

CHINA UPDATE

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MOFCOM Promulgates Two Rules on Anti-Monopoly Review for Concentration of Operators

Key Points:

- **MOFCOM has promulgated new rules providing detailed guidance on its procedure for assessing antitrust reports**
- **The adopted version of MOFCOM's rules on the application and reporting of concentration of operators fails to include detailed explanations that were in the draft circulated for public comments**

On November 27, 2009 China's Ministry of Commerce (MOFCOM) promulgated the Concentration of Operators Assessment Rules (Assessment Rules) and the Concentration of Operator Application/Reporting Rules (Reporting Rules). Both the Assessment Rules and Reporting Rules will take effect on January 1, 2010.

The Assessment Rules focus on the review process after the application for antitrust review is filed with and accepted by the MOFCOM. These rules provide detail on the withdrawal of the application, the right of the involved parties to present their statements and arguments to the MOFCOM, and the procedures of the hearing, as well as how the preliminary decision, the decision for further investigation and the decision for imposing conditions to the transaction should be reached. One notable change in the Assessment Rules from

the draft published in March 2009 is they no longer require that the hearing be held confidentially.

The Reporting Rules were promulgated in accordance with the Anti-Monopoly Law as well as the State Council's Rules on the Application/Reporting Criteria adopted in August 2008. Among other things, the rules provide explanations on how turnover should be calculated.

The Anti-Monopoly Law lists three circumstances that fall within the definition of "concentration of business operators": (i) merger, (ii) a business operator obtaining control of other business operators through the acquisition of their equity or assets, or (iii) a business operator obtaining control of or being able to exercise a decisive influence on other business operators through contractual or other means. There were a lot of questions with respect to what will be considered "obtaining control of other business operators" when the Anti-Monopoly Law was issued. In the draft of the Reporting Rules circulated in March 2009, the MOFCOM provided detailed explanations of "obtaining control of other business operators," which included obtaining 50 percent voting rights, or obtaining less than 50 percent voting rights but gaining the power to appoint/remove a director or direct on important issues such as budgets or sale price investment. The March draft also exempted the veto right granted to protect minority shareholders from the definition of "obtaining the control of other business." People were expecting

such details to be clarified in the official version, but it fails to do so. The absence of such explanations in the Reporting Rules leaves a lot of uncertainty for business entities and more discretion for the MOFCOM.

Another important change is the March draft specified that establishing a new joint venture is a “concentration of operators,” so an antitrust report must be filed if the thresholds are met. The final version deleted such wording.

– *Laura Wang*

TV/Radio Broadcasters Ordered to Pay Copyright Royalties

Key Points:

- ***New regulations enhance existing copyright law***
- ***The State Council has adopted royalty formulas for TV and radio broadcasters***

The State Council has adopted regulations that require television and radio broadcasters to pay royalties to copyright holders if they play music on the air. The new regulations, effective January 1, 2010, require radio and television stations to pay fees based upon one of three criteria: (i) an annual fixed lump-sum fee mutually agreed upon by the broadcasters and copyright collective management organizations, (ii) a portion of advertising revenues

(e.g., 0.01 percent of a station’s advertising income if music makes up less than 1 percent of program time) or (iii) the duration of music played during the program (e.g., radio stations pay RMB 0.3 if they play music for 1 minute, and television stations pay RMB 1.5 per minute, a rate that will increase in five years). It is left for observation as to whether the rules will be effectively implemented. See the Provisional Measures on Payment of Compensation for Utilization of Sound Recordings by Radio and Television Stations, Order No. 566, promulgated by the State Council on November 10, 2009 and effective on January 1, 2010.

– *James M. Zimmerman*

China Further Opens Gate for RMB Funds Run by Foreign Private Equity Firms

Key Points:

- ***Obstacles for foreign private equity firms forming an RMB fund have been eliminated***
- ***Foreign-funded equity investment management enterprises (FEIMEs) are allowed in Pudong***
- ***Incentives will be provided to FEIMEs***
- ***Uncertainties and restrictions remain***

After the Provisions for the Acquisition of Domestic Enterprises by Foreign Investors, commonly known as the 2006 M&A Rules, were issued, it became

more and more difficult for foreign investors to invest in China. Onshore RMB private equity funds funded from overseas (RMB funds) then became an attractive option for foreign investors to invest in China as they provided a cheaper and smoother investment process.

