currency Stocks Listed in the Domestic Stock Markets (B Share)*, promulgated and implemented by the Shenzhen Securities Exchange, has stipulated the required documents for foreign investors to open B-share securities accounts.

10.4.2 Qualified Investors

In accordance with *the Provisions on B-shares*, B-share investors are limited to the following:

(1) Foreign individuals, legal persons and other organizations;

(2) Individuals, legal persons and other organizations in Hong Kong, Macau and Taiwan;

(3) Chinese citizens residing in a foreign country;

(4) Other investors to Foreign Currency Stocks Listed in the Domestic Stock Markets stipulated by CSRC.

In light of the relevant provisions in certain laws and regulations, foreign individuals, legal persons and other organizations are authorized to open B-share accounts to subscribe, purchase and sell B-shares with foreign currency.

10.4.3 Account Opening

Based on the relevant provisions in certain laws and regulations, the following documents shall be delivered to a security exchange qualified to conduct B-share business on the Shenzhen Stock Exchange or agencies entrusted by the Shenzhen Stock Exchange, for foreign investors to open a B-share securities account: i)identity cards for foreign residents, passports or other valid identification documents and the photocopies shall be provided for foreign individuals to open a B-share securities account; ii) registration certificates of business incorporation, power of attorney, identification certificates of the directors and their photocopies as well as the identification certificates of the agent and their photocopies shall be provided for foreign institutional investors to open a B-share securities account.

10.4.4 Capital

According to the relevant laws and regulations, the profits of the B share capital accounts for foreign investors shall include foreign currency being transferred from abroad, foreign currency legally deposited with domestic commercial banks and profits from the B-share trading. The cost thereof shall include the cost of the foreign currency being transferred abroad or the foreign currency being deposited into their legal accounts within domestic commercial banks and the foreign currency spent for B share trading. Foreign investors shall not withdraw foreign currency cash from their B share accounts.

10.4.5 Tax

In accordance with the *Letter by the State Administration of Taxation Foreign-related Tax Management Bureau on B-share Taxation* (promulgated and implemented on November 4, 1996), for profits in B-share transfers and dividends therefrom acquired by foreign enterprises or individuals, the *Circular of the State Administration of Taxation on Issues Concerning the Taxation of Profits from the Transfer of Stocks (Equity) and Dividend Income of Foreign-invested Enterprises, Foreign Enterprises and Foreign Individuals* (Guo Shui Fa [1993]No. 045) is still binding and the above-mentioned profits are temporarily exempt from withholding income tax or individual income tax.

CHAPTER IV LABOR

1 General Introduction

1.1 Employment Legislation in China

Currently, a large number of laws and regulations concerning employment matters at the national and local level are promulgated by the National People's Congress and its Standing Committee, the State Council and in-charge nationwide and local labor and security departments, which constitute the labor law system in China.

Before 2007, the *Labor Law of the People's Republic of China* (promulgated on July 5, 1994 and effective as of January 1, 1995, the "**PRC Labor Law**") played a significant role in regulating employment matters. In recent years, as labor legislation process has sped up, a number of laws and regulations of general applicability have been promulgated, such as the *Labor Contract Law of the People's Republic of China* (promulgated in June, 2007 and effective as of January 1, 2008, the "**PRC Labor Contract Law**"), the *Amendment to Labor Contract Law of the People's Republic of China* (promulgated in December, 2012 and effective as of July 1, 2013, the "**Amendment to PRC Labor Contract Law**"), the *Labor Dispute Mediation and Arbitration Law of the People's Republic of China* (promulgated in December, 2007 and effective as of May 1, 2008, the "**PRC Labor Dispute Mediation and Arbitration Law**"), the *Social Insurance Law of the People's Republic of China*(promulgated in October, 2010 and effective as of July 1, 2011, the "**PRC Social Insurance Law**") and their supporting regulations, such as the *Regulations on Work-related Injury Insurance* (amended in December, 2010 and effective as of January 1, 2011) have been subsequently promulgated.

The PRC labor law system mainly *consists* of the following sub-sectors: (1) labor contract system; (2) labor standard system (such as rules with respect to working time, salaries and safety in working place; (3) social insurance system; (4) labor dispute resolution system; and (5) labor security supervision system.

1.2 Main Regulatory Governmental Authorities

In China, the labor and *social* security departments are the competent authorities responsible for the labor administrative affairs, which include the following: various labor administrative approvals and registrations, the formulation and implementation of labor policies, the registration, collection, verification and other affairs of social insurance and housing fund, as well as the supervision and inspection of violations of labor laws and regulations.

2 Forms of Employment Adopted by Foreign-Invested Enterprises and Representative Offices

Foreign investors mainly form Sino-foreign equity joint venture enterprises, Sino-foreign cooperative joint venture enterprises and wholly-foreign-owned enterprises (each referred to as a "**FIE**" and collectively referred to as "**FIEs**") as

investment vehicles to operate their businesses in China. However, few foreign investors form representative offices in China for the purposes of business liaison, product introduction, market research, technology exchange, and other indirect business activities. Under PRC law, FIEs are considered competent employers, and are thus entitled to hire employees on their own in China. In contrast, representative offices are not competent employers and are not allowed to hire employees directly in China. Unless otherwise specified, "employer(s)" shall refer to FIE(s) hereunder.

2.1 Forms of Employment Adopted by Foreign-Invested Enterprises

Enterprises established under PRC law, including FIEs, shall directly hire full-time employees on their own as the main form of employment, use labor dispatch and hire part-time employees as a supplementary workforce.

(1) Hiring Full-time Employees

If FIEs directly hire full-time employees by themselves, they shall conclude labor contracts with full-time employees following the "labor contract rules" (please refer to "Labor Contract Rules" under Section 7.3).

(2) Labor Dispatch

Under labor dispatch, there are three parties: labor dispatch units, dispatched employees and receiving units. Labor dispatch units, acting as employers under the *PRC Labor Contract Law*, shall conclude labor contracts with dispatched employees, and shall conclude labor dispatch agreements with receiving unites. Dispatched employees shall work under the instructions of receiving units. However, there are no legal labor relationships between dispatched employees and receiving units.

China's labor dispatch system can effectively reduce the cost of recruitment, training and management of the receiving units. It can also lower the risk of disputes arising between the receiving units and the dispatched employees. However, in the event that labor disputes between dispatched employees and dispatched units arise, it is likely that the receiving units will get involved and their tripartite relationships will make such labor disputes more complicated and difficult to settle.

Employees are dispatched generally for temporary, auxiliary or substitute jobs. A "Temporary Job Position" refers to a position with a term no longer than six (6) months. An "Auxiliary Job Position" refers to a non-primary business position aimed at providing services to the primary business position. A "Substitute Job Position" refers to a position where an employee of the receiving unit whom is not able to work for a given period due to full-time study, vocation or other reasons can be substituted by another worker. A receiving unit shall strictly control the number of dispatched employees, and such number may not exceed a certain percentage of its total number of workers. Furthermore, receiving units shall ensure that dispatched employees enjoy the right of equal pay for equal work as the employees directly hired on their own do.

(3) Hire Part-time Employees

FIEs may hire part-time employees by themselves. Employers and part-time employees may conclude oral agreements. Part-time employees may conclude labor contracts with one (1) or more employers. However, the labor contracts concluded at a subsequent date may not affect the performance of the labor contracts concluded at an earlier date. No probationary period may be agreed on by the employers and part-time employees, and either party may inform the other party to terminate the labor relationship any time. In the event of the termination of labor services, employers do not have to pay economic compensation to part-time employees.

According to the *PRC Labor Contract Law*, part-time employees are paid on an hourly basis. Part-time employees normally work for no more than four (4) hours a day on average for one (1) employer, and work no more than twenty-four (24) hours in total per week. Part-time employees' hourly wages should not be lower than the minimum hourly wage as stipulated by the local governments, and the settlement interval for payment of part-time labor services shall not exceed fifteen (15) days.

2.2 Form of Employment Adopted by Representative Offices

According to the relevant laws and regulations, representative offices are not certified employers. A representative office shall not recruit employees within China by and for itself unless it entrusts a qualified foreign affairs services agent to recruit employees.

3 Labor Contract Rules

3.1 Types of Labor Contract

According to the *PRC Labor Contract Law*, labor contracts can be divided into the following: fixed-term labor contracts specifying the specific termination date of the contracts, open-ended labor contracts without a specific termination date of the contracts and labor contracts with terms expiring upon the completion of a particular work or task.

3.2 Clauses of Labor Contract

A labor contract shall contain the following essential terms and conditions: the basic information of the employer and the employee, term of the labor contract, job description and working place, working hours and rest time, labor remuneration, social insurance, labor protection, working conditions and occupational hazard protection and other matters that should be included in labor contracts as stipulated by the relevant laws and regulations. Employers and employees may specify other matters in the labor contracts, such as the probation period clause (please refer below), confidentiality clause (please refer below), non-competition clause (please refer below), supplementary insurance and welfare benefits, etc., provided that such clauses do not violate the mandatory provisions of the relevant laws and regulations.

(1) Probation Period

The probation period shall be decided in accordance with the term of labor contracts. If the term of a labor contract is more than three (3) months but less than one (1) year,

the probation period may not exceed one (1) month; if the term is more than one (1) year but less than three (3) years, the probation period may not exceed two (2) months; and if the term is fixed for three (3) or more years or is open-ended, the probation period may not exceed six (6) months. Where the term of a labor contract depends on the completion of a task or is shorter than three (3) months, or it is about part-time labor service, no probationary period may be agreed on in a labor contract.

(2) Confidentiality Clause

According to Article 23 of the *PRC* Labor *Contract Law*, employers and employees may agree on confidentiality clauses in the labor contract. In the event that employees violate the confidentiality clauses and divulge the employers' commercial secrets without authorization, which cause economic losses to employers, such employees shall be held liable for the employers' losses.

(3) Non-Competition Clause

According to Article 24 of the *PRC Labor Contract Law*, employers may agree on non-competition clauses with senior management personnel, senior technical personnel and other personnel obligated to keep secrets, and the scope, geographic region and period of non-competition shall be agreed on. The period of non-competition shall not exceed two (2) years after the dissolution or termination of a labor contract. During the period of non-competition, the aforesaid employees shall not work for other employers that produce or operate the same type of products or engage in the same type of business as those of the original employers, or commence their own business in producing or operating the same type of products or engaging in the same type of business. Employees who breach the stipulated non-competition obligation shall be liable to pay liquidated damages to their employers, and employers have the right to require the employees to continue to perform the non-competition obligation. If an employer fails to pay compensation to employees for a period of three (3) months due to its own reason, such employees have the right to rescind the non-competition clause.

During the period of non-competition, employers shall pay non-competition compensation to their employees. The amount of non-competition compensation is mainly determined by the mutual agreements between the employers and their employees. If there is no such agreement, according to the *Interpretation of the Supreme People's Court on Certain Issues Concerning the Application of Law in Trying Cases Involving Labor Disputes (IV)*, employees have the right to claim a monthly compensation amounting to 30% of their monthly salary for the twelve (12) months prior to the dissolution or termination of the labor contract, or equal to the local minimum salary standard of the local place of performing the labor contract, whichever one is higher.

3.3 Conclusion of Labor Contract

According to the *PRC Labor Contract Law*, a written labor contract shall be concluded in order to establish a labor relationship. If a labor relationship has been established, but no labor contract has been concluded at the same time, a written labor contract shall be concluded within one (1) month from the date of employment. Where an employer fails to conclude a written labor contract with an employee who

has worked for the employer for more than one (1) month but less than one (1) year from the day on which he/she was hired, the employer shall pay twice of the salary to the employee each month. Where an employer fails to conclude a written labor contract with an employee after the employee has worked for the employer for one (1) full year from the day when he/she was hired, the employer shall be deemed to have concluded a open-ended labor contract with the employee on the day when the employee's service period reaches a full year. However, within one (1) month from the date of hiring, if the employee refuses to conclude a written labor contract with the employer after a written notice is given by the employer, the employer shall terminate the labor relationships in writing and pay a salary to the employee based on his/her actual working time, and no economic compensation shall be paid under such circumstance.

Where no labor contract has been concluded, and the parties have excised their rights and performed their duties acting like employer and employee, a defacto labor relationship is established. For example, if an employer and an employee fail to conclude a labor contract within one (1) month from the date of employment, or when a labor contract has expired without extension and the employee still works for the employer and the employer still pays wages to the employee, defacto labor relationships may exist. The parties to defacto labor relationships are treated as employers and employees and shall be regulated under the PRC labor law system.

3.4 Modification of Labor Contract

According to the *PRC Labor Law* and the *PRC Labor Contract Law*, an employer and its employees may modify their labor contracts upon mutual agreement through amicable consultation. The modification of a labor contract shall be made in writing.

3.5 Dissolution of Labor Contract

(1) A labor contract may be dissolved upon mutual agreement between the employer and the employee.

(2) An employee may have his/her labor contract dissolved by giving a written notice to his/her employer thirty (30) days in advance or three (3) days in advance if he/she is still on probation. An employee shall enjoy the right to choose jobs freely, and also have the right to terminate his/her labor contract without the prior consent of his/her employer, provided that he/she has given certain prior notices to his/her employer in accordance with the relevant laws and regulations.

(3) An employee may have his/her labor contract dissolved at any time by notifying his/her employer if the employer is found to be under any of the following circumstances:

(a) the employer fails to provide labor protection or working conditions according to the labor contract;

(b) the employer fails to pay the labor remuneration on time and in full according to the labor contract;

(c) the employer fails to pay social insurance premiums for the employee according relevant laws or regulations;

(d) the rules and regulations of the employer are in violation of the relevant laws and regulations, thereby impairing the employee's rights and interests;

(e) the employer makes the employee enter into or modify the labor contract against the employee's true will by means of deceit, coercion or taking advantage of the employee's precarious position;

(f) the employer forces the employee to work by resorting to violence, intimidation or the illegal restriction of personal freedoms; or the employer gives instructions in violation of the relevant laws and regulations or gives peremptory orders to the employee to perform hazardous operations, which endanger the employee's personal safety; or

(g) any other circumstances as stipulated by the relevant laws or regulations.

