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Inside

MOFCOM Delegates Foreign Investment Examination and Approval Authorities

Key Points:

- ***Delegates approval authority for foreign invested enterprises within encouraged industries***
- ***Delegates approval authority for mergers and acquisitions by foreign investors and foreign invested enterprises ("FIEs")***
- ***Delegates approval authority for amendments to foreign invested enterprises originally approved by MOFCOM***
- ***Delegates approval authority for foreign invested holding companies with registered capital of no more than US$100 million***

The Ministry of Commerce of the PRC ("MOFCOM") released two circulars in March to further delegate examination and approval authority for foreign investment to the local government: the MOFCOM Circular on Further Improving Examination and Approval of Foreign Investment (*Shang Zi Han* [2009] No. 7) and MOFCOM Circular on Delegation of Authority to Examine and Approve the Establishment of Foreign Invested Holding Companies (*Shang Zi Han* [2009] No. 8). Observers expect that the delegation of authority based on these two circulars may not only accelerate the approval process for foreign invested projects, but also increase their likelihood of success.

MOFCOM Circular on Further Improving Examination and Approval of Foreign Investment ("Circular No. 7")

Circular No. 7 delegates approval authority for the establishment and subsequent amendment of FIE agreements within MOFCOM's current list of examined and approved encouraged industries to local MOFCOM authorities at the provincial level ("Provincial MOFCOM"), as well as national economic and technological development zones, unless "state overall adjustment" is necessary.

For mergers and acquisitions of China-based enterprises by foreign investors or FIEs, approval authority will be designated to local authorities based on the amount of the transaction, rather than on the total amount of investment. Projects in encouraged or permitted industries can be approved locally if the transaction amount is below US$100 million. Local approval can also be obtained in restricted industries if the transaction amount does not exceed US$50 million.

FIEs originally approved by MOFCOM may now have any subsequent amendments of their enterprise agreements approved by Provincial MOFCOM, except for increases of registered capital above the quota verified by the State Development and Reform Commission and transfer of control from the China-based party to the foreign (non-China) party.

The previous practices of Provincial MOFCOM in establishing branches in China for FIEs varied from region to region. Some required examination and approval in advance of registration with the State Administration for Industry and Commerce (“SAIC”). Circular No. 7 clarifies this issue by stipulating that filing with the relevant local MOFCOM after registration is sufficient, unless other requirements are imposed by specific regulations.

In addition, Circular No. 7 clarifies that the local MOFCOM authorities in subprovincial cities and national economic and technological development zones will have the same authority in examining and approving FIEs as previously delegated to the Provincial MOFCOM. Also, examination and approval in advance of the lifting of controls on equipment imports by FIEs is no longer required under Circular No. 7.

MOFCOM Circular on Delegation of Authority to Examine and Approve the Establishment of Foreign Invested Holding Companies (“Circular No. 8”)

Previously, the establishment of foreign invested holding companies required approval from MOFCOM, regardless of their registered capital. Circular No. 8 now delegates the approval authority for foreign invested holding companies with registered capital of US$100 million or less to Provincial MOFCOM, including subprovincial MOFCOM branches.

Similarly to Circular No. 7, Circular No. 8 permits foreign invested holding companies that were originally examined and approved by MOFCOM to have subsequent amendments to their operational agreements approved by Provincial MOFCOM, except for one-off increases of registered capital above US$100 million and changes of shareholder.

However, Circular No. 8 also stipulates that foreign invested holding companies may not invest in areas that are closed to foreign investment, and Provincial MOFCOM may not further delegate their authority to other lower MOFCOM branches.

– *Chen Dongying (Doris)*

MOFCOM Releases Administrative Measures for Overseas Investments

Key Points:

- ***Less focused on evaluating desirability of establishment than on guidance and support***
- ***Simplifies procedures for examination and approval***

MOFCOM released the Administrative Measures for Overseas Investments (Measures) (境外投资管理办法) on 16 March 2009. The Measures, which took effect on 1 May 2009, replace the Regulations on

Approval for Establishing Enterprises by Overseas Investment (2004).

The Measures reflect China's ongoing interest in supporting outbound investment by PRC enterprises. However, they also reflect a departure from earlier approaches in that they are more deferential to companies' own assessment of the *bona fides* of their proposed investment targets (i.e., there is less paternalism involved in evaluating whether the substance of a transaction is desirable) and more focused on providing service and support for PRC enterprises akin to that provided to US companies by the US Foreign Commercial Service.

