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Lovells**

Investing in China's TMT Sector: What should you know?

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Introduction

Many TMT companies have found China a market that is challenging to navigate. The challenges have included restricted sub-sectors, data localization requirements, and intellectual property protection. These market access issues have been the key issues during the trade war between the United States and China.

Regardless of the outcome of the trade war, China is likely to further loosen restrictions on foreign investment in the TMT sector. We have prepared this Guide to help investors understand the opportunities available.

What's included?

This Guide is organized in two parts:

Part I – Q&A

Part I provides an introduction to the foreign investment basics and certain issues that a TMT investor must consider when approaching the Chinese market.

Part I covers the following topics and is organized in a Question & Answer format to make it easy for you to find the information you need:

Market access issues

We begin with an overview of the Chinese foreign investment regime and the restrictions applicable to the TMT sectors, including a China Market Access Chart explaining which sub-sectors are open for foreign investment and which are restricted.

Foreign investment vehicles

We have included a primer on the main foreign investment vehicles available to foreign investors. This primer walks you through the benefits and challenges of each vehicle to help you decide how to best structure your investment, and explains the impact that the new Foreign Investment Law – the most significant overhaul of the Chinese FDI regime since it was put in place in the 1980s and 1990s – will have on existing and new foreign invested enterprises in China.

VIE structure

A discussion on the VIE structure is also included as a way to work around restrictions on market access. The VIE structure presents important benefits as well as challenges and risks that must be carefully assessed in evaluating the opportunity of using this particular structure.

Cyber security and data protection

Any investor in the TMT sector needs to understand how China's cyber security and data protection laws will affect their business particularly around the requirements for data localization, cross-border data transfers, and the protection of China's national security interests. We have included a short discussion on the key aspects of the rules to help you understand what you need to know. And we explain why complying with the GDPR only doesn't afford you complete protection in China.

Intellectual property

Intellectual property is lifeblood of any TMT business. We have included a short section to help you understand the intellectual property protections available in China as well as the key developments you need to know.

Litigation

Many companies worry about the reliability of the Chinese court system to protect them should issues arise. We have provided an overview of the court system in China and the opportunities for legal recourse.

Part II – Client alerts

Part II includes a selection of recent client alerts we have published which are most relevant to the TMT sector. We have included a full version of some of these client alerts and links to other client alerts that are available for download on our website.

We hope you find this Guide useful. Please feel free to contact any of the authors listed here for more information



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Part I – Q&A

Market access issues

1. Q: Are there foreign investment restrictions in China?

A: The first question to ask when engaging in an investment project in the People’s Republic of China (“**China**” or “**PRC**” – excluding for purposes of this definition the territories of Hong Kong, Macau and Taiwan) is whether a foreign investor is permitted by law to own equity interests in a company operating in the targeted industry sector, and if so, what is the maximum percentage permitted.

At present, whether foreign investment into an industry sector is prohibited or restricted is set forth in:

- the Special Administrative Measures (Negative List) for Foreign Investment Access (“**National Negative List**”) published by the National Development and Reform Commission (“**NDRC**”) and the Ministry of Commerce (“**MOFCOM**”), setting out the Chinese government’s policy on foreign investment applicable at the national level, the latest version of which took effect on July 28, 2018; and
- a similar but more favorable list named Special Administrative Measures (Negative List) for Foreign Investment Access in the Free Trade Zones (“**FTZ Negative List**”) and, together with the National Negative List, “**Negative Lists**”) published by NDRC and MOFCOM, applicable in the Chinese Free Trade Zones (“**FTZs**”)¹, the latest version of which took effect on July 30, 2018.

Some industries in China are completely off-limits to foreign investment (e.g. many media sectors) and some others such as the telecommunications and Internet industries (which come under the same regulator in China) restrict the form of participation to joint ventures, as set forth in the Negative Lists.

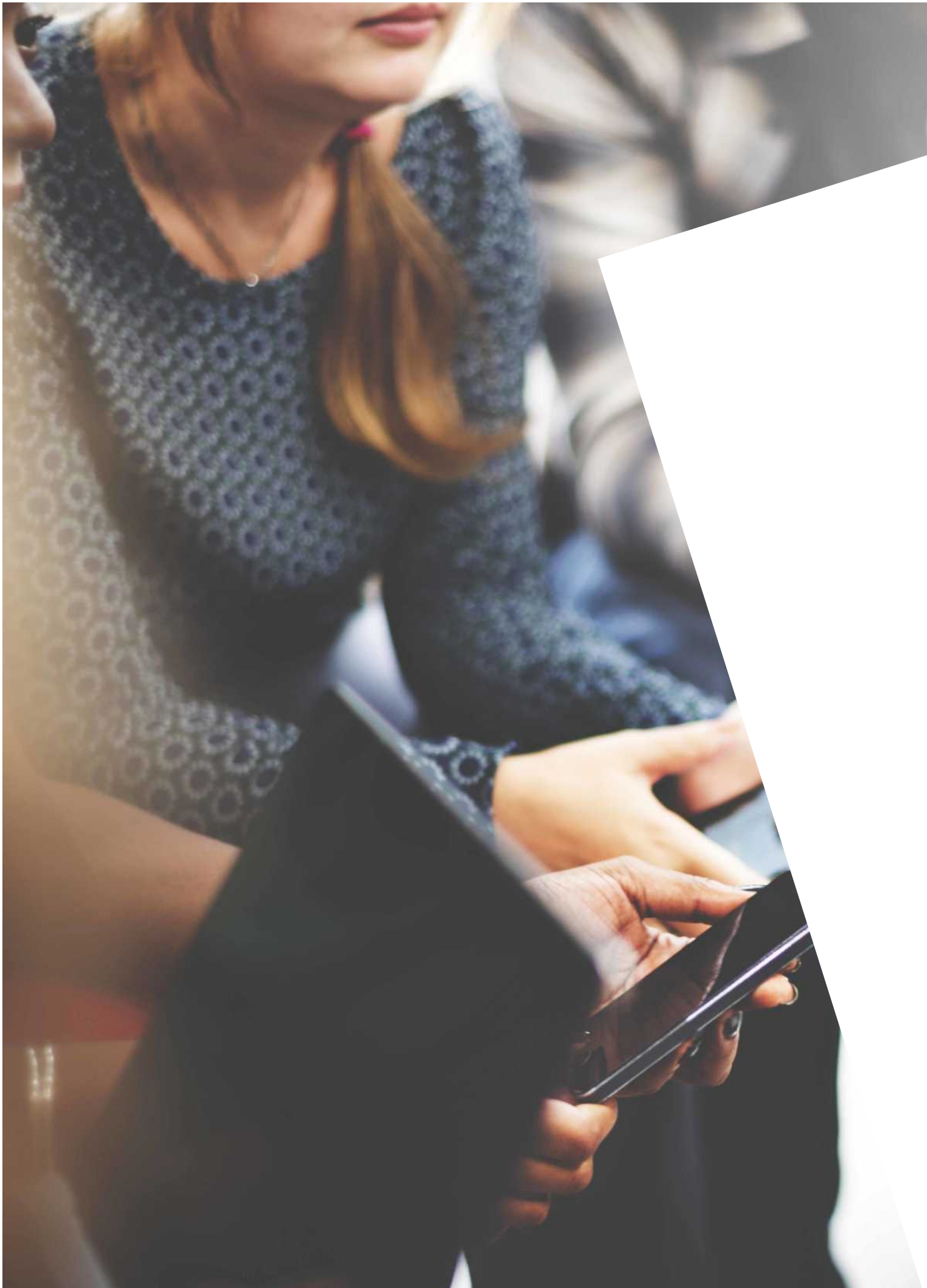
An analysis of the Negative Lists is a required prelude to any investment in China. They only list sectors which are ‘restricted’ or ‘prohibited’ to foreign investment: in principle, anything outside the Negative Lists is fully open to foreign investors, and no regulatory approval is required from MOFCOM or other PRC regulator.

Additional consideration should also be given to the need to obtain industry-specific licences and permits, which may appear to be obtainable on paper, but may not always be available in practice. This may thereby serve as an additional de facto barrier to foreign equity participation in the market and is not uncommon in the TMT sectors, whereby the rules provide that foreign investors may obtain equity ownership up to 50% but in reality the Ministry of Industry and Information Technology (“**MIIT**”) – the TMT industry regulator – is not going to hand out its approval as an unspoken policy.

Therefore, if a target industry sector is prohibited or restricted to foreign investment based on the National Negative List or market access otherwise ‘blocked’ in any given locality due to policy reasons, you should consider turning to one of the FTZs, to see whether the industry sector has been opened up there based on the more liberal FTZ Negative List and local policies. If it is also not open there, consider involvement in the sector in a way which does not involve direct ownership of equity (see discussion of the VIE structure in section “[VIE Structure](#)” below).

¹ In an effort to continue to attract high levels of foreign investment, China established a pilot first FTZ in Shanghai, which officially opened as of September 29, 2013. The unique selling point of the Shanghai FTZ was that it permitted greater foreign equity participation in certain sectors beyond those levels permitted elsewhere in China and streamlined administrative procedures on an experimental, ‘pilot’ basis, to give foreign investors in sectors not on the FTZ Negative List true national treatment and a true level playing field with domestic competitor. Up to now, China has rolled out 11 additional FTZs (bringing the total number of FTZs to 12), largely based on the Shanghai model, albeit with some local tailoring in Tianjin, Chongqing, Guangdong, Fujian, Liaoning, Zhejiang, Henan, Hubei, Sichuan, Shaanxi and Hainan. The FTZs have introduced a number of reforms designed to create a preferential environment for foreign investment, including relaxed policies in various service industries including medical services, VATS, ocean freight and international ship management, and banking. Some of these relaxed policies remain unique to the FTZs, but some others have been adopted on a nation-wide basis as well, thereby diminishing the attractiveness of the FTZs.





Finally, note that under the Closer Economic Partnership Arrangements between Mainland China and each of Hong Kong and Macao (“**CEPAs**”), investments made by Hong Kong or Macao Service Suppliers (as defined in and qualified under the respective CEPA, “**Service Suppliers**”)² may enjoy a more favorable treatment compared to the Negative Lists (such as no foreign shareholding percentage limitation on certain value-added telecom services (“**VATS**”) sub-sectors: see Question 2 below).

2. Q: Which particular restrictions apply to the TMT sector?

A: By comparison to the previous version of the Negative Lists issued in 2017, the 2018 version reduces the number of industry sectors restricted to foreign investors. However, many key sectors of interest to foreign investors, particularly in the services sectors, remain prohibited or restricted to foreign investment, such as basic telecom services and numerous VATS sub-sectors. Most media sectors, such as online publishing or provision of online audio-visual services such as Video-on-Demand remain off-limits to foreign investment.

TMT is a highly regulated sector and foreign investment in most businesses within the TMT sector is subject to restrictions or prohibited. We have summarized in the China Market Access Chart available [here](#) the differentiated treatments on market access in China in the various TMT sectors: (i) based on China’s WTO commitments, (ii) on a national level (based on the National Negative List and the various rules applicable nationwide), (iii) in the FTZs (based on the FTZ Negative List and the various rules applicable in the FTZs), and (iv) under the CEPAs.

3. Q: Is China prepared to further open up the TMT sector?

A: Reportedly, yes. China just passed its landmark PRC Foreign Investment Law (“**FIL**”) on March 15, 2019, against the backdrop of the trade tension with the United States (we analyze certain implications of the FIL in Questions 6 and 7 of section “[Foreign Investment Vehicles](#)” below). Together with other measures, China wants to show to the world that foreign investment is more than welcome.

During the Boao Forum 2019 Session held in late March 2019, Premier Li Keqiang stated publicly that, by the end of June 2019, both the National Negative List and the FTZ Negative List will be updated to further reduce restrictions on market access in service sectors such as VATS, medical institutions, education services, as well as other industries like transportation, infrastructure and energy sources. Premier Li made similar encouraging statements earlier that month during the China Development Forum 2019 Session about a proposed pilot open-up policy in the cloud computing sector.

These statements stirred a new round of expectation and enthusiasm from foreign players in this area. Some of them have long been waiting for a policy change allowing them to enter the Chinese market under the right conditions; some others have already entered the Chinese market adopting alternative contractual structures with no direct equity ownership in the business and wish to upgrade their current structure to a direct equity ownership structure as soon as the sector opens up.

² In order for a legal entity from Hong Kong/Macao to be qualified as a Service Supplier thus eligible for the special treatments under the CEPAs, such legal entity must meet the following requirements, among others: (1) established in Hong Kong/Macao and having a license or permit for the relevant service; (2) operating in Hong Kong/Macao in the same nature and scope of the services intended to be provided in the PRC; and (3) engaged in substantive business operations for 3 years or more.

Foreign investment vehicles

1. Q: Do I need to establish an entity in China to carry out my project?

A: For some investors, depending on the industry and the nature of the business (e.g. simple cross-border trading in goods and services), engaging China on a cross-border basis may be sufficient for their current objectives. For others, establishing a local entity is imperative, whether because it is required by law, intrinsically necessary to roll out their business model, or because their current business has grown to the point where they must incorporate locally to achieve their next phase of growth.

Establishing or acquiring an entity in China, rather than purely doing business with China on a cross-border basis, is especially important if one or more of the following functions is important to your business:

- opening bank accounts in China;
- receiving payments in RMB;
- issuing official Chinese tax receipts (fapiao);
- sponsoring work visas for foreign employees; and
- building a strong brand amongst consumers in China.

2. Q: Which vehicles are available for foreign investment under the laws of China?

A: There are broadly two types of corporate entities in China: (1) limited liability companies and (2) companies limited by shares.³ The latter are public companies and relatively rare as far as foreign investment is concerned, so the focus here is on the former.

If a corporate entity is to have foreign investment from the outset, it will have to be established as a foreign-invested enterprise (“**FIE**”), either as a wholly foreign-owned enterprise (“**WFOE**”), a Sino-foreign equity joint venture (“**EJV**”), or a Sino-foreign cooperative joint

venture (“**CJV**”)⁴. Each is treated as a limited liability company (subject to certain limited circumstances where it is possible to ‘pierce the corporate veil’), with the exception that it is possible to set up a CJV without legal person status which operates like an unlimited liability partnership, where each partner has unlimited liability and no new entity is formed, although this structure has rarely been seen in practice for many years.

Another possibility available to foreign investors is the establishment of a representative office (“**RO**”) although it cannot be used to carry out business directly (see Question 3 below).

3. Q: Why should I choose a RO?

A: ROs are generally intended for liaison and market research activities and may be useful transitional vehicles for businesses initially exploring the Chinese market and identifying local partners for future projects.

Compared to other vehicles, a RO may be established more quickly and at a lower cost. Typically, RO registration can be completed within one month after compiling the relevant application materials and filing them with the relevant local branch of the State Administration for Market Regulation (“**SAMR**”), and there is normally no industry specific approval required for the establishment of a RO.

However, ROs are not independent PRC legal entities, but rather liaison offices with a limited range of authorized activities. A RO does not have separate legal personality from its ‘parent’ or head office entity, and all liabilities incurred by the RO will be borne by the parent.

ROs are prohibited from engaging in profit-making activities, and lack the legal capacity to enter into business-related contracts on their own behalf.⁵ Nevertheless, a RO may engage in the following types of expressly permitted activities:

³ A foreign-invested partnership is an additional vehicle available to foreign investors for engaging in business in China. It is the preferred/optional vehicle for investors making private equity or venture capital-type investments. Foreign-invested partnerships are more rarely seen, however, as a vehicle for investments in technology, real estate, life sciences and manufacturing sectors, either because the general partner would have to take unlimited liability (and most investors engaging in these businesses are not willing to take on unlimited liability, but want to participate in the management of the business) or because Chinese law forbids the use of a foreign-invested partnership to invest in sectors where foreign equity ownership restrictions apply. Therefore, this note does not focus on foreign-invested partnerships

⁴ CJVs are not commonly used in practice. Therefore, this note does not focus on CJVs.

⁵ Although ROs are not independent legal entities and may not enter into contracts on their own behalf, in practice ROs are often permitted by third parties to enter into certain contracts relating to RO office operations and administration, such as renting office space, importing office equipment and materials, obtaining telephone lines, opening a bank account, and are able to apply for and obtain resident visas and other permits for expatriate employees.

- market surveys, exhibition or promotional activities which relate to the products and services offered by its head office; and
- business liaison activities relating to product sales, provision of services, procurement and investment in China on behalf of its head office.

The following additional restrictions apply to ROs:

- a RO can only hire employees via a third-party labor dispatch services contractor, rather than by itself;
- a RO can only appoint at most four individual 'representatives', effectively limiting the number of foreign nationals who may be employed by a RO, as foreign nationals are usually required to be registered as representatives in order to obtain a work visa; and
- to be eligible to establish a RO, the head office must have been legally registered in its home country and have been in existence for at least two years. Therefore it is not possible to set up a RO under a newly-established overseas 'shelf company', which is instead commonly used to establish WFOEs or EJV.

4. Q: Why should I choose a WFOE?

A: A WFOE is normally the preferred choice for investors conducting business in China in sectors not subject to foreign shareholding restrictions. Upon establishment, a WFOE will be an independent legal entity with limited liability. A WFOE can conduct profit-generating activities within its approved business scope and, where a specific permit is needed to engage in a given activity, within the scope of such permit.

The attraction of a WFOE is that no Chinese equity partner is required. However, a WFOE cannot be formed in all sectors, including in many VATS sub-sectors (please refer to section "[Market Access Issues](#)" above), and there may be legal or good business reasons for wanting to partner with a Chinese company.

Compared to ROs, the establishment of a WFOE (as well as an EJV – see Question 5 below) requires a more lengthy process involving several governmental authorities (MOFCOM, SAMR, and the industry regulator if it operates in a regulated sector, such as MIIT

for the TMT sector) and a larger capital investment. It is not unusual for the establishment of a relatively simple WFOE to take three to five months from the time the decision is made to go ahead.

