FOREIGN INVESTMENT IN CHINA: AN INTRODUCTION

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Law With “Chinese Characteristics”

Over the past thirty years, China has imprinted on a civil law platform its own unique cultural and political characteristics and developed a distinct legal regime that, in a number of respects, cannot be understood by direct reference to Western standards. Chinese legislation tends to be drafted in broad terms that give civil servants and judges wide discretionary authority to interpret the rules in line with policy changes and China’s developing market economy. As a result, businesses must constantly keep abreast of current policies and practices, in addition to published legislation.

The following is a brief introduction to some of the key laws and regulations that impact foreign investors in China today and areas where continued change is expected in the next few years.

Basic Principles of Foreign Investment

CHINA’S GOVERNMENT

Any discussion of China’s government – or its legal system – begins with the Chinese Communist Party. Party officials supervise every legislative, administrative and judicial body within the government hierarchy and are charged with supervising China’s formidable state-owned enterprises that continue to play a major role in China’s economy.

The highest legislative institution in China is the National Peoples’ Congress (NPC), which is also the highest organ of state power. The State Council is the highest administrative authority. China’s various administrative agencies, many of which directly supervise the commercial activities of any foreign-invested business in China, are established under the State Council. The Supreme People’s Court (SPC), together with the Supreme People’s Procuratorate (SPP), form China’s highest judicial organs.

The government hierarchy extends vertically from China’s President down through the State Council and the SPC and SPP, to China’s Ministries and administrative agencies, and to their respective counterparts at the provincial, municipal, county and township or village level. The system also extends horizontally across the legislative, administrative and judicial branches of the People’s Governments at each level.

China’s legislative hierarchy begins with the Constitution of the People’s Republic of China. Laws are enacted by the NPC or its Standing Committee. Administrative regulations are promulgated by the State Council. Local decrees are issued by the local People’s Congresses, and various types of binding regulations, notices and opinions are issued by China’s administrative agencies at the central level in Beijing or by the local People’s Governments.

Finally, the SPC and SPP publish judicial interpretations of key provisions of important laws that should be given strong guiding weight by lower courts. Courts in China are not bound by precedent decisions of higher courts, as in common law jurisdictions. In an effort to bring greater certainty to the judicial legal system, in November 2010 the SPC issued the Provisions on Case Guidance Work pursuant to which the SPC will issue details of so-called “guiding cases.” Guiding cases must satisfy the following conditions: (1) the judgment is final and effective, (2) the subject matter is of broad concern to the public, (3) the relevant legislation provides only general principles, (4) the subject matter is ordinary, and (5) the case involves an area of the law that is difficult, complicated or new. In December 2011, the SPC issued the Notice on Releasing the First Batch of Guiding Cases and reiterated that the lower People’s Courts are required to refer to guiding cases in adjudicating cases that involve similar circumstances.

FOREIGN INVESTMENT CATALOGUE AND BUSINESS SCOPE

Unlike many other legal systems, China does not ordinarily permit the establishment of a general purpose company. Most commercial entities in China operate pursuant to an approved scope of business which narrowly defines the scope of activities that may be conducted by the entity.

The examination and approval of any foreign investment project in China is determined by reference to the Catalogue for Guiding Foreign Investment in Industry (Foreign Investment Catalogue). The Foreign Investment Catalogue is issued approximately once every five years and reflects the government's broader policies and plans for the economy. The most recent Foreign Investment Catalogue was issued in December 2011 and is effective as of February 1, 2012. The Foreign Catalogue divides foreign investment projects by industry sector into three categories: encouraged, restricted and prohibited. Prohibited projects are not open to foreign investment. Restricted projects are open to foreign investment, but may be subject to ownership caps, higher approval thresholds or other limitations. Encouraged projects may be eligible for certain incentives and/or the regulatory approval process may involve a lower level of scrutiny, though ownership caps and other restrictions may apply in certain sectors. Industry sectors not listed in the Foreign Investment Catalogue are viewed as "permitted" for foreign investment.

CHINA'S FOREIGN INVESTMENT APPROVAL REGIME

In order to invest or operate in China, foreign investors generally must undergo a government approval and registration process. In addition, if an investor wishes to have more than 25% ownership in a business in China it must establish a new entity as, or convert an existing domestic entity into, some form of foreign-invested enterprise (FIE). An entity with less than 25% foreign ownership typically does not have FIE status, although it is still subject to restrictions on foreign investment under the Foreign Investment Catalogue.

The approval and registration process involves a number of administrative agencies.[1] These may include the relevant industry regulator for the project, the National Development and Reform Commission (NDRC), the Ministry of Commerce (MOFCOM) and the State Administration for Industry and Commerce (SAIC). If a foreign investment project involves state-owned assets, the approval of the State Assets Supervision and Administration Commission (SASAC) also may be required. Upon issuance of a business license (or registration certificate), the newly established (or newly converted) FIE must carry out a series of ancillary registration procedures with the other relevant government agencies in charge of the administration of the entity, e.g., the finance, foreign exchange control, customs and tax authorities.

According to rules adopted by the State Council in 2010, where the total amount of investment of an encouraged or permitted project under the Foreign Investment Catalogue is between US$300 million and US$500 million, the project must be approved by the NDRC and MOFCOM, respectively, at the central government level. If the total amount of investment of an encouraged or permitted project is US$500 million or more, State Council approval is required. The approvals thresholds for restricted projects are lower. Foreign investment projects with a total amount of investment below the applicable thresholds generally may be approved at lower levels within China's governmental hierarchy.

[1] References in this guide to a government agency at the central government level include references to its respective counterparts at the provincial, municipal or local level.

TOTAL AMOUNT OF INVESTMENT AND REGISTERED CAPITAL

Each FIE company is subject to certain minimum capitalization requirements and mandatory debt-to-equity limitations that restrict the FIE's ability to incur debt. The equity capital of a company in China is referred to as its "registered capital." Registered capital is defined as the total amount of capital subscribed by the investor(s) in the company and registered with the authorities. Subject to a general appraisal requirement and industry based limitations, up to 70% of the contributions to the registered capital of an FIE may be made in-kind by way of machinery and equipment, land-use rights, buildings and other tangible assets and certain intangible assets such as technology or trademarks. An FIE also has a "total investment" limit. Total investment is defined as the sum of the registered capital of an FIE and its official borrowing capacity. Hence, the difference between the total amount of investment and the registered capital represents the maximum ability of the FIE to take on registered debt.

The maximum permitted total investment relative to registered capital is determined based on the amount of registered capital.

The following table sets out the standard ratios:

TOTAL INVESTMENT	RATIO OF REGISTERED CAPITAL TO TOTAL INVESTMENT	MINIMUM REGISTERED CAPITAL
Less than US$3 million	70%	RMB 30,000
More than US$3 million and less than or equal to US$10 million	50%	US$2.1 million, if the total investment is ⇠ US$4.2 million
More than US$10 million but less than or equal to US$30 million	40%	US$5 million, if the total investment is ⇠ US$12.5 million
More than US$30 million	33%	US$12 million, if the total investment is ⇠ US$36 million

Higher minimum registered capital requirements may apply by law and practice depending on industry and location, while lower total investment to registered capital ratios may apply in certain industries such as real estate, and higher ratios for significant investments, such as holding companies *(please see page 7)*.