The Measures provide the following incentives to overseas investment:

1. **Delegation of authority for examination and approval.** MOFCOM will reserve authority to examine and approve only certain major and sensitive investments including overseas investments of more than US$100 million and investments in some countries.

   Enterprises will be required to submit applications to the provincial counterparts of MOFCOM ("COFCOM") for making only the following types of overseas investments:

   a) Overseas investments by China-based parties of more than US$10 million but not more than US$100 million;

   b) Overseas investments in energy and minerals; and

   c) Overseas investments that require local investment promotions.

As a result, it is estimated that up to 85% of outbound investments will be simplified under the new rules.

2. **Simplification of the procedures for examination and approval.** Most overseas investment enterprises will obtain Enterprise Overseas Investment Certificates within three working days after submitting an application. The new measures indicate that the review process will not focus on substantive aspects. Investors will have more decision-making power regarding their investments. At the same time, they must take responsibility for them, particularly regarding the feasibility study from the economic or technical perspective.

3. **Reduction of items on which embassies or consulates need to be consulted.** MOFCOM will consult with commercial sections of PRC embassies or consulates overseas for opinions on central state-owned enterprises' investment. For local enterprises, this requirement to consult with embassies or consulates applies only to the energy and mineral resource sectors. COFCOM, however, may exercise discretion on whether to seek opinions from

embassies or consulates regarding other forms of investment.

The Measures also emphasize guidance and other services by:

1. **Strengthening the provision of guidance and services for overseas investments.** The Measures require MOFCOM to establish a system for guiding, promoting and enhancing overseas investment through cooperation with other departments.

   Since releasing the Measures, MOFCOM has compiled a Guide to Countries (Regions) for Overseas Investment (对外投资合作国别（地区）指南), which will be updated periodically.

2. **Encouraging enterprises to adopt the standards already established by host countries.** The Measures urge enterprises to comply with host country laws and regulations. At the same time, MOFCOM officials encourage investors to fully understand the policies, laws and regulations of the host country before making an investment.

Reports indicate that other governmental authorities involved in supervision of outside investment, including the National Development and Reform Commission and the State Administration of Foreign Exchange, will also implement new regulations regarding such investment. Their guidelines for drafting their own new regulations will likely be consistent with the Measures.

Government authorities are seeking to improve their efficiency and provide better guidance, service and information to China-based enterprises with respect to outside investment, rather than attempting to control investment via complicated and time-consuming administrative procedures. At the same time, the government is shifting part of the responsibility for risk control to investors by giving them more decision-making autonomy.

– Zhan Zhijing (Olivia)

Shanghai to Become an International Financial Center and Shipping Center; RMB Settlement in International Trade Permitted in Five Cities

Key Points:

- ***Shanghai's economic structure to be reformed***
- ***Shanghai, Shenzhen, Zhuhai, Guangzhou and Dongguan approved to use RMB as settlement currency in international trade on a trial basis***

On March 25, China's State Council issued an Opinion to Support Shanghai Becoming an International Financial Center and Shipping Center by 2020 ("Two Center Opinion"). The Two Center Opinion reinforces the status of Shanghai as the only potential international financial center and shipping center in mainland China and distinguishes Shanghai from other regional financial centers in Beijing, Tianjin and Shenzhen.

Although the Two Center Opinion does not specify the detailed measures or actions to be taken for Shanghai to accomplish the goal by 2020, it is believed that the Two Center Opinion will be the starting point for reform of Shanghai's economic structure. It also presents a good opportunity for outside investors to participate in the reform process. By identifying itself as an "international" center, Shanghai is expected to provide investors outside the country with more access to various sectors of its and China's economy, especially in the areas of finance, logistics and services.

Shanghai is drafting a number of rules and regulations toward its goal of implementing the Two Center Opinion. Subject to the State Council's approval, these new regulations may include the following measures:

1. Financial Center Related Measures

- **a)** Becoming an international RMB settlement center;
- **b)** Providing tax benefits for private equity funds;
- **c)** Allowing transactions at the Shanghai Exchange of funds based on Hong Kong stocks;
- **d)** Developing over-the-counter markets for unlisted companies;
- **e)** Allowing enterprises from outside China to issue renminbi (RMB)-denominated bonds in China; and
- **f)** Allowing qualified companies from outside China to issue RMB-denominated shares.