Compared to EJV, WFOEs have the following advantages:

- a WFOE has no Chinese investors, and in many cases a WFOE only has one foreign shareholder, thus eliminating or reducing the time spent on negotiations with business partners, and allowing the foreign investor(s) to maintain full control over the entity;
- a WFOE has a straightforward internal governance structure, similar to that of a LLC in other civil law and common law jurisdictions, including: a shareholder or shareholders meeting as the highest authority, a board of directors as the highest management body, management personnel and a board of supervisors monitoring the activities of directors and management personnel. Besides, WFOEs which have a limited number of shareholders and small scale of operation can opt for a further simplified governance structure consisting of a single director (e.g. "executive director") and a single supervisor; and
- the sole constitutional document of a WFOE is the articles of association and a shareholders' agreement is not required (although it is possible to have one if there are multiple shareholders) while EJV require the parties to enter into a joint venture contract in addition to the articles of association.

5. Q: Why should I choose an EJV?

A: An EJV is a joint venture company established between one or more Chinese investors and one or more foreign investors. Same as a WFOE, an EJV is an independent legal entity with limited liability, can conduct profit-generating activities within its approved business scope and, where a specific permit is needed to engage in a given activity, within the scope of such permit.

EJVs are the only option available to foreign investors who wish to own a direct equity stake in companies operating in sectors restricted to foreign investment (e.g. where the law requires foreign investors to share

the ownership of the company with one or more Chinese partners – please refer to section “[Market Access Issues](#)” above). Additionally, business or other reasons may suggest the use of EJV’s even where no foreign investment restrictions apply (e.g. to get access to the Chinese partner’s resources such as land use rights, access to domestic market, preferential relationship with local government and the possibility to unlock government subsidies).

Under the existing FIE laws:

- EJV’s are governed at the highest level by a board of directors, rather than by shareholders meetings, and thus rights to make board appointments are critical, as all key management decisions are made at board level. The number of board seats each investor gets will generally be more or less proportionate to its percentage of equity participation;
- if one EJV party appoints the chairman, the other EJV party appoints the vice chairman, and if one EJV party appoints the general manager, the other EJV party appoints the deputy general manager; and
- the EJV parties are required to share profits, risks, and losses in proportion to their respective ownership ratio.

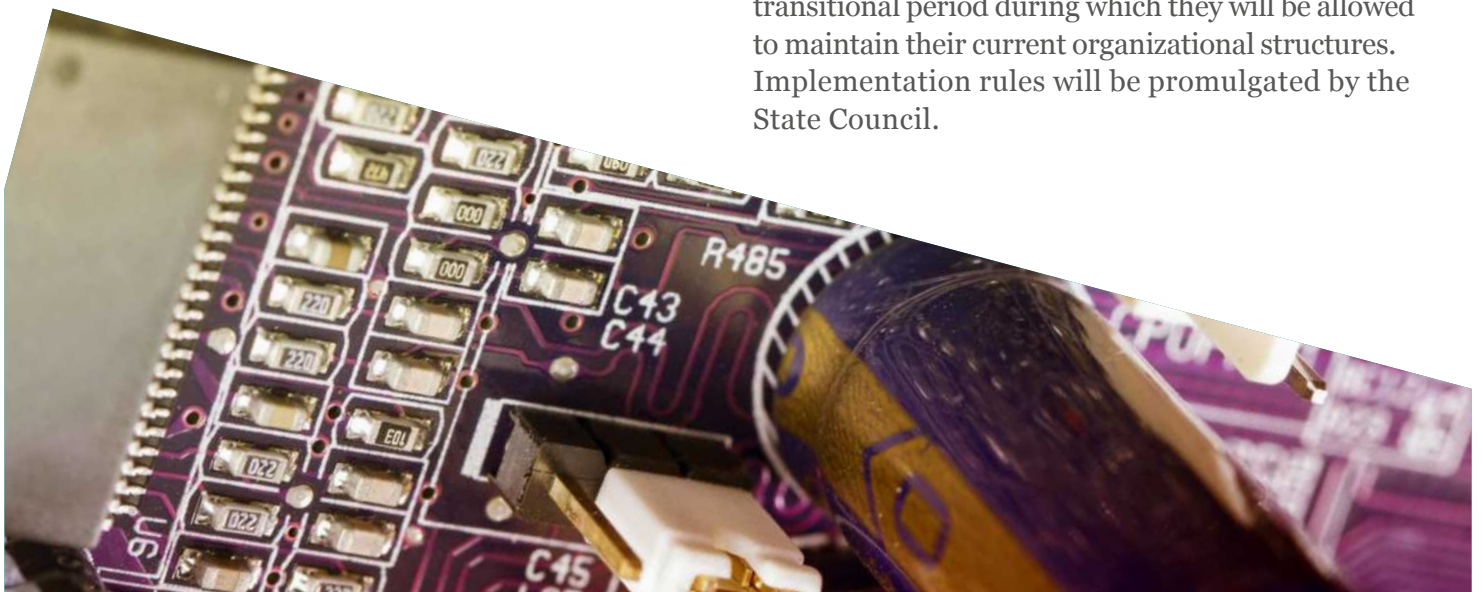
The above rules will be eliminated once the FIL will be implemented (although a 5-year transitional period will apply to existing EJV’s) (see Questions 6 and 7 below).

The establishment procedures applicable to EJV’s and WFOEs (see Question 4 above) are similar. However, establishing an EJV may take even longer (often nine months or more to negotiate and document) primarily due to the length and complexity of the negotiations between foreign investor(s) and Chinese business partner(s) over the joint venture contract, on business matters such as business scope, board structure (with in-built entrenched minority protections), resolution of deadlocks, number of employees, related party contracts and so forth, as well as on the general business objectives.

6. Q: What is the importance of the new PRC Foreign Investment Law?

A: In recent years, China took considerable endeavors to unify its legal regime on inbound foreign investment (“FDI”) into China. On March 15, 2019, China finally adopted the widely anticipated FIL, which takes effect from January 1, 2020 and attempts to create a unified foreign investment regime (replacing the laws and regulations governing EJV’s, CJV’s and WFOEs which have been in existence for the past four decades).

From the date the FIL becomes effective, the FIE laws will cease to be in effect. According to Article 42 of the FIL, existing FIEs (including JV’s) established in accordance with the FIE laws will be provided a 5-year transitional period during which they will be allowed to maintain their current organizational structures. Implementation rules will be promulgated by the State Council.



7. Q: What will happen to EJV and WFOEs after the new PRC Foreign Investment Law comes into effect on January 1, 2020?

A: Absent implementing rules to be issued by the State Council, past experience suggests that foreign investors and FIEs may need to get aligned with the rules applicable to purely domestic funded enterprises, particularly the PRC Company Law (“**Company Law**”), within the 5-year transitional period provided by Article 42 of the FIL. What other changes need to be made by existing FIEs during the said transitional period is an open question and requires further clarification.

Compared to WFOEs (whose governance structure is already substantially in line with the Company Law – see Question 4 above), EJV will face far more changes as a result of the alignment with the Company Law. Some changes will result in more favorable outcomes than under existing FIE laws. For instance, currently the Company Law applies concurrently with the FIE laws to FIEs, with the tailored requirements of the FIE laws prevailing in the event of inconsistencies. Abolishing the FIE laws means removing such tailored requirements on FIEs provided thereunder, which seems to move us in the positive direction of providing a (more) level playing field for FIEs and Chinese domestic capital enterprises. In particular, EJV will enjoy more flexibility in terms of corporate governance under the new regime applicable under the FIL and the Company Law.

The alignment with the Company Law could impose a significant documentary and management burden on existing FIEs or newly established (or in the process of being established) FIEs and presents certain important uncertainties. For instance:

- any attempt to align FIE governance with the Company Law will inevitably reopen negotiations among the EJV investors, and investor consent will be needed to amend the articles of association and the joint venture contract. The EJV parties may see this as an opportunity to reallocate rights and benefits or a chance to walk away from a bad deal or partner. Under the Company Law, except for a few statutory reserved matters requiring shareholder super-majority (two-thirds) approval, all other

matters can be subject to majority rule and may be subject to renegotiation;⁶

- under the Company Law, a company does not need to file its shareholders agreement (if any) with SAMR. However, it is not entirely clear as to whether joint venture contracts for FIEs in restricted sectors set out in the Negative Lists will still be subject to MOFCOM examination and approval; and
- it is unclear how existing FIEs should carry out certain corporate activities. Is there a choice to be made in terms of which rules to apply (e.g. can an EJV, from 1 January 2020 make a dividend that no longer corresponds to shareholding interests assuming the shareholders have agreed to this)? FIEs currently in the process of being established may have to either: (a) apply existing FIE laws and align themselves with the new rules after the FIL becomes effective (which will involve extra cost to investors); (b) apply the FIL before it has come into force (which feels inappropriate); or (c) wait until the FIL takes effect to establish (which will delay the launch of business operations).
- The above uncertainties need to be addressed in the FIL implementing rules, which are expected to be issued in the coming months.

If you are interested in a more in-depth analysis of the FIL’s implications on FDI, please read our client note “The foreign investment law: A new chapter opens for foreign direct investment in China” available [here](#). Our client note “China breaks new ground with Foreign Investment Law-related Intellectual Property (“IP”) reform” analyses the FIL’s impact on intellectual property matters and is available [here](#).

⁶ Including: how to allocate rights and obligations among shareholders and the rights to appoint the members of the board and general manager; the voting requirements on each matter at the shareholders meeting and/or board meeting level; additional mechanisms to protect minority shareholders at the shareholder level to replace the statutory reserved matters under the EJV law (although such mechanism may increase the risk of deadlock).



VIE structure

1. Q: Why using a VIE structure?

A: If an industry sector is closed to FDI under the Negative Lists, or confronted with de facto market barriers (not out of written law, but rather, case-by-case discretion of regulatory authorities responsible for reviewing application for and issuance of permit(s) for a given sector, such as the TMT sector regulator MIIT) – please refer to section “[Market Access Issues](#)” above – other avenues for involvement may be available that do not require direct equity participation, such as targeted cross-border cooperation with a qualified domestic capital entity not involving the creation of a legal presence in China, or, where greater control is desired, through a contractual control structure, known as a Variable Interest Entity (“VIE”).

Historically the VIE structure and its predecessors essentially came about as a ‘workaround’ to allow indirect non-equity based ‘investment’ in industries in China in which foreign investment was restricted or prohibited, e.g. telecommunications services and media. It has been used by Chinese Internet companies (requiring a license that can only be held by a Chinese-owned entity) to raise capital in foreign capital markets and/or through venture capital and private equity investments that are made offshore. For those with long memories, the Chinese-Chinese-Foreign (中-中-外) (C-C-F) structure was initially thought up by China Unicom to get round the then prohibition on foreign investment to establish various mobile telecommunication ventures involving foreign investment in the 1990s. The structure was declared ‘irregular’ in 1998, but has since re-emerged in various forms and guises. It was notably adopted by various Chinese Internet-based companies including Sina in its 2000 listing on NASDAQ to allow them to list overseas, despite industry restrictions on foreign investment.⁷ A slightly modified form of the structure was subsequently renamed the “VIE structure”.

A considerable number of Chinese companies using the VIE structure have now either been listed overseas or have become sector leaders or national champions (or all of the above), such as Sina, Sohu, Tencent, Baidu, Alibaba, JD, and recently Meituan and Xiaomi to name just a few. Over

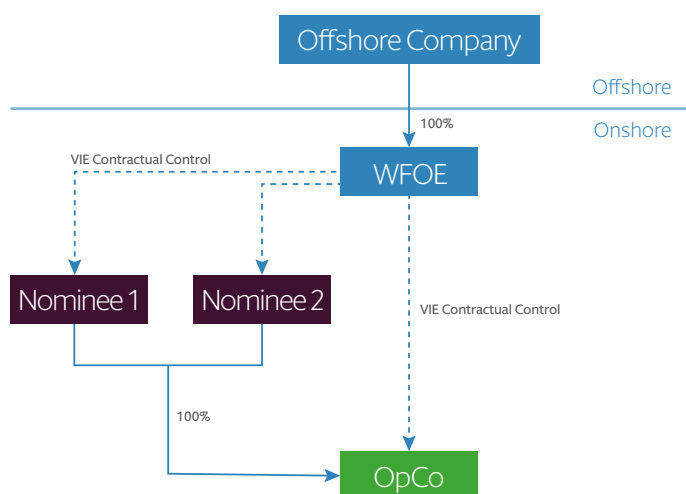
the years, the VIE structure has been widely deployed in certain sectors such as TMT sectors, education and so forth.

2. Q: How does a VIE structure work?

A: VIE structure refers to a structure whereby an entity established in China that is wholly or partially foreign owned, typically a WFOE (“**Controlling Company**”) exercises de facto control over the operations and management of a domestic capital operating company (“**Operating Company**”) which holds the necessary permit(s) to operate in a sector in which foreign investment is restricted or prohibited. De facto control is established through the adoption of various contractual arrangements between the Controlling Company and the Operating Company and granting of Powers of Attorney by the shareholders of the Operating Company to the WFOE acting as the Controlling Company. These arrangements also allow the profits/cash flows of the Operating Company to flow back to the Controlling

Company as technical services fees (or similar) such that they can ultimately be consolidated into the finances of the Controlling Company and its offshore parent and/or remitted offshore as dividends to provide a return to the investors.

The structure chart of a typical VIE structure is set out below:



⁷ This transaction was particularly notable as it was reported that the then industry regulator, the Ministry of Information Industry (MII) issued an opinion to the Administration of Industry and Commerce recognising the spin-off of Sina's Internet Content Provider business to a domestic company and granting permission for the newly incorporated domestic entity to be issued an Internet-related operating permit as part of the pre-IPO restructuring, perhaps the closest MII has ever got to approving the structure.

3. Q: Is there any concern in using a VIE structure?

A: The VIE structure involves a more considered risk assessment and greater risk appetite as compared to direct equity investment in the form of a WFOE or EJV.

The control gained via a VIE structure has merely a contractual nature and is therefore less robust than control acquired by equity ownership. The stability of the VIE control depends largely on whether the nominee shareholder(s) abide by the terms and conditions of the VIE agreements.

The VIE structure has been operating in (at best) a grey area (and at worst, an obvious circumvention) of the Chinese laws since its first appearance. There is no clear prohibition against the VIE structure as a whole, but there is no legal basis to support it either. For almost two decades, the Chinese government has essentially turned a blind eye to VIEs, and given the importance and size of the companies that have deployed a VIE structure and the tremendous impact any legislation may have on them, the Chinese government has been taking a cautious approach and studiously avoided any action that might be interpreted as endorsing or forbidding the VIE structure.

But in recent years, we have seen several attempts of the Chinese government to regulate VIEs: (1) two implementing rules related to national security review over FDI did make it clear that foreign investors may not circumvent the jurisdiction of such rules through “contractual arrangements” (without specifically citing VIEs); (2) a policy document and a draft legislation in the education sector published in 2018 expressly mentioned

“control through contract” and/or “VIEs”; (3) on March 1, 2019, the China Securities Regulatory Commission (CSRC – China’s stock markets regulator) issued the registration measures for the “Science and Technology Innovation Board” of the Shanghai Stock Exchange, encouraging high-tech companies organized through a VIE structure and listed overseas to apply for listing onshore through this new board; (4) a non-public source indicated that the Anti-monopoly Bureau of SAMR reviewed and unconditionally approved an EJV in which one partner adopts a VIE structure; and (5) the FIL, by its very broad definition of foreign investment, has increased the chance that investment activities conducted through a VIE structure could be interpreted as a form of foreign investment defined under and thus subject to the jurisdiction of the FIL. All of the above suggest that more attempts to regulate VIEs might be on the way.

Considering the uncertainty surrounding the VIE model, investors planning to set up or acquire equity interests in a business utilising a VIE model will want to make a full assessment of the relevant risks and go in with their eyes open.



Cyber security and data protection

1. Q: What is the Cyber Security Law?

A: The passage of the PRC Cyber Security Law (“**Cyber Security Law**”) was part of a wider set of national security regulatory reforms. It was officially adopted on November 7, 2016, becoming effective from June 1, 2017. Key parts of the Cyber Security Law are framed in general terms with specific compliance requirements to follow in implementing rules and regulations, most of which are still in draft forms. As such, significant uncertainty remains as to the specific scope and requirements of the law.

2. Q: I understand that the Cyber Security Law regulates “network operators”. Can we get a definition of this term and guidance on whether this applies to us?

A: “Network operator” means an owner or manager of any cyber network, or a network service provider, and “network” is further defined as a system comprising computers or other information terminals and relevant devices that collect, store, transmit, exchange and process information based on certain rules and procedures. On its face, the very wide definition of “network operator” could potentially apply to any entity doing business in China using a computer network (even if that system is entirely internal to the organization, such as industrial control systems), website, app or other electronic platform in China.

3. Q: What are the key requirements for “network operators” under the Cyber Security Law?

A: The Cyber Security Law primarily regulates two types of “network operators”:

- operators of “critical information infrastructure” (“**CIIO**”); and
- other network operators that are not CIIO (“**NO**”).

The heaviest regulations under the Cyber Security Law fall on CIIO and the key ones are:

- **Data Localization Requirement:** personal information and **important data** collected or created by CIIOs during the course of operation within China must be stored within China. If a cross-border transfer of data is necessary due to

operational needs, a security assessment must be conducted (the default position is a self-assessment, but if the proposed transfer meets certain criteria, then a security assessment conducted by a competent regulatory authority is required). Currently there is a set of draft guidelines issued in August 2017 for public comment (“**Draft Data Cross-Border Transfer Security Assessment Guidelines**”), which set out in some details the methodology for conducting a security assessment.

- **Purchase of network products and services** that may potentially have an impact on national security will need to go through a national security review.
- The key obligations on NOs are the following:
 - meet various data protection requirements including establishing control systems, operating procedures, and maintaining web logs for no less than six months; and
 - provide technological support and assistance to public and state security organs in national security and criminal investigations.

4. Q: If I am compliant with the GDPR, can I assume that I will be compliant with the data protection requirements under the Cyber Security Law?