Market Entry

ACQUISITIONS

Foreign investors may enter the China market or expand an existing presence by acquiring an operating entity or its assets in China or an offshore company that holds an operating asset in China. In an onshore acquisition, the acquiring entity may be an offshore operating or investment vehicle, or it may be an FIE. An offshore acquisition generally is not subject to an examination and approval process under Chinese law, though certain notice or reporting obligations may be involved.

ACQUISITION OF DOMESTIC COMPANY OR BUSINESS BY FOREIGN INVESTOR

An onshore acquisition of the equity or assets of an existing domestic-invested enterprise in China by an offshore entity is generally subject to a detailed examination and approval regime that provides limited flexibility to structure transactions commercially. For example, the transaction price must be based on an appraisal conducted by a China-licensed appraisal institution and generally must be paid in full (including any holdback against vendor warranties) within three months of closing.

In an equity acquisition, the target is converted into an FIE and succeeds to the claims, debts and employment relationships of the domestic company. It is permitted to continue to use the licenses, permits and other regulatory approvals of the domestic company, subject to review by the industry regulator (as applicable).

In an asset acquisition, the foreign investor will generally simultaneously establish a new FIE as the acquisition vehicle to acquire the assets. The new FIE will not succeed to the claims, debts and employment relationships of the domestic company, except to the extent contractually agreed. The seller is required to provide notice to creditors and, like an equity

acquisition, to prepare a formal plan for employee resettlement. The licenses, permits and other regulatory approvals of the seller ordinarily may not be transferred to the buyer. This can present challenges in regulated industries due to the often lengthy timeline needed to obtain such licenses and permits and the fact that ownership or right of use of the assets is often a prerequisite to obtaining them. It is worth noting that a transfer of assets by a domestic company to an FIE comprising only part of its business may not be subject to approval. Each such transaction should be reviewed on its merits to determine if approval is required.

Share and asset transactions (both onshore and offshore) may be subject to a merger control review if the parties to a transaction meet specific thresholds under the Anti-Monopoly Law. In addition, in 2011, a new national security review procedure was implemented, though as of this writing the process is relatively untested. The rules give the government broad power to stop or unwind any transaction that gives or is perceived to give a foreign investor “control” over an enterprise in a “key industry” that could impact China’s “economic security.”

ACQUISITION OF FIE BY FOREIGN INVESTOR OR FIE

An acquisition by a foreign investor of an equity interest (or a subscription to a capital increase) in an existing FIE is also subject to a thorough examination and approval procedure and most of the same rules may apply, including the appraisal and merger control rules. An acquired FIE will succeed to the claims, debts and employment relationships of the FIE prior to its acquisition and generally will be permitted to continue to use the licenses, permits and other regulatory approvals of the domestic company.

An acquisition by an FIE of an equity interest in another FIE also is subject to government approval, as all changes in the shareholding of an existing FIE require approval from MOFCOM and registration with the SAIC. In addition, all such changes must conform to the Foreign Investment Catalogue and the rules related to transfers of state-owned assets (if applicable).

ACQUISITION OF DOMESTIC COMPANY AND OTHER INVESTMENT BY FIE

Most FIEs are permitted to purchase an equity interest in an existing domestic-invested limited liability company, or to establish a new enterprise, subject to the Foreign Investment Catalogue and China’s foreign investment rules. The purchase of an equity interest in a domestic-invested company, or the establishment of a new enterprise, by an FIE requires approval if the invested enterprise will operate in a restricted industry under the Foreign Investment Catalogue. If the invested enterprise will operate in a permitted or encouraged industry, approval generally is not required except where foreign ownership limitations apply, but the transaction must be registered with the SAIC.

Two long-standing complications exist in regard to equity investments by operating FIEs. In many industries, an FIE is still prohibited from investing more than 50% of its registered capital in other enterprises, although the general prohibition on such reinvestment has been abolished. Moreover, the foreign currency contributions to the registered capital of an FIE and foreign currency shareholder loans may not be converted into RMB, except where such conversion is for a purpose expressly permitted under China’s foreign exchange control regime (please see page 10). Thus, unless an FIE has independently generated sufficient RMB cash, it may not be able to fund a new investment.

OPERATING VEHICLES

China’s foreign investment regime offers several alternative choices for an operating vehicle, including a Sino-foreign equity joint venture (EJV), two types of Sino-foreign cooperative joint ventures (CJV), a wholly foreign-owned enterprise (WFOE) and a foreign-invested company limited by shares, commonly known as a joint stock company or a “FICLS.” Each option presents a foreign investor with various benefits and limitations, and may be particularly suited to achieving certain goals as outlined in the following.

JOINT VENTURES

An EJV is an independent legal person with limited liability established for a fixed term (usually 10-50 years). It may engage in any commercial activity within its authorized scope of business. An EJV does not issue shares. Instead, the Chinese and foreign investors hold "equity interests," and they incur liability and receive profit distributions based strictly on the value of their respective contributions to the EJV's registered capital.

The management organization of an EJV has three tiers: a board of directors, supervisory board and management personnel *(please see page 10)*. Unlike most limited liability companies in China, the board of directors (and not the shareholders' assembly) represents the highest authority of an EJV, and its members are appointed by the investors roughly in accordance with the ratio of their respective capital contributions. The unanimous consent of the shareholders through their representatives on the board, and government approval, is required to change an EJV's articles of association and to take certain other major decisions.

A CJV may be in the form of an independent legal person with limited liability or a purely contractual joint venture in which no separate legal entity is created and for which the investors bear direct liability. The latter form is rarely used today. A legal person CJV offers a more flexible capital structure than an EJV. Apart from contributions to registered capital, the investors also may provide "cooperative conditions," which typically comprise assets or other conditions that are not acceptable forms of contributions to registered capital, such as leases, services or assets that are difficult to value. The parties are permitted to fix the ratio at which profits are distributed. A foreign investor in a CJV generally may recover its capital investment at an accelerated rate during the operating term of the joint venture, as long as the Chinese investor takes ownership of the CJV's assets at the conclusion of the term. Guaranteed returns, however, are prohibited for all projects.

In other respects, a legal person CJV is subject to the same rules and regulations as an EJV. CJVs are most common for projects involving large fixed assets, such as real estate development and infrastructure. A foreign investor also may find the CJV form useful where a joint venture is required, for either regulatory or business reasons, but one party does not possess the cash or other assets necessary to establish an EJV.

WFOES

A WFOE is an independent legal person with one or more foreign corporate or individual investors. Like EJVs, WFOEs do not issue shares and the investors hold equity interests based on the value of their respective capital contributions. The term of operation of a WFOE is typically between 10 and 30 years.

Management control is one of the principal advantages that a WFOE offers a foreign investor. The governance structure of a WFOE, like most companies, is largely dictated by the Company Law of the People's Republic of China (Company Law). Unlike an EJV, therefore, a WFOE's highest authority is its shareholders, though the shareholder is permitted to delegate most of its powers to a board of directors or an executive director in practice. Where there is more than one foreign investor, the investment is often made through an offshore holding company as this allows the investors greater flexibility in determining their respective rights and obligations.

An application to establish a WFOE is usually filed directly with MOFCOM, although separate applications with and approvals from the relevant industry regulator(s) and other government authorities may be needed. Following approval, the investor must register the WFOE with the SAIC, obtain a business license, and complete additional formalities in the manner described above for all FIEs *(please see page 4)*.