A private equity (PE) fund is typically run by a foreign PE firm as a general partner (GP) and several limited partnerships (LPs). However, a foreign-invested RMB fund in the form of a limited partnership, with a foreign fund manager as the GP and China-based investors as limited partners, is not feasible yet. One of the important reasons for this is the lack of legal basis for foreign investment in a limited partnership. An alternative to foreign PE firms is the so-called foreign-invested venture capital investment enterprise (FIVCIE), which has been allowed since 2003 under the Administration Measures of Foreign-Invested Venture Capital Investment Enterprise and was intended to take the form of a corporation. Nevertheless, FIVCIEs have not been implemented extensively, as they are permitted to invest only in nonlisted high- and new-technology enterprises. A notice promulgated by the State Administration of Foreign Exchange (SAFE) in August 2008 (Circular 142) prevents existing foreign-invested enterprises from making further investments outside their business scope using their original capital.

Due to the global financial crisis, China's previous market development strategy of attracting foreign investment has been facing significant challenges. In contrast, the massive capital reserve and increasing investment demands within the country have created demand for new investment opportunities. Given this dilemma, the State Council issued Several Opinions on Providing Financing Support for Economic Development at the end of 2008, based on which several localities have promulgated rules or opinions encouraging foreign-invested onshore management entities, which may to a certain extent surpass the state law. For example, in order to build Shanghai into an international financial center on par with Hong Kong, the city continues to negotiate with the central government and to reduce barriers for onshore PE funds. In August 2008, four governmental divisions of Shanghai Municipality jointly issued the Notice on Business Registration and Other Issues of Equity Investment Enterprises (the Notice). The Notice stipulates various incentives to be granted to so-called equity investment enterprises and equity investment management enterprises. In June 2009, Pudong, Shanghai's largest district, issued its Pilot Measures Regarding the Establishment of Foreign-Funded Equity Investment Management Enterprises (the Pilot Measures). The Pilot Measures allow, for the first time in China, foreign PE firms to register onshore FEIMEs. Although an FEIME is required to be a limited company instead of a partnership, it is

able to act as both fund manager and GP to form RMB funds in association with China-based limited partners. However, equity investment enterprises, which are intended to be GPs, have not been given a clear definition and established guidance. Officials from the Shanghai Finance Service Office confirmed that so far no FEIMEs have been approved in Shanghai.

The Pilot Measures provide several conditions for setting up an FEIME including:

- The FEIME shall be incorporated as a limited company instead of a limited partnership;
- Its registered capital shall be no less than US\$2 million;
- At least one of the FEIME's investors (or its affiliated entities) shall be legally engaged in equity investment or equity investment management; and
- The FEIME shall have at least two executives with two or more years of experience in a senior management position in either equity investment or equity investment management.

The Pilot Measures further confirm that the specific incentive and preferential tax policies offered to domestic equity investors as set forth in the Notice shall be applicable to the FEIME. For instance, if

the registered capital of an FEIME amounts to US\$500 million, it will be granted a lump-sum award of US\$5 million. US\$10 million or US\$15 million will be awarded to a FEIME if its registered capital reaches US\$3 billion or US\$5 billion, respectively.

With the help of the Pilot Measures, Shanghai has attracted foreign PE firms such as The Blackstone Group, which launched its first RMB fund in Pudong in November, as well as The Carlyle Group and First Eastern Investment Group.

Despite the most recent development, obstacles that impede the establishment of onshore PEs still exist due to the uncertainty of the legislation. So far there is no unified central law or regulation with regard to foreign-managed RMB funds. The Pilot Measures will automatically expire after June 2010. Foreign exchange approval is still required when foreign capital is converted to RMB, and investment projects of the PE firm require the approval of the MOFCOM in advance. In addition, there remain strict limitations for overseas funds to invest in certain "investment-prohibited industries" or "investment-restricted industries" in China, let alone the fact that foreign PE firms are facing increasing competition from domestic funds. The long-awaited Administrative Measures on Establishment of Partnership Enterprises by Foreign Enterprises and Individuals in China (Foreign Invested Partnership Measures) were promulgated on November 25, 2009 and will be effective as of March 1, 2010. It was previously expected that the Foreign Invested

Partnership Measures would make it possible for foreign PE firms to form partnerships directly in China. The measures, however, stipulate that the foreign enterprises or individuals forming partnerships for the purpose of investment will be subject to separate regulations. This has been confirmed by officials from the State Council. We will continue to report on further legislative developments.

– Doris Chen

China Encourages Development of Internet Café Chains

Key Points:

- ***New measures have been promulgated to encourage the development of café chains***
- ***A national café chain must have registered capital of RMB 50 million and at least 30 café sites, whereas a regional café chain must have registered capital of RMB 10 million and at least five café sites***
- ***Favorable policies will facilitate a café chain's acquisition of individual cafés***
- ***A café chain will be disqualified in certain circumstances***

In an effort to further strengthen the administration of the Internet café market, PRC authorities are encouraging the development of Internet café chains with uniform service standards and management systems. Early in April 2009 the PRC Ministry of Culture (MOC) implied that no individual café would be granted a café operation license, thus creating a favorable environment for the expansion of Internet café chains. More recently, the MOC promulgated the Administrative Measures for the Qualification of Internet Café Chains (the Measures) on September 7, 2009, which more clearly defined Internet café chains and introduced the favorable policies.