A: No, the data protection requirements under the Cyber Security Law need to be separately assessed. Although it was drafted by Chinese regulators after considering the GDPR, there are still important differences. One key additional requirement under the Cyber Security Law is the Data Localization Requirement imposed on not only personal data, but also “important data”. Currently only the Draft Data Cross-Border Transfer Security Assessment Guidelines can shed some light on what constitutes “important data”; examples of important data are provided on an industry-by-industry basis. A more in-depth analysis of these issues is available in our client alert [“Busting the myth: Compliance with the ‘gold standard’ of the GDPR does not buy you a ‘free pass’ under China’s new personal information guidelines.”](#)

5. Q: Am I a CIIO or NO?

A: The determination of whether a network operator is a CIIO is difficult, as certain implementing rules on such determination process have not been issued. A number of industries are clearly listed as a critical information infrastructure, making players in that industry potentially CIIOs but that list is not exhaustive. The Cyber Security Administration Commission (“CAC”) launched a nationwide identification of CIIOs exercise starting in July 2016, and used internal guidelines to identify CIIOs. The identification process is still on-going, and so far we are aware, some manufacturing companies in certain localities have received questionnaires from the relevant industry regulators, asking them to fill out surveys that clearly have the purpose of identifying potential critical information infrastructures. We have also heard that as of June 2018, there are a total of around 500 products or systems identified as critical information infrastructure across over 20 industries. But if none of your China entities has been approached by its industry regulator and asked to complete surveys relating to the identification of critical information infrastructure, then it is unlikely to be on CAC’s existing internal list of CIIOs, although the possibility that the list could be subsequently expanded cannot be entirely ruled out.

6. Q: Do I need to store all of my data in China?

A: Yes if you are a CIIO (with limited cross-border transfer permit); no if you are a NO. But note that there is a set of measures (still in draft form) released by CAC for public comment in May 2017 proposed that NOs would also be subject to the localization measures (e.g. the security assessment requirement). This came as a ‘bolt from the blue’ and appeared to be overstepping the scope of the Cyber Security Law. There was such a backlash the whole draft was ‘put on ice’.

7. Q: Some cloud computing services are banned in China. What services are allowed and which are banned?

A: For foreign companies, cloud computing services are not ‘banned’ per se in China in the sense that there is a law expressly prohibiting foreign investment in them, but on a policy level, FIEs in China (except for qualifying Hong Kong or Macau investors with foreign investment capped at 50%) are simply not able to obtain the required telecoms permits. We have seen certain ‘workarounds’ to such restrictions such as the use of technical cooperation arrangements with domestic permit holders, or the use of a VIE structure to obtain the required permits.

8. Q: Will my cross-border cloud services provider be able to continue providing services from offshore into China?

A: Probably not, as China is telling users of such services in China to move over to a licensed provider of cloud computing services in China.

9. Q: How does the Cyber Security Law fit in the whole picture of China’s laws on data protection?

A: In the absence of a dedicated regulator and a unifying legal framework, China’s approach to data protection remains piecemeal (see Question 10 below). The Cyber Security Law has a chapter dedicated to personal data protection which repeats most of the requirements set out in earlier laws, rules and guidelines. In terms of what the Cyber Security Law has added to existing requirements on data protection, the most important addition is the Data Localization Requirement. After the issuance of the Cyber Security Law, the most notable addition to this area is a set of recommended but non-binding national standard (GB/T 35273) which came into effect on May 1, 2018 and has recently been revised (please refer to our client alert “[A new model for obtaining data protection consents: unbundling the proposed amendments to China’s Personal Information Security Specification](#)”).

10. Q: Is there a data protection law in China?

A: China does not have a unified personal data protection legal regime. The relevant provisions are scattered around different laws, regulations and rules. Different types of personal information are regulated by different rules issued by different regulators. For example, personal information of internet users is regulated by MIIT and personal information of consumers is protected under the amendments to the PRC Consumer Protection Law. After the issuance of the Cyber Security Law, the key requirements on personal data protection are stipulated there.

11. Q: What are the key requirements under China's data protection law?

A: China's data protection law generally prohibits any collection or use of personal data, unless the data subject has given his or her consent to the collection and/or use, after being informed of the purpose and method of data collection, and the scope of intended use. Violations of a citizen's right to privacy could, in serious cases, involving sale or unlawful provision or receipt of personal data, result in criminal sanctions of fixed-term imprisonment or detention.

12. Q: Given all of the uncertainty, what should I be doing now?

A: The finalization of the draft rules and guidelines to the Cyber Security Law are critical pieces in the puzzle. In the meantime:

- review PRC data collection and processing and improve consents and procedures:
 - express consents will need to be in place in order to enable exports of personal data;
 - the law is signaling a need to align data handling practices with international standards (GDPR and so forth), if this has not been done already; and
 - consider models for onshore storage if thresholds under the Draft Data Cross-Border Transfer Security Assessment Guidelines are likely to be exceeded;

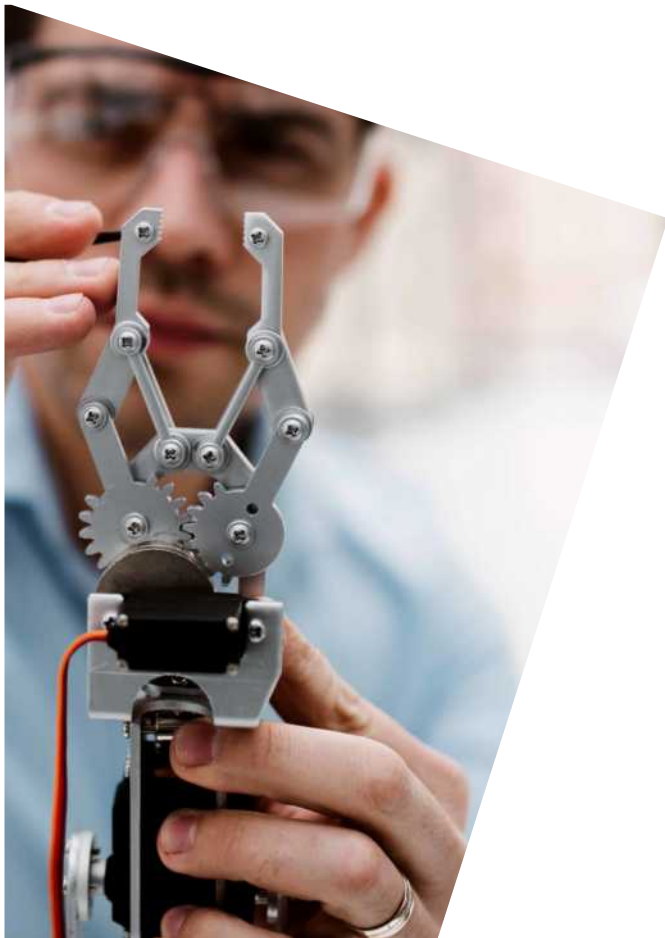
- consider position with third parties (which may be CIO) from which your business receives data or collects data on your behalf (e.g. cloud computing service providers);
- consider how to meet the various requirements on NOs; and
- consider telecommunications network arrangements in light of significant tightening of VPN regulation.



Intellectual Property

1. Q: What kind of intellectual property rights can receive protection under Chinese law?

A: Intellectual property is the intangible property created by human intellect, including copyright, trademark, trade name, trade secret, geographical indication, patent, layout design and plant variety, etc. In China, trademarks, patents and copyrights are protected under the Trademark Law, the Patent Law and the Copyright Law respectively. The Patent Law applies to the inventions, utility models and designs including graphical user interface. The Patent Law does not apply to integrated circuit layout designs and plant variety. They are regulated and protected under other regulations especially for them. China also issued specific provisions and measures for protection of geographical indications. Trade names, trade secrets and other interests (such as good will) obtained in the business are protected under the Anti Unfair Competition Law. The discussion below mainly focuses on trademarks, patents and copyrights.



2. Q: How can IP rights be obtained in China?

A: To obtain trademark rights, business operators need to apply to the State Intellectual Property Office for registration of a trademark. China adopts the 'first to file' rule. So the first applicant filing the trademark application will obtain the registration of the trademark if the trademark is distinctive and it is not identical with or similar to any prior registered trademark in the same or similar classification of goods or service. In China, words, graphics, letters, numbers, 3D logos, combination of colors or sounds, or any combination of the above-mentioned element that can identify the business operator's goods or service from others' are eligible for registration and use as trademarks. Scents or single colors are not allowed to register as trademarks. Since China take the measures on reforming and facilitating the trademark registration system from 2017, it takes about 6 to 9 months to complete a trademark application from acceptance of the filing. A registered trademark is valid for 10 years and renewable for unlimited times.

An invention patent will be granted if it meets the requirements on novelty, innovativeness and utility. So the patent application will be subject to strict substance examination. For utility model and design patents, there is no requirement on innovativeness. So the SIPO will grant patent protection to a utility model or design if there is no reason for refusal after preliminary examination. The following items are not eligible for patent protection:

- scientific discoveries;
- rules and methods of intellectual activity;
- methods for the diagnosis and cure of diseases;
- varieties of animals and plants; and
- substances obtained from nuclear fission.

China also adopted the 'first to file' rule for granting patents. An invention patent is valid for 20 years while the utility model and design patent is valid for 10 years.

A work can be automatically protected under the Copyright Law once the author completes it. Registration of a work with the National Copyright Administration of China is not mandatory for copyright protection. But the registration can be used as the prima facie evidence of the ownership of the copyright where there is a dispute over ownership of the copyright or a copyright infringement. The scope of copyrightable works covers various types of literary and artistic works spanning from written works, oral works, musical works, fine art, architectural works, to graphical works such as engineering design drawings and product design drawings, modules, maps and computer software, etc. Pure title, short phrases and slogans, ideas, principles and concepts, legislative documents, news on current events, calendars, numerical tables, forms of general use and formulas are not copyrightable. The term of copyright protection is the life of the author plus 50 years after the author's death.

3. Q: In what situations may the IP owner lose the IP rights?

A: A trademark owner may lose its exclusive rights to a registered trademark when:

- the trademark expires and the trademark owner fails to renew it;
- the trademark is invalidated due to a breach of the Trademark Law; or
- the trademark is cancelled by the SIPO because the trademark owner modifies the trademark without permission while using the trademark or the trademark owner fails to put the trademark into use for 3 consecutive years without reasonable grounds.

A patent owner may lose the patent right if the patent expires or the owner fails to pay the patent fees or the patent is invalidated due to a breach of the Patent Law.

A copyright owner may lose the copyright to a work when the copyright expires.

4. Q: How to protect and enforce IP rights when the infringement takes place?

A: When someone uses the IP rights without permission, the IP owner should investigate and collect evidence of the infringement. An IP owner typically uses the following measures to protect the IP rights in the event of an infringement (depending on the specific circumstances of the infringement):

- send a 'cease and desist' letter to the infringer demanding the end of the infringement;
- file a civil action with the competent court demanding injunction and damages;
- report to the local administrative enforcement authorities demanding the end of the infringement and administrative penalties against the infringer, or report to local customs demanding the end of the exportation or importation of the infringing products; and
- report to the criminal enforcement authorities demanding the cessation of the infringement and criminal penalties against the infringer.

Civil actions are taken in the event of a serious IP infringement. The damages caused by the infringement are determined according to the loss that the IP right owner suffered due to the infringement or the proceeds that the infringer obtained from the infringement. Where it is difficult to determine such loss or proceeds, the damages are reasonably determined by referring to the multiplied number of the licensing fee of the relevant IP right. The damages also cover the reasonable expenses that the IP owner incurred to end the infringement (such as litigation fees and attorney fees).

China took notable measures to strengthen the judicial protection of IP rights in recent years. For example, China established specialized IP courts in Beijing, Shanghai and Guangzhou and established a specialized Internet Court in Hangzhou where e-commerce is booming. From 2019, the Supreme People's Court has been given jurisdiction over IP infringement appeal cases involving complex technical issues, such as patents, software, trade secrets and plant variety, etc.

5. Q: Why is protection of IP rights important for doing business in China and what should I do?

A: Infringement of IP rights is a serious issue for business operators in China. According to the “Report on the protection and enforcement of intellectual property rights in third countries” issued by the European Commission in 2018, China is the main producer of counterfeit goods in the world. The proliferation of online trading platforms and online piracy increased the seriousness and size of IP infringements in China, providing wider and easier access to Chinese counterfeit and pirated products globally. Against this backdrop, business operators should:

- secure the protection of their IP rights in China as early as possible (for example, register the trademarks before enter into the Chinese market or engaging in negotiations with potential Chinese partners), record their IP rights with the Chinese customs (to obtain customs enforcement) and implement appropriate policies for the management of their IP portfolio;
- keep a close eye on the development of IP legislation and court precedents in China; and
- monitor the existence of IP infringements and take appropriate and timely actions against them.



Litigation

1. Q: What does the court system in China look like?

A: China has established courts nationwide organized in a four-tier structure. In the bottom tier, every administrative district or county has a Basic People's Court. Above that, each city has an Intermediate People's Court and each province, a Higher People's Court. The highest court is the Supreme People's Court in Beijing.

China has adopted a two-tier trial system, which means that an appeal can be made from the court of first instance to a higher court. The appeal judgment is final and binding on the parties.

China is a civil law jurisdiction. Courts can only hand down a judgment in accordance with prescribed laws and regulations and must cite these when giving judgment. A judgment rendered by a higher court is not a precedent binding on lower courts. Generally, however, the courts like to be consistent with decisions of other courts especially those higher up where cases have a similar fact pattern. Guidance on the implementation of laws and regulations is found in the judicial interpretations issued by the Supreme People's Court. These interpretations consist of rules drawn from its own judicial practice and that of lower courts. The interpretations are cited by courts in their own decisions together with the laws and regulations to which they relate.

2. Q: Which court has jurisdiction over a dispute?

A: Simple cases often start off in the Basic People's Court whilst cases involving more complex fact patterns or more substantial sums of money are heard first in the Intermediate People's Court. The Higher People's Court hears first-instance cases involving even more difficult issues or which have significant implications for the province as a whole.

If a party is not satisfied with the decision made by a Basic People's Court, it can appeal to the Intermediate People's Court in the city where the Basic People's Court is located. An appeal from a decision of first instance made by an Intermediate People's Court goes to the Higher People's Court in the province where the Intermediate People's Court is situated. In turn, an appeal from a decision made by a Higher People's Court is made to the Supreme People's Court. From January 1, 2019, the Supreme

People's Court has jurisdiction over patent, trade secrets or other IP appeal cases involving complex technical or legal issues throughout the entire country.

The court in the place where the defendant is domiciled (for an individual) or operated (for a corporate entity) usually has territorial jurisdiction over a case. Concurrent jurisdiction is accorded, in contract disputes, to the place where the main obligations under the contract were to be performed and in the case of tort or infringement cases, to the place where the tort or infringement took place.

3. Q: What does a typical civil trial process look like?

A: Usually a civil case follows these steps:

- a plaintiff files a complaint with a court;
- the court serves the complaint on the defendant;
- the defendant has fifteen days to submit an answer to the complaint or challenge the jurisdiction of the court;
- both parties may submit evidence to the court. There is no discovery procedure for evidence as typically seen in common law jurisdictions such as the United States. A party can request the court for a 'preservation of evidence order' or 'evidence collection order' if it has prima facie evidence to show that the evidence in question is kept by, or under the control of, the other party or a third party and it is difficult to obtain. The court can issue an order to enter the premises of the counterparty or the third party for the purposes of evidence preservation;
- court hearing: the plaintiff and the defendant each make opening statements and then present their evidence. The evidence is subject to cross-examination by the other party. In a case involving a large amount of evidence, the court may arrange the parties to produce the evidence on which they intend to rely and conduct cross examination on it before the court hearing takes place. The court tries to establish the facts of the case before moving on to consider the merits;

- usually, the court will ask the parties if they are minded to settle the dispute before the court gives judgment;
- the court is required to give judgment within a certain time limit under the law. In cases involving foreign aspects, such as where one of the parties originates from a foreign country, there is no mandated time limit;
- a judgment will be considered binding if there is no appeal within fifteen days from the date of the judgment, or thirty days in a case involving a foreign party. An appeal can take place without a court hearing where no new evidence is produced and once the appeal court has examined the case files and interrogated the parties; and
- if one or both parties do produce new evidence in the appeal, the procedure will be similar to that described above in the case of a first instance hearing. The time limit for the court to render a final judgment in an appeal is shorter than that in a first instance hearing.

4. Q: What can the successful party do if the losing party fails to act as ordered in a binding court decision?

A: If the losing party (for example, an infringer) fails to pay the damages as awarded in the judgment, the successful party can apply to the court of first instance or the court in the place where the assets subject to enforcement are located for mandatory enforcement of the order in the judgment. The court is empowered to seize and freeze the losing party's assets subject to the enforcement and sell or dispose of them in other ways so as to satisfy the judgment. If the assistance of a third party, such as a bank, is necessary to enforce the judgment, the court can issue a notice demanding that the bank makes a transfer from the unsuccessful party's account in order to satisfy the judgment. Resisting enforcement of a judgment may incur administrative penalties such as fines or even criminal penalties for serious cases such as where the resistance is violent.

5. Q: What can I do if I am not satisfied with a penalty decision made by an administrative body or a rejection of my application for a licence?

A: If a party (for example, a network service provider) is not satisfied with a penalty decision made by an administrative authority (for example, a local office of the Ministry of Industry and Information Technology) or the office refuses an application for a licence for a network service, the party can apply to the superior administrative office to have the decision reviewed. Alternatively, it can go straight to the court and file administrative proceedings there unless the matter is of a type as provided by the law that should first be reviewed by the administrative office. If the review office confirms the original decision, both the original administrative office and the reviewing office will be named as co-defendants in the consequent court proceedings. If the review office reverses the original decision, the review office alone is named as the defendant in the proceedings. The relevant office bears the burden of proof of justifying its decision and must produce the evidence and documentation on which it based the decision. For its part, the complainant may produce evidence to show that the decision was illegal. Any failure by the complainant to produce evidence does not exempt the review office from the need to produce evidence itself.

6. Q: Should I choose litigation or arbitration?

A: Whilst the quality of Chinese judges is improving, in view of certain unresolved problems existing in the Chinese judicial system (including interference by government officials in the process, delays in judgments and local protectionism) many foreign investors who have the option to do so (i.e. where it is a contract with a foreign element, such as where there is at least one non-Chinese party and no specific legal prohibition on doing so) prefer to use arbitration in an independent forum in a neutral jurisdiction outside mainland China as the method for dispute resolution, whether for an investment agreement (such as a Joint Venture Contract) or an M&A agreement (such as an Equity Transfer Agreement). This often takes the form of arbitration in Hong Kong under the auspices of the Hong Kong International Arbitration Centre (HKIAC) or in Singapore under the Singapore International Arbitration Centre (SIAC). Where the parties are required to have dispute resolution in China

(e.g. in a contract between two Chinese legal persons, even if both parties are FIEs, and there is no other obvious foreign element), arbitration at the China International Economic and Trade Arbitration Commission (CIETAC) is generally preferred over other local arbitration institutions or local courts.