FOREIGN-INVESTED COMPANIES LIMITED BY SHARES

An FICLS is an independent legal person with limited liability that issues shares of equal value and may be used as a listing vehicle. To qualify as an FICLS, the foreign shareholder or shareholders must hold at least 25%, but less than 100%, of the shares. The minimum registered capital of an FICLS is RMB 30 million.

An FICLS may be established by the "promoter method," where at least five promoters subscribe to all of the initial shares, or by the "share float method," in which the promoters subscribe to a portion of the initial shares and the balance of the shares are sold to the public. Foreign shareholders must pay cash for the shares of a listed FICLS, while the shares of an unlisted FICLS may be acquired using cash, machinery and equipment, proprietary technology, or land-use rights.

An existing FIE may be reorganized as an FICLS after three consecutive years of profitability. A domestically owned joint stock company may be reorganized as an FICLS after five years of operation and three consecutive years of profitability if one or more foreign shareholders acquire at least 25% of the shares.

R&D CENTERS

A research and development center (R&D Center) is generally organized as an EJV or a WFOE, or as a branch of an existing FIE *(please see page 4)*, that meets certain minimum qualification thresholds and engages principally in R&D activities. Qualified R&D Centers are eligible to enjoy preferential treatment in the form of sector-specific local government subsidies and rebates; favorable income tax rates, refunds and exemptions; business tax exemptions; value-added tax (VAT) exemptions on R&D-related purchases; rebates on land-use rights grant fees or premises lease expenses; and incentives for personnel of the R&D Center.

BONDED ZONE FIES

Most major cities in China have established bonded zones. Originally created to encourage foreign companies to establish FIEs for the manufacturing and processing of goods for export, FIEs established in bonded zones were permitted to conduct various support services inside the zones, including marketing and exhibition, trading, warehousing, trade financing, packaging and transportation. Prior to China's entry to the WTO, these FIEs were commonly used to circumvent restrictions on foreign investment in importing and distribution. Now that an EJV or WFOE is permitted to obtain foreign trade and distribution rights, the attraction of the zones to foreign investors has diminished. For certain businesses, such as logistics companies and manufacturers primarily involved in manufacturing products for exports using imported parts, bonded zones still offer a tax efficient means of operating.

BRANCHES

At present, foreign companies are not permitted to establish branches in China, except in a very limited number of sectors, such as banking. Although China enacted general legislation in 1994 regarding foreign company branches, the government has not yet promulgated implementing regulations or procedures. Under its WTO accession protocol, China may delay the establishment of foreign company branches indefinitely.

By contrast, an FIE is permitted to establish branches outside of the district or city where the FIE is registered. Subject to the terms of its business scope, a branch may engage in full business operations consistent with but not exceeding the business scope of the FIE, issue invoices, and collect revenue. A branch does not have legal existence independent from the parent FIE and branch establishment does not require approval from MOFCOM, although separate regulatory approval may be required in certain industries. Instead, the FIE may register the branch directly with the SAIC in the location of the branch and record the branch registration with the SAIC where the FIE is registered. A similar filing procedure is often required with the FIE's original approval authority and the approval authority where the branch is located.

INVESTMENT VEHICLES

China offers an increasing range of investment vehicles for foreign investors, including a foreign-invested investment enterprise (Holding Company), which permits multinationals to consolidate their China and Asian regional subsidiaries, a regional headquarters investment company (RHQ) which may be holding, management or investment enterprises, a foreign-invested venture capital enterprise (FIVCE), which may engage in a limited scope of venture capital-style investment activities, a foreign-invested partnership enterprise (FIP), which may be used as an investment vehicle, subject to certain capital conversion and portfolio investment restrictions, and an equity investment enterprise (EIE), which lacks express central level authorization and largely is available only to foreign brand name investment houses.

HOLDING COMPANIES AND REGIONAL HEADQUARTERS

The Holding Company vehicle was designed to provide benefits for significant investors in China and as such, the investment thresholds are steep. A Holding Company may be established as an EJV or a WFOE. Unlike other FIEs, a Holding Company is treated as a foreign investor and may invest in any industry or sector, subject to the Foreign Investment Catalogue and its authorized scope of business *(please see page 2)*. It may be used to centralize and provide a variety of services for subsidiaries, including sales agency and distribution, after sales services, procurement, logistics, financial support, human resources management, technical support and training, equipment leasing and market consulting. It may also establish an R&D Center, to procure goods in China for export, and to conduct trial sales of affiliate company products in China.

A Holding Company is exempt from income tax on dividends received from its subsidiaries in China, and it may incur higher levels of debt than other FIEs, i.e. four times the amount of paid-in registered capital, or, if the registered capital is at least US$100 million, six times the paid-in registered capital. A Holding Company also may obtain certification as a "regional headquarters," or "RHQ," which may be eligible for local incentives and preferential treatment. Various local rules also enable the direct establishment of an RHQ that is subject to a lower minimum capitalization requirement than a Holding Company and that is permitted to engage in certain investment and management activities and to provide centralized services to its regional subsidiaries or affiliates. Moreover, upon the approval of China's banking regulator, an RHQ may establish a finance company, which may provide financial services to the Holding Company / RHQ and its subsidiaries.

VENTURE CAPITAL ENTERPRISES

An FIVCE may be established as a non-legal person enterprise or as a limited liability company by between two and 50 investors, including one or more foreign entities or individuals and one "requisite investor." The requisite investor must be a well-established venture capital entity that meets certain minimum capitalization and management personnel qualifications. The procedure to establish an FIVCE follows the procedure to establish most other FIEs, except that MOFCOM is also required to consult with the relevant department in charge of the administration of science and technology before issuing approval, which may delay the approval process.

The scope of business of an FIVCE meets the typical requirements of a venture capital investor, and it is permitted to invest in privately held technology companies, subject to the provisions of the Foreign Investment Catalogue. An FIVCE also is permitted to provide consulting and management services to its invested enterprises and it may be permitted to provide management services to other venture capital enterprises. To carry out investment activities within an encouraged or permitted industry sector, an FIVCE is required to complete a filing procedure with MOFCOM in the location of the target enterprise. If the target operates within a restricted industry, however, an FIVCE must obtain approval from the local MOFCOM.

Contributions by foreign investors must be made in cash in a freely convertible currency and are subject to China's foreign exchange control regime. Unlike most FIEs, an FIVCE is permitted to convert foreign exchange into RMB to make capital contributions to its invested enterprises and is permitted to make equity investments in China using foreign currency.

The sale of an FIVCE's equity investments also is subject to the provisions of the Foreign Investment Catalogue, and an FIVCE is required to carry out recordal and annual reporting procedures in regard to its investment and divestment activities. A limited liability company FIVCE is subject to enterprise income tax; a non-legal person FIVCE is treated as a pass-through entity by most local tax authorities, though outward remittances of capital gains are subject to withholding tax.

PARTNERSHIP ENTERPRISES

China recently promulgated national level rules to permit the establishment of an FIP by foreign entities or individuals, with or without Chinese partners. An FIP does not require MOFCOM approval and may be established by carrying out a registration procedure with the SAIC, though the SAIC is required to notify the relevant MOFCOM.

An FIP may be organized as a general partnership, where the partners have joint and several liability, or as a limited partnership, where the liability of at least some partners is limited to the respective amount of their subscribed capital. An FIP organized as a limited partnership must have at least one general partner and may have no more than 50 partners.