The Measures classify Internet café chains into two categories, namely national chains and regional chains. A national café chain must have registered capital of at least RMB 50 million and at least 30 café sites under direct management in which it holds all or a majority stake (direct sites) spread over at least three different provinces. A regional café chain is defined under the Measures as having at least RMB 10 million in registered capital and at least five direct sites (or a minimum number of direct sites as determined by the provincial-level cultural administration authority) in the region where it is located.

An Internet café chain, whether national or regional, should adopt a uniform financial management system for all of its café sites. To apply for qualification as an Internet café chain, an applicant

must submit its financial statements verified by a licensed intermediary agency.

Cultural administration authorities were urged to give priority to the development of café chains when creating overall plans for the Internet café industry and to adopt an expedited procedure for a café chain to modify its Internet operation license when it acquires or merges with an individual café. According to the Measures, cultural administration authorities will develop other favorable policies for café chains in the future.

Alongside the favorable policies comes the stringent regulation of café chains. An enterprise will be disqualified as a café chain if (i) the chain applies for an Internet operation license on behalf of an entity in which it does not hold a 100 percent or a majority stake, (ii) any of its café sites receive penalties five times or more in one year or (iii) five of its café sites (or more than 10 percent of its café sites) receive a penalty in one year. In the event of disqualification, the enterprise and other enterprises in which the legal representative or responsible person with the disqualified enterprise assumes the major position will not be allowed to apply for re-qualification of the café chain until two years after the disqualification.

– Ryan Chen

Issues to Watch for When Filing With Government Agencies

An interview with Xin Lan Liu¹.

What are the normal approval procedures to follow when establishing a wholly foreign-owned enterprise (WFOE) or joint venture (JV) in China?

Liu: For establishing an ordinary WFOE/JV company, there are usually 10 steps to be followed:

1. Name reservation;
2. Application for approvals of the articles of association (AOA) and board of directors (BOD);
3. Application for a business license;
4. Application for public security registration;
5. Application for an organization code certificate;
6. Application for tax registration;
7. Application for foreign exchange registration;
8. Application for statistical registration;
9. Application for financial registration; and
10. Application for customs registration.

¹ Xinlan Liu is a paralegal in the Beijing office of Squire, Sanders & Dempsey L.L.P. Her practice focuses on government filings on behalf of clients.

But in some cases extra application procedures will be required. For example, if the WFOE/JV will be engaged in manufacturing, applications for environmental assessment and project establishment are also required. If the WFOE/JV will be engaged in business related to public health and safety, an application for preliminary approval by related supervising government agencies will be required before the entity submits applications for approval to the AOA and BOD. If the WFOE/JV will buy a piece of land to serve as its work premises, an application for land purchasing approval will be necessary, too.

What government agencies do you frequently file documents with, and what is the objective of the filings?

Liu: There are quite a few government agencies in China that must review applications for the establishment and registration of a WFOE/JV. They mainly include:

- The Municipal/District Administration for Industry & Commerce (AIC);
- The Municipal/District Bureau of Commerce (MOC);
- The Public Security Bureau (PSB);
- The Administration for Quality Supervision, Inspection and Quarantine (AQSIQ);
- The state/local taxation bureau;
- The SAFE;
- The Statistical Administration Bureau;
- The Financial Administration Bureau; and
- Customs.

As mentioned in the response to question 1, sometimes the National Development and Reform Commission (NDRC), Environmental Protection Administration (EPA) and Food and Drug Administration (FDA) and their local counterparts will also be involved as necessary. In such case, their approval is usually required before the WFOE/JV may submit an application to the MOC for AOA and BOD approval.

The objectives of filing with these government agencies include:

- Obtaining name reservation approval and a business license from the AIC;
- Obtaining the approval letter of the AOA and BOD and the certificate of registration from the MOC;
- Obtaining company and financial chops and the public security registration certificate from the PSB;
- Obtaining organization code certificates from the AQSIQ;
- Obtaining state and local tax registration certificate(s) from the taxation bureau;
- Obtaining a foreign exchange registration IC card from the SAFE;

- Obtaining statistical registration certificates from the Statistical Administration Bureau;
- Obtaining financial registration certificates from the Financial Administration Bureau; and
- Obtaining a customs registration certificate from customs.

Do the various government agencies have standard practices, or do you find significant differences from city to city?