7. Q: Are there any issues in enforcing a foreign arbitral award in China?

A: China is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also known as the New York Convention), so in principle recognizes and enforces foreign arbitral awards from other contracting states subject to certain treaty defenses and exceptions (including the 'public policy' exception, which China has adopted, but has tended to use quite sparingly in recent years). Supreme People's Court consent is required for a local court to refuse to enforce a foreign arbitration award under the New York Convention. Nevertheless, carrying out enforcement can be challenging in practice when enforcing against a well-connected individual or state-owned enterprise (SOE) in China or in smaller cities, and ultimately requires assistance from a local court in China, with all the issues around local protectionism that implies.

8. Q: Is it possible to enforce a foreign court judgment in China?

A: It is important to bear in mind enforcement issues when drafting a dispute resolution clause in a contract which may need to be enforced in China. China will only enforce an overseas court judgment on two bases: (a) there is reciprocity, or (b) there is a bilateral or multilateral agreement in place. There is no such agreement in place or de facto reciprocity with many of China's major trading partners such as the US (although there has been at least one isolated case of enforcement in the US) so a US court judgment is likely to be unenforceable in China. Hong Kong does have a mutual enforcement agreement with Mainland China, but care needs to be taken to come within its scope as you must opt for the exclusive jurisdiction of the Hong Kong courts and it only applies to monetary awards (not injunctions or the like) and labor disputes are excluded from its scope.



Chart - China market access in TMT sectors

No.	TMT sectors ⁸	WTO commitment areas	Treatment applicable nationwide	Treatment applicable in the FTZs	Treatment under the CEPAs
1.	Internet data center services (including internet resources coordination services)	– None	– Not open	– Not open	– Open, with shareholding percentage of Service Suppliers capped at 50%
2.	Content delivery network services	– None	– Not open	– Not open	– Not open
3.	Domestic internet protocol virtual private network services	– None	– Not open	– Open, with shareholding percentage of foreign investors capped at 50%	– Open, with shareholding percentage of Service Suppliers capped at 50%
4.	Internet access services	– None	– Not open – Exception: for internet access service for web users, open with no cap on foreign shareholding percentage, only in Beijing pilot areas until January 30, 2022	– Not open – Exception: for internet access services provided to web users, open with no cap on shareholding percentage, but such services can only be provided within the territory of the FTZs	– Open, with shareholding percentage of Service Suppliers capped at 50% – Exception: for internet access services provided to web users, no cap on shareholding percentage
5.	On-line data processing and transaction processing services	– On-line information and/or data processing (including transaction processing) and electronic data interchange	– Open for WTO commitment areas, with shareholding percentage of foreign investors capped at 50% – Exception: for e-commerce, no cap on shareholding percentage	– Open for WTO commitment areas, with shareholding percentage of foreign investors capped at 50% – Exception: for e-commerce, no cap on shareholding percentage	– Open, with shareholding percentage of Service Suppliers capped at 50% – Exception: for e-commerce, no cap on shareholding percentage
6.	Domestic multi-party communication services	– None	– Not open – Exception: open in Beijing pilot areas, with no cap on foreign shareholding percentage until January 30, 2022	– Open, with no cap on foreign shareholding percentage	– Open, with no cap on shareholding percentage of Service Suppliers
7.	Store-and-forward services	– Electronic mail, voice mail, and value-added facsimile services (including store and forward, store and invoking)	– Open for WTO commitment areas, with shareholding percentage of foreign investors capped at 50% – Exception: in Beijing pilot areas, no cap on foreign shareholding percentage until January 30, 2022	– Open for WTO commitment areas, with no cap on foreign shareholding percentage	– Open, with no cap on shareholding percentage of Service Suppliers

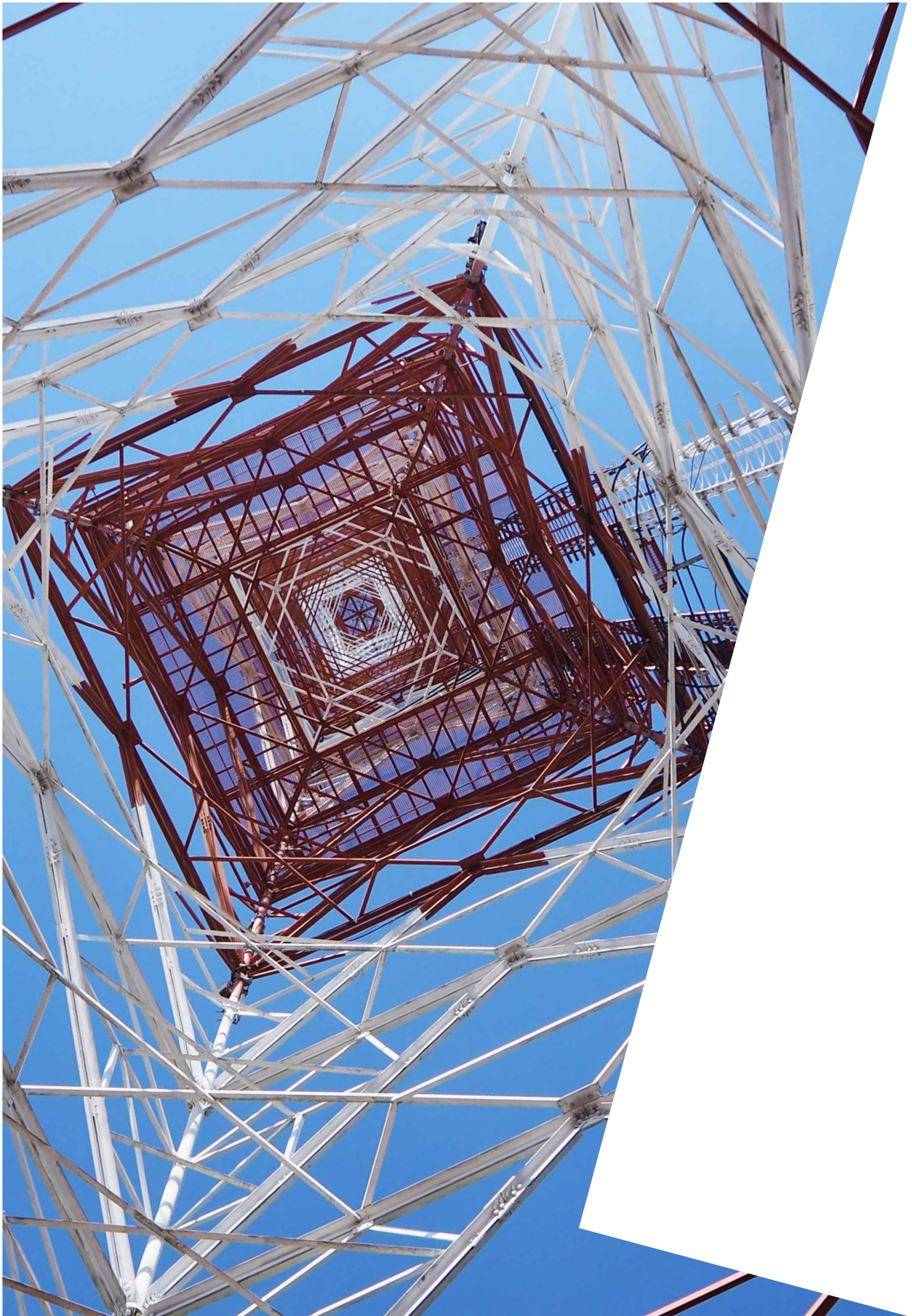
⁸ Sectors 1 to 10 are VATS sectors, listed according to the classification under the 2015 PRC Telecoms Catalogue. Sectors 11 to 17 are media, cultural services or entertainment sectors, listed according to the classification under the National Negative List.

No.	TMT sectors	WTO commitment areas	Treatment applicable nationwide	Treatment applicable in the FTZs	Treatment under the CEPAs
8.	Call center services	– None	<ul style="list-style-type: none"> – Not open – Exception: for offshore call center services, open with no cap on foreign shareholding percentage, only in pilot territories until June 30, 2020 	– Open, with no cap on foreign shareholding percentage	– Open, with no cap on shareholding percentage of Service Suppliers
9.	Information services (including internet content service)	– On-line information and database retrieval	<ul style="list-style-type: none"> – Open for WTO commitment areas, with shareholding percentage of foreign investors capped at 50% – Exception: for internet content service not for profit, no cap on shareholding percentage 	<ul style="list-style-type: none"> – Open for WTO commitment areas, with shareholding percentage of foreign investors capped at 50% – Exception: for App stores, no cap on shareholding percentage 	<ul style="list-style-type: none"> – Open, with shareholding percentage of Service Suppliers capped at 50% – Exception: for App stores, no cap on shareholding percentage
10.	Domestic internet protocol virtual private network services	– Code and protocol translation	– Open for WTO commitment areas, with shareholding percentage of foreign investors capped at 50%	– No special treatment in addition to national rules	– No special treatment in addition to national rules
11.	Internet news information services, online publication services, online audio-visual program services, online cultural business (excluding music services) and the Internet public information release services	– None	– Not open	– Not open	<ul style="list-style-type: none"> – Not open – Exception: internet culture business, for Service Suppliers, allowing joint venture controlled by Chinese party
12.	Audio-visual products	– Distribution of audio-visual products (excluding motion pictures) through contractual joint ventures	<ul style="list-style-type: none"> – Open: retail, wholesale, rental and exhibition, with no cap on shareholding percentage of foreign investors – Not open: editing, publication and production 	– No special treatment in addition to national rules	– Special treatment in addition to national rules: open to Service Suppliers business of producing video and sound recording products, with no cap on shareholding percentage

No.	TMT sectors ⁸	WTO commitment areas	Treatment applicable nationwide	Treatment applicable in the FTZs	Treatment under the CEPAs
13.	Radio and television video-on-demand services and installation services for satellite television and radio ground receiving facilities	– None	– Not open	– Not open	<ul style="list-style-type: none"> – Not open to investment activities – Allowed: Hong Kong/Macao companies engaging in the operation of cable television networks to provide professional technical services for cable television networks in the PRC upon approval of Chinese government
14.	Radio and television program production and operating (including import business)	– None	– Not open	<ul style="list-style-type: none"> – Not open to investment activities – Allowed: joint production of TV dramas (including TV cartoons) by Chinese and foreign entities, subject to approval by Chinese government 	<ul style="list-style-type: none"> – Not open to investment activities – Allowed: joint production of TV dramas by Chinese and Hong Kong/Macao entities, subject to approval by Chinese government, and upon approval, can be recognized as Chinese domestic produced TV drama in broadcasting and publication
15.	Investment in companies conducting motion pictures production and distribution and theater chain business; business of motion pictures importation	<ul style="list-style-type: none"> – No commitment on investment activities – Allowed: importation of motion pictures within limited number and limitation on the pattern of importation 	– Not open	<ul style="list-style-type: none"> – Not open to investment activities – Allowed: joint production of motion pictures by Chinese and foreign entities, subject to approval by Chinese government 	<ul style="list-style-type: none"> – Not open to investment activities – Allowed: joint production of motion pictures by Chinese and Hong Kong/Macao entities, subject to approval by Chinese government, and upon approval, can be recognized as Chinese domestic produced motion pictures in publication and free from quota restriction

No.	TMT sectors ⁸	WTO commitment areas	Treatment applicable nationwide	Treatment applicable in the FTZs	Treatment under the CEPAs
16.	Performance brokerage agencies	– None	<ul style="list-style-type: none"> – Open, in the form of joint venture controlled by Chinese party – Exception: for Hong Kong/Macao investors (the scope of which is broader than Service Suppliers), no cap on shareholding percentage – Exception: open in certain areas of Beijing, with no cap on shareholding percentage until January 30, 2022 	<ul style="list-style-type: none"> – Special treatment in addition to national rules: no cap on shareholding percentage of foreign investors, but the agencies can only provide services within the provincial territory where an FTZ is located 	<ul style="list-style-type: none"> – Open, with no cap on shareholding percentage of Service Suppliers
17.	Performance venue	– None	<ul style="list-style-type: none"> – Open, with shareholding percentage of foreign investors capped at 49% – Exception: for Hong Kong/Macao investors, no cap on shareholding percentage – Exception: open in certain areas of Beijing, with no cap on shareholding percentage until January 30, 2022 	<ul style="list-style-type: none"> – Special treatment in addition to national rules: no cap on shareholding percentage of foreign investors in the four FTZs in Shanghai, Fujian, Tianjin and Guangdong 	<ul style="list-style-type: none"> – Open, with no cap on shareholding percentage of Service Suppliers





Part II – Client alerts

The foreign investment law: A new chapter opens for foreign direct investment in China

1. Introduction and Overview

As had been widely anticipated, the Foreign Investment Law (the “**FIL**”, full text in Chinese [here](#), in-house English translation available⁹ upon request) was voted into law by China’s highest legislative body, the National People’s Congress (“**NPC**”) of the People’s Republic of China¹⁰ (“**China**” or “**PRC**”) on March 15, 2019.

The FIL will form the backbone of legislation regulating and governing foreign direct investment (“**FDI**”) in China going forwards. Against the backdrop of trade tensions with the United States and the EU, the official purposes of the FIL are (leaving out the more political ones) to expand the opening up policy, promote FDI into China and protect lawful the rights and interests of foreign investors, and to regulate the administration of foreign investment. How it opens up a new chapter in FDI regulation in China is by replacing the main existing rules governing foreign invested enterprises (“**FIEs**”), namely the Sino-Foreign Equity Joint Venture Law (the “**EJV Law**”) the Sino-Foreign Cooperative Joint Venture Law (the “**CJV Law**”), and the Wholly Foreign-Owned Enterprise Law (the “**WFOE Law**”) (collectively the “**FIE Laws**”).

The FIL will take effect from January 1, 2020. The final version was largely based on a draft law issued by the NPC in December 2018 for public comment (the “**2018 Draft**”). There have not been many significant changes in the newly-promulgated FIL compared to its 2018 Draft, so much of our recent analysis of the 2018 Draft still applies. Please see our Client Note “New draft of the Foreign Investment Law takes a more ‘stripped-down’ approach, but defers discussion on the ‘elephant in the room’” dated February, 2019 for further details (the “[Earlier Note](#)”).

This note will not cover old ground, particularly the now of largely only historical interest comparison between the 2018 Draft and the earlier draft of the FIL issued by the Ministry of Commerce (“**MOFCOM**”) in 2015 (“**2015 Draft**”), except where particularly pertinent to the analysis. Instead, in this note we will try to highlight changes in the substance of the FIL that have taken place since December 2018, as well as

analysing some of the more important implications of the FIL, such as in relation to foreign investment involving: (a) Sino-foreign joint ventures (“**JVs**”); (b) variable interest entity (“**VIE**”) structures; and (c) national security review (“**NSR**”).

For the intellectual property rights-related implications, please see our separate Client Note “China breaks new ground with Foreign Investment Law-related Intellectual Property (“**IP**”) reform” (the “[IP Note](#)”).

2. Key Changes Compared to the 2018 Draft

Further expanded definition of “Foreign Investment”

In Article 2, “**Foreign Investment**” refers to “investment activities carried out directly or indirectly within the PRC by foreign natural persons, enterprises and or other organizations (“**Foreign Investors**”), including circumstances where a Foreign Investor: (**Changes kept to show differences**)

- a) Either individually, or together with other investors, invest in new projects, establishes foreign-invested enterprises or increase investment in the PRC;
- b) Obtains shares, equity interests, asset shares or other similar rights and interests in PRC-based enterprises by way of mergers acquisitions;
- c) Either individually, or together with other investors, invests in new projects within China; and
- d) Invests in the PRC by other means specified by laws, administrative regulations or the State Council.

A foreign-invested enterprise (FIE) referred to hereunder means an enterprise invested in whole or in part by Foreign Investor(s) and registered and established in the PRC in accordance with PRC laws.”

The above changes, as marked against the 2018 Draft, seem to give more space for interpretation regarding the VIE structure. In particular, the changes in paragraph (b) above could potentially capture newly-created VIE structures by a foreign investor or an FIE. Please see further discussion on the implications for the VIE structure in section 4 below.

⁹ Given the amount of time and effort expended in making this, availability will be limited to existing and potential clients of the firm.

¹⁰ In this note, references to China exclude the Hong Kong Special Administrative Region, the Macau Special Administrative Region and Taiwan.

Further clarification of certain terms and articles

The FIL further clarifies the wording and expression of certain, including the following:

- a) In Article 4, explaining the meaning of “pre-[market] access national treatment”, e.g. at the market access stage, giving foreign investors and their investments treatment that is no less favourable than that granted to Chinese investors and their investments;
- b) In Articles 3, 9, 16, among other things, placing greater emphasis on fair competition and equal treatment between foreign investors and Chinese domestic investors;
- c) In Article 16, adding services (on top of products) into the scope of government procurement activities in relation to which foreign investors are equally eligible to participate on the basis of fair competition;
- d) In Article 20, specifying that compensation for expropriation shall be paid “in a timely manner” and adding that the state shall also only engage in “requisitioning” as well as “expropriation” in special circumstances; Foreign Investors may need to look at any applicable bilateral investment protection treaty which trumps domestic law like the FIL to determine whether it provides additional safeguards or protections against expropriation;
- e) In Article 21, adding asset disposal and liquidation proceeds (in addition to capital contributions, profits, capital gains, intellectual property licensing fees, compensation or indemnification obtained in accordance with law) which foreign investors are allowed to transfer freely in or out of the PRC in accordance with law;
- f) In Articles 23 and 39, requiring governmental authorities and officials to keep trade secrets of foreign investors and FIEs confidential, failing which administrative penalties and even criminal liability will be imposed;
- g) In Article 31, clarifying that in terms of organizational form, institutional framework and standards for activities of FIEs they shall apply the PRC Company Law (the “**Company Law**”) or the PRC Partnership Law (the “**Partnership Law**”) as appropriate, thus confirming the legislative link to

the main rules regulating domestic capital entities (“**Domestic Capital Entities**”); and

- h) In Article 42, clarifying that it will be the State Council that will promulgate implementing rules regarding the transition from the organizational form of existing FIEs’ to that under the Company Law or the Partnership Law during the 5-year transitional period.