(4) the employer may have the labor contract dissolved at any time without paying any economic compensation to the employee, and if necessary, request the employee to leave the employer's workplace immediately if the employee is found to be under any of the following circumstances:

(a) the employee has been proved unable to meet the hiring requirements during the probation period;

(b) the employee seriously violates the labor disciplines and/or the rules and/or regulations of the employer;

(c) the employee causes significant damages to the employer due to serious dereliction of duty or engagement in malpractices for personal gain;

(d) the employee concurrently establishes a labor relationship with other employer(s), which seriously affects the accomplishment of the tasks assigned by the employer, or the employee refuses to rectify after the employer brings the matter to employee's attention;

(e) the employee makes the employer enter into or modify the labor contract against the employer's true will by means of deceit, coercion or taking advantage of the employer's precarious position; or

(f) criminal liability is pursued against the employee in accordance with the relevant laws and regulations.

(5) In any of the following circumstances, the employer may have the labor contract dissolved, if the employer notifies the employee in writing of its intention thirty (30) days in advance or after paying the employee an extra month's salary:

(a) the employee is unable to resume his/her original work or any other work arranged by the employer on the expiration of the specified period of medical treatment for illness or for injury incurred due to non-work-related reasons;

(b) the employee is incompetent for the post and remains incompetent after receiving training or being assigned to another post; or

(c) the objective conditions taken as the basis for conclusion of the labor contract have greatly changed, so that the labor contract cannot be performed and, after consultation between the employer and the employee, no agreement is reached on modification of the contents of the labor contract.

(6) The employer may not dissolve the labor contract under any of the following circumstances:

(a) being engaged in operations exposed to occupational disease hazards, the employee is not given pre-departure occupational health examinations; or being suspected of an occupational disease, the employee is in the process of being diagnosed or is under medical observation;

(b) having contracted an occupational disease or being injured at work during the period working for the employer, the employee is confirmed to have totally or partially lost the ability to work;

(c) the employee is in the prescribed period of medical treatment for illness, or for injury incurred due to non-work-related reasons;

(d) the employee is during the pregnant, puerperal or breast-feeding stage;

(e) the employee has been working for the employee continuously for fifteen (15) years in full and is less than five (5) years away from the statutory retirement age; or

(f) any other circumstances as stipulated by the relevant laws and regulations.

3.6 Termination of Labor Contract

According to the *PRC Labor Contract Law*, a labor contract will be terminated under any of the following circumstances: (i) the term of the labor contract expires; (ii) the employee begins to enjoy the benefits of the basic pension insurance in accordance with the relevant laws and regulations; (iii) the employee dies, or is declared dead or missing by the courts; (iv) the employer is declared bankrupt (v) the employer's business license is revoked, and the business is ordered to close or is closed down, or the employer decides to dissolve itself on an earlier date; or (iv) any other circumstances stipulated by the relevant laws and regulations.

3.7 Economic Compensation and Damages

(1) Circumstances where an employer shall make economic compensation to an employee and the standard of the economic compensation

According to the Article 46 of the *PRC Labor Contract Law*, the economic compensation shall be paid when a labor contract is dissolved provided that there is no fault made by employee.

If a labor contract is dissolved under any of the following circumstances, an employer shall pay economic compensation to its employee(s):

(a) the employer proposes to dissolve the labor contract and the labor contract is dissolved upon mutual agreement between the employer and the employee;

(b) the employer fails to provide labor protection or working conditions as agreed in the labor contract;

(c) the employer fails to pay remunerations on time and in full according to the labor contract;

(d) the employer fails to pay social insurance premiums for the employee;

(e) the rules and regulations of the employer are in violation of the relevant laws and regulations, thereby impairing the employee's rights and interests;

(f) the employer makes the employee enter into or modify the labor contract against the employee's true will by means of deceit, coercion or taking advantage of the employee's precarious position;

(g) the employer exempts itself from the statutory responsibility or excludes the rights of the employee in the labor contract;

(h) the employer violates the mandatory provisions of the relevant laws and regulations;

(i) the employer forces the employee to work by resorting to violence, intimidation or the illegal restriction of personal freedoms;

(j) the employer gives instructions in violation of the relevant PRC laws and regulations, or gives peremptory orders to the employee to perform hazardous operations, which endanger the employee's personal safety;

(k) the employee is unable to resume his/her original work or any other work arranged by the employer upon the expiration of the specified period of medical treatment for illness or for injury incurred due to non-work-related reasons;

(l) the employee is incompetent for the post and remains incompetent after receiving training or being assigned to another post; or

(m) the objective conditions taken as the basis for the conclusion of the labor contract have greatly changed, so that the labor contract cannot be performed and, after consultation between the employer and the employee, no agreement is reached on the modification of the contents of the labor contract.

If a labor contract is dissolved under any of the following circumstances, an employer shall not pay economic compensation to its employee(s):

(a) the employee has been proved unable to meet the hiring requirements during the probation period;

(b) the employee seriously violates the employer's rules and regulations;

(c) the employee causes significant damages to the employer due to serious dereliction of duty or engagement in malpractices for personal gain;

(d) the employee concurrently establishes a labor relationship with other employer(s), which seriously affects the accomplishment of the tasks of the employee, or the employee refuses to rectify after the employer brings the matter to the employee's attention;

(e) the employee makes the employer enter into or modify the labor contract against the employer's true will by means of deceit, coercion or taking advantage of the employer's precarious position; or

(f) criminal liability is pursued against the employee in accordance with the relevant laws and regulations.

The economic compensation shall be calculated based on the years of service of the employee, and one (1) month's salary shall be made for each year of service. If the period of service is more than six (6) months but less than a year, it shall be deemed as a completed year of service and if the period of service is less than six (6) months, the employer shall pay half a month's salary to the employee as economic compensation. If the monthly salary of an employee is three (3) times or above the average monthly salary of the employees of the region for the previous year[23], the rate for his/her economic compensation payable shall be three (3) times the average monthly salary of the employees, and the number of years to calculate the economic compensation shall not exceed twelve (12) years. The monthly salary of the employee shall mean the average salary of the employee over twelve (12) months before the dissolution or termination of the labor contract, including the hourly wages or piecework wages and other monetary income such as bonuses, allowances and subsidies. If the average salaries of the employee in the twelve (12) months before the labor contract is dissolved or terminated are below the local minimum salaries level, the economic compensation shall be calculated based on the local minimum salaries. If the employee's service is less than twelve (12) months, the average salaries shall be calculated based on the actual working time.

(2) Compensation paid when labor contracts are dissolved or terminated by employers in violation of laws and regulations

Where an employer dissolves or terminates a labor contract in violation of the provisions of the *PRC Labor Contract Law*, and the employee requests the performance of the labor contract, the employer shall continue to perform the labor contract. Where the employee does not request the performance of the labor contract or the labor contract cannot be performed, the employer shall pay twice of the economic compensation that is calculated by the methods addressed above.

[23] The average monthly salary of the employees of a specific region for the previous year shall be published by the people's government of the municipality directly under the Central Government or by that of the city divided into districts.

4 Social Insurance and Housing Funds

In accordance with the PRC Social Insurance Law and other relevant laws and regulations, China has established a social insurance system including basic pension insurance, basic medical insurance, work-related injury insurance, unemployment insurance and maternity insurance. An employer shall apply for social insurance registration with the local social insurance agency and pay the social insurance for its employees in accordance with the rates provided under relevant regulations, and shall withhold the social insurance that should be assumed by the employees. The authorities in charge of social insurance may request an employer's compliance and impose sanctions if such employer fails to pay and withhold social insurance in a timely manner.

Under the Regulations on the Administration of Housing Fund effective in 1999 and amended in 2002, employers must register with the applicable housing fund management centers and establish a special housing fund account in an entrusted bank. Both the employers and their employees are required to contribute to the housing fund.

5 Labor Unions and Labor Rules and Regulations of Employers

Chinese employees have the right to establish labor unions to represent them in signing collective labor contracts with the employing company and to supervise the implementation of their employment contracts. All FIEs must contribute to a labor union fund 2% of the total take-home pay of their employees.

An employer shall legally establish and improve its labor rules and regulations, and ensure that employees enjoy their labor rights and perform their labor obligations. Where an employer formulates, amends or decides on rules and systems or important matters that are directly related to the vital interests of the employers(i.e. labor remuneration, working hours, rest time, labor safety and health, insurance benefits, employee training, labor discipline and quota labor management, to ensure the legality of the above actions), it shall solicit opinions and comments from the meeting of employees' representatives or the general meeting of all employees, and all such decisions shall be made known to all employees. The labor union or employees have the right to voice out any inappropriate issues during the implementation of labor rules and regulations, and the employer should consult with the labor union or employees for revision.

In practice, the common methods for the releasing and announcing of labor rules and regulations include: putting the labor rules and regulations on bulletin boards, organizing an internal training of the labor rules and regulations for employees, distributing the labor rules and regulations to employees and requiring employees to confirm the receipt of the labor rules and regulations in writing and study the labor rules and regulations.

6 Settlement of Labor Disputes

If a labor dispute between an employer and an employee arises, the employer and the employee may settle the dispute through consultation on their own or under the auspices of the labor union or a third party. If the parties are unwilling to resort to consultation, such consultation fails, or the settlement agreement is not performed by the parties, such parties may apply to a mediation committee for mediation. If the parties are unwilling to resort to mediation, such mediation fails, or the mediation agreement is not performed by the parties, the parties may apply to a labor dispute arbitration institution for arbitration. If any party is not satisfied with the arbitration award, that party may bring a lawsuit to the people's court. Labor dispute arbitration is a preliminary procedure that precedes lawsuit. Without going through labor dispute arbitration procedures, the parties shall not bring a lawsuit for labor dispute directly to the people's court.

According to the *PRC Labor* Disputes *Mediation and Arbitration Law*, the parties involved shall file for arbitration within one (1) year from the date when the parties are aware or shall become aware of the infringement of their rights.

In respect of the following labor disputes related to small claims or claims that are subject to clear national standards, employers shall not apply for any other arbitrations or litigations in respect of the following disputes: (i) disputes in relation to the claim of labor remunerations, work-related injury medical expenses, economic compensation or damages which do not exceed the local monthly salary standard for an amount of twelve (12) months; or (ii) disputes arising from working hours, rest days and leave days and social insurance in the implementation of state labor standards. However, if employees are dissatisfied with the arbitral awards, they are still entitled to initiate litigations to the competent courts as provided by the *PRC Labor Disputes Mediation and Arbitration Law*.

The involved parties who assert their claims in a labor dispute shall bear the burden of proof. However, according to the relevant laws and regulations, employers are required to provide evidences kept by them in a labor dispute, or they shall have to bear the unfavorable consequences.

7 Special Rules for Hiring Foreign Employees

Generally, to hire foreign employees (including employees from Hong Kong, Macau and Taiwan) to work in mainland China (excluding Hong Kong, Macau and Taiwan), employers shall follow the procedures below: (i) before the potential foreign employees arrive in China, employers shall get approval on the matter related to hiring foreign employees from the departments in-charge of the type of business the employers operate in, and apply for employment permission certificates for foreigners with the local labor department; (ii) the foreigners shall apply for a work visa after the employment permission certificates are issued; (iii) the foreigners shall obtain work permits after they arrive in China; and (iv) the foreigners shall obtain residence permits from the local Public Security Bureau Department after their work permits are issued.

Furthermore, both employers and foreigner employees are obligated to contribute to social insurance in China, and employers shall handle the social insurance registration

for the foreign employees within thirty (30) days upon obtaining the work permit. Where a foreigner enters into an employment contract with an overseas employer and is seconded to work in a branch or representative office registered in China (the "**PRC Accepting Unit**"), the foreigner and the PRC Accepting Units shall be subject to the same aforementioned requirements.

CHAPTER V TAX

1 Introduction to the PRC Tax System

The tax system in China comprises of 18 types of taxes, which can be classified into: (i) income taxes; (ii) turnover taxes; and (iii) other taxes levied on resources, property or behavior and customs duties.

1.1 Income Taxes

1.1.1 Enterprise Income Tax

The new Enterprise Income Tax Law ("**EITL**") and its implementation rules took effect as of January 1, 2008, which integrates the enterprise income tax ("**EIT**") treatments of domestic and foreign enterprises.

Taxpayers

- Resident enterprises: Resident enterprises are defined as enterprises: (i) incorporated in China; or (ii) incorporated outside China with the place of effective management[24] in China. Resident enterprises are taxed on their worldwide income.

- Non-resident enterprises: Non-resident enterprises are enterprises incorporated outside China, whose place of effective management is also situated outside China. Non-resident enterprises are taxed on their China-sourced income.

Tax Rate

The standard tax rate is 25% (reduced from 33% prior to 2008).

A lower EIT rate of 20% is available for "small businesses with low profit", which should be resident enterprises and should fall within either of the following categories:

- Industrial enterprise with annual taxable income not exceeding RMB 300,000; number of employees not exceeding 100 and total assets not exceeding RMB 30,000,000;

- Other enterprises with annual taxable income not exceeding RMB 300,000; number of employees not exceeding 80 and total assets not exceeding RMB 10,000,000.

Tax Incentives

[24] A "Place of effective management" refers to "an establishment that exercises substantial overall management and control over the production and business, personnel, accounting, properties, etc. of an enterprise". However, the application of this definition is subject to different provisions in bilateral tax treaties.

The EITL sets out the following tax incentives.

