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This TMT Newsletter contains the following articles:

- Supplementary Amendments to the Measures for the Administration of Foreign Investment in the Commercial Sector
- Administrative Measures for Overseas Investment

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SUPPLEMENTARY AMENDMENTS TO THE MEASURES FOR THE ADMINISTRATION OF FOREIGN INVESTMENT IN THE COMMERCIAL SECTOR

Introduction

On 5 February 2009, the Ministry of Commerce (**MOFCOM**) published the *4th Supplementary Provisions to the Measures for the Administration of Foreign Investment in the Commercial Sector* (**2009 Amendments**). The 2009 Amendments, for the first time, allow Hong Kong and Macao investors to establish wholly-owned foreign enterprises (**WFOE**s). The investors must operate a minimum of 30 stores selling commodities such as medicines, pesticides, film covers for agricultural use, fertilizers, vegetable oil, sugar and cotton under varied brand names and from multiple suppliers. To date, this represents the biggest relaxation on investment restrictions in China's wholesale and retail sectors for Hong Kong and Macao investors, but other foreign investors are still required to comply with the 49% equity percentage restriction (as set forth hereunder).

Starting in 1992, foreign investors were permitted to engage in wholesale and retail activities in China, but only by establishing joint ventures (**JV**s) with Chinese partners. This changed dramatically on 1 June 2004, when the *Measures on the Administration of Foreign Investment in the Commercial Sector* (**FICE Measures**) issued by the MOFCOM, came into effect and further opened China's commercial sector to foreign investors. The FICE Measures decreased the establishment requirements for JVs and allowed WFOEs to engage in wholesale and retail activities for the first time.

Supplementary Provisions

From 2006 on, a gradual relaxation has progressed, depicted mainly by amendments to the FICE Measures. All previous amendments have specifically encouraged Hong Kong and Macao investors to put their money into China's wholesale and retail sectors, a direct attempt to keep in line with the *Hong Kong and Macao Closer Economic Partnership Agreements* (**CEPA**) and foster closer economic ties between China and these 2 regions.

The 2009 Amendments directly target Article 18 of the FICE Measures, which originally provided that: a foreign investor intending to establish more than 30 stores selling books, newspapers, magazines, automobiles (the restriction on automobiles later being lifted on 11 December 2006), medicines, pesticides, film covers for agricultural use, fertilizers, refined oil, grains, vegetable oil, sugar, cotton, and other commodities (**Commodity Category**), and offer the aforementioned commodities under varied brand names and from multiple suppliers, must do so via a JV, in which the foreign investor's equity percentage must not exceed 49%.

To date, Article 18 of the FICE Measures has been amended 4 times from 2006 to 2009 as follows:

1. 2006 Amendments I (9 January 2006)

    - Raised the 49% equity percentage cap to 51%;
    - Allowed Hong Kong and Macao investors to hold controlling shares in the JV; and
    - Removed refined oil from the Commodity Category (it is already regulated under other specific regulations).

2. 2006 Amendments II (3 November 2006)

    - Increased the cap from 51% to 65%.

3. 2007 Amendments (5 November 2007)

    - Removed print materials from the Commodity Category (books, newspapers, and magazines are also regulated by other specific regulations); and
    - Raised the minimum number of stores that must be opened to 50 from the previous 30.

4. 2009 Amendments

    - Reverted the necessary number of established stores back to the original minimum of 30;
    - Removed the previously imposed equity percentage cap; and
    - Allowed Hong Kong and Macao investors to establish WFOEs, and, in turn, allowed those WFOEs to run the established stores.

TAL Commentary

The FICE Measures have no doubt resulted in a more favorable environment for foreign investors. The additional relaxation provided by the amendments to the FICE Measures will result in broader possibilities for Hong Kong and Macao investors, as they will be able to directly invest, establish, manage, and stimulate the growth of WFOEs in Mainland China.

Obviously, opening certain sectors to outside investment during tough economic times is a skillful tactic to encourage further growth and stimulate the economy. That said, one should wonder why other foreign investors remain restricted under Article 18 of the FICE Measures.

It thus appears likely that more liberal regulations and policies for other foreign investors will soon follow to encourage more foreign investment in these sectors. However, at this stage, foreign investors who are trying to cope with the current restrictions might notice the practicality of establishing enterprises in Hong Kong or Macao (so-called "special purpose vehicles"). They could then use such vehicles for purposes of indirect investment in Mainland China, provided that the vehicles satisfy the criteria provided under the Hong Kong and Macao CEPA with Mainland China.

This newsletter was coauthored by Tina Feng and Amanda Rose McCreight.

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ADMINISTRATIVE MEASURES FOR OVERSEAS INVESTMENT

Introduction

Following the solicitation of public opinions under the *Draft Administrative Measures for Overseas Investment* (**Draft Measures**) at the end of January 2009, on 17 March 2009 the Ministry of Commerce (**MOFCOM**) promulgated the *Administrative Measures for Overseas Investment* (**Measures**), which will come into effect as of 1 May 2009.