Local incentives

In Article 18, it is further specified that only “governmental authorities at the county level or above” have the authority to promulgate promotional and/or facilitation measures for Foreign Investment “in accordance with laws, administrative regulations or local regulations”. This means such preferential investment measures must have a legal basis, and cannot be issued by lower-level governmental authorities. This Article aims to prevent unlawful or ultra vires policies being issued by local governments. However, as mentioned in our Earlier Note, when read together with Article 25 which requires local governments to perform their policy commitments and/or contractual agreements, Article 18 may, on the other hand, increase the due diligence burden on foreign investors and FIEs in distinguishing lawful and authorized commitments from unlawful or ultra vires ones prior to making investment decisions or entering into contracts. On the positive side, the FIL does give foreign investors a baseline: if a government authority below county level offers an incentive, it can be ignored.

Link to AML

The FIL incorporates an article (Article 33) to link to the existing merger filing and anti-monopoly regime under the PRC Anti-monopoly Law effective 1 August 2008, specifying that foreign investors carrying out mergers and acquisitions of Chinese Domestic Capital Entities or otherwise participating in concentrations of businesses must go through merger control review. Merger control filing remains a concern in terms of timing of establishment of joint ventures and/or M&A transactions involving concentrations, in that where a case is accepted for simple case treatment it may need 1-2 months for clearance, but if not cases can take between 3-5 months to process. Given that the law

prohibits implementation of the concentration before clearance is granted, a merger filing in China (not to mention in other jurisdictions) has the potential to push out closing timelines significantly.

Legal liability for violation of Negative List

- a) Article 36 adds that in the event of violation of restrictions or prohibitions under the Negative List, foreign investors must assume the corresponding legal liability in addition to those already specified under the FIL, such as cessation of investment, disposing of shares or assets and returning to the pre-investment status quo.
- b) The FIL also adds a separate penalty provision (Article 37) on violation of information reporting rules by foreign investors or FIEs, and specifies that MOFCOM is the competent authority to impose such penalties, which may range from RMB 100,000 to 500,000. For a more detailed discussion of the current information reporting system run by MOFCOM, please refer to our Earlier Note.

The new paradigm

Overall, the FIL has established a revamped multi-pronged framework for Foreign Investment, based around the following core concepts:

- a) pre- [market] access national treatment plus negative list administrative system;
- b) FIE general or sector-specific regulation by corresponding governmental departments such as the Ministry of Industry and Information Technology for Internet, telecoms and certain manufacture sector FIEs and so forth;
- c) project-level regulation by NDRC;
- d) merger control review for concentrations;
- e) national security review;
- f) information reporting;
- g) governance rules and registration rules for changes in senior management (such as directors, general manager or legal representative), members of governance bodies and so forth; and

- h) general ongoing regulation of FIE operational activities, such as labor protection, tax, foreign exchange, and so forth.

Most, if not all of these concepts are not new, but the FIL brings them together in a single piece of legislation that is 'vehicle agnostic', in contrast to the previous approach. (a) to (e) are applicable at the point of investment, while (f) to (h) are ongoing in nature.

3. What Will Happen to Existing JVs?

This is one of the "million dollar questions" raised by the FIL. Article 31 of the FIL provides that the FIE Laws shall cease to be in force from its effective date (e.g. January 1, 2020), and from such date onwards, the PRC Company Law or the Partnership Law will regulate and govern the organizational structures, organizational bodies and rules governing activities by FIEs. Since a wholly foreign-owned enterprise ("WFOE") is already in the form of a limited liability company with its shareholders meeting as the supreme governance body as stipulated under the Company Law, the changes will mostly affect JVs, e.g. equity joint ventures ("EJV") and cooperative joint ventures ("CJV").

Corporate governance under the Company Law vs. EJV Law and CJV Law

As briefly set out in our Earlier Note, FIEs may actually benefit (e.g. enjoy more flexibility in terms of corporate governance) from moving from the FIE Laws to the Company Law or the Partnership Law. The FIE Laws were written at a time when the relationships between foreign investors and Chinese investors were very different, with the emphasis on protecting a perceived weaker Chinese party, as opposed to now, where the parties may have roughly equal or similar bargaining power, so included things like entrenched minority protections for Chinese investors in key areas like changes to Articles of Association ("AOA"), capital increase or decrease, termination and dissolution, merger and demerger and mortgages of assets or change of corporate form (the latter two for CJVs only). On the other hand, such alignment may impose a significant documentary and management burden on existing FIEs in China. There are various 'flavours' of equity FIEs under current FIE Laws, including WFOEs, EJVs, and CJVs, the latter

either with or without separate legal personality from investors, which resemble a partnership but are quite rare not to mention a few joint stock foreign-invested limited liability companies (foreign-invested companies limited by shares). The most impacted vehicles will be EJVs and CJVs. We have summarized in the table below the main differences in governance structure and rules governing certain corporate actions (e.g. profit distributions) under the Company Law compared to those provided under the EJV Law and/or CJV Law.

Matters	The Company Law	The EJV Law	The CJV Law
Supreme governance body	Shareholder/shareholder(s) meeting.	Board of directors ("Board").	Board joint management committee ¹¹ ("JMC").
Minimum number of board/committee members	1	3	3
Term of directors	≤ 3 years.	4 years.	≤ 3 years.
Restrictions on allocation of board/committee seats	None.	Based on consultations by reference to each investor's ownership ratio.	Based on consultations by reference to the ownership ratio of/cooperation conditions provided by each investor.
Restrictions on appointment of chairman/general manager	None.	If one party appoints the chairman/general manager, the vice chairman/deputy general manager shall be appointed by the other party.	If one party appoints the chairman/committee head, the vice chairman/head shall be appointed by the other party.
Board/committee member	Nominated by shareholders and appointed by shareholder(s) resolution.	Appointed by shareholders.	Appointed by shareholders/parties.
Quorum requirement for meetings of the supreme governance body	None. Normally provided in AOA.	2/3 of the Board members.	2/3 of the Board/JMC members.
Voting requirement for statutory reserved matters	Votes in favour representing 2/3 of shareholding rights for amendment of AOA, increase/decrease capital, mergers or splits, change of corporate form.	Unanimous approval of the board for amendment of AOA, increase/decrease capital, mergers or splits, termination and dissolution.	Unanimous approval of the Board/JMC members for same matters as for EJVs plus mortgage of assets of CJV or change of corporate form.
Profit distributions	Based on percentage of paid-in capital, except where all shareholders agree otherwise.	Based on the ownership ratio of the shareholders.	As agreed by the parties in the CJV contract, and allows early recovery of investment by foreign investors. In-kind distributions expressly permitted.

¹¹ Under the CJV Law, a CJV can be established with no separate legal personality from its investors. The highest internal governance body of such CJV is the "joint management committee", corresponding to the board of directors of a CJV with separate legal personality.

Matters	The Company Law	The EJV Law	The CJV Law
Mandatory after-tax fund contributions prior to profit distribution	Statutory funds (and discretionary funds, as decided by the shareholder(s)). 10% minimum allocation until cumulative amount equals 50% of registered capital.	Statutory reserve fund, expansion fund and employee bonus and welfare fund. Percentages determined by Board.	None.
PRC individual as an initial shareholder	Allowed.	Not expressly specified (read not allowed in practice for a greenfield EJV).	Not expressly specified (read not allowed in practice for a greenfield CJV).
Share/interest transfer restrictions	Consent of non-transferring shareholders representing the majority of the non-transferring shares.	Consent of all the other shareholder(s) who also have pre-emptive right to buy on the same terms as a third party.	Consent of all the other shareholder(s)/party(ies) who also have pre-emptive right to buy on the same terms as a third party.
Available organization form	Limited liability company with undivided shareholding rights and separate legal personality from investors ("LLC"); or limited liability company with divisible shares (or joint stock company).	LLC.	LLC; or partnership type contractual joint enterprise, with no separate legal personality but unlimited liability for parties.
Governance document(s)	AOA to be filed with registration authority; shareholders may choose to have a separate shareholders agreement, which is not required to be submitted to registration authority or MOFCOM local branch.	AOA to be submitted to registration authority; and joint venture contract ("JVC"), to be submitted to the respective MOFCOM local branch together with AOA if the EJV is engaged in business in a restricted sector.	AOA to be submitted to registration authority; and JVC, to be submitted to the respective MOFCOM local branch together with AOA if the CJV is engaged in business in a restricted sector.

Main issues FIEs should expect to encounter within the transitional period.

Article 42 of the FIL provides that existing FIEs may maintain their original governance structures for five years after the FIL takes effect (January 1, 2020). Implementation rules will be promulgated by the State Council during this transitional period. Currently, the issue is that there is insufficient detail to guide either existing FIEs, or FIEs which will be established in the period prior to the FIL becoming effective through the transitional period.

a) Absent legislation on the implementation of Article 42, past practice by the Chinese government suggests that foreign investors and FIEs may need to complete their alignment with the Company Law or Partnership Law within the transitional period. There was a governance structure transition for FIEs in 2005 and 2006, triggered by a major amendment to the Company Law in 2005 (the "**2005 Amendment**"), where WFOEs went down the

Company Law 'track' with the shareholders meeting becoming the supreme organ, whilst EJV and CJV continued with the Board/JMC as supreme authority. Two subordinate rules issued in 2006 clarify the implementing mechanisms for that transition, one of which was jointly issued by five ministries including MOFCOM and the then company registration authority – the State Administration for Industry and Commerce ("SAIC", now part of the restructured 'super regulator' the "State Administration for Market Regulation" or "SAMR" for short), and the other issued by SAIC itself. The latter provides that FIEs established prior to the entry into force of the 2005 Amendment may decide whether to adopt the new governance structure and amend their AOA accordingly. However in practice, in our experience, WFOEs were often required by local branches of SAIC to amend their AOA to be in line with the new governance structure requirements when they tried to register or file other changes (e.g. to business

scope or legal representative) with local branches of SAIC. Gradually over the years, most WFOEs have aligned their organizational structure with these requirements, although there may still be some outliers where they have not needed to make any changes or enforcement at the local level has been lax.

- b) It is clear from the comparison table in section 3 that EJV and CJV and their investors will be faced with significant changes, although some will result in more favourable outcomes than under existing FIE Laws. Any attempt to align FIE governance with the Company Law will inevitably reopen negotiations among the investors in EJV and CJV, and investor consent will be needed to amend the AOA and JVC. This in itself can be a source of uncertainty, particularly if one party sees this as an opportunity to reallocate rights and benefits or a chance to walk away from a bad deal or partner. Under the Company Law, except for a few statutory reserved matters requiring shareholder super-majority (two-thirds) approval, all other matters can be subject to majority rule and may be subject to renegotiation, including: how to allocate rights and obligations among shareholders, the rights to appoint the members of the Board and general manager; the voting requirements on each matter at the shareholders meeting and/or Board meeting level; additional mechanisms to protect minority shareholders at the shareholder level to replace the statutory reserved matters under the EJV Law/CJV Law (although such mechanism may increase the risk of deadlock), and so forth.
- c) There are various other uncertainties associated with the transition to the FIL regime, including:
- i. Upon the CJV Law being repealed, CJVs with no separate legal personality will lose the legal basis for their current organisational form. What forms (e.g. partnerships) are available needs to be clarified in the implementing rules;
 - ii. Under the Company Law, a company does not need to file its shareholders agreement (if any) with SAMR. However, it is not clear as to whether JVCs for FIEs in restricted sectors set out in

the Negative List are still subject to MOFCOM examination and approval; and

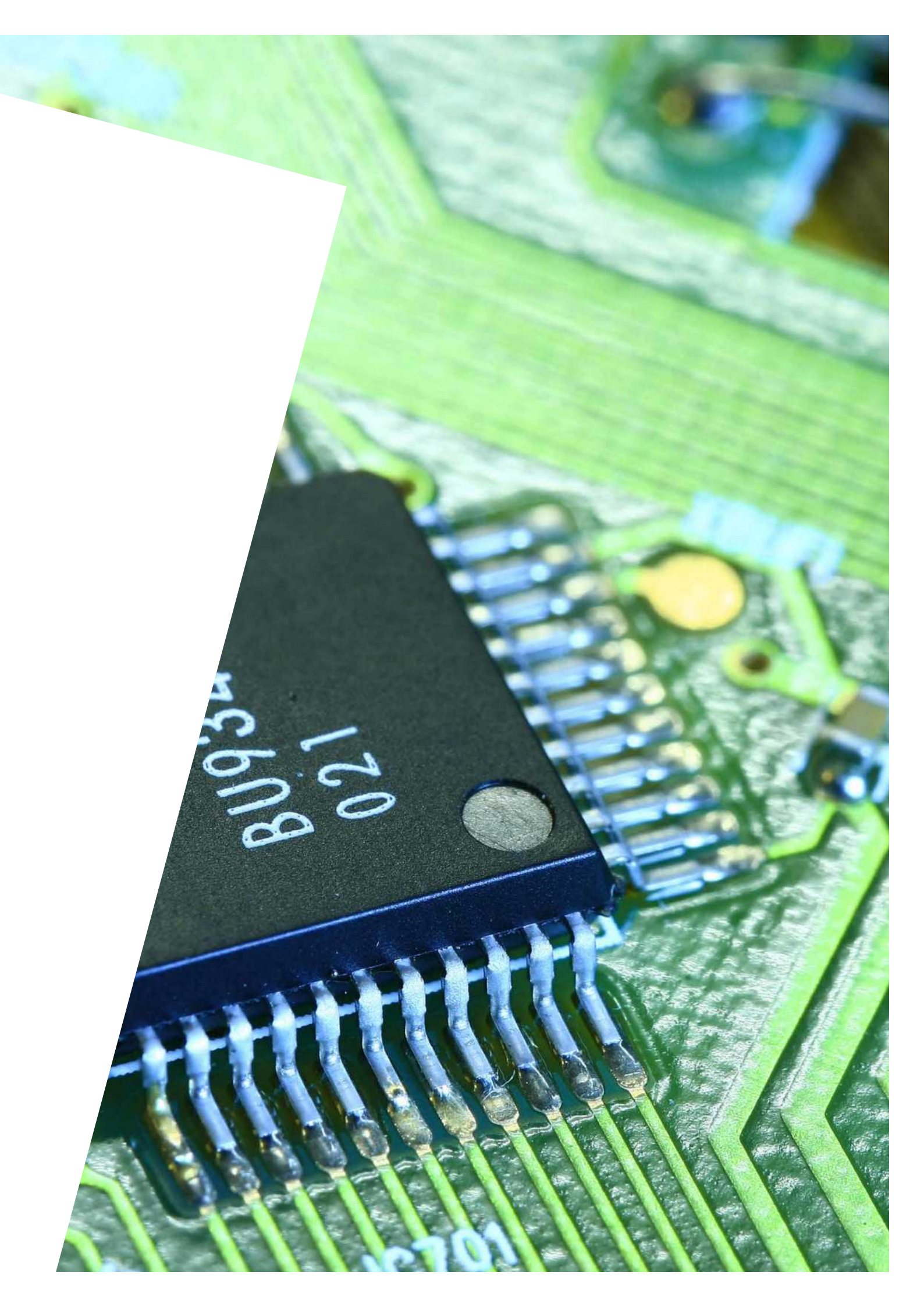
- iii. There are now only eight months to go before the FIL becomes effective, from 1 January 2020, but it is not clear what organizational form FIEs proposed to be established during this interim period should adopt, what governance structures should they create, and how they should carry out certain corporate activities. Is there a choice to be made in terms of which rules to apply (e.g. can an EJV, from 1 January 2020 make a dividend that no longer corresponds to shareholding interests assuming the shareholders have agreed to this)? FIEs currently under negotiation may have to either: (a) apply existing FIE laws and align themselves with the new rules after the FIL becomes effective (which will involve extra cost to investors); or (b) apply the FIL before it has come into force (which feels inappropriate); or (c) wait until the FIL takes effect to establish (which will delay the launch of business operations).

The above uncertainties need to be addressed in the implementing rules, which are expected to be issued in the coming months. Foreign investors and FIEs will need to take note and plan accordingly: in fact it is possible that the uncertainty may lead to a drop in FIE formation in the period prior to the implementing rules being promulgated.

4. Implications on VIE structure

The VIE structure in a nutshell.

A VIE structure is a control structure consisting of a set of contractual arrangements, through which an offshore parent (or foreign investor), normally through its owned FIE (typically a WFOE), is able to obtain de facto control over one or more Domestic Capital Entities registered and operating in the PRC (usually referred to as the “OpCo”). Under the VIE structure, the WFOE is normally granted power of attorney by the nominee shareholder(s) of the OpCo to exercise shareholder rights, and profits/cash flows generated by the OpCo are flowed back to the WFOE in the name of technical services fees (or similar) and/or be remitted to the offshore parent as dividends. By means



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of this structure, the finances of the OpCo can normally be consolidated by the offshore parent.¹²

This structure was initially used by Chinese Internet companies (requiring a permit that could only be held by a Domestic Capital Entity or where they needed a WFOE for the overseas financing aspects, but the permit could only be obtained by an EJV) to raise capital on overseas capital markets and/or through venture capital and private equity investments that are made offshore. A considerable number of such companies have now either been listed overseas or have become sector leaders or national champions (or all of the above), such as Sina, Sohu, Tencent, Baidu, Alibaba, JD, and very recently Meituan and Xiaomi to name but a few. Over the years, the VIE Structure has been widely deployed in certain sectors such as telecommunications, education, media and so forth.

The Chinese government has studiously avoided any action that might be interpreted as either endorsing or banning the VIE structure since its first appearance almost twenty years ago, not least because the personal fortunes of some of China's captains of industry are tied up in such structures. But in recent years, we have seen several attempts by the Chinese government to regulate VIEs.