An FIP offers a more flexible investment option than a traditional FIE, such as an EJV or WFOE. The partners in an FIP are not subject to a minimum capitalization threshold, a timing requirement for capital contributions or a cap on non-cash contributions, and are free to structure profit and interest-sharing relationships without regard to a capitalization ratio. The governance and management organization of an FIP is also free from the rigid requirements imposed on other FIEs. The partners generally are free to capitalize and govern an FIP, and share in its profits, in accordance with a partnership agreement.

On the other hand, the use of an FIP as an equity investment vehicle is expressly conditioned on rules that enable an FIP to engage in equity investment activities and currently only limited exceptions are available under the local rules as outlined in the next section.

EQUITY INVESTMENT ENTERPRISES

In recent years, several large municipalities, including Shanghai and Tianjin, have issued policies or rules in an effort to relax the restrictions on foreign-invested equity investment vehicles and thus, attract foreign investment to their region. The status of foreign-invested EIEs at a national level is still uncertain. While the central government has not issued enabling rules that expressly permit the establishment of a foreign-invested EIE, it has recognized their existence and the need to manage the development of this type of investment vehicle. In November 2011, the NDRC issued the Circular on Promoting the Standardized Development of Equity Investment Enterprises (Circular 2864). Circular 2864 expressly requires a foreign-invested EIE to carry out the standard NDRC project verification and approval procedure, where applicable, when making new investments.

Circular 2864 does not, however, address the issue of foreign currency conversion for a foreign-invested EIE. As noted under the foreign exchange control regulations *(please see page 10)*, an FIE is prohibited from converting foreign currency into RMB for the purpose of investing in a domestic target, except as otherwise expressly permitted (e.g. under the FIVCE rules). Hence, unless the investors in an EIE plan to restrict its investments to local targets, and unless the local EIE enabling rules provide a legal basis for currency conversion (or the EIE can otherwise lawfully obtain RMB), an EIE may not present an attractive option to foreign equity investors at this time.

Each set of local rules permits the establishment of a foreign-invested EIE and EIE management enterprise organized as a partnership or limited liability company. In addition, the press has widely reported central government approval of a quota system for "qualified foreign limited partners" that would expressly permit a RMB-denominated foreign-invested EIE established in certain pilot cities to convert foreign currency capital contributions into RMB for the purpose of making equity investments. It remains to be seen if the central government will issue enabling rules to permit the establishment of a foreign-invested EIE expressly, or the conversion of foreign currency for equity investment.

REPRESENTATIVE OFFICES

A representative office (RO) has traditionally been one of the most common ways for foreign investors to enter the China market. An RO is a liaison office for a foreign company, which is legally liable for its acts and must sign all commercial contracts (other than the RO's lease, utilities contracts, etc.). An RO lacks the status of an independent legal person and may not conduct business (including technical services and after-sales services) in its own name. An RO may introduce and promote products, conduct market research, engage in technical exchanges, and interface with customers and government agencies. Limited exceptions to these business scope restrictions have been recognized for legal, accounting and tax service providers, and foreign banks, insurance companies and securities firms, as well as for businesses, such as airline offices, where bilateral or multilateral treaties prevail over domestic law.

In recent years the government has tightened the rules on the establishment, amendment and administration of ROs and curtailed the use of ROs by foreign investors. Under the new rules, only companies that have been in existence for at least two years are permitted to establish an RO, preventing a foreign investor from using a new offshore holding company or special purpose vehicle to establish an RO. In addition, an RO may register no more than three representatives in addition to the chief representative. This rule effectively limits the number of non-mainland Chinese that are permitted to work for an RO as each individual must be registered as a representative and Chinese nationals cannot be registered as representatives nor can they be directly employed by the RO *(please see page 11)*.

The operating term of an RO may be no longer than the term of its foreign head office, and an RO is required to undergo an annual approval procedure to ensure the continuing validity of its registration certificate, to confirm the lawful existence of its head office, and to describe its operating situation and audited expenses, revenues and costs.

Notwithstanding that most ROs are not permitted to receive revenue due to their liaison status, most are still subject to income tax in China calculated on either (1) a deemed basis using a cost-plus calculation based on the RO's expenses, or (2) an actual basis recognizing the fees or commissions generated as a result of the RO's activities.

Operations Phase

GOVERNANCE AND MANAGEMENT

Under the Company Law, the shareholders' assembly is the highest governing authority of a company. The shareholders are required to establish a board of directors (or a single executive director), which is responsible for the overall management of a company. The shareholders also are required to establish a supervisory board (or a single supervisor), which is empowered to supervise the financial and management activities of the company, to order rectification actions, and to initiate civil claims against the shareholders and officers on behalf of the company. A supervisor of a company may not concurrently serve as a director or senior manager of the company. Foreigners are permitted to act as directors, supervisors or senior managers of an FIE and most other companies.

Shareholders have certain statutory rights, including access to the company's books and records, pre-emptive rights over the equity of other shareholders in limited liability companies, certain management rights (including the appointment of directors and supervisors and changes to a company's registered capital or articles of association), rights to bring claims against directors and senior management personnel who damage the shareholder's interests, and put rights upon the occurrence of certain events.

Chinese organizations invariably have an individual "responsible person," who bears personal legal liability for the acts of the company and possesses actual and apparent authority to act on behalf of the organization. For companies, including FIEs, the responsible person is referred to as the "legal representative." The legal representative may be the chairman of the board of directors, general manager or managing director of the company. Chinese administrative agencies generally treat foreign corporate investors in a similar way and record one individual as the de facto legal representative of the foreign parent for governance purposes in China.

The daily operations of an FIE are led by a general manager, who reports to the board of directors and may be assisted by one or more deputy general managers (often acting as department heads) and a finance director, who normally reports to the general manager.

Legal representatives, directors, supervisors and senior managers bear a duty of loyalty and diligence to the company, and must comply with corporate, commercial, managerial and financial duties similar to those imposed on company officers in most Western countries. Company officers also are subject to civil, administrative and criminal liability for their own acts and for the acts of the company.

FOREIGN EXCHANGE CONTROL

China's currency is not fully convertible. The Chinese government controls the inflow and outflow of foreign exchange by regulating the types of banks and bank accounts into which foreign exchange may be deposited and the types of transactions that involve foreign exchange. The State Administration of Foreign Exchange (SAFE) must approve or register foreign currency capital account transactions (e.g. contributions to registered capital, loans and loan principal repayments). Current account transactions (e.g. loan interest, insurance premiums and trade payments) generally are freely convertible, but the payer must submit certain supporting documents to the designated foreign exchange bank before the transaction can be completed.

Upon issuance of its business license, an FIE is required to submit an application to SAFE to carry out a foreign exchange registration procedure. The foreign exchange registration is required to capitalize the FIE and to carry out all subsequent inbound and outbound remittances of foreign exchange capital, including foreign shareholder loans to the FIE and outward remittances from the FIE of dividends and royalty payments.

LAND-USE RIGHTS

There is a fundamental distinction in China between "rights of ownership in land" and "rights to use land." All land is owned by the state or by a rural collective, and rights of ownership in land are not transferrable. By contrast, the right to use land is transferrable under certain circumstances. Use rights for land that is collectively owned may not be transferred until completion of a state requisition procedure and conversion to state owned land.

Chinese law also categorizes land-use rights according to the permitted use (i.e. agricultural, industrial, commercial or residential) of specific parcels of land, and generally agricultural land may not be used for industrial, commercial or residential projects. The State Council revises China's national land-use plan – and thus alters the zoning of specific parcels of land – once every five years, and provincial, municipal, county and township or village level governments are required to adhere to the State Council's plan.