Key Changes

As compared to the current regulatory regime for overseas investments by Chinese entities, which is governed by the *Provisions on the Examination and Approval of Investments to Establish Overseas Enterprises* (**Provisions**, promulgated by the MOFCOM on 1 October 2004), the Measures set forth various key changes relating to the MOFCOM's jurisdiction. The approval requirements for overseas investments have also been clarified and somewhat streamlined.

1. Approval Framework Revised

Existing System

Under the current regime, the MOFCOM in Beijing is responsible for approving overseas investments undertaken by central state-owned enterprises and PRC enterprises with investments in those countries which are not listed in the appendix to the Provisions. All other overseas investments are the responsibility of the MOFCOM's provincial bureaus (*i.e.,* the provincial Bureaus of Commerce).

New System

Under the Measures, central-level MOFCOM approval is only required if an overseas investment:

- is made in a country that has not established diplomatic relations with the

PRC;

- is made in a country (or region) specified for central-level approval by the MOFCOM or another relevant authority, such as the Ministry of Foreign Affairs;
- involves a total amount of US$ 100 million or more;
- involves multi-national or multi-regional interests; or
- involves the establishment of an offshore special purpose vehicle.

The MOFCOM will issue its decision on whether to approve such an investment within 20 to 30 working days of receiving the application documents.

Provincial-level MOFCOM approval is required for an overseas investment that:

- involves a total transaction amount of between US$ 10 million and 100 million;
- is in the energy and minerals sectors; or
- is in an entity which has PRC-registered clients.

The competent Bureau of Commerce will issue its decision on whether or not to approve an application for such investments within 20 working days of receipt.

2. Simplified Approval Procedures

For overseas investments which do not fall within either of the above 2 sets of rules, the applicant may simply submit an overseas investment application letter to the MOFCOM online. Central enterprises must submit their applications to the central MOFCOM; all other applicants must submit them to the relevant provincial Bureau of Commerce.

The MOFCOM at either level will approve or disallow an investment within 3 working days of receiving the corresponding application letter.

3. Approval Authorities Harmonized

In addition to the MOFCOM, the National Development and Reform Commission (**NDRC**) and the State Administration of Foreign Exchange (**SAFE**) regulate aspects of overseas investments by Chinese companies.

Depending on the nature of a particular overseas investment and the use of foreign exchange therein, the approval of the MOFCOM (with regard to the investment as a whole) and the SAFE (with regard to the use of foreign exchange for purposes of the investment) must be obtained. The project must also be either filed with, or approved by, the NDRC. Under the Provisions, the order in which approvals must be obtained from the NDRC, SAFE and MOFCOM was not properly clarified, particularly at the local level. Some investments have therefore proceeded without

NDRC approval, because the investors simply skipped that step and proceeded directly to apply for approval from the MOFCOM.

The Measures attempt to resolve this situation by stipulating that all necessary approvals or filing documents from other relevant governmental agencies must be included in the approval application package submitted to the MOFCOM. This is intended to integrate more effectively the various aspects of the application process for overseas investments.

4. Penalties

There is no penalty provision in the current overseas investment regime. However, the Measures state that enterprises which violate its provisions will be prohibited from enjoying "national overseas investment policies" for 3 years.

The Measures also introduce penalties for deliberately submitting an overseas investment approval application which contains false information. These penalties include receiving a warning, being precluded from applying to undertake overseas investments for up to 3 years, and having approval documents issued on the basis of the application revoked.

TAL Commentary

The Measures reform the administration of the present overseas investment system and simplify the approval procedures under the MOFCOM's authority.

Under the new regime, only overseas investments which fall into the 8 criteria stipulated above must undergo lengthy MOFCOM approval procedures. The bulk of overseas investments applications (approximately 85%, according to one MOFCOM official) will be approved or rejected within 3 working days via the online application process. The Measures thus mark a significant improvement in the efficiency of China's overseas investment regulatory framework, and indicate the Chinese government's intent to facilitate such investments being made.

However, as expected, given the short consultation period on the Draft Measures and how quickly the Measures were promulgated, some of the problems identified in the Draft Measures have not been properly addressed. For example, it remains unclear whether approval must be obtained from the central MOFCOM or the provincial Bureau of Commerce, if an overseas investment which was originally less than US$ 100 million is increased to exceed that amount.

Further, in order for the Measures to have the desired effect of (a) facilitating overseas investments, and (b) encouraging PRC enterprises to undertake them, thereby stimulating the Chinese economy, the NDRC and SAFE need to promptly update and simplify their own approval procedures. For example, it would be useful to distinguish those investments requiring a lengthy approval process from those only requiring a simplified review, so as to work in line with the new regime introduced under the Measures.

This newsletter was coauthored by Michelle Wei and Tan Joonho.

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We trust that you will find our newsletter both timely and informative. If you have any questions on these subjects or any other area of telecoms, media or technology law, please contact:

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