FIL's potential jurisdiction over foreign investments incorporate a VIE structure

The 2018 Draft was widely seen as a compromise document to address the tension between the Chinese government's attempt to expand jurisdiction over VIEs and the negative impact this might have on the above mentioned national champions and high-tech industry players with a VIE structure already set up or in process who were seeking overseas financing.¹³

With the very broadly worded sub-clause (2) of Article 2, the FIL seems to have moved one step further by bringing certain FDI forms once enumerated under the 2015 Draft but deleted in the 2018 Draft back within the scope of regulated FDI. By reading sub-clause (2) together with the paragraph defining "Foreign Investment", you can arrive at the following conclusion "Foreign Investment" includes the obtaining of shares, equities, property shares or any other similar rights and interests in an enterprise in China by foreign investors directly or indirectly. This sub-clause neither enumerates nor does it carve out any specific means whereby such interests were obtained (e.g. via capital contribution or contract). Thus on the face of sub-article (2), even without the help of the catch-all sub-article (4)¹⁴ (which would require the type of investment to be specified in legislation to count), VIEs could be interpreted as falling within the wording, thus becoming Foreign Investments subject to regulation under the FIL.

Potential information reporting requirement on ultimate controller

Under the FIL, Foreign Investment includes both direct and indirect investment activities, and again, without defining the scope of "indirect" or enumeration of any structures that are (or are not) deemed "indirect" investment activities. Thus, there is a potential risk from this broad definition that the ultimate shareholder or beneficial owner of an FIE (which might indirectly hold an interest in such FIE through several intermediate holding vehicles) might still be viewed as a foreign investor under the FIL and thus become subject to various obligations, including information reporting. The current record-filing system run by MOFCOM requires FIEs to submit information on their ultimate controller (though as noted in the Earlier Note, curiously this has not yet been extended to FIEs conducting business in restricted sectors under the Negative List), which echoes our concern. Considering the fact that the FIL potentially covers VIEs, the information relating to the ultimate controller of a VIE might fall under the scope of information reporting, if future implementing regulations go in this direction. Ultimate shareholder/controller was previously the core concept under the 2015 Draft to distinguish between "true foreign investment" and "true domestic

¹² For a more detailed explanation of VIEs, please refer to our Client Note "China VIE structure for foreign investment under attack from multiple directions: Will it emerge (relatively) unscathed or is its very survival threatened?" dated September 2012.

¹³ The 2018 Draft simplified the definition of foreign investment in the 2015 Draft by, among others, deleting detailed descriptions of several FDI forms, including "obtaining control over or interests in domestic enterprises through contract", and deleting the definition of "control" which includes "control through contract" – this was one of the most controversial aspects of the 2015 Draft when it was first made public. The 2018 Draft adopted a catch-all FDI definition, leaving space for future legislation expressly providing jurisdiction over VIEs.

¹⁴ The catch-all sub-article (4) stipulates that Foreign Investment includes investment activities by other means specified by laws, administrative regulations or the State Council, leaving space for future legislation to expand the scope of Foreign Investment and thereby broaden the jurisdiction regulated by the FIL.

investment” (e.g. the so-called “round-tripping” invested companies, controlled by, say PRC individuals, indirectly through such individuals’ overseas entities or individual shareholdings). If future legislation takes the approach of the 2015 Draft in terms of this point (as has happened with respect to certain other aspects), such “round-tripping” companies may be deemed to be domestic investment and thus not subject to some or all of the restrictions or prohibitions under the Negative List, but conversely, VIEs invested/controlled by foreign investors may be viewed as Foreign Investment and thus governed by the Negative List. Taking this one step furthermore, absent a material liberalisation of sectors like telecoms or the Internet, such OpCos and/or associated WFOEs may be seen as having circumvented the rules on obtaining permits in the sector in question and therefore to be in violation of restrictions or prohibitions under the Negative List. The basic remedy in such circumstances would be restructuring to return to a compliant state, e.g. stripping out all direct or indirect foreign investment or elements giving rise to foreign control in relation to an OpCo conducting business in one or more prohibited sectors. It might be possible to restructure a VIE into a JV if it only runs say a single business which is a ‘restricted’ sector activity subject to foreign investment equity caps, and the shareholders meet the conditions for obtaining the permits needed for running that business as a JV, but this is the exception rather than the rule. Most of the larger VIE-based operators have “fingers in many pies”, some of which are ‘restricted’ and some “prohibited” to foreign investment, making this type of restructuring impractical and unachievable.

Other new trends on VIE regulation

a) In the education sector, we have seen two attempts in policies and draft legislation in 2018¹⁵ that suggest that more sector-specific rules may be on the way. Although the provisions are less than clear, under these documents, “control through contract” and/or “VIEs” are specifically mentioned (but not defined) and subject to regulation. The education sector may, therefore, become a pilot sector for imposing VIE regulation.

b) In the PRC capital markets, the China Securities Regulatory Commission (“CSRC”), China’s stock markets regulator, indicated in early 2018 that the Chinese government will encourage technology and innovation companies which are listed overseas or intend to seek overseas IPOs to return to the PRC stock markets, including “red-chip companies” (this usually refers to overseas companies seeking an overseas listing while its main business operations are in China, many of which have incorporated a VIE structure). On March 1, 2019, CSRC issued the registration measures for the “Science and Technology Innovation Board” (“STI Board”), a newly-established board of the Shanghai Stock Exchange (“SHSE”), and on the same day, the SHSE issued the listing rules for the STI Board. These rules expressly provides that red-chip companies (including those with a contractual control structure) are eligible for apply for listing on the STI Board, if they have met the listing requirements and made full and detailed disclosures about such structure, especially on the associated risks and corporate governance aspects.

c) Information from a non-public source indicates that the Antimonopoly Bureau of SAMR has reviewed and unconditionally approved a joint venture in which one partner had adopted a VIE structure. If verified, this can be viewed as an important shift in terms of the attitude of Chinese government authorities towards VIEs. Previously, MOFCOM (when it was in charge of merger filings) had refrained from reviewing merger filings containing a VIE element for more than a decade by ‘sitting’ on them, to avoid being interpreted as endorsing the VIE structure or had caveated its approval (such as in the Walmart acquisition of Yihaodian from PingAn).

15 These two documents are: (i) the Amendment to the Regulations on the Implementation of the PRC Private Education Promotion Law, issued by MOJ on August 10, 2018 for public comments; and (ii) Several Opinions of the CPC Central Committee and the State Council on Further Reform and Well-regulated Development of Preschool Education, issued on November 7, 2018.

d) National security review (NSR) over foreign investment is another area where more implementing rules and expanded jurisdiction are expected in the next few years (please see further analysis below in section 5). Under existing implementing rules on NSR in relating to foreign investment, it has already been made clear that foreign investors may not circumvent the jurisdiction of such rules through “contractual arrangements” (e.g. VIEs).

5. Implications for NSR of foreign investments

Article 33 of FIL provides that Foreign Investment that has or may have national security implications shall be subject to NSR and that decisions made in relation to NSR cases are final and cannot be challenged. In defining the scope of coverage of NSR over foreign investment, this article takes the same general approach as Article 59 of the National Security Law (the “NSL”), e.g. all foreign investment activities, regardless of sector, vehicle/means of investment, direct or indirect, or transaction type (minority or control deals), and so forth. This scope is much broader than the existing implementing rules. We have analysed the existing NSR regime in relating to foreign investment and the implications of the new law in our Earlier Note, however as this topic is of general concern of clients across-sectors, we have briefly recapped the key issues below.

Expected expansion of jurisdiction

The existing implementing rules¹⁶ applicable nationwide took effect in 2011, only covering certain sectors (of national security concern), and transaction types (“merging with or acquiring Chinese Domestic Capital Entities”), and where investments in certain sectors automatically triggered NSR and in others required the element of acquiring control to trigger NSR. Another implementing rule¹⁷ applicable in four free trade zones on a pilot basis taking effect in 2015, a few months prior to the NSL, expanded sector coverage and covered greenfield investments in terms of transaction types, but still

required the element of acquiring control to trigger NSR over foreign investments in such sectors.

Now, by reiterating the broad coverage under the FIL, it seems the Chinese government is ready to roll out the pilot nationwide and to even go one step further – to impose NSR over FDI activities in the broadest possible sense.

Decisions made about NSR cases are final

The FIL makes it clear that the decisions made about NSR cases are final (while existing implementing rules are silent on this point). This means that NSR cases are exempted from both administrative review and administrative litigation. We think this change may not be of great practical significance to foreign investors in China. For one thing, it follows the precedent set by NSR legislation in other jurisdictions, such as US CFIUS review. This may, therefore, be something investors and MNCs worldwide conducting business worldwide have grown to accept. For another, even absent such provision, there have been very few cases (if any) where foreign investors have made formal challenges through administrative review or administrative litigation to general examination and review decisions made by Chinese government authorities, let alone those touching upon national security.

6. The reciprocity rule and trade tensions

China provides itself with a legal basis for trade retaliation

Article 40 of the FIL provides that “if any country or territory adopts discriminatory measures against China in respect of investment matters, such as prohibitions, restrictions or other similar measures, China may adopt corresponding measures against such country or territory based on the actual circumstances.” In the context of an ongoing trade war between China and the US and growing trade tensions with the EU leading to a raft of NSR-type legislation in Europe, this Article provides the legal basis for China to launch investigations and sanctions against companies based in US or possibly Europe, similar to the steps taken by the Trump Administration in the ZTE and Huawei cases.

¹⁶ The existing rules include: (i) the Announcement of Provisions of the Ministry of Commerce on the Implementation of Security Review System for Foreign Mergers and Acquisitions of Domestic Enterprises issued by MOFCOM; and (ii) the Office of the State Council's Notice on the Establishment of the Security Review System for Foreign Mergers and Acquisitions of Domestic Enterprises.

¹⁷ The Office of the State Council's Circular on Issuing the Measures for the Pilot Program of National Security Review of Foreign Investments in Pilot Free Trade Zones.

The implication of this Article is that China may also seek to use tools similar to CFIUS, the use of which has become increasingly aggressive under the Trump Administration (e.g. expanding coverage to minority investments, adding a number of high-tech sectors into areas of national security concern); the reference to “discriminatory treatment” in this Article presumably reflects the fact that while not mentioning China by name, recent cases and US legislation in this area have clearly been drafted with China and Chinese investors in mind, with a view to preventing certain types of transactions in perceived sensitive sectors. What it could mean is that if China follows through on its implied threat to take retaliatory action above and beyond the tit-for-tat tariffs game, and depending on the outcome of current trade negotiations, we may see further policy restrictions on acquisitions by certain foreign investors in certain sectors which China views as sensitive, e.g. Chinese-owned semiconductor manufacturers or possibly, and more controversially, VIEs in the telecoms, Internet and media sectors.

7. Conclusions

The FIL is probably the most significant overhaul of the Chinese FDI regime since it was put in place in the 1980s and 1990s. It clearly represents a step in the right direction in terms of moving away from the outdated model of having different sets of rules for different vehicles, rather than one set of rules for all vehicles. However in many ways the new regime under the FIL raises more questions than it provides answers, foremost of which are:

1. when will there be sufficient guidance from implementing rules to tell foreign investors:
 - i. What kind of a legal structure to use from now until 1 January 2020 and which rules to follow between now and then when setting up an FIE in the next few months?
 - ii. What parts of the previous FIE rules e.g. on debt equity ratios not set out in the laws being repealed or their implementing regulations will still apply going forward, or will these automatically fall away under the “equal treatment” principle (as no such restrictions apply to Domestic Capital Entities under the Company Law)?
 2. What is going to happen to VIEs? To what extent are they going to be regulated under the FIL? Do foreign investors in these need to think about restructuring if they operate in Negative List sectors?
 3. How will information disclosure obligations work and just how far up the chain does information reporting go? How does “actual needs-based” disclosure work in practice? Who decides?
 4. When are we going to get detailed implementing rules on when NSR does and does not apply to FDI or M&A: leaving it open ended is likely to leave Foreign Investors frustrated and struggling to work out when a filing is needed (while NSR tends to be quite “black box” anywhere in the world, the US, for example, does have some guidance on when CFIUS filings are required) or lead to an avalanche of defensive filings.
 5. Will legacy JVs be forced to more over to the new FIL organisation structures in the same way as previously happened to WFOEs in 2006, e.g. when they first make a change to their AOA or other registered particulars? Is the five year grace period for legacy JVs real, or just a backstop period by which time any outliers will be forced to align with the FIL? Should such legacy JVs “bite the bullet” and start changing their structures now? What happens if no consensus can be reached between the shareholders in JVs that have been running well for say 20 years needed to make the changes to comply with the FIL regime? Will we see a wave of sales and exits on the back of disruptive change brought about by the FIL?
 6. Will the Foreign Investor complaint mechanism work? How can this operate in a way that does not mean Foreign Investors end up reporting to another part of the same local government that gave rise to the complaint in the first place, raising issues of local protectionism.
- It surely cannot be healthy or conducive to FDI to have a hole in the legislative framework such as has been left by the FIL for too long.

Only time will tell whether the FIL is an improvement on the “clunky” but “road tested” prior regime. Officials trying to implement the FIL may also struggle with “regime change” and this could lead to the confusion and processing delays we saw in 2016 with the introduction of record filing instead of approval as the default process for establishing a new FIE. Above all, has China really chosen an opportune time to foist this game-changing reform on Foreign Investors, when it has just recorded its slowest year of growth since 1990, and is starting to feel the pain of the trade wars in its exporting manufacturing sector and therefore needs every last dollar of FDI it can get to create jobs and support the increasingly difficult domestic economic growth narrative?



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Busting the myth: Compliance with the ‘gold standard’ of the GDPR does not buy you a ‘free pass’ under China’s new personal information guidelines

Overview and background

On December 29, 2017, the Standardization Administration of China (“**SAC**”), jointly with the PRC General Administration of Quality Supervision, Inspection and Quarantine (“**AQSIQ**”, now part of the new super-regulator, the State Administration for Market Regulation or “**SAMR**”), issued the Information Security Technology – Personal Information Security Specification (GB/T 35273-2017, the “**Specification**”), which officially came into effect on May 1, 2018. The Specification supplements the broad principles set out in the PRC Cyber Security Law, effective on June 1, 2017 (the “**Cyber Security Law**”) and provides detailed and practical requirements and examples with respect to the processing of personal information.

Although the Specification is only a recommended (as opposed to a mandatory) national standard, we still recommend full compliance with the Specification, given its practical value in terms of demonstrating a compliance culture in this area, and the fact that the authorities in China appear to be using it as a compliance yardstick in practice, and are holding companies in China to account for failing to comply with the Specification. This recommendation has taken on particular importance in the context of the current tensions in international trade, leading many multinationals to conclude that demonstrations of strict compliance in sensitive areas of Chinese regulations are as important now as they have ever been. The introduction of the Specification also comes at a time when public awareness of data protection appears to be on the rise in China, with consumers more likely to demand that their rights in personal data be respected.

This alert discusses what has changed or is new under the Specification, as compared to earlier non-mandatory guidelines also issued by SAC and AQSIQ, the Guidelines on Personal Information Protection within Information Systems for Public and Commercial Services on Information Security Technology (“**2013 Guidelines**”). We will also look at some of the differences between the Specification and the General Data Protection Regulation (“**GDPR**”) (EU) 2016/679, made by the European Parliament and Council of the European Union and

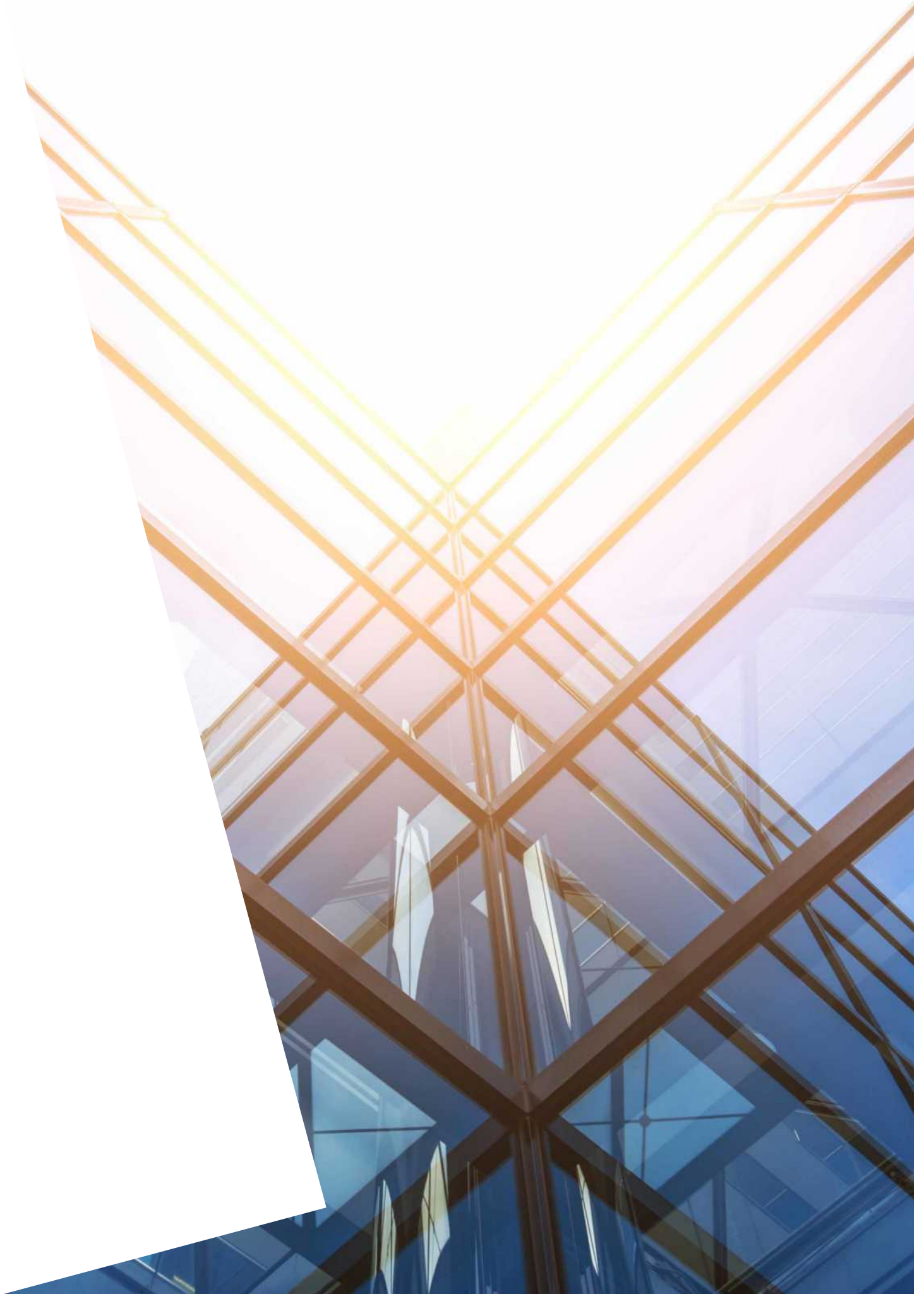
effective from May 25, 2018. Although the Specification purports to have used GDPR as one of its reference points, companies should not assume that compliance with the GDPR automatically implies compliance with the Specification.