Land-use rights may be transferred by allocation (i.e. a transfer without compensation) or by grant (i.e. a transfer in exchange for payment of a land grant fee). In addition, granted land-use rights may be acquired by purchase. There are several legal restrictions on the right to use allocated land, and an FIE generally may obtain land-use rights only by grant or by purchase. Land-use rights may be granted by means of a public bidding, auction or listing process. Granted land-use rights may be purchased by negotiated agreement with the current holder of the land-use rights, payment of a fee and relevant transfer taxes and registration with the local land authority.

The grantee or transferee of properly requisitioned and granted state-owned land-use rights that is properly zoned for industrial, commercial or residential use may enjoy an enforceable right to use the land for a fixed term of between 40 and 70 years for the purposes specified in the relevant land grant contract and, subject to certain restrictions, may transfer, lease or mortgage the land-use rights.

LABOR

China's labor regulatory environment has undergone a major change since January 1, 2008 when the Labor Contract Law of the People's Republic of China (Labor Contract Law) took effect. The Labor Contract Law was promulgated after a lengthy public consultation process with employers, employees, unions and other interested parties. It has been followed by numerous employment related national and local level laws and implementing regulations and several SPC interpretations. The effect of these changes has been to create a more comprehensive national system of employment regulation with increased protection for employees, though implementation at a local level has been inconsistent and much uncertainty remains. This has in turn resulted in a significant increase in labor disputes.

HIRING

FIEs may hire local employees directly in the labor market or through a labor service company. In contrast, an RO does not have the right to directly hire Chinese nationals, who must be hired through a qualified labor service company which serves as the technical legal employer of local employees who are then seconded to the RO.

The Labor Contract Law requires all employers to enter into a written labor contract containing certain mandated provisions. If an employer fails to do so within one month of employment, the employer is liable to pay to the employee a penalty of double salary commencing from the second month of employment until a written labor contract is established.

WORKING HOURS AND OVERTIME

Strict rules exist governing working hours, overtime and exempt employment. These rules are unevenly applied and enforced throughout China by employers and regulators, and provide a common source of disputes. In fact, disputes related to overtime constitute the second-most common source of disputes in China, after termination-related cases. To limit compliance risks, employers must understand the local rules and the related record keeping obligations.

OTHER EMPLOYER RULES – IMPORTANCE OF EMPLOYEE HANDBOOK

The uncertainty and lack of detail in China's employment laws and implementing regulations has increased the importance of having detailed rules and regulations that address these gaps. An employer may set out detailed rules that apply to the employment relationship in an employee handbook or separate document. In many cases, the ability of an employer to take action against employee misconduct turns on whether the relevant conduct is addressed in the employee handbook. An employer must consult with its employees and, if one exists, the labor service company to implement or change a handbook or other employment rules.

CONFIDENTIALITY AND NON-COMPETITION

While there is a general obligation on an employee to keep employer information confidential, separate confidentiality undertakings, either as part of the labor contract or in a separate standalone agreement, are recommended for all employees who may have access to confidential information. It is difficult to enforce a general obligation of confidentiality without strong evidence that the employer took all possible steps to keep the information in question confidential and specified the information that was to be kept confidential.

In addition, an employer may impose a post-employment non-competition restraint on senior management, highly skilled technicians, and those with confidentiality obligations. The duration of the non-competition period must not exceed two years. The Labor Contract Law makes it clear that separate, monthly compensation must be paid for a non-competition undertaking after the employee's termination, but does not impose a minimum consideration threshold, and the applicable amount depends on the location of employment.

TERMINATION

There is no employment "at will" under Chinese law. A labor contract terminates when the term of the contract expires or the contract is terminated in accordance with the law. An employee may terminate his or her labor contract at any time upon thirty days notice, or during the probation period upon three days notice, to the employer. An employee also may terminate the labor contract if the employer is in breach of key obligations under the Labor Contract Law.

By contrast, an employer may terminate a labor contract with an employee only in limited, specifically enumerated circumstances, and some classes of employees are statutorily protected or given preferential protection from termination. Termination without due grounds may result in penalties of up to double the wages due for the remaining term of the contract and severance or reinstatement. In most cases, termination by an employer will require payment of statutory severance. Severance is calculated based on the term of service, subject to different rules and exceptions depending on the basis for the termination, the location of the employee, and whether the employee was employed before or after January 1, 2008.

WELFARE AND BENEFITS

All employers and employees must join the social security (social insurance) system and pay premiums in accordance with law. For the employer, these obligations may add up to 40-50% of the cost of employment. Employees are entitled to generous medical leave, maternity leave and other statutory leave entitlements.

DISPUTES

Employment disputes are handled through a dedicated labor mediation and arbitration system, although most decisions are ultimately subject to appeal in the People's Courts. The significant increase in disputes since the introduction of the Labor Contract Law has resulted in the government placing greater emphasis on mediation. Beginning January 1, 2012, all medium and large scale enterprises are required to implement an internal labor mediation system with a view to relieving the burden on the arbitration and court system.

INTELLECTUAL PROPERTY RIGHTS

China has put in place a relatively well-developed legislative framework governing intellectual property rights. Enforcement of these rules, however, remains inconsistent.

TRADEMARKS

The government authority responsible for the regulation of trademarks is the China Trademark Office (TMO), which is under the supervision of the SAIC. The Trademark Review and Adjudication Board handles most appeals concerning registration matters. The People's Courts hear appeals involving infringement issues, which are decided in the first instance by the SAIC, as well as actions for preliminary orders and suits for damages and other remedies.

China maintains a "first to file" system for the protection of intellectual property rights. Hence, the exclusive right to a trademark in China ordinarily commences upon the registration of the mark by the TMO by the party first to file, although limited protection is available for "well-known" trademarks not registered in China. To qualify for registration, a trademark must be sufficiently distinctive to render it easily distinguishable from other marks. Trademarks in China may contain combinations of words, numerals, devices, colors, and three-dimensional images, but may not use government names or symbols. Collective marks, certification marks and, in certain cases, "well-known" trademarks also may qualify for protection. Owners are well-advised to register each trademark in each class of goods or services for which the mark will be used.

To register, a trademark applicant must apply to the TMO, which will issue a public notice in the China Trademark Gazette. If no notice of opposition is filed within three months of the public notice, the TMO will proceed to register the mark. Trademark registrations are valid for a renewable 10-year period.

Foreign investors should consider creating and registering the Chinese language equivalent of their foreign language trademarks prior to entering the market. In developing a Chinese language mark, a business owner must be attentive to both marketing and translation issues to ensure that the mark communicates the intended meaning (and avoids an unintended meaning) across the many dialects and regions of Greater China.

A registered trademark may be licensed pursuant to a written agreement filed with the TMO. Applications to assign a trademark must be submitted to the TMO by the assignor and assignee, and the assignor is required to assign simultaneously all identical or similar marks covering the same or similar goods. An assignment may be rejected if it may lead to confusion in the marketplace.

COPYRIGHTS

The administrative department in charge of copyright matters is the National Copyright Administration. The People's Courts hear actions for preliminary orders and suits for damages and other remedies. China became a member of the Berne Convention in 1992 and subsequently amended its copyright law to conform to TRIPS.