Categories	Preferential Treatments
High-tech enterprises	• General: ❖ reduced tax rate of 15% • If established in the 5 Special Economic Zones or Pudong on or after January 1, 2008, as of the year on which operating income is derived: ❖ 2-year exemption ❖ 3-year 50% tax reduction (based on the 25% standard tax rate)
Income from technology transfer	• Exemption of EIT on annual income up to RMB 5 million • 50% reduction of EIT for annual income above RMB 5 million
Enterprises in environmental protection, water and energy savings	As of the year on which operating income is derived: • 3-year exemption • 3-year 50% reduction
Enterprises in public infrastructure projects	As of the year on which operating income is derived: • 3-year exemption • 3-year 50% reduction
Enterprises in farming, forestry, animal husbandry and fishery	EIT exemption or 50% reduction depending on the activity
Software production companies	Starting from the first profit-making year: • 2-year exemption • 3-year 50% reduction Key software production companies are eligible to a reduced tax rate of 10%
R&D expenditures	• 150% super deduction; or • Amortization on the basis of 150% of the cost of intangible assets
Venture capital enterprises investing in non-listed hi-tech small and medium enterprises	70% of the invested amounts may be deducted from taxable income after the share holding period reaches 2 years
Investment in equipment for environmental protection, water and energy savings and production safety	Tax credit: 10% of equipment cost
Products made from the comprehensive utilisation of resources	Income reduced by 10%

Withholding Tax

Non-resident enterprises are subject to a withholding enterprise income tax ("**WIT**")

for their China-sourced income, if (i) they do not have a place of business/establishment in China; or (ii) they have a place of business/establishment in China but the China-sourced income is not effectively connected with such place of business/establishment. WIT shall be withheld by the Chinese taxpayer who makes payment to the non-resident enterprise at the time of payment or when the payment becomes due.

WIT is in principle imposed on the total taxable income derived by a non-resident enterprise, and other taxes, such as business tax on royalties and interests, paid on the same income is not deductible from the tax base of WIT.

The standard WIT rate under the EITL is 10%, which could be lowered or exempt by applicable tax treaties.

1.1.2 Individual Income Tax

Chinese individuals as well as expatriates who derive income from China are subject to an Individual Income Tax ("**IIT**").

Individual incomes are divided into 11 categories for IIT purposes, which include salary and wages income, individual service income and various other personal income or remuneration. In the following section, we will focus on employment income that is taxed as salary and wages income.

1.1.2.1 Chinese domiciled individuals

Individuals domiciled in China are liable to pay IIT on their worldwide income.

An individual is deemed to be domiciled in China for tax proposes when she/he usually or habitually resides in China by reason of household registration, family or economic interests.

Tax base

- **Salaries and Wages:** the concept of salaries and wages includes salaries, bonuses, indemnities, allowances and compensation of all types (including reimbursement of taxes) that are derived from an employment relationship.

- **Social Security:** statutory social security contributions are deductible from the taxable income.

- **Standard deduction:** a standard monthly deduction for expenses of RMB 3,500 is currently provided for Chinese taxpayers.

Tax Rates

A progressive IIT rate ranging from 3% to 45% applies to salaries and wages income.

Monthly Taxable Income (RMB) (after standard deduction)	Tax Rate	Quick Deduction
Up to 1,500	3 %	0

Monthly Taxable Income (RMB) (after standard deduction)	Tax Rate	Quick Deduction
More than 1,500 and up to 4,500	10 %	105
More than 4,500 and up to 9,000	20%	555
More than 9,000 and up to 35,000	25%	1,005
More than 35,000 and up to 55,000	30 %	2,755
More than 55,000 and up to 80,000	35 %	5,505
More than 80,000	45 %	13,505

Computation

The normal IIT calculation formula is as follows:

IIT = (monthly income – monthly standard deduction) x tax rate – quick deduction

Tax Payment, Withholding Obligation and Annual Tax Return

IIT shall be paid on a monthly basis. Employers are responsible for withholding IIT when making payment to individuals and for making the corresponding tax declaration. IIT withheld shall be paid to the local tax authorities within 15 days after the end of the each month.

Individuals, including both Chinese nationals and expatriates who have lived in China for one full year, are required to file an annual tax return within three (3) months after the end of the calendar year when their annual income in China that is subject to IIT has exceeded RMB 120,000.

1.1.2.2 Expatriates

The general IIT regime stated above also applies to expatriates. In this section, we will discuss the special IIT rules apply to expatriates.

Liability to tax

A non-resident individual's liability to pay IIT depends on his/her duration of stay in China. The tax liability of expatriates is summarized in the following table:

Duration of an expatriate's stay in China	**Income for period of working within China**		**Income for period of working** outside **China**	
	Paid or borne by an entity within China	**Paid or borne by an entity outside China**	**Paid or borne by an entity within China**	**Paid or borne by an entity outside China**
Less than 90/183 days[25]	Taxable	Exempted	Exempted	Exempted

[25] The 90-day threshold applies if the taxpayer's home country has not concluded a double tax treaty with China; otherwise, the 183-day threshold applies.

Duration of an expatriate's stay in China	Income for period of working within China		Income for period of working outside China	
	Paid or borne by an entity within China	Paid or borne by an entity outside China	Paid or borne by an entity within China	Paid or borne by an entity outside China
More than 90/183 days but less than 1 year	Taxable	Taxable	Exempted	Exempted
More than 1 year but less than 5 years	Taxable	Taxable	Taxable	Exempted
More than 5 years	Taxable	Taxable	Taxable	Taxable

- **Chief Representatives of a representative office**: The 90/183-day rule does not apply to foreign chief representatives of a representative office as their income is usually deemed to be borne by the representative office, regardless of whether they are actually paid by an overseas entity. Accordingly, chief representatives are liable to IIT for any remuneration, either paid within or outside China, for their period of working in China.

- **Senior management positions**: The 90/183-day rule does not apply to expatriates holding a senior management position in a Chinese company. Such expatriates become liable to IIT as soon as they arrive in China on their remuneration paid by Chinese entities. Senior management positions include directors, general manager, deputy general manager as well as any other position that involve management functions in a Chinese entity (irrespective of whether the enterprise is foreign or domestically invested).

- **Dual employment positions**: Expatriates who are not Chinese tax residents and hold "dual employment positions" are not taxable on the part of their remuneration for the period working abroad. In any event, the expatriate must be simultaneously employed by a Chinese employer for a position in China and by a foreign employer for a position abroad, and must not hold a senior management position in a Chinese enterprise.

Tax base

- **Salaries and Wages:** Reasonable allowances for housing, relocation, reimbursement of local transportation, meals and laundry, tuition fees for children, foreign language courses, medical and business-related expenses and travels to home country (up to two (2) per year) are exempted from IIT.

- **Social Insurance**: in practice, expatriates usually do not make contributions under the Chinese social insurance regime. Contributions or premiums paid by both the employer and the employee to a foreign organization for social insurance coverage are to be included in the taxable income. However, social contributions paid by the employer for an expatriate are exempt from IIT if the three following conditions are met simultaneously: i)the employer does not deduct the contributions for the calculation of its taxable income for the purpose of the Chinese EIT; ii) contributions are compulsory in accordance with an

applicable foreign law; and iii) contributions are borne by the employer in compliance with such applicable foreign law.

Standard monthly deduction

The standard monthly deduction for expenses is RMB 4,800 for expatriates.

1.2 Turnover Taxes

1.2.1 Value-added Tax

Scope of charge

Value-added tax ("VAT") is a tax levied on all units and individuals engaged in:

- Sales of goods in China (where goods are defined as tangible and movable property, including water, electricity, heat energy and gas);
- Processing, repair and replacement services rendered in China;
- Import of goods in China.

The pilot VAT reform program (the "**VAT Reform**"), which was first launched in Shanghai since January 1, 2012, changes the charge of turnover tax from business tax to VAT for the transportation industries and certain modern service industries, including, among others, consulting, financial lease and operating lease of tangible movable properties, research and development and technical services, information technology services, and cultural and creative services. The pilot VAT reform program initially applied only to the pilot industries in Shanghai, and has been expanded to ten additional municipalities and provinces, including Beijing, Tianjin, Jiangsu, Zhejiang, Anhui, Fujian, Hubei, Guangdong, Xiamen and Shenzhen. The VAT Reform will be expanded nationwide on August 2013.

Taxpayers

VAT taxpayers are generally divided into two categories, i.e. "general taxpayer" and "small-scale taxpayer":

- **General taxpayer**: To qualify as a general taxpayer, a taxpayer shall generate a minimum annual turnover of (i) RMB 0.5 million for production and service activities; or (ii) RMB 0.8 million for trading activities; or (iii) RMB 5 million for VAT taxable services within the scope of the VAT Reform in pilot regions.

General taxpayers are entitled to deduct input VAT from output VAT.

- **Small-scale taxpayer**: Taxpayers who do not qualify as general taxpayers are regarded as small-scale taxpayers.

Small-scale taxpayers may not credit input VAT against output VAT, and may not issue VAT invoices. As a consequence, a general taxpayer may not deduct input tax related to purchases from a small-scale taxpayer, unless the later asks its in-charge tax

authorities to issue a VAT invoice on its behalf.

Tax Rates

Taxable Item	Tax Rate
Standard rate	**17%**
Cereals and oil, utilities, books, newspapers and magazines, animal feed, fertilizer and insecticides, etc.	13%
Transportation services (VAT Reform)	11%
Modern services (excluding lease of tangible movable properties) (VAT Reform)	6%
Small-scale taxpayers	3%
Sale of second-hand goods	2%
Sale of used or self-produced fixed assets: if the seller can deduct input tax if the seller cannot deduct input tax	 17% 2%

Computation

- **General taxpayers:** VAT payable = output tax – input tax

Exceptions: non-deductible input tax:

- ❖ Input tax on fixed assets used exclusively for VAT-exempted or non-VAT taxable activities (including the sale or construction of immovable property);
- ❖ Input tax on goods or services used for collective welfare or personal consumption; and
- ❖ Input tax on certain goods subject to consumption tax (cars, motorcycles and yachts)

- **Small-scale taxpayers:** VAT payable = taxable turnover x VAT rate
- **Imported goods:** VAT payable = (CIF price + custom duties + CT) x VAT rate

Export of goods

The export of goods is generally exempt from VAT. The taxpayer may also apply for a refund of input tax related to the exported goods. Different VAT refund methods apply depending on the activities carried out by the taxpayer.

- **Exemption, credit &** refund **policy available for general taxpayers engaged in the production or provision of services the export VAT rate of which is zero:**
  - ❖ Exemption of output tax related to exported goods/services

- ❖ Credit of input tax related to exported goods/services against output tax related to domestic sales/service provision
- ❖ Refund of the excess input tax

- **Exemption & refund** policy **available for taxpayers engaged in trading:**
  - ❖ Exemption of output tax related to exported goods
  - ❖ Refund of input VAT based on the refund rate (i.e. purchase price of the exported goods x refund rate)

Please note that the difference between the VAT rate and the VAT refund rate, which exists for most exported goods, disallows the full recovery of input VAT and generates a permanent cost for export enterprises.

Time When VAT Liability Arises and Time of Payment

- **General rule:** The date of receipt of the purchase price or the contractual payment date, or the date of receipt of the VAT invoice if earlier;
- **Provision of services:** The date of completion of services and receipt of the sales income, or the date of receipt of the VAT invoice if earlier;
- **Import of goods:** Customs declaration date;
- **Sales with advance** payment**:** the date of dispatch;
- **Sales of large-scaled** equipment **with advance payment (construction period of which is more than 12 months):** the date of receipt of advance payment or contractual payment date;
- **Sales on credit or by instalment:** contractual payment date or the date of dispatch, in case of no contractual payment date;
- **Collection of payment by a third party:** the date of dispatch and completion of the entrusted payment procedure;
- **Entrusted sales by a third party:** the date of receipt of the list of the goods for entrusted sales or the receipt of full or partial sales income. However, if the list of the goods for entrusted sales is not received within 180 days after the dispatch of the entrusted goods, the date being 180 days following the dispatch of the entrusted goods.

The VAT payment shall generally be made within 15 days after the end of each one-month period. For import-related VAT, the payment shall be made within 15 days from the issuance by customs authorities of the import VAT tax payment certificate.

1.2.2 Business Tax

Scope of charge

Business Tax ("**BT**") applies on:

- The turnover derived from services rendered in China;
- The turnover derived from assignment of intellectual property rights to a party located in China; and
- The turnover derived from the sales and rental of immovable properties located in China

"Services rendered in China" is defined as services the provider or recipient of which is located in China.

For income paid to overseas enterprises that do not have an establishment in China, BT shall be withheld by the taxpayer.

Tax Rates

Taxable Item	Tax **Rate**
Standard rate	**5%**
Entertainment	5% or 20%
Transportation	3%
Construction	3%
Post and telecommunications	3%
Cultural activities and sports	3%

Computation

BT liability = turnover × tax rate

Time When BT Liability Arises

- **General rule:** Receipt of payment, contractual payment date of completion of performance, whichever is earlier;
- **Transfer of immovable** property **with advance payment:** Receipt of advance payment;
- **Provision of construction or leasing services with advance payment:** Receipt of advance payment.

Time and Place of Payment

BT shall be paid within 15 days after the end of each one-month period to the tax authorities where the taxpayer has its business establishment or residence.

However, for construction services and real estate transactions, tax filling shall be completed at the place of performance of the services or the location of the property, respectively.

1.2.3 Consumption tax

Scope of charge

Consumption tax applies in connection with:

- Manufacture of certain goods in China;
- Processing of certain goods in China;
- Import of certain goods in China; and
- Sales of certain goods in China as determined by the State Council

Tax rate:

Fourteen categories of goods are subject to a consumption tax and their respective tax rate is as follows:

Taxable Consumer Goods	Tax Rate
Tobacco	25%-45% and/or fixed sum
Liquor	5%-20% and/or fixed sum
Cosmetics	30%
Expensive ornaments, pearls, jewels and jade	5% or 10%
Firecrackers and fireworks	15%
Processed oil	Fixed sum per litre
Motor vehicle tyres	3%
Motorcycles	3% or 10%
Motorcars	1%-40%
Golf balls and golf equipment	10%
Luxury watches	20%
Yachts	10%
Disposable wooden chopsticks	5%
Solid wooden floor boards	5%

1.2.4 Surtaxes

Surtaxes include City Maintenance and Construction Tax, Education Surcharge and Local Education Surcharge (the "**Surtaxes**").

Scope of charge:

Taxpayers who pay VAT, business tax or consumption tax are also liable to the Surtaxes.