Non-binding but highly influential and useful as a compliance tool

In common with the 2013 Guidelines, the Specification is not a mandatory national standard. However, the Specification goes a step further than the 2013 Guidelines in that it expressly says that it not only applies to the regulation of personal information processing activities by various types of organizations, but also applies to the supervision, management and assessment of personal information processing by regulators and third party assessment agencies. This has played out in practice and in terms of how the regulators have been applying the Specification.

In January this year, a well-known non-banking payment institution in China was reportedly summoned by the Cyberspace Administration of China (“**CAC**”) for an interview due to “inappropriate” collection of users’ personal information (by using pre-ticked consent boxes in its online T&Cs). Days later, the CAC decided that the manner in which the payment institution collected personal information was against the “spirit” of the Specification, and recommended that the institution should conduct a comprehensive internal review pursuant to the Cyber Security Law and rectify the position. This demonstrates that the Specification is indeed being used by the regulatory authorities when assessing whether a company complies with the provisions of the Cyber Security Law and the relevant laws and regulations concerning the protection of personal information.

Looking beyond the data protection provisions found in the Cyber Security Law, the Chinese data protection regulatory landscape is notable for the proliferation in recent years of mandatory data protection requirements, such as the amendments to the PRC Consumer Rights Protection Law (the “**Consumer Protection Law**”) introduced in 2014, provisions in the recently passed PRC E-Commerce Law and the complex array of laws and measures addressing online data collection in China.



The data protection provisions in these laws and measures are often very general in their wording – the Specification provides a more granular, comprehensive approach to data protection that can ease the confusion created by conflicting standards.

The definition of “personal information”

The Specification broadens the definition of personal information under the 2013 Guidelines and under the Cyber Security Law to include information reflecting not just the factual and biometric attributes, but also the activities of a particular natural person, including an individual’s location data, correspondence records, online browsing history, transaction information and so forth.

The Specification follows the logic of the 2013 Guidelines and “distils” sensitive personal information from (more general and hence less sensitive) personal information. “Sensitive personal information” is defined as “personal information which can potentially put personal or property safety at risk, or which is very likely to cause damage to, or discrimination with respect to, an individual’s reputation, physical or mental health if disclosed, unlawfully provided or misused”. Non-exhaustive examples of sensitive personal information listed in the main body of the Specification include identification card numbers, biometric identification information, bank account numbers, correspondence records, property information, credit information, location data, residential information, health information, transaction information, personal information of minors of 14 years of age or under and so forth. Personal information which has been anonymised will not be treated as personal information.

The Specification includes annexures giving further examples of personal information and sensitive personal information, respectively. Further examples of sensitive personal information include online identity information (such as system account number and email address and passcode, password, answers to security questions relating to the foregoing, and user’s personal digital certificates), personal telephone number, sexual orientation, marital history, religion, unpublished records of law violations, website browsing history, and precise positioning information.

GDPR imposes stricter requirements on “special categories of personal data”

Under the GDPR, “special categories of personal data” (broadly similar to “sensitive personal data” under EU Directive 95/46) are regulated more heavily (for instance, a data protection impact assessment on such data will be required under certain circumstances). However, the scope of “special categories of personal data” under the GDPR appears to be narrower than “sensitive personal information” under the Specification. “Special categories of personal data” means personal data processed to reveal racial or ethnic origin, political opinions, religious or philosophical beliefs, or trade union membership, genetic data, biometric data processed for the purpose of uniquely identifying a natural person, and data concerning health or data concerning a natural person’s sex life or sexual orientation.

The collection and use of personal information

Under the Specification, prior to the collection of personal information, certain disclosures need to be made and/or certain steps need to be taken. Some of these requirements are simply repeating the requirements under the 2013 Guidelines; others are new.

- Collection from data subjects

A data controller must expressly inform personal information data subjects of each type of personal information to be collected corresponding to each different business function of the product or service in question (explained further below), as well as rules for collecting or using personal information (e.g. the purpose for which the personal information is collected and used; how and how often personal information is collected; where and for how long the personal information is to be stored; its ability to keep data secure; whether such personal information is to be shared, transferred or disclosed). After such disclosure, consent must be obtained from data subjects.

A data controller must develop privacy policies. In addition to the information in the preceding paragraph, there is other prescribed information that must be disclosed in the privacy policy. A sample privacy policy is included as an appendix in the Specification. Based on our experience, achieving compliance means the typical online privacy policy we

have seen being used in the Chinese market will need to be revised quite significantly.

Under the 2013 Guidelines, there was no mention of a compulsory privacy policy, and no requirement to disclose where the personal information is to be stored.

- Collection from third parties

A data controller must require the supplier of personal information to indicate the source from which the personal information was originally obtained, and verify the lawfulness of such source; it must also learn about the scope of authority having been granted to the supplier of the personal information for processing the personal information, including the purpose(s) of the use, and whether the personal information subject consents to its transfer, sharing and disclosure. If processing of personal information outside the scope of the authority granted is required, explicit consent from the personal information subject must be obtained within a reasonable period following acquisition of such personal information or prior to processing the personal information.

The above requirements to ascertain the source of information and verify its lawfulness are new. Although they are likely to increase the costs of personal data collection by companies, they may have the benefit of it minimizing the risk that the data collector will be held criminally liable for violating Article 253 of the PRC Criminal Law (revised to take effect from 4 November 2017), which states that any person who unlawfully obtains citizens' personal information by theft or through other means will be held criminally liable.

- Collection of sensitive personal information

As with the 2013 Guidelines, the collection of sensitive personal information is subject to stricter requirements – an explicit consent must be obtained and such explicit consent must be made by the personal information subject after being fully informed, and on a voluntary basis, and must reflect his/her specific and clear intent. The Specification also requires a data controller to distinguish between “core business functions” and “additional business functions” of the products or services it provides. With respect to sensitive personal information

required to be collected for realizing “core business functions” e.g. to register on the network, identify the client and send or receive payment of bills in the case of a mobile telephone operator, a data subject must be given the option to choose whether to supply sensitive personal information or whether to agree to automatic collection, after being explicitly informed of the consequences of refusing to supply the personal information or providing consent (e.g. termination of service). Where a data subject refuses to provide his or her personal information required for the provision of additional business functions e.g. optional services like international data roaming, such additional business functions may be removed, whilst the core business functions must not be terminated on such grounds and the quality of service must not be affected.

A valid form of explicit consent means either: (i) providing a written acknowledgement; or (ii) taking voluntary affirmative actions (such as voluntary acknowledgements made either electronically or physically, voluntary “box checking”, voluntary clicks on the “Agree”, “Register”, “Send” or “Call” buttons and so forth).

The collection of personal information from minors between 14 and 18 is subject to explicit consent from either the minor or his/her legal guardian. The collection of personal information from minors under 14 requires explicit consent from his or her legal guardian.

Consent requirements are in some ways more flexible than the GDPR, but the Standard does not permit “legitimate interests” processing

Localizing data handling processes developed under GDPR compliance programs to China will involve some important changes, consent requirements being a key area to note.

Under the GDPR, silence, pre-ticked boxes or inactivity do not constitute consent. An explicit consent, similar to China, is required to be obtained for not only “special categories of personal data”, but also for all types of personal information, unless a derogation is available, for example, the processing is justified by the data controller's legitimate interests.

The legitimate interests derogation is a critical tool for compliance programs under the GDPR, given the strictness of consent requirements.

The collection of personal information under the Standard permits implied consent as a basis for processing. This is likely, in the online context in particular, to ease the burden on lawful collection, even if there is no concept of legitimate interests available to Chinese data controllers. There is also a list of exemptions from the consent requirement that broadly tracks the lists of exemptions found under the GDPR and national data protection laws found in the Asia-Pacific region, including exemptions for processing required by applicable law, for the purpose of investigating criminal activity and as may be necessary for the performance of a contract entered into by the data subject.

This is the first time that China has articulated exceptions to the consent requirement. It is anticipated that the “necessary to perform contract” exception will be the most welcome and widely-used one, and companies will seek to rely on this exception to process significant volumes of personal information.

Importantly, there is also an exception for personal information which has been publicly disclosed by the data subject, which is an important exception in the context of online data processing, such as through social media. There is no corresponding exception under the GDPR, and it will be interesting to see how this exception can be reconciled with the “right to deletion” found in article 7.6 of the Specification, which has been noted by some commentators to be China’s equivalent of the GDPR’s “right to be forgotten”.

Transferring, sharing and (publicly) disclosing personal information

- Required disclosure and consent

As with the 2013 Guidelines, under the Specification, prior to data sharing, transfer or (public) disclosure, informed consent must be obtained for the transfer, and data controllers must carry out a personal information security impact assessment and adopt effective measures to protect data subjects, based on the results of such assessment. Unlike the 2013 Guidelines, the name, address and contact method for

the recipient do not need to be disclosed to the data subject; the Specification only requires the type of data recipient to be disclosed, unless the transfer of sensitive personal information is involved. Again, explicit consent is only required for the sharing or transfer of sensitive personal information, but (publicly) disclosing any type of personal information will require explicit consent.

- Record keeping

Accurate records of the sharing and transferring of personal information, including the date, scope and purpose of such sharing and transferring, as well as basic information about the data recipients, must be kept and maintained.

This is a new requirement. There is a similar but more onerous requirement under the GDPR, but under the GDPR, companies with less than 250 employees are not required to keep records unless the data processing is more than occasional or involves sensitive information. No such exemption exists under the Specification, and enterprises doing business in China will find themselves subject to this extra administrative burden which could be costly.

- Transfer in connection with M&A

The Specification introduces a new requirement where personal data is to be transferred in connection with a merger, acquisition or restructuring (“M&A”). In such M&A transactions, the data controller must notify the data subjects of this fact, and its successor should continue to perform the original data controller’s responsibilities and obligations. If the purpose of use has changed post-transaction, the successor must obtain a new explicit consent from the data subjects. The requirement to notify data subjects for the data transfer in M&A deals is a new requirement. In the past, we have commonly seen that reliance has been placed on prior consent obtained (via employee handbooks or company policies) from individuals for the potential transfer of personal data in case of M&A, and no notification of the M&A deal per se was required. This new requirement clearly adds an administrative burden on companies in M&A transactions.

- Cross-border transfer

The Specification does not purport to regulate cross-border personal data transfer, other than to say that the data controller must carry out a security assessment in accordance with the measures and relevant standards prescribed by the CAC in conjunction with relevant departments under the State Council.

For discussion of cross-border personal data transfers, please refer to our earlier briefing [China's Revised Draft Data Localisation Measures](#). Although the Security Assessment for Personal Information and Important Data Transmitted Outside of PRC Measures (“**Draft Export Review Measures**”) issued by the CAC last year was still in draft form at time of writing, it is expected that if the Draft Export Review Measures are adopted in their current form, cross-border transfers of personal information and/or in relation to cross-border transfers of “**important data**” by network operators will require explicit consent from data subjects. It is important to note that the requirement to conduct a security assessment not only on the cross-border transfer of personal information, but also “important data” is expected to be one of the key differences between the Cyber Security Law and the GDPR. This essentially reflects the political dimension that China sees in certain cross-border transfers of information, allowing China to track and potentially prevent transfers overseas of what it considers to be politically sensitive information and information which may be exploited against Chinese national interests through cyber-espionage, a concept closely linked to the nebulous and malleable definition of state secrets. These considerations have no counterparts under the GDPR.

The rights of data subjects

Compared with the 2013 Guidelines, the Specification grants data subjects stronger control over their personal information. It is reassuring to see that to a large extent, such rights mirror those under the GDPR. Articles 7.4 to 7.10 of the Specification confer the following rights on a personal information subject:

- to access personal information (this includes access to personal information, the source of such personal information and purpose for which it is used, and the

identities or types of third parties who have obtained such personal information);

- to rectify personal information;
- to erase personal information if the collection, use, share, transfer or public disclosure of the personal information are in violation of laws or regulations, or agreements;
- to withdraw consent including the right to refuse to receive commercial advertisements;
- to deregister accounts;
- to obtain copies of certain types of personal information, or transfer the same directly to a third party; or
- to lodge complaints where decisions which significantly affect the rights and interests of personal information subjects are made solely on the basis of automatic decision-making by the information system.

With respect to the right to copy and the right to data portability, the right is limited to basic personal information, personal identity information, personal health and physiological information, education and employment information (“**Restrictions**”). The rationale behind the Restrictions is not clear, as portability generally enhances consumer protection, but may be the result of lobbying by industry players who see this as a cost issue. Such Restrictions do not exist under the GDPR.

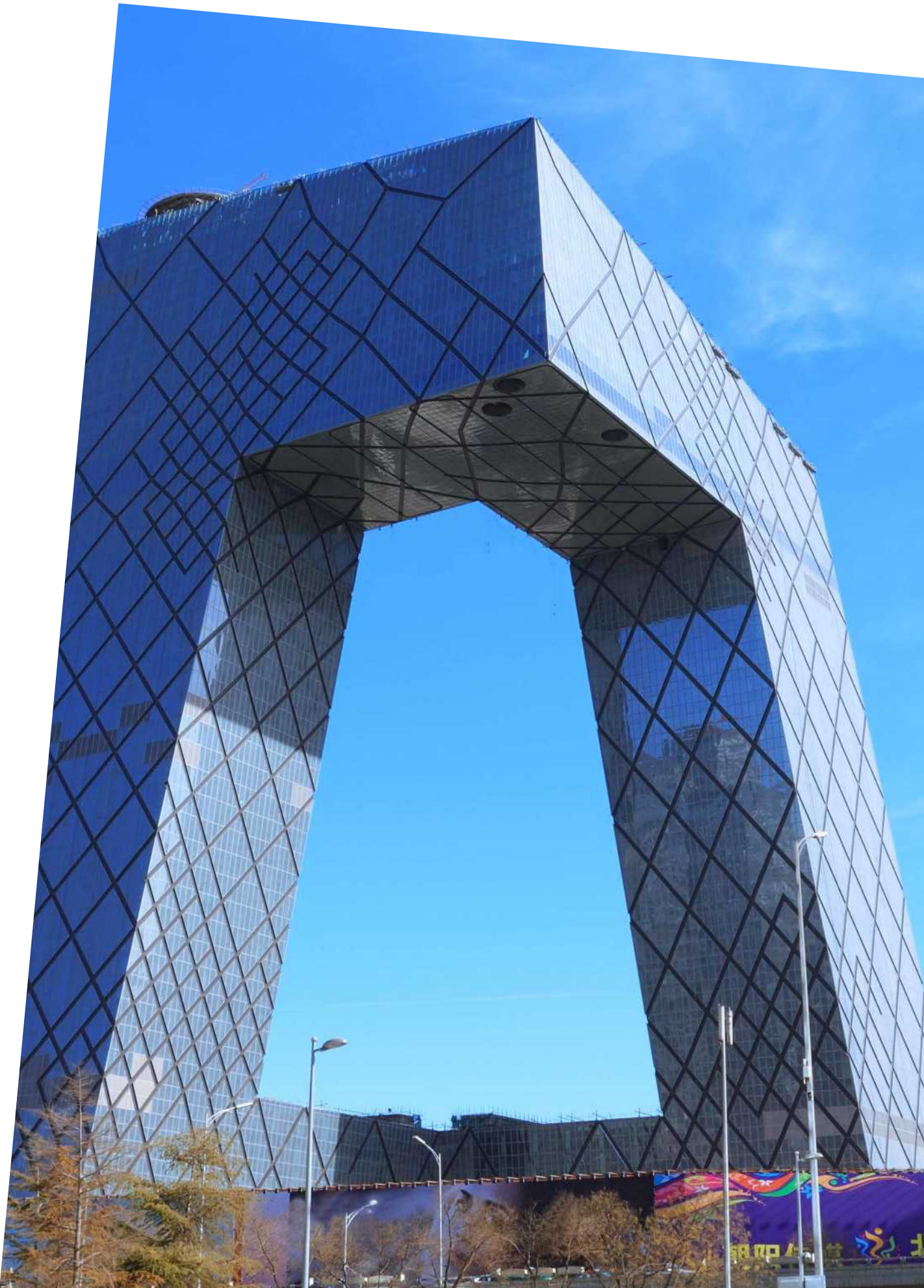
Despite giving data subjects the above-mentioned rights, the Specification specifies certain circumstances under which the data controller may choose not to respond to requests by personal information subjects.

The Specification gives the data controller 30 days to respond to requests from data subjects. Under the GDPR, it is generally one month, but the response can be postponed for up to two months, taking into account the complexity of the request and the large number of requests.