Under the Copyright Law, rights of ownership to published and unpublished work generally belong to the author who created the corresponding work, except where the work is created in the course of employment and the author and employer agree otherwise. Copyright protection generally extends 50 years after the author's lifetime (where the author is a natural person) or 50 years from publication (where the author is a legal person).

Copyright in software is protected by law in China. Copyright registration, including the registration of software products, is voluntary, and copyright protection exists even where copyright has not been registered. Registration may assist, however, in demonstrating the validity and ownership of copyright during a dispute.

Copyright may be assigned by a written contract that identifies the assigned rights, the territory and term of the assignment, and the amount and method of remuneration. Copyright may be licensed pursuant to an agreement that contains similar terms and also specifies whether the license is exclusive or non-exclusive. Moral rights, i.e. the rights of authorship, may not be assigned.

Preliminary court orders to ban infringement, preserve evidence and confiscate goods are available, and a copyright infringer is liable for compensation for losses. Administrative remedies include an order to cease an infringing act, the confiscation of illegal income, the seizure and destruction of infringing copies, the imposition of penalties, and in serious cases criminal sanctions.

PATENTS

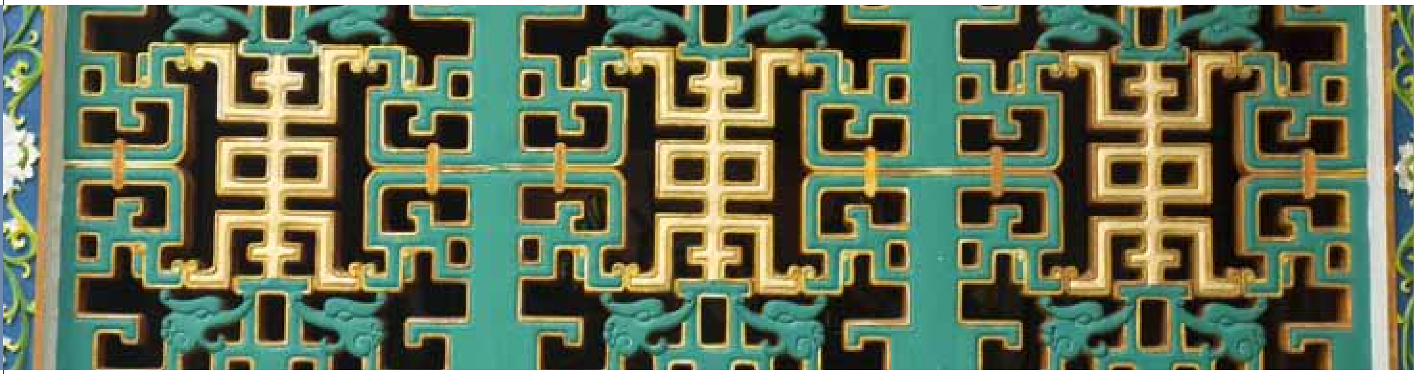
The government department in charge of the administration of patents is the Patent Office, which is under the State Intellectual Property Office. China is a member of the Paris Convention and the Patent Cooperation Treaty (PCT).

Foreign patents do not offer protection in China, and a patent rights holder must register separately for protection in China. Patents filed in another PCT member country under the PCT international patent application process may be registered in China pursuant to the applicable rules. China's patent law distinguishes between inventions and "creations," which include utility models and designs. The process for obtaining patent protection for creations is shorter and less invasive.

The assignment of patent rights to a foreign assignee requires registration with the Patent Office. Such an assignment also must comply with the rules related to technology exports described in the next section. Assignments to a domestic assignee, including an FIE, generally are not subject to these restrictions as there is no "export," and only registration with the Patent Office is required.

TECHNOLOGY TRANSFER

China regulates the import and export of technology. Technology imports and exports include assignments or licenses of patents, technical secrets, software or other proprietary technology; the provision of technical services; and cooperative arrangements between Chinese and foreign parties for design, research and development, co-development and co-production of technology.



The regulations divide technology imports and exports into three categories: prohibited, restricted and unrestricted. Prohibited technology may not be imported or exported. Restricted technology may be imported or exported upon completion of an approval procedure and issuance of a technology import or export license. Unrestricted technology may be imported or exported upon completion of an online registration procedure. A technology import or export contract for restricted technology takes effect upon issuance of the technology import or export license, while a contract involving unrestricted technology takes effect upon execution.

The rules governing technology imports impose a number of requirements and restrictions on foreign licensors. The licensor must provide certain warranties as to the effectiveness of the technology, may not unreasonably restrict the licensee from making improvements or from reverse engineering the technology, and may not unreasonably limit the licensee's sources of materials, production volumes or sales and export channels. In addition, the technology import license or the registration certificate is necessary to effect outward remittances of royalty payments for the license.

The rules governing technology exports are also problematic. The catalogue of restricted technology is lengthy. Restricted technology generally must be mature and "commercialized" prior to export, though the export of early-stage restricted technology may be permitted if the technology cannot be commercialized in China and the intellectual property rights to the technology have been secured in China and abroad.

ANTI-CORRUPTION

China has an extensive body of law addressing both criminal and commercial bribery that is, on its face, broader than that which applies in most countries. The Criminal Law makes it an offence to either offer or accept a bribe in the course of business. There are also detailed offences dealing with the offering and acceptance of bribes to and by government officials. In addition to the Criminal Law, many government departments have their own stringent rules and guidelines designed to prevent bribery. The penalties for breach of the applicable laws and regulations can be harsh and include heavy fines and imprisonment. Despite this, enforcement is far from uniform and corruption and compliance remains a major issue of concern for foreign investors who are also subject to scrutiny from regulators in their own countries as a result of laws such as the US Foreign Corrupt Practices Act and the UK Bribery Act.

Common problem areas are businesses subject to discretionary approval and licensing requirements, local management operating without due oversight or too much discretion, disgruntled employees and use of third party contractors.

PRICE AND MARKET REGULATION

China's Anti-Price Monopoly Regulations (APMR), formulated under the Anti-Monopoly Law (AML), prohibit so-called price-related monopoly agreements between competitors or between trading partners and price related abuse of dominance. Examples of prohibited agreements and abuse of dominance cited in the APMR will be familiar to businesses that are aware of antitrust and competition laws in other mature jurisdictions. In each case there is also a catchall prohibition of "other price-related monopoly agreements/price-related monopolistic conducts in the form of abuse of dominance as determined by the competent price regulatory authority under the State Council."

Examples of prohibited price-related monopoly agreements between competitors listed in the APMR are fixing or changing commodity prices, fixing or changing the proportion of price changes, fixing or changing processing fees or rebates that affect prices, adopting uniform prices when negotiating with a third party, adopting uniformly agreed formulae in calculating prices, entering agreements that prohibit operators from effecting price changes without prior consent from other signatory operators and fixing or changing commodity prices by means of restricting output or sales or segmenting sales and procurement markets. Examples of prohibited price-related monopoly agreements between trading parties at different levels of the supply chain listed are agreements to fix the price of a commodity for resale to a third party and agreements to set the minimum price of a commodity for sale to a third party.

Prohibited price-related abuse of dominance includes selling or purchasing commodities at unfairly high or low prices, selling commodities at prices below cost without justifiable cause, commanding overly high or low prices as a way of refusing to trade with a trading partner and offering differential prices to trading partners of equal standing without justifiable cause.

Trade associations are prohibited from making or publishing rules, decisions and announcements of the association to fix or change prices and from convening discussions among business operators regarding the same. There is also a more general prohibition on trade associations facilitating the conclusion of price monopoly agreements among business operators.