Tax rate:

- City Maintenance and Construction Tax: the tax rate of City Maintenance and

Construction Tax varies depending on the location of the taxpayer:

- ❖ Taxpayers located in urban areas: 7%
- ❖ Taxpayers located in counties or towns: 5%
- ❖ Taxpayers not located in the above areas: 1%

- Education Surcharge: 3%
- Local Education Surcharge: 2%

Time when tax liability arises and place of payment:

The tax liability of the Surtaxes arises concurrently with the tax liability of VAT, business tax or consumption tax. The Surtaxes should be paid together with the payment of VAT, business tax or consumption tax.

1.3 Other Taxes

- **Deed Tax**: Deed tax applies to the transfer of land use rights or ownership of a building. The transferee is liable to pay a deed tax at a rate between 3% and 5%, depending on the location of the land or building. The tax base for deed tax is the price of the transferred immovable property.

- **Urban Land Use Tax**: All domestic and foreign enterprises/individuals that use land within cities, counties, townships and mining areas are subject to land use tax. Land use tax is collected on an annual basis and may be paid by instalments. The tax rate ranges from RMB 0.6 to RMB 30 per square meter depending on the locality of the land.

- **Land VAT**: Land VAT is levied on the gains realised from the transfer of land, buildings and associated structures. The seller is subject to land VAT at progressive rates between 30% and 60% on the added value. Some costs are deductible in calculating the added value.

- **Real Estate Tax**: Both domestic and foreign enterprises and individuals are subject to real estate tax. Real estate tax should be paid by the owner of the buildings. The tax is calculated either (i) on the residual value after subtracting an amount between 10% and 30% of the original value of the real estate at a rate of 1.2%; or (ii) on the rental income at the rate of 12% in case of a lease. The tax is collected annually with payment by instalments.

- **Stamp Duty**: Stamp duty is a tax imposed on certain documents executed or used in China, such as contracts, property transfer documents, accounting books, documentation of rights or license, etc. Documents required or intended to be enforced under Chinese law are subject to a stamp duty, irrespective of whether they are concluded in China. The amount of a stamp duty depends on the nature of the taxable documents. For some documents, stamp duty is calculated based on flat rates (i.e., 0,005%, 0,03%, 0,05% or 0,1%) and for others, a fixed amount of stamp duty is imposed (e.g., RMB 5).

- **Customs Duty**: A customs duty is a duty levied on the import and export of goods and articles. The duty rate varies significantly depending on the classification and the country of origin of the dutiable goods or article. Currently, the overall duty rate is around 9.8%. Customs duty is collected and administered by PRC customs authorities.

2 Taxation on the Different Forms of Business Presence

2.1 Taxation of Representative Offices

Representative offices ("**ROs**") are considered a special type of permanent establishment of their non-resident enterprise headquarters and are subject to both an enterprise income tax and a business tax (or VAT) in China.

2.1.1 Enterprise Income Tax

ROs should in principle maintain accurate accounting records and be taxed on their actual profits. However, in practice, the tax base is usually computed on a deemed profit basis at the standard deemed profit rate ("**DPR**") of 15%, either based on the gross income of the RO or the expenditure of the RO. The standard EIT rate of 25% applies to ROs.

2.1.2 Business Tax

With respect to BT, such tax shall normally be levied on the gross income attributable to the RO or, alternatively, be based on the expenditure method. In the latter case, taxable income = total expenditures / (1 – DPR – BT rate). The standard BT rate of 5% applies to ROs.

2.1.3 Value-added Tax

By virtue of the VAT reform, certain ROs are now subject to VAT rather than BT. In particular, ROs of foreign law firms are now subject to VAT at the rate of 6% in the pilot regions where the VAT Reform is implemented. Other ROs in the pilot regions that consider the activities they carry out fall within the scope of charge of VAT may also apply to their in-charge tax authorities to be taxed to VAT instead of BT.

2.1.4 Surtaxes

ROs that pay BT or VAT should also pay the Surtaxes on the basis of the amount of VAT or BT paid.

2.2 Taxation of Foreign Invested Enterprises

Foreign invested enterprises ("**FIEs**") are generally required to keep complete and accurate accounting records and be taxed based on their actual income and profits.

2.2.1 Enterprise Income Tax

The EIT is imposed on the actual taxable profits of an FIE, after proper tax adjustment of income and costs/expenses. The standard tax rate of 25% normally apply, subject

to any preferential tax treatment the FIE may obtain (please refer to the introduction of EIT for more details).

2.2.2 Business Tax and/or Value-added Tax

Depending on the businesses carried out by the FIE, the FIE may be subject to BT or VAT, or both. The Surtaxes will also apply if the FIE becomes liable to BT and/or VAT.

2.2.3 Other taxes

An FIE may also be subject to the other taxes listed in the introduction part.

2.3 Taxation of Partnerships

2.3.1 Enterprise Income Tax

Unlike an FIE, a partnership is a tax-transparent entity and is not itself subject to enterprise income tax. Instead, the partners of the FIE are liable to income taxes on their shares of the partnership's profit: i.e., individual partners are in principle liable to an individual income tax for production and business income at the progressive rate from 5% to 35%; while enterprise partners should include the profit in their taxable income and pay EIT at the regular tax rate applicable to them (the standard EIT rate being 25%).

2.3.2 Business Tax and/or Value-added Tax

Partnerships are only transparent with regard to EIT. Thus, partnerships may be liable to business tax and/or VAT if they carry out relevant taxable activities.

3 Taxation of M&A Transactions

Income tax liabilities are the major tax consideration in M&A transactions.

3.1 Enterprise Income Tax

3.1.1 Special tax treatment

As a principle, gain or loss arising from the disposition of assets and liabilities in M&A transactions should be recognized at the time when the transactions take place, and the tax liability (if any) should arise accordingly. However, when special conditions are met, the tax liability may be deferred until the subsequent transfer of the relevant assets (the "**Special Tax Treatment**"). In order to benefit from the deferred tax treatment, the following conditions must be met simultaneously:

- Business purpose: the transaction must have a reasonable business purpose and is not carried out mainly to reduce, avoid or defer tax payment;

- Substantiality of reorganization: the percentage of assets or equity interests being acquired, merged or spun off should meet specific requirements (e.g., in an asset

acquisition, the assets being acquired should not be less than 75% of the total assets of the transferor; in an equity acquisition, the equity interests being transferred should not be less than 75% of the total equity interest of the target);

- Continuity of business: there should not be any change in the actual business activities of the assets involved in the reorganization within 12 consecutive months following the reorganization;

- Continuity of interest: a substantial portion of the consideration should be paid in the form of equity of the acquirer or a shareholder of the acquirer (e.g., 85% of the total consideration should be equity consideration in equity/asset acquisition, merger or spin-off);

- Continuity of shareholding: the former shareholders that receive the equity consideration should not transfer such equity interest acquired within 12 consecutive months following the reorganization.

Where the reorganization involves cross-border elements, the Special Tax Treatment may only apply in the following three (3) situations, subject to the fulfillment of all the above general conditions:

- A non-resident enterprise transferor transfers to another non-resident enterprise, which is 100% directly held by the transferor, the equity interest the transferor holds in a resident enterprise. The equity transfer should not lead to any change in the withholding tax burden of capital gains, and the transferor shall undertake in writing to the in-charge tax authorities of the target resident enterprise that it will not transfer the equity interest it holds in the non-resident enterprise transferee within three (3) years (inclusive) following the reorganization; or

- A non-resident enterprise transferor transfers to a resident enterprise, which is 100% directly held by the transferor, the equity interest the transferor held in a resident enterprise; or

- A resident enterprise contributes assets or equity interest it possesses to a non-resident enterprise that is 100% directly held by the resident enterprise.

In practice, it is very difficult for cross-border reorganizations to benefit from the Special Tax Treatment, which is partly due to the difficulty in carrying out the qualifying reorganizations in the first place.

3.1.2 Indirect transfer

As a rule, non-resident enterprises that do not have a place of business or establishment in China should be liable to the EIT only to the extent that they derive any China-sourced income. As far as capital gains derived from equity transfers are concerned, the gains are sourced from China if the invested enterprise (i.e., the enterprise the equity interest of which is being transferred) is located in China.

However, the Chinese government has extended its jurisdictions to tax capital gains to certain indirect transfers, i.e., the disposition of the equity interests of an overseas holding company that in turn holds equity interest in a resident enterprise ("**Indirect**

Transfers"). Where the overseas holding company is located in certain low tax jurisdictions (i.e., jurisdictions that either have an effective tax rate of lower than 12.5% for capital gains arising from equity transfers or do not tax offshore income obtained by their residents), the non-resident enterprise transferor shall report to the competent tax authorities of the PRC resident enterprise about this Indirect Transfer. The PRC tax authorities may, by adopting the "substance over form" principle, disregard the existence of the overseas holding company if it lacks a reasonable commercial purpose and was established principally for the purpose of reducing, avoiding or deferring PRC taxes. As a result, gains derived from such Indirect Transfer may be subject to PRC tax at a rate that is normally 10%.

3.2 Other Taxes

In addition to enterprise income tax, reorganization may also give rise to other tax liabilities. Below is a summary of the tax liabilities that may be triggered in corporate reorganizations.

3.2.1 Equity acquisition

- Enterprise income tax (normally at the rate of 25%) or individual income tax (at the rate of 20%);
- Stamp duty: 0.05% on the equity transfer price, payable by both the purchaser and the seller.

3.2.2 Asset acquisition

- VAT: for the transfer of equipment, vehicles, inventories, etc. VAT is usually charged at the rate of 17% (see the introduction part for the VAT treatment of used assets). Payable by the seller and would normally constitute input VAT for the purchasers;
- Business tax: for the transfer of trademarks, know-how, patents, goodwill, or immovable properties, such as land use rights or buildings. BT is usually charged at the rate of 5%. Payable by the seller;
- Land value-added tax: for transfer of land use rights or buildings. Land value-added tax is charged at the progressive rate ranging from 30% to 60% on land appreciation. Payable by the seller;
- Deed tax: for the acquisition of land use rights or buildings. Deed tax is charged at the rate of 3% to 5% depending on the location of the real estate. Payable by the purchaser.
- Enterprise income tax (normally at the rate of 25%) or individual income tax (at the rate of 20%);
- Stamp duty: 0.05% on the transfer price for the transfer of intangibles, land use rights and buildings; 0.03% on the transfer of equipment,

vehicles or inventories (if separately itemized). Payable by both the purchaser and the seller.

CHAPTER VI OTHER COMPLIANCE ISSUES

1 Anti-trust

1.1 General Introduction

There are three statutes of general application that protect the fair competition on the market in China, namely the *Anti-Monopoly Law of the People's Republic of China* (the "**Anti-Monopoly Law**"), which became effective on August 1, 2008, the *Anti-Unfair Competition Law of the People's Republic of China* (the "**Anti- Unfair Competition Law**"), which became effective on December 1, 1993, and the *Price Law of the People's Republic of China* (the "**Price Law**"), which came into effect on May 1, 1998. Although the legal framework of anti-trust is primarily based on the Anti-Monopoly Law, when addressing relevant concerns, Chinese competition authorities and courts often apply a broad approach to competition law enforcement. Instead, they rely on the Anti-Unfair Competition Law and the Price Law, rather than merely focusing on the Anti-Monopoly Law.

According to the Anti-Monopoly Law, the anti-trust regime of China comprises four broad sets of rules:

(a) Rules to control mergers and acquisitions that may result in the effect of eliminating or restricting market competition;

(b) Rules to prohibit agreements between two or more independent market operators which restrict competition;

(c) Rules to prohibit operators holding a dominant position on a determined market to abuse that position;

(d) Rules to prohibit the abuse of administrative power that leads to restriction of competition.

The Anti-monopoly Law applies not only to anti-competitive activities that have occurred within China, but also to those conducted outside China that have the potential to eliminate or restrict competition within China.

China has a unique structure for antitrust enforcement, with regulatory power allocated among separate authorities, i.e. the Anti-Monopoly Commission of the State Council, the Ministry of Commerce ("**MOFCOM**"), the National Development and Reform Commission (the "**NDRC**"), and the State Administration for Industry and Commerce ("**SAIC**"). Among these authorities, the Anti-Monopoly Commission of the State Council is the consultation and coordination body primarily responsible for formulating competition policy and ensuring the overall coordination of the enforcement activities, and the other three authorities are the enforcers of the Anti-Monopoly Law. In particular, the Anti-Monopoly Bureau of MOFCOM reviews and clears mergers and acquisitions that may eliminate or restrict market competition by enforcing the merger control rules. The Price Supervision and Anti-Monopoly Bureau of the NDRC is in charge of the examination and regulation of price-related monopolistic activities. The Anti-Monopoly and Anti-Unfair Competition

Enforcement Bureau of SAIC handles monopolistic allegations not related to price, such as monopoly agreements and abuse of dominance or administrative power to restrict competition under the non-price-related context. However, since the distinction between price and non-price related violations may be difficult to discern in practice and both two aspects can be involved in the same case, the administrative enforcement jurisdiction of the NDRC and SAIC are less obvious than that of MOFCOM.

The Anti-Monopoly Law also provides for a private enforcement regime, and private plaintiffs have initiated numerous cases since the Anti-Monopoly Law came into effect. On June 1, 2012, the first judicial interpretation of the Supreme People's Court, namely the *Provisions on Certain Issues Concerning the Application of Law in Hearing Civil Dispute Cases Caused by Monopoly* became effective and addressed, inter alia, the anti-monopoly civil lawsuits accepted by the court, standing to sue, jurisdiction, and evidence rules.

In this Section, we will briefly introduce and analyze the enforcement of anti-trust law by the NDRC and SAIC. For the merger control rules and practices of MOFCOM, please refer to Chapter III Merger and Acquisitions: Anti-trust Review.

1.2 Governing Legislations

Below sets forth the laws enacted by the Standing Committee of the National People's Congress of the PRC and the major implementing regulations and rules promulgated by the NDRC and SAIC in anti-trust regime.

(a) Laws

- The *Anti-Monopoly Law of the People's Republic of China*, effective on August 1, 2008;
- The *Anti-Unfair Competition Law of the People's Republic of China*, effective on December 1, 1993;
- The *Price Law of the People's Republic of China*, effective on May 1, 1998.

(b) Regulations promulgated by the State Council

- The *Provisions on the Administrative Sanctions Against Price-related* Illegal *Activities*, amended on December 4, 2010.