2. Shipping Center Related Measures

- **a)** Providing tax benefits to vessel leasing companies;
- **b)** Providing tax benefits to shipping companies at Yangshan Port;
- **c)** Providing tax breaks on shipping-related insurance revenue for insurance companies registered in Shanghai; and
- **d)** Encouraging the establishment of a Shanghai-based luxury cruise business, including permitting a cruise company from outside China to form a wholly foreign owned enterprise in Shanghai.

RMB Settlement in International Trade Permitted in Five Cities

Among the above proposals, the approval of Shanghai as an RMB settlement center for international trade has already been achieved. Shanghai, together with four cities in Guangdong (Shenzhen, Zhuhai, Guangzhou and Dongguan), has been approved to use RMB as a settlement currency in international trade on a trial basis as of

8 April 2009, which means companies in these five cities may use RMB as the settlement currency for import and export, instead of US dollars, euros or other non-China currency, to avoid the risk of currency exchange rate fluctuation.

While this new policy is exciting news for banks and export companies, the implementation rules – currently in draft form – to be provided by the People's Bank will provide a greater understanding of the policy and clarify numerous details and issues. One of the major problems posed by the policy is that the RMB is not a freely convertible currency. Given the strict foreign exchange control regulations of China, this problem raises the question of how to conduct RMB settlement in actual practice. Answering that question requires determining:

1. a means by which a company outside China may open an RMB bank account overseas, most likely either at a China-based bank branch located outside China or through an agency arrangement between a China-based bank and a bank outside China;

2. whether a company outside China receiving RMB may own the physical RMB (in cash) or merely a credit;

3. how a China-based bank may settle RMB with a bank outside China;

4. when a company outside China that owns RMB overseas uses those RMB to make a payment to a China-based company, how such a payment can be deemed as export income in order to comply with existing import and export verification regulations; and

5. whether an RMB investment made in China by a foreign invested company located in China (e.g., a wholly foreign owned enterprise) would be considered a foreign investment.

It is believed that at the trial stage, only a few China-based banks will be licensed to conduct a business in RMB settlement. The implementation rules to be published by the People's Bank will outline the requirements and procedures for applying for such a license. It is also believed that Hong Kong is most likely to become the first region to begin RMB settlement. Because Hong Kong has the closest business relationship with mainland China, Hong Kong companies have significant need of RMB, as evidenced by the enormous amount of RMB currently flowing between Hong Kong and mainland China via the black market. Also, Hong Kong has experience in doing individual RMB business, and RMB settlement would provide considerable support to Hong Kong's economy from its central government during the worldwide financial crisis. – *Zhu Ju (Lindsay)*

MOFCOM Rejects Coca-Cola's Proposed Takeover of Huiyuan Under the Antimonopoly Law

Key Points:

- ***First major test of China's new antimonopoly law***
- ***Demonstrates that competition authorities will block transactions they deem anticompetitive***

On March 18, 2009 MOFCOM rejected the Coca-Cola Company's proposed US$2.4 billion takeover of the country's leading juice maker, China Huiyuan Juice Group Ltd., saying that the deal could have an adverse impact on competition and lead to higher prices for consumers.

Article 27 of China's Antimonopoly Law (the "AML"), which took effect on August 1, 2008, directs MOFCOM, in reviewing mergers and acquisitions, to consider the parties' market shares and market power, market concentration, the impact on market entry and technological advances, the effect on consumers and other relevant business operators, and the effect on the development of the national economy. The term "other relevant business operators" can be interpreted to include competitors, customers and suppliers. The proposed Coca-Cola/Huiyuan acquisition was the first transaction blocked by MOFCOM under the new law.

Coca-Cola has a strong presence in China's carbonated drinks market, with some estimates putting its market share at 54%, while Huiyuan is the dominant player in the pure fruit juice market in China, with an estimated 42% market share. Coca-Cola already owns the well-known Minute Maid juice brand. According to some industry reports, Coca-Cola and Huiyuan, if combined, would control about 20% of the juice market in China.