Liu: Usually the same government agency in different cities/regions will follow standard practices, but sometimes there will be differences between cities and regions. For example, in some cities, statistical registration is not required, while in other cities, it is part of all registration procedures. In most cities/regions, the approval authorities for registration certificates and business licenses are respectively the MOC and AIC, while in some cities/regions, the AIC is responsible for both registrations. In some cities, financial registration can proceed only after the contribution of registered capital, while in other cities, it can be done before capital injection. In some cities, lease registration is required before an entity may apply for a business license, while in other cities, it is not required.

In short, the establishment and registration procedures in economic development zones,

scientific parks and midsize/small cities are usually much simpler than those in big cities; therefore, good research may be quite helpful before starting to prepare application documents.

What problems do you usually encounter when handling government filings? What should a non-China-based company watch for when filing documents with government agencies?

Liu: The professional knowledge and experience of government officials can vary even if they are in the same government department. This can make it difficult to understand officials' exact requirements well. The problem that we usually encounter is that the documents we revised according to one official may have to be further amended at the request of another official; sometimes the revisions involve reverting to the earlier draft. In addition, some officials are quite strict regarding the wording of Chinese documents even if the meaning before and after revision remains the same.

In order to ensure things go smoothly, the following points may be helpful when filing with authorities:

- **Work with the right approving official** – Sometimes there are several officials responsible for the same application in a government agency, but not all of them give good instructions, so the most important thing is to find the “right” official; usually he or she is the director and the approving official of the department. After finding the

right responsible official, always keep in touch with that person, which means getting answers only from him or her for all your questions; otherwise you may become confused by different answers to the same question.

- **Try to accept the official's requirements instead of persuading him or her to accept yours** – When talking with officials, be sure not to argue with them even if you think they are wrong. Officials do not like to confess they are wrong or they know less than you, so accept or “pretend” to accept their comments first; otherwise, your application documents will likely be rejected by officials and you may have to visit the official several times to submit application documents. When it is unreasonable for you to accept the official's comments, try to say a few friendly words first to establish a rapport with the official; then you can share your concerns with the official.
- **Don't expect officials to be forthcoming with information, so ask many specific questions** – Authorities in China will answer only the specific questions you ask instead of reminding you about other issues related to your question. In such case, it is better to create opportunities for officials to share more information by properly asking additional questions in the course of the

discussion. By doing so, you can find more useful information from the officials. If you are lucky, you can obtain good suggestions regarding your application documents.

- **Try to separate the signature page from main part of the application** – As mentioned above, officials will sometimes require changes to the application documents even if, in your eyes, such changes may not be necessary. To avoid unnecessary paperwork, always separate the signature page from the main part of the document. By doing so, you won't have to re-sign the documents if no significant changes have been made.

Articles, Publications and Other Media

James M. Zimmerman was quoted on LATimes.com Dec. 7 regarding the “made in China” publicity campaign launched by China’s Ministry of Commerce and a group of China-based trade associations.

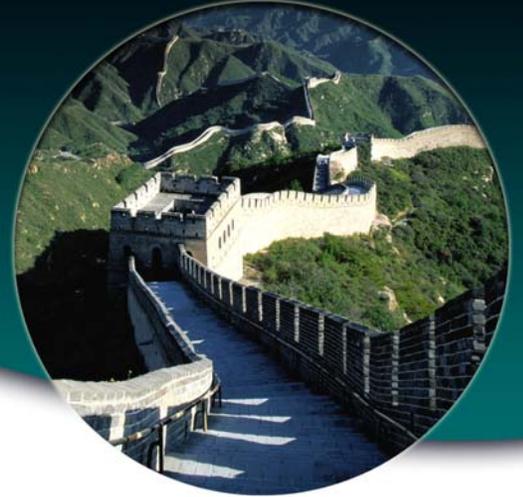
WSJ.com quoted **Charles R. McElwee II** Dec. 7 on environmental litigation in two of China’s provincial environmental courts brought by a China-based environmental group. The matters are significant because until these cases only individual citizens could sue polluters. Mr. McElwee was also quoted Nov. 25 on WSJ.com regarding growing government support for China’s clean energy exports and interviewed by National Public Radio and the BBC regarding China-based entrepreneurs who see opportunity in green tech projects in China.

Tyre Asia quoted **David M. Spooner** in November regarding the impact of the US government’s decision to impose tariffs on low-cost tires imported from China.

Squire Sanders published the following *China Alert* in December: [China Releases Rules Allowing Foreign-Invested Partnerships.](#)

Past Events

On December 2 Squire Sanders hosted a private presentation by Dale L. Matschullat, general counsel, Newell Rubbermaid, in our Shanghai office, with a reception in honor of Mr. Matschullat following. Lorraine M. Brennan, senior vice president of programs and international, CPR Institute, was also in attendance to discuss the international initiatives of the organization.



CHINA UPDATE

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