(c) Implementing rules promulgated by the NDRC

- The *Regulation on Monopolistic Pricing Practices*, effective on December 29, 2010;
- The *Procedural Rules on the Administrative Enforcement of the Prohibition of Monopolistic Pricing Practices*), effective on December 29, 2010.

(d) Implementing rules promulgated by SAIC

- The *SAIC Regulations on the Prohibition of Anti-Competitive Practices of* Public

Enterprises, effective on December 24, 1993;

- The *SAIC Procedural Rules on the Investigation of Cases regarding Monopoly Agreements and Abuse of Dominance*, effective on July 1, 2009;
- The *SAIC Procedural Rules on the Prohibition of Abuse of Administrative Power to Eliminate or Restrict Competition*, effective on July 1, 2009;
- The *SAIC Provisions on Prohibiting Monopoly Agreements*, effective on February 1, 2011*;*
- The *SAIC Provisions on Prohibiting Abuse of Dominance*, effective on February 1, 2011;
- The *SAIC Provisions on Preventing Abuse of Administrative Power to Eliminate or Restrict* Competition *by Administrations for Industry and Commerce*, effective on February 1, 2011;

1.3 Price-Related Monopoly

1.3.1 Definition of Price-Related Monopoly

Although the Anti-monopoly Law explicitly prohibits monopolistic conduct such as monopoly agreements, abuse of dominance, and abuse of administrative power, there is no definition of price-related monopoly provided. Such definition was first introduced in the *Regulation on Monopolistic Pricing Practices* (the "**Anti-Price Monopoly Regulation**") by the NDRC based on its regulatory responsibility of tackling price-related monopolies, particularly price fixing.

According to the Anti-Price Monopoly Regulation, price-related monopolistic activities include:

(a) business operators that reach a monopoly agreement related to price matters;

(b) a business operator that has a dominant market position which restricts or eliminates competition through price fixing; and

(c) an administrative agency that abuses its administrative power in such as way that it leads to the restriction and elimination of price competition.

1.3.2 Monopoly Agreement Related to Price

1.3.2.1 Concept of Monopoly Agreement

The monopoly agreements prohibited by the Anti-Monopoly Law and the Anti-Price Monopoly Regulation refer to any agreement, decision or concerted practice that eliminates or restricts competition. Notably, monopoly agreements can be reached even where there is only concerted practice (informal undertakings and other forms of illegal collusion), and no physical contract or document is required. The Anti-Price Monopoly Regulation further provides that when seeking to establish the concerted practice, the unison and consistency of the concerted actions, the intention and

communication of the operators, the structure of the market and the state of competition, and other relevant factors shall be taken into consideration.

The Anti-Monopoly Law and the Anti-Price Monopoly Regulation also list certain common horizontal monopoly agreements, which are reached between or among the competitors at the same level of trade and competition, and vertical monopoly agreements, which are reached between or among the business operators in upstream and downstream relevant markets (i.e. retailer and supplier). Additionally, trade associations must not assist or encourage their members to engage in any type of monopoly agreements.

1.3.2.2 Exemptions

Under the Anti-Monopoly Law and the Anti-Price Monopoly Regulation, certain exemptions are permissible, provided that the operators can prove the agreements will not seriously restrict competition and consumers will benefit from such agreements. Such pro-competitive benefits and purposes include improving technology, developing new products, improving operational efficiency, enhancing the competitiveness of small and medium enterprises, promoting public interests such as energy conservation, environmental protection, and providing disaster relief, mitigating severe decreases in sales or overstocking during economic recession, and protecting the legitimate interests of international trade and foreign economic cooperation.

1.3.3 Abuse of Dominance by Pricing Means

1.3.3.1 Definition of Dominance

Both the Anti-Monopoly Law and the Anti-Price Monopoly Regulation define market dominance as "a market position where a business operator has the ability to control the price or quantity of goods or other trading conditions in the relevant market, or to impede or affect the entry of other operators into such relevant market". The Anti-Price Monopoly Regulation further explains that: (i) "other trading conditions" refer to factors other than the price and quantity that may substantially affect arms-length transactions, such as product quality, terms of payment, method of delivery, after sale services, trade options, or technology constraints, and (ii) "impede or affect the entry of other operators into the relevant market" means the ability of the operator to exclude, delay or make it more difficult for other operators to enter or expand into the relevant market, or for the operators who have entered into the relevant market, the cost of entry is increased too significantly to compete with other competitors effectively.

Article 18 of the Anti-Monopoly Law identifies various factors that are relevant for determining market dominance, such as the market share and competitive conditions in the relevant market, the ability to control the sales market or raw materials market, and the available financial and technical resources.

Additionally, demonstration of a sufficiently high market share creates a presumption of dominance. The presumption shifts the burden of proof to the operator under investigation to provide evidence of why it is not dominant, and the enforcement authority should remain receptive toward evidence that may overcome the

presumption. The market share thresholds to apply the presumption as provided in the Anti-Monopoly Law and the Anti-Price Monopoly Regulation are as follows:

(a) A single operator is presumed dominant if its market share amounts to at least half of the relevant market;

(b) Two operators are presumed jointly dominant if their combined market share amounts to at least two thirds of the relevant market;

(c) Three operators are presumed jointly dominant if their combined market share amounts to at least three fourths of the relevant market.

1.3.3.2 Price-Related Abusive Conduct

Article 17 of the Anti-Monopoly Law lists the following specific abusive conducts of a dominant operator that are prohibited:

(a) selling goods at an unfair high price or purchasing goods at an unfair low price;

(b) selling goods at a price below cost without justification;

(c) refusing to deal by setting an excessive sale price without justification;

(d) exclusive dealing by virtue of conditional debates or other means without justification;

(e) tying products or imposing unreasonable trade terms and conditions; and

(f) discriminatory treatment without justification.

Articles 11 to 16 of the Anti-Price Monopoly Regulation further provide the factors the NDRC will rely on in its determination of whether the price-based abuses have been established. For example, when determining an unfair high or low price, the enforcement authorities shall consider whether the prices charged by the dominant operator significantly deviate from that charged by other competitors, whether the price variance is reasonable while the cost remains constant, etc. As another example, the justifications of selling below cost include the clearance sale of a deteriorating inventory, promotion of a new product and other certain circumstances.

1.3.4 Price-Related Abuse of Administrative Power

The Anti-Monopoly Law prohibits administrative agencies (governmental agencies or other organizations empowered by the relevant laws or regulations to perform the function of administering public affairs) from abusing their regulatory and administrative power to exclude or restrict competition. The most common forms of administrative abuse include compelling consumers to buy or use products supplied by the designated entities, and hindering the free movement of goods among different regions for the purpose of restricting competition.

The Anti-Price Monopoly Regulation further provides that administrative agencies may not issue any rules containing price-based anti-competitive content.

1.3.5 Penalties and Leniency

According to the Anti-Monopoly Law and the Anti-Price Monopoly Regulation, for violations in relation to monopoly agreements or abuse of dominance, the relevant enforcement agency may order the business operator to cease and desist, confiscate all illegal gains and impose a fine of 1% to 10% of the turnover of the business operator in the preceding business year. A fine of up to RMB500,000 may be imposed, if the monopoly agreement has been reached but not implemented.

The Anti-Monopoly Law also provides that if a business operator voluntarily reports to the NDRC the existence of a monopoly agreement and provides material evidence, the NDRC may mitigate or exempt such informer from penalties at its discretion. The *Procedural Rules on the Administrative Enforcement of the Prohibition of Monopolistic Pricing Practices* further clarifies this leniency provision by stating that the first informer to report may benefit from a total immunity from penalties, the second informer may receive at least a 50% reduction of penalties, whilst subsequent informers may receive up to a 50% reduction.

1.3.6 Case Study

1.3.6.1 LCD Panel Cartel

On January 4, 2013, the NDRC announced a crackdown against six leading international LCD panel manufacturers (collectively the "**Group**"), namely Samsung, LG, Chimei, AU Optronics ("**AUO**"), Chunghwa Picture Tubes ("**CPT**") and HannStar, for creating a price-fixing cartel among them from 2001 to 2006. The total penalty imposed against the Group was RMB 353 million. This case is the first enforcement action by China against price-related monopoly activities of firms outside Mainland China, and the RMB 353 million penalty is also the largest penalty that China has ever imposed for price-related violations. The price-fixing cartel among the Group has also been investigated and punished in the United States, the European Union and South Korea.

The NDRC found that from 2001 to 2006, the Group had 53 "LCD" meetings in Taiwan and South Korea mainly to exchange information on the LCD panel market and negotiate prices for LCD panels. The Group members artificially manipulated prices for LCD panels they sold in Mainland China based on prices agreed on and information exchanged during the LCD meetings. The total illegal gains obtained by the Group from the sale of LCD panels involved were found to be RMB 208 million.

On January 4, 2013, the NDRC announced its sanctions against the Group, including the return by the Group to Chinese television enterprises overcharged prices for LCD panels amounting to RMB 172 million, confiscation of all other illegal gains amounting to RMB 36.75 million and payment of fines amounting to RMB 144 million.

There are a few points that are worth noting in this LCD panel cartel case:

(a) The Anti-Monopoly Law applies not only to anti-competitive activities that have occurred within China, but also to those conducted outside China having an impact to eliminate or restrict competition within China. This cartel case has

illustrated that Chinese anti-monopoly regulators are further strengthening supervision on and enforcement of anti-trust related violations by foreign companies.

(b) The Group's plot to manipulate prices falls within the definition of monopoly agreements that are prohibited under the Anti-Monopoly Law. Since the Group's monopoly activities occurred before the Anti-Monopoly Law took effect, the NDRC decided the penalties be based on the Price Law instead. Both the Price Law and the Anti-Monopoly Law provide for the confiscation of illegal gains as penalties for business operators engaging in price-related monopoly activities. However, in respect of fines that may be imposed in addition to the confiscation of illegal gains, the Price Law allows fines up to five times of the illegal gains, while the Anti-Monopoly Law provides for fines equal to 1% to 10% of the turnover in the preceding year. Since illegal gains are much lower than annual turnovers at most cases, fines imposed under the Anti-Monopoly Law will normally be much higher than fines under the Price Law.

(c) Although the Price Law does not expressly include a leniency provision like the Anti-Monopoly Law, the NDRC applied a leniency scheme in this case. Since AUO was the first to report to the NDRC the price-fixing cartel among the Group, AUO was exempted from fines and the punishment on it was only the return and confiscation of all illegal gains AUO obtained. Besides, the NDRC stated that the fines imposed on all other five firms were also reduced due to their confession.

1.3.6.2 Moutai and Wuliangye Case

On February 22, 2013, only one month after the LCD penal case, the NDRC imposed penalties on Moutai and Wuliangye, two high-end alcohol giants, for administering resale price maintenance ("**RPM**") of RMB 247 million and RMB 202 million respectively. The relevant official decisions of the NDRC pointed out that the two companies fixed the minimum resale price to third-party distributors and punished those distributors and retailers selling the products below the price floor, which violated Article 14 of the Anti-Monopoly Law. It is the most high-profile enforcement action against RPM launched by the NDRC recently.

The Anti-Monopoly Law does not provide whether RPM is illegal per se, and the NDRC did not discuss its approach towards RPM in its decisions clearly. Rather, the NDRC emphasized the anti-competitive effects arising from the RPM practices by Moutai and Wuliangye. The NDRC held that:

(a) Moutai and Wuliangye abused their dominant market positions and entered into monopoly agreements with downstream suppliers and distributors. The RPM precluded the price competition between different distributors, and also eliminated and reduced the inter-brand competition in the alcohol market. Such anti-competitive effects are more obvious, when Moutai and Wuliangye are leading companies in the industry and there have been other manufacturers following their RPM practices.

(b) The price fixing has harmed consumer interests. Evidence shows that one bottle of Moutai or Wuliangye was RMB 1,300 when the RPM was not implemented, but afterwards the fixed retail price set by Moutai and Wuliangye reached RMB

1,500.

(c) The RPM restricted the pricing rights of the distributors and retailers and restrained distributors and retailers in the pursuit of trade efficiency and creation of new business models.

1.4 Non-Price-Related Monopoly

1.4.1 SAIC Enforcement Jurisdiction

SAIC handles investigations and cases concerning non-price related violations. SAIC has issued three main substantive regulations, i.e. the *SAIC Provisions on Prohibiting Monopoly Agreements*, the *SAIC Provisions on Prohibiting the Abuse of Dominance* and the *SAIC Provisions on Preventing the Abuse of Administrative Power to Eliminate or Restrict Competition by Administrations for Industry and Commerce* (collectively, the "**SAIC Regulations**"), clarifying the way SAIC interprets and applies the Anti-Monopoly Law in regard to non-price-related monopoly agreements, abuse of dominance and abuse of administrative power.

The SAIC Regulations illustrate several non-price related monopoly conducts as set forth below that fall into the enforcement jurisdiction of SAIC:

(a) non-price-related monopoly agreements for the purpose of (i) output restrictions; (ii) market sharing and customer allocation; (iii) restricting the purchase or development of new technologies, facilities or products; or (iv) boycotts.

(b) non-price related abuse of dominance such as (i) refusing to deal with another party without justification; (ii) exclusive or selective dealing/distribution without justification; (iii) tying products or imposing other unreasonable trading conditions without justification; and (iv) applying discriminatory treatment to trading parties without justification.

1.4.2 Case Study

1.4.2.1 Concrete Association Cartel

In January 2011, SAIC for the first time published a press release on its website reporting an enforcement action brought by SAIC against a local construction materials and machinery association in the concrete industry in Lianyungang, Jiangsu (the "**Concrete Association**"). SAIC imposed penalties on the Concrete Association and its five principal member enterprises for entering into monopoly agreements amounting to RMB 867,204.

On March 3, 2009, the Concrete Association held a meeting and organized its members, primarily 16 pre-mixed concrete manufacturers attending the meeting, to enter into an agreement prohibiting the member enterprises from entering into pre-mixed concrete sales agreement and undertaking construction projects without approval of the Concrete Association, and imposing penalties for violations of the market sharing and construction projects allocation arrangement under the agreement. The Association also set a fixed price for the pre-mixed concrete.