In the statement announcing its decision, MOFCOM said that it blocked the deal after determining that a combined entity could use its market dominance in carbonated soft drinks to limit competition in the juice market through tying, bundling or other exclusive transactions, resulting in consumers being forced to accept higher prices and reduced variety. MOFCOM also determined that the combined entity would reduce competition opportunities for small and medium-sized juice manufacturers. MOFCOM's statement made it clear that Coca-Cola's bid was not being turned down for any technical reasons.

Some analysts opined that the decision of China's government was made partly under public pressure, as Huiyuan is perceived by many in China as a beloved national brand. Before the decision, Coca-Cola's proposal to buy Huiyuan had stirred protests by China's drink industry, and many Chinese consumers had also expressed concerns about the potential loss of a leading homegrown brand to the international soft drink giant.

One immediate assumption among some observers in the United States and Europe was that MOFCOM's decision was based on nationalistic concerns, as opposed to a genuine concern that this transaction could adversely affect competition. They suggested that support for the belief that MOFCOM was seeking to promote nationalism could be found in Article 27 of the AML itself, which directs MOFCOM to consider, among other things, the impact of a potential transaction on the development of the national economy.

However, it should be noted that in its statement, MOFCOM did not cite the national security provision in the AML that can be applied to protect China-based companies from acquisition if the takeover is perceived to pose risks to China's national economic security, such as reducing employment or eliminating a famous China brand.

Both before and after the AML took effect, there was speculation as to how MOFCOM's Anti-Monopoly Bureau (the "Bureau") would apply the new law. Among other issues, commentators debated whether the Bureau would be protectionist in its application of the law. The Coca-Cola decision was the first significant application of the new law, and it was expected to provide some insight into the answers to these questions. However, it seems that the decision has not really helped clarify matters.

Prior to the Coca-Cola/Huiyuan decision, MOFCOM had completed 24 reviews under the AML and approved 23 earlier transactions (the "23 Transactions") without conditions. The 24th transaction, regarding Inbev's acquisition of Anheuser-Busch, was approved after the acquirer agreed not to acquire shares in competing companies in China without MOFCOM's prior approval.

Under Article 30 of the AML, the Bureau is required to publicly announce decisions that deny merger or acquisition approvals as well as decisions granting conditional approvals, but not decisions granting unconditional approvals. Because all of the 23 Transactions were approved by the Bureau without conditions, they were not publicized. The only publicly announced decisions were those in the Coca-Cola/Huiyuan case and the Inbev/Anheuser-Busch case. Unfortunately, such data are insufficient for drawing clear inferences. It is to be hoped that the outstanding question as to how MOFCOM will apply the AML can be answered when more decisions are publicized in the near future.

Meanwhile, although MOFCOM's decision on Coca-Cola/Huiyuan is only a single data point, the decision demonstrates that China's competition authorities will not hesitate to block transactions they deem to be anticompetitive under the new law. MOFCOM's decision also suggests that the objective of China's merger analysis process is not only to protect consumers, but also to protect the competitive process by ensuring a large number of competitors in the market. In addition, it appears likely that MOFCOM will also make protection of medium- and small-sized competitors a priority. Companies pursuing mergers and acquisitions involving corporations operating in China should, therefore, be prepared to face tough scrutiny from China's competition authorities. – *Phoebe K. Ip*

Articles, Publications and Other Media

Rainer Burkardt, national partner in our Shanghai office, was quoted on Feb. 12 in *ALB Legal News* regarding court reform in China.

Charles R. McElwee, counsel in our Shanghai office, was quoted on March 11 on *Time.com* about how China's environmental problems have been ameliorated by the global financial crisis. He was also quoted on March 12 on *Forbes.com* on the impact the ailing economy has had on China's environmental reform. *BNA World Climate Change Report* and *BNA Daily Report for Executives* quoted him regarding China's proposed energy law, and he also appeared on Earthbeat Radio discussing China and climate change. He was quoted on April 24 on *The New Yorker*'s environmental blog on China's stimulus funding for green tech projects.

Dan Roules, managing partner of our Shanghai office, and **Amy L. Sommers,** national partner in our Shanghai office, were quoted on April 3 in *Counsel to Counsel News* regarding best practices for business compliance with the US Foreign Corrupt Practices Act.