In addition to being required to discontinue any activity that violates the provisions of the APMR, possible penalties for breach of the above provisions include confiscation of any unlawful gains and a fine of not less than one per cent, but not more than ten per cent of sales achieved in the previous year. In the case of a price-related monopoly agreement that has not been implemented, the fine imposed may not be more than RMB 500,000. Trade associations may be fined not more than RMB 500,000 for violations of the APMR and, if the circumstances are serious, their registration may be cancelled.

The much older Pricing Law dates from 1997. It contains provisions in relation to pricing which in some cases overlap with the APMR. The Pricing Law specifically prohibits the following actions by individuals or organizations: colluding with others to harm market prices; dumping commodities at prices lower than production cost in order to drive out rivals and monopolize the market; fabricating and spreading information about price hikes and forcing up prices, using false or misleading prices to deceive consumers or other business managers into transacting a deal; employing price discrimination against trading counterparts with equal transaction conditions for providing the same goods or services; and forcing up or forcing down prices in disguised form by raising or lowering grades when purchasing or selling commodities or providing services and making exorbitant profits in violation of the laws and regulations. As with the APMR, there is a catchall prohibition of "other illegitimate acts in pricing prohibited by laws and administrative rules and regulations." Penalties under the Pricing Law are similar to those under the APMR.

Recent published decisions relating to breaches of the APMR have demonstrated that the authorities are more willing to enforce pricing laws and regulations than they have been in the past and that they are willing to impose very high fines for breaches.

TAX

The Enterprise Income Tax Law of the People's Republic of China, which took effect in 2008, created a unified tax regime applicable to domestic companies and FIEs. The standard rate of Enterprise Income Tax (EIT) is 25% and applies to taxable income, including capital gains. China also imposes a variety of other taxes. Outward remittances of capital gains, dividends, loan interest, royalties, etc. are generally subject to withholding taxes. VAT is levied on the manufacture or trade of goods at a standard rate of 17%, though lower rates apply to certain categories of goods. Customs duties are assessed on imported goods based on the type of goods imported and the country of origin. Transfers of land-use rights attract deed tax at 3-5%. Business tax is imposed at a rate of 3-5% upon the provision of services, including technology, transportation, construction, finance and insurance services, and other services that are not covered by VAT. Recent pilot reforms of the tax system will start to see VAT a rate of between 6-17% imposed on a variety of services in selected locations instead business tax, commencing with Shanghai. Stamp duty and other local taxes may also apply to services and specific transactions.

China offers a variety of tax incentives and holidays to promote investment in selected regions or industry sectors. For example, an FIE established in the 16 provinces and regions in Central and Western China and operating in "encouraged" sectors under the Foreign Investment Catalogue may enjoy a reduced EIT rate of 15% until the end of 2020. An FIE recognized as a "high and new technology enterprise" also qualifies for the reduced EIT rate. A qualified software and/or integrated circuits enterprise may qualify for exempted or reduced EIT, a business tax exemption and/or VAT rebates. Customs duty may be exempted for imported equipment if the value is within an FIE's total amount of investment

and the equipment is for self-use purposes. Local governments also offer a variety of local tax subsidies and preferential treatment to encourage investment in preferred industries. An R&D Center may be eligible for local subsidies and other preferential treatment. Customs duty may be exempted for imported equipment if the value is within an FIE's total amount of investment and the equipment is for self-use purposes.

China has an extensive tax treaty network that now extends to nearly 90 countries. Some treaties offer most preferential rates and flexibility for cross-border investments, mergers and acquisitions, borrowing and lending activities, and technology licensing. On the other hand, China also has been strengthening the enforcement of its antitax avoidance rules in recent years. For example, related party transactions must be reported in a company's annual income tax return and non-arm's length transactions are likely to be subjected to a transfer pricing analysis.

DISPUTE RESOLUTION

To protect a foreign investor doing business in China effectively, it is critical to identify at the outset a fair and transparent dispute resolution forum and ensure the ability to enforce a judgment or arbitration award. For most transactions involving foreign companies or individuals, arbitration still offers the preferred method of dispute resolution.

The available forums for arbitration include the China International Economic and Trade Arbitration Commission, domestic arbitration tribunals set up in China's major cities, and, if the dispute involves a foreign party, arbitration institutions outside China. Popular choices outside mainland China include the Hong Kong International Arbitration Centre, the Singapore International Arbitration Centre, the Stockholm Chamber of Commerce and the International Chamber of Commerce. As the relative bargaining power of Chinese contracting parties has increased in recent years, foreign arbitration has become less common, but Hong Kong often still presents a viable compromise.

To ensure that an arbitration clause is enforceable, the parties must specify in the contract the scope of the arbitration clause, the identity and location of the arbitration tribunal and the rules for the arbitration. Arbitration awards may be final and binding, but a successful claimant seeking to enforce an arbitration award in China must file an action in a People's Court where the defendant's assets are located. China is a member of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the People's Courts are required to recognize and enforce foreign arbitral awards rendered by recognized institutions from member countries. To improve China's record on enforcement, the approval of the Supreme People's Court is required to review any decision by a lower level court not to enforce a foreign arbitral award.

The primary alternative to arbitration is the People's Courts in China. Courts outside of mainland China are largely ineffective because their judgments are usually not recognized in China due to a lack of reciprocal agreements for recognition of Chinese judgments outside mainland China. Hong Kong is one recent exception. The Chinese court system handles several million cases each year, and the central government has made a concerted effort to improve the court system, focusing on better education and training and on the primacy of law over personal relationships and local politics. For routine matters in larger commercial centers such as Shanghai and Beijing, dispute resolution through the court system may be a viable alternative. Inexperience with sophisticated commercial transactions and local protectionism nevertheless remain issues both for foreign parties in cases involving Chinese parties and for Chinese parties (including FIEs) in courts outside of their own locality.

DIVESTMENT AND EXIT

The available options for divesting from an FIE include (1) the sale of the foreign investor's equity interest in the FIE or a sale of the offshore entity that directly or indirectly holds the foreign investor's equity interest in the FIE, (2) the conversion of the FIE to an FICLS, the listing of the shares in the FICLS on an exchange in China, and the subsequent sale of such shares, (3) the listing of the shares of the offshore entity that directly or indirectly holds the foreign investor's equity interest in the FIE and the subsequent sale of such shares, and (4) the sale or liquidation of the FIE's assets and the dissolution of the FIE.

SHARE OR EQUITY TRANSFERS

There are various means for carrying out a share or equity sale. If the equity interest in the FIE is held through a separate offshore holding company, commonly referred to as a special purpose vehicle (SPV), it may be possible to sell the shares of the SPV offshore and avoid onshore notice and approval requirements. All onshore options require the consent of the other shareholder(s) in the FIE, the approval of MOFCOM (and possibly other administrative agencies such as the industry regulator and/or SASAC), and registration with the SAIC. The onshore divestment process essentially mirrors the foreign investment process, except that in some locations it is now necessary to obtain tax clearance by payment of any capital gains tax on the transfer, prior to registration of the transfer.

Shareholders in a limited liability company FIE generally have a statutory pre-emptive right over the transfer of an equity interest in the FIE. In addition, any change in the shareholding of an FIE necessitates a change in the FIE's articles of association, which by law requires the unanimous consent of the shareholders. Put and tag-along rights often may be included in an EJV or CJV joint venture contract and articles of association, subject to the agreement of the other shareholder(s) and MOFCOM approval. Once included such provisions are enforceable in theory, although in practice enforcement still requires the cooperation of the shareholder(s). Without such an express right, however, a foreign investor must find a willing buyer and convince its fellow shareholder(s) to agree to the sale.