In this case, SAIC delegated enforcement power to its provincial counterpart, i.e. the Administration of Industry and Commerce of Jiangsu Province (the "**Jiangsu AIC**"), which in turn investigated the allegations and imposed sanctions. After identifying the violators, monopoly activities and the anti-competitive effects thereof, the Jiangsu AIC concluded that the agreements entered into by and among the members of the Concrete Association that divided market share constituted a "monopoly agreement", which is in violation of the Anti-Monopoly Law, and the exemptions provided in the Anti-Monopoly Law such as improving technology or developing new products, are not applicable.

1.4.2.2 Cement Cartel

In 2012, SAIC took an action against a Liaoning-based cement cartel, and the companies involved were imposed a wide amount of punishment of up to RMB 16.37 million.

According to the press release published by SAIC on its website on February 19, 2013, more than ten cement manufacturers in Liaoning entered into a "Self-disciplinary Agreement" on November 30, 2010, pursuant to which all parties agreed to (i) limit the output during the winter under the guise of equipment maintenance, and (ii) fix the sales price of the clinker at RMB 260 per ton, and (iii) any party who breached such agreement would be subject to fines.

The Administration of Industry and Commerce of Liaoning Province (the "**Liaoning** AIC"), which was delegated enforcement authority by SAIC, alleged that:

(a) Monopoly agreements may take various forms, and the key point to identify a monopoly agreement is to focus on the content and the effects of the agreement involved. For example, monopoly agreements related to price may contain provisions about price fixing and price control scheme; monopoly agreements in respect of volume are for the purpose of limiting or controlling the output and sales volume; monopoly agreements in relation to market sharing may share the common market and allocate customers.

(b) In the cement market of Liaoning, the manufacturers, which are normally large-scale and control the sources of supply, take the dominant position compared to other market participants. The cement manufacturers that were sanctioned abused the dominance and entered into the monopoly agreement that affected the prevention and restriction of competition within the cement market. This cement cartel significantly increased in the product price, seriously distorted the competition in the relevant market, and infringed upon the public interest and consumers' interests.

2 IP Protection

2.1 Legislation and Protection of Intellectual Property in China

Intellectual property rights have been acknowledged and protected in the People's Republic of China (the "PRC" or "China"). However, there is no uniform

intellectual property code in the PRC. The protection of intellectual property law, which is in the form of special legislation, has been established by government legislation, administrative regulations, and judicial interpretation in the areas of trademark, copyright, patent and layout-design of integrated circuits. Legislation on patent rights mainly includes:

- Patent Law;
- Implementing Rules of the Patent Law;
- Several Provisions of the Supreme People's Court on Issues Concerning the Application of Law in the Hearing of Patent Dispute Cases;
- Several Provisions of the Supreme People's Court on the Issues Concerning the Application of Law to Terminating Infringement upon Patent Prior to Litigation;
- Interpretations of the Supreme People's Court Concerning Certain Issues on the Application of Law for the Trial of Cases on Disputes over Infringement on Patent Rights.

Legislation on trademark rights mainly includes:

- Trademark Law;
- Implementing Regulations of the Trademark Law;
- Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law in Hearing Civil Cases Related to Trademark Disputes;
- Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law in Hearing Civil Dispute Cases Concerning the Protection of Famous Trademarks.

Legislation on copyright includes:

- Copyright Law;
- Implementing Regulations of the Copyright Law;
- Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law in Hearing Cases of Civil Disputes over Copyright;
- Provisions of Supreme People's Court on Several Issues Concerning Application of Law in Civil Dispute Cases of Infringing the Right to Network Dissemination of Information.

Legislation on layout-designs of integrated circuits mainly includes:

- Regulations on the Protection of Layout-Designs of Integrated Circuits;
- Circular of the Supreme People's Court on Hearing Cases Involving Integrated

Circuit Layout Designs.

According to the relevant PRC laws above, intellectual property rights holders (the "IPR Holder") may apply the three approaches below to protect their legitimate rights against infringers:

- Administrative Adjudication: the IPR Holder may submit a complaint to the administrative authorities in charge of the management of intellectual property rights and request for an administrative investigation of potentially infringing behavior. Once the administrative authorities find that the infringement is established, the IPR Holder will be rendered certain administrative remedies, including injunctions, cease and desist orders, confiscation of illegal earnings, fines and mediation upon the request of the parties;

- Civil Litigation: the IPR Holder may file a lawsuit with the competent court with jurisdiction. Once the court finds that the infringement is established, the IPR Holder will be rendered certain civil remedies, including an order to cease infringing activities, elimination of the effects of the infringement, compensation for damages suffered or any combination of the above;

- Criminal Prosecution: if the severity of intellectual property rights infringement reaches a certain level, the competent procuratorate with jurisdiction will prosecute the infringer. Once the court finds the infringer is guilty, certain criminal liabilities, including imprisonment, fines and damages will be imposed on such infringer.

2.2 Recent Legal Developments

2.2.1 Patent Law

The Standing Committee of the National People's Congress revised the *Patent Law* in 2008, and the State Council revised Implementing Rules of the *Patent Law* in 2010 thereafter, which was not long before the Supreme People's Court issued judicial interpretations on the trial of patent disputes in 2009. There are two main highlights of the revision:

(1) The patent license requirements are more stringent: Before the revision of the Patent Law, if only in a foreign country is there public use or sale of technology, are patents allowed to be granted in the PRC, which was known as the "Relative Novelty Standard". The newly revised Patent Law has adopted an "Absolute Novelty Standard", which means that the abovementioned technology in the PRC is no longer patentable.

(2) The scope of damage compensation within the discretion of the court has been increased the range from RMB 5,000 to RMB 50,000 and the range from RMB 10,000 to RMB 1,000,000. On April 1, 2013, the *Certain Provisions on Issues Concerning the Application of Law in the Hearing of Patent Dispute Cases* was modified by the Supreme People's Court, allowing the Supreme People's Court to designate district courts to have the jurisdiction to hear patent disputes of first instance, which was formerly only under to the jurisdiction of the intermediate courts. This change is more convenient for litigants to file a lawsuit nearby.

2.2.2 Trademark Law

In 2009, the Supreme People's Court issued a judicial interpretation on the protection of famous trademarks, which clearly identified the judicial standard of famous trademarks. It also stipulated the factors needed to be considered, and the scope of protection on cross-class protection of famous trademarks, thereby establishing a clear legal basis on how to protect unregistered well-known trademarks.

2.2.3 Copyright Law

In 2010, the Standing Committee of the National People's Congress modified the *Copyright Law*. Thereafter, the State Council modified the *Implementing Regulations of the Copyright Law* in 2013, which was not long before the Supreme People's Court promulgated judicial interpretations on the protection of the right to network dissemination of information (the "2012 Interpretation") in 2012. According to this 2012 Interpretation, the Supreme Court has confirmed that copyright holders have the Information Network Transmission Right. In addition, the 2012 Interpretation provided that where the internet service supplier could prove that the infringement of information network transmission rights could not be discovered even by the reasonable and effective technical measures it had taken, such internet service supplier would not be held liable for the infringement. This eases the liability imposed on the internet service supplier to some extent.

3 Anti-Commercial Bribery

3.1 Laws and Regulations on Anti-Commercial Bribery

Any enterprises or individuals investing in the PRC are required to comply with the relevant Chinese laws and regulations on commercial bribery. Unlike the legislative practices of some foreign countries, there is no unified PRC code on commercial bribery. There are two major laws and regulations on anti-commercial bribery, the *Tentative Regulations of the State Administration for Industry and Commerce on the Prohibition of Commercial Bribery* (the "Tentative Regulations") promulgated in 1996 and the *Opinions of the Supreme People's Court and the Supreme People's Procuratorate on Some Issues Concerning the Applicable Laws for Handling Criminal Cases of Commercial Bribery* (the "Opinions") promulgated in 2008. Other industry-specific provisions are scattered in different laws and regulations, such as the *Drug Administration Law of the People's Republic of China*, the *Construction Law of the People's Republic of China*, the *Bidding Law of the People's Republic of China*, *Anti-Unfair Competition Law*, etc.

3.2 Legal Liability for Commercial Bribery in the PRC

Any enterprises or individuals in violation of the anti-commercial bribery laws and regulations in the PRC may bear the following three kinds of liabilities according to the respective nature of the act:

Criminal Liability: the *Criminal Law* and its Amendments as well as the *Opinions* serve as major legal basis for judicial authorities to prosecute commercial bribery acts. According to the *Opinions*, commercial bribery involves the following eight charges provided by the Criminal Law: Bribery, Offering Bribes, Entity Offering Bribes,

Intro-bribe, Bribery of Non-State Functionaries, Offering Bribes to Non-State Functionaries, Bribe Acceptance by an Entity and Offering Bribes to an Entity, all of which can be classified into three types below:

(1) Commercial bribery: a crime in which state functionaries accept the bribe (including Bribery, Offering Bribes, Intro-bribe and Entity Offering Bribes);

(2) Commercial bribery: a crime in which non-state functionaries accept the bribes (including Bribery of Non-State Functionaries and Offering Bribes to Non-State Functionaries);

(3) Commercial bribery: a crime in which entities accept the bribes (including Bribe Acceptance by an Entity and Offering Bribes to an Entity)

Individuals committing the crimes above, based on the circumstances of the crimes, are usually sentenced to detention, imprisonment and/or penalties. Entities committing the crime will bear the corresponding penalties while the persons who are in direct charge and other persons directly responsible shall be punished according to the preceding provisions of the individual crimes. In addition, there are some other special provisions applicable in some specific areas, such as the education, medicine and construction fields.

Administrative Liability: According to the *Tentative Regulations*, commercial bribery refers to a business operator's behavior of bribing other organizations or individuals with money or property or other means for sale or purchase of goods. Commercial bribery includes different types, which are described below:

(1) Money or property provided to other organizations or individuals;

(2) Secret commissions provided to other organizations or individuals without normal accounting records;

(3) Cash or material objects provided to other organizations or individuals in the sale or purchase of goods;

(4) Means of payment of any interest other than the property.

The business operators whose commercial bribery acts do not violate the *Criminal Law* shall be imposed a fine of no more than RMB 10,000 and no less than RMB 200,000 in accordance with the actual circumstances, and all illegal income shall be confiscated. In addition, in some special areas, the competent government authorities are empowered to impose other types of administrative punishments. For example, in the pharmaceutical industry, health administrative departments have the power to impose administrative penalties on commercial bribery in the field of medicine, including warnings, fines, confiscation of illegal income, revocation of business licenses or relevant qualification certificates, cancellation of licenses, etc.

Civil Liability: according to the Anti-*Unfair Competition Law* and relevant judicial interpretations, any operator whom has suffered from commercial bribery has the right to file a civil lawsuit, claiming compensation of damages from the commercial briber including the damages of the loss suffered by the operator as well as any reasonable expenses for the investigation of unfair competitive behavior. In addition,

in accordance with the *General Principles of the Civil Law of the PRC*, the *Contract Law of the PRC* and relevant judicial interpretations. If both parties of the transaction have reached an agreement on the prohibition of commercial bribery, once one party of the transaction commits commercial bribery, the other party can hold the breaching party liable for breach of the contract.

3.3 Case Analysis

Regarding cases where transnational corporations are suspected of involvement in commercial bribery in the PRC, according to the publicly disclosed information, some of them have not been held liable for any form of legal responsibility and some have been held liable and punished by the competent branch of the State Administration for Industry and Commerce (the "SAIC"). However, few are held liable for criminal responsibility. Based on our analysis, we found that transnational corporations usually violate the laws and regulations on anti-commercial bribery in two forms: one form is inappropriate behavior with government officials, such as inappropriate travel reimbursements to government officials supplied by a cosmetics multinational company. The other form is paying kickbacks to the business partners i.e. a multinational food company paying kickbacks to its partners. Therefore, we recommend that any enterprises and individuals preparing to invest in China should seek professional legal advice from lawyers in respect of what specific acts and operations may violate the anti-commercial bribery laws and regulations in the PRC.

4 Anti-unfair Competition

4.1 Laws and Regulations on Anti-unfair Competition in China

The Anti-Unfair Competition Law (the "*AUCL*") was promulgated in the PRC in 1993 to deal with some intellectual property concerns such as the attempt to pass off a product as legitimate, the imitation of trade dress, the infringement of trade secrets, and the unauthorized use of an enterprise name. There are 11 kinds of unfair competition acts are listed in the *AUCL*, including counterfeiting, restricting competition by public utility enterprises, unfair operation through administrative power, commercial bribery, false advertising, infringement of trade secrets, dumping, unfair conditional sales, unfair premium sales, damage to goodwill and traditional bidding. In 2007, the Supreme People's Court promulgated the *Interpretation of the Application of Law on the Trial of Civil Cases of Unfair Competition*, which made a more refined interpretation of the provisions of the *AUCL*. In addition, SAIC promulgated six sets of supporting regulations in accordance with the *AUCL*, such as the *Certain Provisions on the Prohibition of Unfair Competition Behavior That Counterfeit Specific Name, Packaging, Decoration of Well-Known Commodity*, the *Certain Regulations on Prohibiting Infringements upon Trade Secrets*, etc.

4.2 Protection Against Unfair Competition

When a foreign enterprise is damaged by the unfair competitive behaviors of its competitors, such foreign enterprise may apply three approaches below to protect its legitimate rights against the competitors:

- Criminal Prosecution: the infringed foreign enterprise may report the unfair competition acts to the police. If the police believe that the unfair competition acts conducted by the competitor has reached the degree set by criminal law after due investigation, such competitor will be prosecuted and imprisoned, in addition to being fined.

- Administrative Adjudication: the infringed foreign enterprise may file an administrative complaint regarding the unfair competition acts to the competent SAIC. According to the *AUCL*, the SAIC has the power to investigate the acts of unfair competition and render certain administrative remedies, including cease and desist orders, confiscation of illegal earnings, fines (the amount depends on the circumstances), and revocation of business license. For example, if an business operator counterfeits the commercial mark of others without authorization, the SAIC may impose on such business operator, according to the circumstances, a fine of no more than twice and no less than three times the amount of its illegal earnings, or revoke the business license of such business operator if the circumstances are serious. If an operator commits false advertising, the SAIC may, according to circumstances, impose a fine ranging from RMB 10,000 to RMB 200,000.