David M. Spooner, of counsel in our Washington DC office, was quoted on April 20 on *Bloomberg.com* regarding a petition filed by the United Steelworkers with the Obama administration that seeks a quota on tires imported from China. *Inside US-China Trade* quoted him on the issue on April 22. He also appeared on CCTV-9's "Dialogue" on March 20 discussing US-China trade issues. He also was quoted on March 18 by *Women's Wear Daily* about the global recession's impact on trade policies proposed by the new US administration. The article was also posted on *Condé Nast Portfolio.com.*

David Spooner, as well as **Barry A. Pupkin,** partner in our Washington DC office, and **Dan Roules** were all quoted by various media outlets regarding the Coca-Cola Company's bid to purchase China Huiyan Juice Group Ltd. Mr. Pupkin was quoted on March 18 by *Law360* on antitrust issues raised by the proposed merger; Mr. Roules was also quoted on March 18 by the *Los Angeles Times* on China's decision to deny the bid, with the article also appearing on *LATimes.com* and *CantonRep.com,* and Mr. Spooner was quoted on March 30 by *Oriental Morning Post*.

James M. Zimmerman, partner in our Beijing office, is author of *China Law Deskbook, Second Edition (2005): A Legal Guide for Foreign-Invested Enterprises.* More information on the *China Law Deskbook* is available on the ABA website:
http://www.abanet.org/abastore/index.cfm?section=main&fm=Product.AddToCart&pid=5210139

Past Events

The Symposium on Legal Practice Issues Concerning Chinese Export in the Context of Financial Crisis, sponsored by the Jiangsu Provincial Bar Association on April 23 in Nanjing, addressed ways in which the province's business sector can positively respond to various legal issues affecting China's export business during the financial crisis, as well as strengthen communication among lawyers within the province and with businesses across the province. **Mark C. Goodman,** litigation partner in our San Francisco office, delivered a presentation on the most recent product liability litigation in the United States related to China-based manufacturers as part of this event.

Upcoming Events

Nicholas Chan, partner in our Hong Kong office, will be a guest speaker for the Youth Employment Start (Y.E.S.) self-employment course covering sessions of law in Hong Kong on May 21 and 22 from 7 to 9 p.m. The seminars will be held at the Mongkok Y.E.S. facility, Suites 8-11, Level 42, Office Tower, Langham Place, 8 Argyle Street. His topics on May 21 will be types of partnerships and drafting contacts, tenders and quotations; his topics on May 22 will be insurance, copyrights and labor ordinances.

C5's 2nd China Summit on Anti-Corruption, June 15-17 in Shanghai, will bring together an exceptional group of seasoned corporate ethics and compliance executives, senior lawyer, forensic accountants and government officials to provide a comprehensive update on the antibribery landscape in China. Topics include the intersection of the FCPA and local China antibribery laws and how to implement robust anticorruption policies that comply with China laws and the FCPA. On June 15, **Amy Sommers** will present the Pre-Conference Workshop "The Fundamentals of FCPA Compliance: The U.S. Foreign Corrupt Practices Act Demystified," discussing core FCPA issues, focusing on the "nuts and bolts" and supplying a foundation for dealing with day-to-day issues. The workshop will provide a comprehensive introduction to the FCPA and its anticorruption and antibribery elements, internal controls and accounting requirements, and intersections with Sarbanes-Oxley and Securities and Exchange Commission reporting requirements. Ms. Sommers will also moderate the panel "Dealing With Requests for Bribes or 'Consideration' When Obtaining Regulatory Approvals or Responding to Local Government Investigations/Audits." The panel, from 4:30 to 5:30 p.m. on June 16, will cover:

- Preventive measures to minimize corruption risks in daily interactions with government officials
- What not to do when faced with a direct or implied extortion demand by a local government official

- Why asking a local partner, associate or accountant to solve the problem is not the answer
- Ethical strategies, tactics and techniques for achieving your company's goals without paying a bribe
- Pacing clearance and permit requests efforts to avoid troublesome officials
- Why giving your China employees result-oriented instructions can backfire in ensuring adherence to your company's compliance program

Register now online or by calling +44.20.7878.6888 or +1.888.224.2480.

This newsletter provides free information on the influence of certain aspects of the Chinese legal environment and does not constitute legal advice.

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