A share swap with an onshore listed company is theoretically possible, but it involves a complicated regulatory procedure. The foreign investor may be obligated to acquire at least 10% of the issued share capital of the listed company, and such shares are subject to a three-year lock-up restriction. A share swap requires approvals from the listed company's board of directors, its shareholders board, SASAC, China's securities regulator, the China Securities Regulatory Commission (CSRC) and MOFCOM.

INITIAL PUBLIC OFFERING

ONSHORE LISTINGS

Mainland China has two main stock exchanges located in Shanghai and Shenzhen, respectively. These stock exchanges have several markets, known as the Main Board, the SME board and the Growth Enterprise Market (or ChiNext), respectively. Shares traded on these markets can be categorized as "A Shares"and "B Shares." A Shares are subscribed for and traded in RMB. Due to China's foreign exchange control regime, foreign involvement in the A Share market is limited to a quota system designed for "qualified foreign institutional investors" and certain strategic investors. B Shares are subscribed for and traded in foreign currency or Hong Kong dollars, but the B Share market has not attracted many IPOs in recent years. The ChiNext, which currently only trades A Shares, was established in October 2009 to assist growth-stage companies and offers less stringent qualification requirements.

The CSRC requires an FIE that wishes to list to convert to an FICLS and undergo a rigorous approval procedure prior to listing. An FIE generally is required to operate for three years before it applies to convert to an FICLS, and an FICLS generally is required to operate for three years before listing. Exceptions to these rules may be available where continuity of the business can be demonstrated, especially where common control by the shareholders of any predecessor business can be established. Likewise, the CSRC may waive the three-year FICLS rule if it views the conversion as "total" (based on the company's book net asset value) and if it meets various other listing requirements.

HONG KONG AND FOREIGN LISTINGS

An FIE also may elect to list in Hong Kong or outside China. Options in Hong Kong include the Main Board of the Hong Kong Stock Exchange or, for growth companies that do not meet the main board listing requirements on profitability or track record, its Growth Enterprise Market.

An FIE may be listed by way of an “H Share” listing or a “red chip” listing. An H share listing refers to the listing of a joint stock company established in China. By contrast, a red chip listing refers to the listing of a foreign entity with major assets in China. Red chip listings, as well as foreign listings involving China-based assets, often involve a corporate reorganization to transfer the equity held by Chinese shareholders in the relevant FIE to the listing vehicle or its subsidiaries. The reorganization is subject to approval from MOFCOM or its local subordinates. SAFE also imposes registration requirements on transactions involving “round-trip investments” (that is an investment using funds remitted from China by Chinese nationals in an offshore company that then reinvests in the Chinese listing vehicle or its subsidiaries). China’s foreign exchange control rules (please see page 10) apply to the outward remittances of profit and other distributions from the China-based assets.

Approval from the CSRC also may be required before a joint stock company is permitted to make an H share listing or prior to a red chip or foreign listing that involves state-owned assets. Red chip and foreign listings involving privately held China assets generally do not require CSRC approval, though the CSRC retains final authority to determine if approval is required.

LIQUIDATION

An FIE may be wound up upon the election of its shareholders, the expiration of its operating term, the occurrence of an event specified in a joint venture contract, the issuance of an administrative or judicial order, or for other reasons, including insolvency (which is governed by the Enterprise Bankruptcy Law of the People’s Republic of China (Enterprise Bankruptcy Law). The procedure to liquidate an FIE’s assets voluntarily and dissolve the FIE, which commences upon formation of a liquidation committee, may only proceed upon issuance of MOFCOM approval. The whole process usually takes at least six to twelve months, the longest part of which is usually the tax clearance as this involves a final liquidation audit by the tax office.

The chief function of the liquidation committee is to prepare a liquidation plan, which resolves issues related to the FIE’s assets and liabilities, as well as complications involving employee resettlement and the repayment of any tax benefits and subsidies. An FIE’s liabilities are discharged in the following priority: (1) liquidation expenses, (2) employee salaries, social insurance and welfare benefits and statutory compensation, (3) outstanding taxes, and (4) commercial obligations. Any balance is distributed to the shareholders in accordance with their respective share percentages, subject to SAFE approval.

Upon completing the liquidation procedures, the liquidation committee is required to prepare a liquidation report for confirmation by the shareholders or a People’s Court and submission to the SAIC for de-registration of the FIE. A public announcement also must be made in regard to the dissolution of the FIE.

INSOLVENCY

Until the introduction of the Enterprise Bankruptcy Law in 2007, China did not have a national unified bankruptcy regime. The Enterprise Bankruptcy Law allows for both debt restructuring and settlement as alternatives to liquidation, so that going-concern value can be preserved. Any creditor, as well as any debtor, may initiate a reorganization proceeding if the debtor is unable to pay its due debts and either of the following is true: (1) the debtor’s assets are insufficient to settle all of its debts or (2) the debtor is “obviously insolvent.” Upon acceptance of a bankruptcy application, the People’s Court will appoint an administrator to take possession of the debtor’s property and manage the business on behalf of the creditors.

As in other countries, secured creditors are paid first in relation to their secured assets, and unsecured claims are paid from unsecured assets; however, employee claims accrued until August 27, 2006 have priority over secured creditors’ claims if they cannot be satisfied outof the debtor’s unsecured assets.

The Enterprise Bankruptcy Law provides for the formation of a creditors’ committee consisting of up to nine members. Creditors may exercise broad powers relating to the bankruptcy proceedings through majority vote of the number of unsecured creditors at a duly convened meeting of creditors holding at least half of the unsecured debt.

Where a petition for restructuring is filed and accepted by the People's Court, the administrator or debtor must file the restructuring plan within six months. This deadline may be extended for three months, after which conversion to liquidation is mandatory. Any debt settlement must be approved by holders of two-thirds of all unsecured claims.

Administrators may petition the People's Court to unwind certain fraudulent or preferential transactions entered into by the debtor within one year before the acceptance of the bankruptcy petition. Officers of an enterprise who breach their obligations of loyalty or due diligence, causing the enterprise to go into bankruptcy, may be subject to civil, or even criminal, liability.

GLOSSARY OF ACRONYMS

AML	Anti-Monopoly Law
APMR	Anti-Price Monopoly Regulations
CJV	Cooperative Joint Venture
CSRC	China Securities and Regulatory Commission
EIE	Equity Investment Enterprise
EIT	Enterprise Income Tax
EJV	Equity Joint Venture
FICLS	Foreign-invested Company Limited by Shares
FIVCE	Foreign-invested Venture Capital Enterprise
FIE	Foreign-invested Enterprise
FIP	Foreign-invested Partnership
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
NPC	National People's Congress
PCT	Patent Cooperation Treaty
RHQ	Regional Headquarters
RO	Representative Office
SAFE	State Administration of Foreign Exchange
SAIC	State Administration of Industry and Commerce
SASAC	State Assets Supervision and Administration Commission
SPC	Supreme People's Court
SPP	Supreme People's Procuratorate
SPV	Special Purpose Vehicle
TMO	Trademark Office
VAT	Value Added Tax
WFOE	Wholly Foreign Owned Enterprise

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