- Civil Litigation: the infringed foreign enterprise may file a lawsuit with the competent court with the jurisdiction to require responsible competitors to compensate the losses caused by acts of unfair competition. According to the *AUCL*, where an operator is damaged by its competing operator, such competing operator shall bear the responsibility for compensating the damages; where the losses suffered by the injured operator are difficult to calculate, the amount of damages shall be the profit gained by the infringer during the period of infringement through the infringing act; the infringer shall also bear all the reasonable costs paid by the injured operator in investigating the acts of unfair competition committed by the operator suspected of infringing its, his or her lawful rights and interests.

4.3 Cases Analysis

With the strengthening of intellectual property protection in the PRC, it is advisable for any foreign enterprises entering the Chinese market to protect their legitimate rights through the combination of the intellectual property rights protection and unfair competition, especially for the protection of intangible property such as trade secrets, business information that cannot be protected by patent or trademark. For example, some employees from one of our Japanese clients, a printing press manufacturer, quit their jobs and established a small company. These former employees manufactured the same printing presses with the trade secrets obtained during their employment with such Japanese manufacturer, which resulted in a loss of more than RMB 2,000,000 to such Japanese manufacturer. The Japanese manufacturer adopted both civil and criminal approaches to protect its legitimate rights. Ultimately, the court sentenced the company producing the infringed printing presses to compensate the Japanese manufacturer's total loss, while those former employees in violation of trade secrets were held criminally responsible as well.

CHAPTER VII DISPUTE RESOLUTION

1 Overview

Under the PRC legal system, parties in dispute may seek remedy either from people's courts or arbitration commissions. So it is advisable that the parties make a clear agreement on the appropriate venue to solve disputes before they arise.

Below is a comparison of litigation vs. arbitration:

	Litigation	Arbitration
Advantages	1. The court has the authority and power to take measures of property preservation and evidence preservation before and during the litigation. 2. For evidence that a party cannot obtain by itself, such party may apply for investigation and collection of evidence with the court. 3. Normally, the court fee is less than the arbitration fee. In addition, the parties are able to estimate the total court fee. 4. If the judgment of the court of first instance is not satisfactory to one party, it may appeal to a higher court for second instance. 5. The enforcement of a court judgment is easier than that of an arbitration award.	1. Arbitration procedures are more flexible, the parties may choose the arbitration commissions, arbitration rules, governing laws, place of arbitration, arbitrators, etc. 2. Some arbitrators have more expertise than judges within certain areas, and they are more suitable to try certain cases. 3. The arbitration will be held in private, and the arbitration process and arbitration results will not be disclosed to the public. 4. Normally, the arbitration award will be final and binding on the parties, and it can be compulsorily enforced. 5. Normally, the arbitration procedure will cost less time than litigation procedures. 6. Most of the arbitration awards rendered by a foreign arbitration commission may be recognized by Chinese courts.
Disadvantages	1. A foreign court's judgment may not be recognized or enforced by the Chinese court. 2. The parties have no rights in choosing judges. 3. Each court has its own jurisdiction, and the parties	1. The parties will have very limited remedies if the arbitration award is not satisfactory. 2. Different arbitration commissions have different arbitration fee standards, and sometimes it is difficult to

	will have a very limited chance in choosing the court.	estimate the arbitration cost. 3. The jurisdiction of an arbitration commission is subject to the parities' mutual agreement. 4. Certain types of disputes cannot be arbitrated.

2 Litigation

2.1 Court System

The Chinese court system comprises the Supreme Court, ordinary courts and special courts.

	Court Name	Level
Supreme Court	The Supreme People's Court	State Level
Ordinary Court	High court	Provincial level
	Intermediate court	Municipal level
	Basic-level court	District level
Special Court	Military court	N/A
	Maritime court	N/A
	Forest court	N/A

2.2 Jurisdiction of Courts

2.2.1 Level of Jurisdiction

Generally, a case will be tried by a lower level court, and then the parties may appeal to a higher court within 15 days from the date on which the judgment for the first instance was served. Basic-level courts shall have jurisdiction as courts of first instance over all civil cases, except otherwise stipulated by law.

Intermediate courts shall have jurisdiction as courts of first instance over the following types of civil cases: a) major cases involving foreign parties; b) cases with significant impact in the areas over which the courts exercise jurisdiction; and c) cases determined by the Supreme People's Court to come under the jurisdiction of the intermediate courts.

High courts shall have jurisdiction as courts of first instance over civil cases with significant impact in the areas over which they exercise jurisdiction. The Supreme People's Court shall have jurisdiction as the court of first instance over the following types of civil cases: a) cases with significant impact on the whole country; and b) cases that the Supreme People's Court deems it should try itself.

2.2.2 Territorial Jurisdiction

General principle: The court in the place where the defendant is domiciled shall have jurisdiction. A civil action instituted against a legal person (such as a limited liability company) or any other organization shall come under the jurisdiction of the court in

the place where the defendant is domiciled. A civil action instituted against a citizen shall come under the jurisdiction of the court in the place where the defendant is domiciled; if the defendant's place of domicile is different from the place of his habitual residence, the court in the place of his habitual residence shall have jurisdiction. If the places of domicile or habitual residence of several defendants in the same lawsuit come under the jurisdiction of two or more courts, all of those courts shall have jurisdiction.

Exceptions: The jurisdiction of certain civil actions is subject to the nature of the disputes:

Nature of Dispute	Jurisdiction
Contractual disputes	Court of the place where the defendant is domiciled or where the contract is performed
Disputes over insurance contracts	Court of the place where the defendant is domiciled or where the insured object is located
Disputes over negotiable instruments	Court of the place where payment on the instrument is made or where the defendant is domiciled
Disputes over the incorporation of a company, confirmation of the eligibility of shareholder(s) of the company, profit distribution or dissolution of the company	Court at the domicile of the company
Disputes over a contract for railways, highways, waterways, air transportation or combined transportation	Court of the place of departure or place of destination or of the place where the defendant is domiciled
Tort	Court of the place where the tort was committed or where the defendant is domiciled
Claims for damages arising from a railway, highway, waterway or aviation accident	Court of the place where the accident took place, where the vehicle or vessel first arrived, where the aircraft first landed or of the place where the defendant is domiciled
Claims for damages arising from a collision of vessels or other maritime accident	Court of the place where the collision took place, where the vessel collided with first docked, where the vessel at fault was detained or where the defendant is domiciled
Actions involving maritime salvage expenses	Court of the place of salvage or of the place where the salvaged ship first docked
Actions involving general average	Court of the place where the ship first docked, where the general average was adjusted or where the voyage ended
Disputes over immovable property	Court of the place where the immovable property is located
Disputes arising from port operations	Court of the place where the port is located
Disputes over inheritance	Court of the place of domicile of the person whose property is inherited or where the major portion of the estate is located

2.2.2.1 Agreement on Jurisdiction

The parties to a contractual dispute or any other property dispute may agree in the written contract on the court at the locality where the defendant is domiciled, where the contract is performed, where the contract is signed, where the plaintiff is domiciled or where the subject matter is located to be the competent court.

2.3 Agents Ad Litem

Before or during litigation, the parties have the right to appoint agents, file lawsuits, challenge adjudication personnel, collect and present evidence, engage in debates, request mediation, file appeals and apply for execution.

Each party may appoint one or two persons to act as his/her/its agent ad litem by submitting to the court a power of attorney bearing his/her/its signature or seal, provided that such persons are: a) lawyers or basic legal service workers; b) close relatives or employees of the party to the lawsuit; or c) citizens recommended by the community where the party resides, or the employer of the party, or any other social organization concerned.

When a party without a domicile within the territory of the People's Republic of China appoints a lawyer or another person of the People's Republic of China as his or its agent ad litem, the power of attorney sent or forwarded from outside the territory of the People's Republic of China shall become effective only after the following has been completed:

(1) the power of attorney has been notarized by a notary public of his/her/its state and either has been authenticated by the embassy or a consulate of the People's Republic of China in the foreign state; or

(2) the certification procedures provided for in the relevant treaty between the People's Republic of China and the foreign state have been carried out.

Except for the power of attorney, the certificate of incorporation (or other equivalent certificate) and the identity certificate of the legal representative (such as executive director, board chairman) of this party shall also be notarized and authenticated.

2.4 Evidence

The following items may be recognized as evidence during litigation: i) statement of the parties; ii) documentary evidence; iii) physical evidence; iv) audio and visual material; v) electronic data; vi) testimony of witnesses; vii) opinions of expert witnesses; and viii) transcript of inspection and examination. Any evidence generated in a foreign territory will not be recognized as evidence by the court unless it has been notarized and authenticated.

2.5 Limitation of Actions

The period of limitation of actions on a request to the Court for the protection of rights in civil matters is two years. However, the period of limitation of actions shall be one year if:

(1) A claim is made for bodily harm compensation;

(2) Sale of a substandard item is not declared to be such;

(3) Payment of rent delays or refuses; and

(4) A deposited article is lost or damaged.

The period of limitation of actions commences from the time it is known, or should have been known, that a right was infringed upon. However, if more than twenty years have passed since the date of the infringement of the right, the court shall not offer any protection.

2.6 Institution of Actions

To institute an action, the following conditions must be satisfied:

(1) the plaintiff must be a citizen, legal person or other organization with a direct interest in the case;

(2) there must be a specific defendant;

(3) there must be a specific claim and a specific factual basis and grounds; and

(4) the suit must fall within the range of civil actions accepted by the courts and within the jurisdiction of the court with which it is filed.

If the court finds the civil action satisfies the above conditions, it shall place the case on its trial docket within seven days and notify the parties. If the court finds that the bill of complaint or verbal complaint does not satisfy the above conditions, it shall rule within seven days not to accept the action. The plaintiff may appeal against such ruling if he is dissatisfied with the ruling.

2.7 Trial Procedure

2.7.1 First Instance

2.7.1.1 Defense

The court shall deliver a copy of a motion of complaint to the defendant within five (5) days after the claim is filed; the defendant shall file a defense within 15 days after receiving the copy of the motion of complaint. Failure by the defendant to provide a defense does not affect the hearing of the case by the court.

If a party objects to the jurisdiction over a case after its acceptance by a court, the party shall raise the objection during the time limit for filing a statement of defense.

2.7.1.2 Trial in Court

When trying a civil case of first instance, a court shall form a collegiate bench that must have an odd number of members. Civil cases to which summary procedure is applied shall be tried by a single judge. The court shall try civil cases in public, except for cases that involve State secrets or private matters of individuals or for which the

law provides differently. The trial procedure includes the following parts:

(1) Trial Preparation

Before a trial hearing is opened, the court clerk shall ascertain the presence of the parties and the other participants in the action and announce the rules of court discipline. At the opening of a trial hearing, the presiding judge shall check the parties present, announce the cause of action, the names of the adjudication personnel and the name of the court clerk, advise the parties of their procedural rights and obligations and inquire whether the parties wish to challenge any adjudication personnel.

(2) Court Investigation

Investigation before the court shall be conducted in accordance with the following procedure: a) statements by the parties are presented; b) witnesses give testimony; the depositions of witnesses not present are read; c) documentary evidence, physical evidence, audio-visual data and electronic data is produced; d) opinion of expert witnesses is read out; and e) the record of the inquest is read out.

(3) Court Debates

Court debates shall be conducted in accordance with the following procedure: a) presentation of oral statements by the plaintiff and his/her/its agent ad litem; b) presentation of oral responses by the defendant and his/her/its agent ad litem; c) presentation of oral statements or responses by the third party and his/her/its agent ad litem; d) debate between the parties. At the conclusion of the court debate, the presiding judge shall first ask the plaintiff, then the defendant and finally the third party to make their final comments.

(4) Judgment

At the conclusion of the court debate or at a later time, the court will render a judgment. If possible, non-compulsory mediation may be conducted prior to making a judgment. If mediation is unsuccessful, a judgment shall be made. Normally the court will conclude the case within six months from the date of putting it on its trial docket. However, the period for a trial by the court of civil cases involving foreign parties shall not be subject to such restrictions.

2.7.2 Second Instance

If a party disagrees with a judgment made by the court of first instance, he shall have the right to lodge an appeal by submitting an appeal petition with the immediate superior court within 15 days (30 days where a foreign party is involved) from the date on which the written judgment was served. If a party disagrees with a ruling made by a local court of first instance, he/she/it shall have the right to lodge an appeal with the immediate superior court within 10 days (30 days where a foreign party is involved) from the date on which the written ruling was served.

When trying a civil case at second instance, a court shall form a collegiate bench of judges. The collegiate bench must have an odd number of members. After an appeal hearing, a court of the second instance shall decide according to the following

circumstances:

(1) where the original judgment or ruling is supported by clear facts and correct application of law, a judgment or ruling shall be made to dismiss the appeal and uphold the original judgment or ruling;

(2) where the original judgment or ruling contains any errors in the verification of facts or application of law, a judgment or ruling amending, revoking or modifying the original judgment or ruling shall be made;

(3) where the original judgment or ruling involves any errors in the verification of fundamental facts, a ruling shall be made to revoke the original judgment and return the case to the court that issued the judgment or ruling for retrial, or amend the judgment after the facts have been properly verified; and

(4) if the original judgment fails to include any party to the case or involves any serious violation of the statutory procedures, including an invalid default judgment, a ruling shall be made to dismiss the original judgment and return the case to the original court for retrial.

2.8 Litigation Costs

A party who files a civil litigation shall pay a case acceptance fee. The case acceptance fees shall be paid pursuant to the following standards respectively:

For cases involving a property dispute, the case acceptance fees shall be paid section by section on a cumulative basis subject to the amount or value of the claim as per the following proportions: 1) for cases of no more than RMB 10,000, RMB 50 shall be paid for each case; 2)for portions of more than RMB 10,000 but less than RMB 100,000, the fee shall be paid at the rate of 2.5%; 3)for portions of more than RMB 100,000 but less than RMB 200,000, the fees shall be paid at the rate of 2%; 4)for portions of more than RMB 200,000 but less than RMB 500,000, the fees shall be paid at the rate of 1.5%;5)for portions of more than RMB 500,000 but less than RMB 1million, the fees shall be paid at the rate of 1%;6)for portions of more than RMB 1 million but less than RMB 2 million, the fees shall be paid at the rate of 0.9%;7)for portions of more than RMB 2 million but less than RMB 5 million, the fees shall be paid at the rate of 0.8%;8)for portions of more than RMB 5 million but less than RMB 10 million, the fees shall be paid at the rate of 0.7%;9)For portions of more than RMB 10 million but less than RMB 20 million, the fees shall be paid at the rate of 0.6%; and 10)for portions of more than RMB 20 million, the fees shall be paid at the rate of 0.5%.

For any cases not involving property, the case acceptance fees shall be paid according to the following standards respectively: 1) for each divorce case, RMB 50 to RMB 300 shall be paid. If property division is involved, and the total value of the property involved does not exceed RMB 200,000, no additional fee shall be paid; for portions of more than RMB 200,000, the fee shall be paid at the rate of 0.5%; 2) for each case of infringement upon the right to name, the right to portrait, the right to reputation, the right to honor or any other right to personality, RMB 100 to RMB 500 shall be paid. If compensation for damage is involved, and the compensation amount is not more than RMB 50,000, no additional fee shall be paid; for portions of more than RMB

50,000 but less than RMB 100,000, the fee shall be paid at the rate of 1%; for portions of more than RMB 100,000, the fee shall be paid at the rate of 0.5%; 3) for other cases not involving property, RMB 50 to RMB 100 shall be paid for each case.

For civil cases of intellectual property rights, if there is no amount or value in the dispute, RMB 500 to RMB 1,000 shall be paid; if there is any amount or price in the dispute, the fee shall be paid at the rate applicable to property cases. For labor dispute cases, RMB 10 shall be paid for each case. For administrative cases, the fees shall be paid according to the following standards: 1) For administrative cases involving trademark, patent, or maritime affairs, RMB 100 shall be paid for each case;2)For other administrative cases, RMB 50 shall be paid for each case. Where the party raises an objection to the jurisdiction over the case, but the objection is not tenable, RMB 50 to RMB 100 shall be paid for each case.

Except for the case acceptance fee, the parties engaged in a civil litigation may be required to pay: 1)application fees (for example, the application fee for an application filed with the court for compulsory enforcement of any legally effective judgment); and 2) travel expenses, accommodation expenses, living expenses and subsidies for missed work that are incurred by the witnesses, authenticators, interpreters and adjusters for appearing before the people' s court on the date designated by the court. Parties engaging an attorney shall need to pay counsels' professional fee.

2.9 Preservation Measures

For a party would suffer irreparable damage if it fails to petition for property preservation promptly, such party may, before instituting a lawsuit or applying for arbitration, apply for property preservation measures with the court at the locality of the property, the domicile of the party on which the application is made or the competent court with jurisdiction over the case. The applicant shall also provide security for such application, or the court will reject the application. Where the applicant fails to institute a lawsuit or apply for arbitration in accordance with the law within 30 days after the court has adopted preservation measures, the court will revoke the preservation order.

In the event that the judgment on the case becomes impossible to enforce or such judgment causes damage to a party because of the conduct of the other party to the case or due to any other reasons, the court may, upon the request of the said party or at its own discretion, order the preservation of the property of the other party, specific performances or injunctions.

When a court receives an urgent application for preservation, it will decide within 48 hours after the receipt of the application. If the court allows the application, such measures shall come into force immediately.

If a party is dissatisfied with a ruling for the preservation of property, he/she/it may have one chance to apply for review. The execution of the ruling shall not be suspended during the period of review.

2.10 Execution of Judgments and Rulings

A legally effective civil judgment or ruling, or that portion of a legally effective

criminal judgment or ruling that pertains to property, shall be enforced by the court of first instance or the court at the same level as the court where the property subject to execution is located.

Where a person subject to enforcement fails to perform the obligations specified in the legal document in accordance with the notice of enforcement, the court shall have the power to direct inquiries to the relevant entities about the deposits, bonds, stocks and funds of the person subject to enforcement. In addition, the court shall have the power to detain, freeze, transfer or sell the deposits of such person, provided that such inquiries, detentions, freezing, transfers or sales do not exceed the scope of the obligations to be performed by the person subject to enforcement.

2.11 Judicial Assistance

Pursuant to international treaties concluded or acceded to by the People's Republic of China or in accordance with the principle of reciprocity, courts and foreign courts may request mutual assistance in the service of legal documents, investigations, collections of evidence, and other acts in connection with litigation, on each other's behalf.

The request for and provision of judicial assistance shall be conducted through the channels stipulated in the international treaties concluded or acceded to by the People's Republic of China. Where no such treaty exists, the request for and provision of judicial assistance shall be conducted through diplomatic channels.

If a party applies for the execution of a legally effective judgment or ruling made by a Chinese court and the party subject to such execution or his/her/its property is not located within the territory of the People's Republic of China, the applicant may directly apply for recognition and execution to the competent foreign court. Alternatively, the Chinese court may, pursuant to an international treaty concluded or acceded to by the People's Republic of China or in accordance with the principle of reciprocity, request the foreign court to recognize and execute the judgment or ruling.

If a legally effective judgment or ruling made by a foreign court requires recognition and execution by a court of the People's Republic of China, the party concerned may directly apply for recognition and execution with the competent intermediate court of the People's Republic of China. Alternatively, the foreign court may, pursuant to the provisions of the international treaty concluded between or acceded to by the foreign state and the People's Republic of China, or in accordance with the principle of reciprocity, request the Chinese court to recognize and execute the judgment or ruling.

3 Arbitration

3.1 Scope of Arbitration

Contractual disputes and disputes arising from property rights and interests between citizens, legal persons and other organizations of equal status in law may be submitted to arbitration. The following disputes shall not be submitted to arbitration: i)disputes over marriage, adoption, guardianship, child maintenance and inheritance; and ii) administrative disputes falling within the jurisdiction of the relevant administrative

organs according to law.

3.2 Arbitration Agreement or Arbitration Clause

The parties adopting arbitration for dispute resolution shall reach an arbitration agreement on a mutually voluntary basis, or the competent arbitration commission will not accept the application for arbitration submitted by one of the parties. An arbitration agreement shall include the arbitration clauses stipulated in a contract as well as any other written agreement for arbitration concluded before or after a dispute occurs. The following contents shall be included in an arbitration agreement: i) the expression of the parties' wish to submit to arbitration; ii) the matters to be arbitrated; and iii) the arbitration commission selected by the parties.

An arbitration agreement shall be invalid under any of the following circumstances: i)matters agreed upon for arbitration are beyond the scope of arbitration prescribed by law; ii) an arbitration agreement concluded by persons with or without limited capacity for civil acts; and iii) one party forces the other party to sign an arbitration agreement by means of duress.

If the parties object to the validity of the arbitration agreement, they may apply to the arbitration commission for a decision or to a court for a ruling. If one of the parties applies for a decision with the arbitration commission, but the other party applies for a court ruling, the court shall give the ruling. If the parties contest the validity of the arbitration agreement, the objection shall be made before the start of the first hearing of the arbitration tribunal.

Where the parties have reached an arbitration agreement, but one of the parties initiates an action in a court without stating the existence of the arbitration agreement, the court shall reject the action if the other party submits to the court the arbitration agreement before the first hearing of the case unless the arbitration agreement is invalid. If the other party fails to object to the hearing by the court before the first hearing, the arbitration agreement shall be considered to have been waived by the party and the court shall proceed with the hearing.

Sample Arbitration Clause:

Any dispute arising from *or in connection with this Contract shall be submitted to the China International Economic and Trade Arbitration Commission (the "CIETAC") for arbitration, which shall be conducted in accordance with the CIETAC's arbitration rules in effect at the time of applying for arbitration. The arbitral award is final and binding upon both parties.*

3.3 Arbitration Commission

An arbitration commission shall be selected by the parties by agreement. The jurisdiction by level system and the territorial jurisdiction system shall not apply in arbitration. The China International Economic and Trade Arbitration Commission (the "CIETAC") is the most influential arbitration commission in Mainland China. In addition, there are also some other arbitration commissions who provide professional arbitration services, such as the Beijing Arbitration Commission.

3.4 Application for Arbitration

Parties applying for arbitration shall meet the following conditions: i) there is an arbitration agreement; ii) there is a specific claim and facts and grounds on which the claim is based; and iii) the claim is under the jurisdiction of the arbitration commission. A party applying for arbitration shall submit to an arbitration commission the arbitration agreement, an application for arbitration and copies thereof.

3.5 Acceptance of Arbitration

The arbitration commission shall, within five (5) days from the date of the receipt of an application for arbitration, notify the parties that it considers the conditions for acceptance have been fulfilled, and that the application is accepted by it. If the arbitration commission considers that the conditions have not been fulfilled, it shall notify the parties in writing of its rejection, stating its reasons.

Upon acceptance of an application for arbitration, the arbitration commission shall, within the time limit specified by the arbitration rules, serve a copy of the arbitration rules and the list of arbitrators on each of the claimant and the respondent.

Upon receipt of a copy of the arbitration application, the respondent shall, within the time limit prescribed by the arbitration rules, submit its defense to the arbitration commission. Upon receipt of the defense, the arbitration commission shall, within the time limit prescribed by the arbitration rules, serve a copy of the reply on the claimant. The failure of the respondent to submit a defense shall not affect the proceeding of the arbitration procedures.

3.6 Arbitral Tribunal

If the parties agree to form an arbitral tribunal comprising three arbitrators, each party shall select or authorize the chairman of the arbitration commission to appoint one arbitrator. The third arbitrator shall be selected jointly by the parties or be nominated by the chairman of the arbitration commission in accordance with a joint mandate given by the parties. The third arbitrator shall be the presiding arbitrator.

If the parties agree to have one arbitrator to form an arbitration tribunal, the arbitrator shall be selected jointly by the parties or be nominated by the chairman of the arbitration commission in accordance with a joint mandate given by the parties.

3.7 Agent

The parties and their legal representatives may appoint lawyers or engage agents to handle matters relating to the arbitration. In the event that a lawyer or an agent is appointed to handle the arbitration matters, a letter of authorization shall be submitted to the arbitration commission.

3.8 Hearing

An arbitration tribunal shall hold a tribunal session to hear an arbitration case. If the parties agree not to hold a hearing, the arbitration tribunal may render an award in accordance with the arbitration application, the defense statement and other

documents. An arbitration tribunal shall not be conducted in public. If the parties agree to a public hearing, the arbitration tribunal may proceed in public, except for those concerning state secrets. The parties have the right to argue during arbitration procedures.

3.9 Evidence

Any evidence shall be produced at the start of the hearing. The parties may challenge the validity of such evidence. In the event that the evidence might be destroyed or would be difficult to obtain later on, the parties may apply for evidence preservation. If the parties apply for such preservation, the arbitration commission shall submit the application to the basic-level court in the place where the evidence is located.

3.10 Preservation Measures

A party may apply for property preservation if, as the result of an act of the other party or for some other reasons, it appears that an award may be impossible or difficult to enforce. If one of the parties applies for property preservation, the arbitration commission shall submit to a court the application of the party.

3.11 Arbitral Award

Before giving an award, an arbitral tribunal may first attempt to conciliate. If the parties apply for conciliation voluntarily, the arbitral tribunal shall conciliate. If conciliation is unsuccessful, an award shall be made promptly. When a settlement agreement is reached by conciliation, the arbitral tribunal shall prepare a conciliation statement or award on the basis of the results of the settlement agreement. A conciliation statement shall have the same legal force as that of an award. During the course of arbitration by an arbitration tribunal, where a part of facts has been made clear, a partial award may first be given in relation to that part. An award shall be legally effective on the date it is given.

The parties may apply to the intermediate court at the place where the arbitration commission is located for cancellation of an award if they provide evidence proving that the award involves one of the following circumstances: i) there is no arbitration agreement between the parties; ii)the matters of the award are beyond the extent of the arbitration agreement or not under the jurisdiction of the arbitration commission; iii)the composition of the arbitral tribunal or the arbitration procedure is in contrary to the legal procedure; iv) the evidence on which the award is based is falsified; v)the other party has concealed evidence which is sufficient to affect the impartiality of the award; or vi) the arbitrator(s) has (have) demanded or accepted bribes, committed graft or perverted the law in making the arbitral award.

The court shall rule to cancel the award if the existence of one of the circumstances prescribed above is confirmed by its collegiate bench. The court shall rule to cancel the award if it holds that the award is contrary to the social and public interests. If a party applies for cancellation of an award, an application shall be submitted within six (6) months after receipt of the award.

If the person against whom the application is made presents evidence that proves that

the arbitral award made by an arbitration institution involves any of the following circumstances, the court shall, after examination and verification by a collegiate bench formed by the court, rule to deny execution of the award: i) the parties have neither included an arbitration clause in their contract nor subsequently reached a written arbitration agreement; ii) the person against whom the application is made was not requested to appoint an arbitrator or take part in the arbitration proceedings or the person was unable to state his opinions due to reasons for which he is not responsible; iii) the composition of the arbitration tribunal or the arbitration procedure was not in conformity with the rules of arbitration; or iv) matters decided in the award exceed the scope of the arbitration agreement or are beyond the arbitral authority of the arbitration institution. If the court determines that the execution of the said award would be against public interest, it shall rule to deny execution.

3.12 Enforcement of Arbitral Award

If one party fails to execute the award, the other party may apply to a court for enforcement. Where the party subject to enforcement or its property is not within the territory of the People's Republic of China, a party applying for the enforcement of a legally effective arbitration award shall apply directly to the foreign court having jurisdiction for recognition and enforcement of the award.

If an award made by a foreign arbitration institution must be recognized and executed by a court of the People's Republic of China, the party concerned shall directly apply to the intermediate court of the place where the party subject to execution is domiciled or where his property is located. The court shall handle the matter pursuant to international treaties concluded or acceded to by the People's Republic of China or in accordance with the principle of reciprocity.

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