Other key requirements under the Specification

Other key requirements under the Specification which were not in the 2013 Guidelines include:

- One of the critical questions for compliance under the GDPR is whether or not the organization is required to appoint a data protection officer (“DPO”), an individual charged with responsibility for monitoring and advising on GDPR compliance. The Specification has no specific analogue to the DPO requirement, but it is notable that data controllers are required to appoint a head of personal information protection and, in cases of organizations employing more than 200 individuals or processing the personal information of more than 500,000 individuals, this individual is required to be dedicated to this role;
- With respect to data storage, data controllers are recommended to de-identify personal information as soon as it is collected and implement technical measures and controls to keep de-identified data separate from information that may be used to re-identify the individual in question in order to ensure that the individual will not be re-identified during any subsequent processing of the personal information; adopting security measures, such as encryption, in the course of transmitting and storing sensitive personal information. This requirement is not explicitly replicated under the GDPR, although in practice re-identification risk must be managed using these and other techniques in order to avoid unlawful processing of re-identified personal data;
- With respect to the use of personal information, certain internal controls for accessing personal information should be in place, such as access limitation and minimization, internal approval process for important operations, and access records keeping; certain limitations must be put on the use of personal information, such as limiting the use of personal information to the effect that the information is not linked to a specific individual, except to the extent necessary to achieve the purposes of collection and use. For example, direct user profiling may be used to obtain an accurate assessment of an individual’s credit standing, whilst indirect user profiling is preferred when the personal information is being used to send commercial advertising;
- When using an agent to process personal information, the data controller must ensure that (i) the engagement must not go beyond the scope of consent obtained, or go outside the exceptions to requirement for consent; (ii) carry out a personal information security impact assessment on the engagement to ensure the agent has sufficient data protection capabilities in place to provide the required level of protection; (iii) supervise the agent by means such as defining the agent’s duties and obligations in a contract or otherwise, or carrying out an audit; and (iv) maintain accurate records of processing activities carried out by the agent;
- With respect to the handling of security incidents involving personal information, data controllers are required to (i) formulate contingency plan for security incidents involving personal information and update the plans when necessary; (ii) conduct internal training and emergency drills at least once a year; (iii) in the event of a security incident, recording the facts about the incident, including but not limited to: the person who identified the incident; the time and place at which the incident was identified; the personal information and number of individuals involved; the name of the system in which the incident occurred; the impact on other interconnected systems; whether law enforcement or relevant authorities have been contacted, adopt necessary measures to contain the situation and eliminate hidden dangers, and report the incident to the relevant Chinese authorities; and (iv) inform the affected data subjects;
- Appointing a personal information protection officer and personal information protection working group. For certain organizations (core activities involving processing personal data with over 200 staff, or processing personal data involving over 500,000 individuals, or expected to do so within the next 12 months), such officer and working group must be dedicated to work on personal information protection; and
- Implementing a personal information security impact assessment system to carry out personal information security impact assessments as required under the Specification and at least once a year.





How to approach to data protection compliance in China?

It is perhaps no coincidence that the Specification was given effect in May, 2018, the same month that saw the implementation of the GDPR. It is clear that the Specification takes much in the way of inspiration from the GDPR, the instrument recognized as the leading edge of regulatory innovation in data protection globally, and represents a concerted push by China towards more responsible and accountable use of personal information.

The Specification is the most definitive and substantial statement of recommended practice in relation to data protection issued by China to date. The fact that it is not law in the formal sense muddies the waters a little in terms of legal enforceability and consequences for non-compliance. Initial signs are that the Specification is being treated as 'quasi-law' by the CAC, and that the standards laid down in it are being used to hold the feet of certain business operators to the fire, which in a market like China, where players are heavily dependent on government support for maintaining licenses, comes pretty close to having the same practical effect as law enforcement.

It is also important to note that in addition to the Cyber Security Law, laws such as the Consumer Protection Law impose general data protection obligations which can be well served by taking the more granular approach set out in the Specification as the practical working standard for compliance.

For organizations that have already invested in GDPR compliance programs, the themes of compliance with the Specification will be familiar. The Specification represents comprehensive data protection compliance that is best served by a compliance strategy similar to that deployed in relation to the GDPR:

- **Information is critical:** Organizations that have completed GDPR implementation programs will be well-versed in data inventory programs which seek to map out the organization's various holdings of personal data and understand how this data was collected, for what purposes it is being processed and to whom it is being transferred. This first step is critical to any compliance assessment.
- **Compliance in fact:** Once armed with reliable information about the organization's personal information holdings, a compliance assessment can be made and the organization can move towards developing a compliance program that meets the applicable requirements (both in respect of the Specification and applicable industry-specific data protection laws). The policy documentation typically seen in a GDPR implementation program will likely outweigh a corresponding set of policy documents for China, but we see benefit to adopting a common general structure that ensures that the China program effectively interfaces, as appropriate, with the global program.
- **Prioritization, prioritization, prioritization:** As with GDPR compliance programs, there is a risk of being overwhelmed by the volume of factual information and requirements that need to be met. Sensible prioritization is recommended, focusing on areas that are more likely to generate complaints and give rise to the risk of loss of sensitive personal information. Some key actions that will need to be taken include:
 - Reviewing and updating data protection consents and notifications;
 - Developing and implementing an internal policy concerning personal information collection, processing and transfer;
 - Devising internal controls for accessing personal information, such as access limitation and minimization, internal approval processes for important operations, and record-keeping of access;
- **Project management discipline:** Like GDPR compliance, compliance with the Specification requires a multi-disciplinary approach, drawing on information inputs and decision-making by personnel from functional areas such as marketing, information technology, operations management and human resources, in addition to the efforts needed from legal and compliance staff,

- Reviewing current use of personal information to ascertain whether certain limitations should be put on such use;
- Ensuring internal procedures are put in place or updated to cover all the rights data subjects are entitled to, including data erasure and data portability;
- Implementing measures to keep accurate records of the sharing and transferring of personal information;
- Checking to see whether sensitive personal information is being collected and if so, ensure stricter controls are in place, such as applying encryption to the data transfer, adopting mechanisms to obtain explicit consent for collection, use or transfer;
- If third party data processors are used to process personal information, complying with the requirements under the Specification (discussed above), especially by conducting a personal information security impact assessment and making sure a robust contract is in place;
- If automatic decision-making by information system is involved, providing personal information subjects with a way to contest the decision;
- If personal information is being collected from third parties, ensuring each source of personal data is lawful and consent has been obtained for the data sharing/transfer;
- Implementing a personal information security impact assessment system to carry out personal information security impact assessments where required under the Specification;
- Formulating a contingency plan for security incidents that involve personal information and conduct emergency drills at least once a year; and
- Having adequate systems in place to verify data subjects' ages and collect consent from guardians if required.



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Software copyright registration for TMT companies in China

Copyright is one of the most important IP rights available to TMT companies in China. Key assets such as databases, media files (texts, videos and photographs), manuals, specifications, computer applications and software are all protected by copyright. Of these rights, software is often the most essential right to TMT companies, because of its high commercial and practical value. In this note, we will describe what can be done to optimize your software protection in China.

1. Is registering obligatory and why register?

Since China is a signatory of the Berne Convention, copyright ownership arises automatically on the date of creation of a work. It is therefore not mandatory to register software (or any other work) in order to claim copyright ownership over it in China.

However, in practice, given the need for swift enforcement when infringements are discovered, the time-consuming and rigid evidentiary requirements in China (especially for foreign companies) and other commercial and licensing needs, registration is sometimes appropriate -though it does mean disclosure of software code to a limited extent, as discussed below.

Copyright certificates are generally a prerequisite for quick and cost-effective administrative enforcement actions and e-commerce takedown requests, and also serve as strong prima facie evidence of ownership of copyright in civil infringement procedures.

2. Copyright registration or patent protection?

In China, software per se is generally not patentable. However, SIPO has adopted a narrow interpretation of that exclusion (similar to the EPO), granting software patents for inventions that solve technical problems and produce “technical effects” by using technical means. This allows the possibility of overlapping patent and copyright protection in certain cases.

Nevertheless, given the cost, publication requirements and complexities relating to software patent applications, only a small fraction of proprietary software is patent protected. Most software is protected by copyright alone.

Copyright protection and patent protection are different in scope and purpose of protection. For software, the copyright regime entitles the copyright owner to exclude others from duplicating and distributing the same or

substantially similar software without permission for a term of 50 years. Under the patent regime, the patentee is entitled to exclude others from practicing the claimed software-related invention without permission for a term of 20 years. In addition, the innovation requirement for patent protection is higher than the originality requirement for copyright protection.

Copyright registration, which can be obtained any time during the period of protection, plays an important role in deterring and attacking software piracy. For stopping others from using software/computer-implemented inventions, the software owner needs to resort to the protections under the Patent Law, assuming patentability requirements are met.

3. Documents required

The following information must be submitted to the Copyright Protection Center of China (“CPCC”):

- (1) a written application. Specifically, the applicant needs to:
 - first file an online application, disclosing the development details (including: version number, type of work (original or compilation, operating system or application etc.), date of completion, method of development, technical characteristics, etc.);
 - print out, chop and sign the completed application (no notarization or legalization needed); and
 - submit the hard copy application with the other supporting information as listed below;
- (2) the applicant’s identification documents. If the applicant is a foreign company, it must additionally file its Articles of Incorporation which needs to be notarized and legalized;
- (3) a certificate of good standing from the company registrar: needs to be legalized.
- (4) a power of attorney (notarized and legalized, it needs to be the original and signed by the person appointed as legal representative in the certificate of good standing); and
- (5) the first thirty consecutive pages and the last thirty consecutive pages of both the source code and the

operation instructions or manual (with no less than 50 lines per page). However, the owner can also request an “exceptional” (=confidential) filing, which is often advisable. In a confidential filing, the applicant can have either up to 50% of the first thirty consecutive pages and the last thirty consecutive pages redacted, or submit the first 10 pages plus any continuous 50 pages of the source code, or else submit the first and last 30 pages of the object code (e.g. executable code) plus any continuous 20 pages of the source code.

In addition, the applicant can request to have the source code sealed, so that no one except for the applicant and the judicial authorities can open the sealed source code.

All of these certificates and documents must be either in Chinese or provided with a Chinese translation.

4. Application procedure

After submission of the abovementioned documents, the CPCC will conduct a preliminary examination of the formalities within 10 days.

After this stage, an Application Notice is sent to the applicant or his agent, The application will then proceed to the substantive examination stage. This stage generally takes one to two months. Expedited examination can be requested.

After the successful completion of the examination stage, the registration will be published and the applicant receives a Copyright Registration Certificate.

The published information includes only the registration number, the classification number, the name of the software, its version, the name and nationality of the copyright owner, the date when the software was published for the first time and the date of registration. The source code and operational instructions are kept for the CPCC's records only and will not be published.



5. Scope of registration

Copyright protection for computer software is limited to the “program” by itself, which is defined as a coded command sequence executable by a computer, or any other device with information processing capability, in order to achieve a certain result.

A copyright registration for the programme therefore does not cover all elements of computer programs, e.g. artwork displayed while the program is in operation, music or sounds, graphical user interface, etc. These works are protectable as other types of works.

6. Deposit services

It is also possible to deposit a copy of a software program on compact discs with the CPCC, in order to have it sealed and archived for evidentiary purposes.

The process involves submitting CDs in sealed envelopes that go directly into the deposits, while the CPCC issues a corresponding official receipt in return.

The CPCC does not examine or access the contents of the CDs in any way. However, the depositor does not receive a copyright certificate, and the deposit receipt cannot be used as prima facie evidence of copyright ownership. Instead, the official receipt together with the deposited program, retrievable on application by the owner, can merely be used as evidence of the date of deposit (and hence existence) of the software.

Given its nature and limitations, depositing software is often only useful as an extra step to supplement, rather than as an alternative to copyright registrations. However, clients often have concerns re security.

7. Conclusion

Software copyright registration can be an effective step towards the efficient protection and commercialization of TMT software solutions in China. Whether the copyright in software needs to be registered should be assessed on a case-by-case basis, depending on your needs and goals, and should fit in with a global IP strategy for China.



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Huawei v. Samsung - A new benchmark for standard essential patent litigation in China?

China has become a new battlefield in the global patent war amongst tech giants in the telecom industry. On 4 January 2018, the Shenzhen Intermediate People's Court ("**Court**") rendered a landmark judgment in the Huawei v. Samsung standard essential patent ("**SEPs**") case that is expected to reshape dynamics between the SEP licensors and licensees. On 21 March 2018, the Court released the [non-confidential version](#) (Chinese) of its judgment to the public.

The Court ruled in Huawei's favor - finding that Huawei had fulfilled its obligations under the fair, reasonable and non-discriminatory ("**FRAND**") principle, but Samsung had not. Based on that finding, the Court granted an injunction against Samsung, forbidding any future infringement of Huawei's SEPs through the commercialization of Samsung's devices. The Court developed a fault-based approach to evaluate Samsung's and Huawei's actions during the licensing negotiations.

Case background

SEPs are patents which are meant to be indispensable for the proper working of a product implementing a standardized technology. The SEPs involved in the Huawei v. Samsung case concerned patents for telecommunication technologies, in particular what is known as 2G, 3G and 4G mobile communication standards.

Both Huawei and Samsung own extensive patent portfolios including numerous SEPs. This case was mainly about Huawei's SEPs – in particular, to what extent Samsung was allowed to use those SEPs in its communication devices like mobile phones, tablets etc. without having obtained a formal license from Huawei. Huawei brought its court action alleging that Samsung's devices infringed its SEPs, and asked the court to grant an injunction against Samsung. Huawei argued that Samsung, by selling communication devices compliant with the 2G, 3G and 4G standards, had by definition implemented Huawei's SEPs. The Court accepted these arguments without much discussion.

The only aspect where the Court made an in-depth analysis was whether Huawei was entitled to seek an injunction based on its SEPs, as SEPs are subject to a set of specific conditions.

When a patent is incorporated into an industry standard and the patent holder believes it may become essential to the implementation of the standard, it will need to make a pledge to license the patent to all interested parties on FRAND terms.

Both Huawei and Samsung agreed to license their communication SEPs on FRAND terms. The question before the Court was whether in the negotiations to cross-license their patent portfolios, each of the two companies had complied with their FRAND obligations. The Court found that Huawei had, and Samsung had not.

The Court re-phrased the FRAND analysis as an assessment of whether the SEP holder was "at fault" in terms of their procedural actions during the negotiation phase. It examined the extensive records of Huawei and Samsung's licensing negotiations and determined that Samsung deliberately "delayed the negotiations" that began in July 2011 and was "clearly at fault." Then, the Court also looked at the substance of the respective licensing offers - e.g. whether the royalty rates that each party offered were compliant with the FRAND principle.

Procedural aspects

The Court started its legal analysis by examining Samsung's conduct during the lengthy (cross)-licensing negotiations. When analyzing Samsung's compliance with the FRAND principle, the Court found the company "at fault" on several aspects, as Samsung was found to have:

- insisted on offering a portfolio license including both SEPs and non-SEPs (while Huawei insisted on only cross-licensing SEPs and later narrowed down the scope to LTE SEPs);
- failed to timely respond to Huawei's claim charts sent during technical discussion (alleging, in part, that its employees were too busy dealing with lawsuits with other competitors and licensors);
- failed to make a proper licensing offer or counter-offer until very late in the negotiations (and not in satisfactory form);
- rejected Huawei's proposal to submit the dispute on the FRAND royalty to arbitration; and
- continued its delaying tactics even during the Court-ordered mediation phase.

As a next step, the Court then examined Huawei's actions during the negotiation phase. It found that Huawei had not committed a material fault. In the Court's view, Huawei's actions during the negotiations did not violate the FRAND principle, as the company had:

- responded quickly to Samsung's declaration of its intention to negotiate a (cross)-licensing agreement;
- insisted on cross-licensing only SEPs;
- sent a list of its patents and claim charts, as well as an evaluation of Samsung's list of patents;
- made six detailed and diverse cross-licensing offers to Samsung;
- proposed to submit the dispute of the royalty rate to a third-party arbitrator (together with a detailed arbitration proposal);
- upon the Court's request during the mediation phase, quickly tabled a new cross-licensing offer; and

- promptly replied to Samsung's licensing offer.

Still, the Court also found a minor fault in Huawei's behavior during the licensing negotiations: the company was not clear enough about the amount of LTE SEP families, acquired from Sharp, were to be included in the cross-license. Nonetheless, since Huawei was found to have corrected its fault later on, the Court held the issue not to materially affect the overall negotiation process.

Substantive aspects

After the analysis on the procedural aspects, the Court also examined the substance of the parties' respective licensing offers. It examined the royalty rates that each party proposed, and held that the Samsung's offer was "clearly at fault," whereas Huawei's was not.

To reach this conclusion, the Court essentially made a two-step analysis: first, it assessed the relative strength of Huawei's and Samsung's SEP portfolios, and, second, it



compared the licensing offers by the two companies with their respective SEP portfolio strength.

In the first step of the analysis – assessing Huawei’s and Samsung’s 3G and 4G SEP portfolio strengths – the Court basically followed a “top-down” approach, although it did not use this precise term. In essence, the “top-down” approach looks first to the overall level of royalties associated with a standard and then allocates a portion of this total to an individual SEP holder based on the relative strength of its SEPs in that standard.

In its assessment, the Court used the numerous pieces of evidence and testimonies (including by economics experts) put before it and conducted a multi-factor analysis. Among others, the Court looked at:

- the number of the parties’ technology proposals accepted by the standard-setting organizations;
- their relative estimates of confirmed SEPs (compared to unilaterally declared SEPs); and
- eight SEP invalidity decisions (as Huawei and Samsung each challenged the validity of their patents before the Patent Reevaluation Board and courts).

For many of the factors of this analysis, Huawei’s number was higher than Samsung’s. Hence, the Court held that the relative strength of Huawei’s and Samsung’s SEPs was at least similar (on a worldwide basis, with Huawei being stronger in China).

Then, the Court undertook the second step of its analysis, comparing the respective offer to the respective relative strength of the SEP portfolio.

The Court examined Huawei’s and Samsung’s licensing offers in quite some detail and concluded that Huawei’s proposed royalty was, and Samsung’s was not, in compliance with the FRAND principle. This finding was made against the backdrop that the parties were discussing a SEP cross-license agreement and Samsung asked for a royalty three times as high as Huawei. Having concluded before that Huawei’s SEP portfolio was at least as valuable as Samsung’s, the Court decided that Samsung’s demand was not reasonable and therefore not in line with the FRAND requirement.

Conclusion

The Court’s judgment in *Huawei v. Samsung* establishes a new approach for SEP licensing. The Court examined the conduct of both parties, both from a procedural and substantive perspective, to assess whether they behaved on FRAND terms.

The judgment is in line with the outcome in *Xi’an Iwncomm v. Sony*, where the Beijing High People’s Court at second instance affirmed that the licensor (Iwncomm, a Chinese company) had complied with FRAND obligations when negotiating SEP licensing with Sony. At the same time, however, the *Huawei v. Samsung* judgment departs (both in terms of outcome and analysis) from a prior key judgment of the same court – the Shenzhen Intermediate People’s Court – in *Huawei v. InterDigital*. As a couple of SEP cases are pending before Chinese courts at this point in time, it will be interesting to see whether the *Huawei v. Samsung* judgment indicates a shift to a more pro-licensor position more generally.

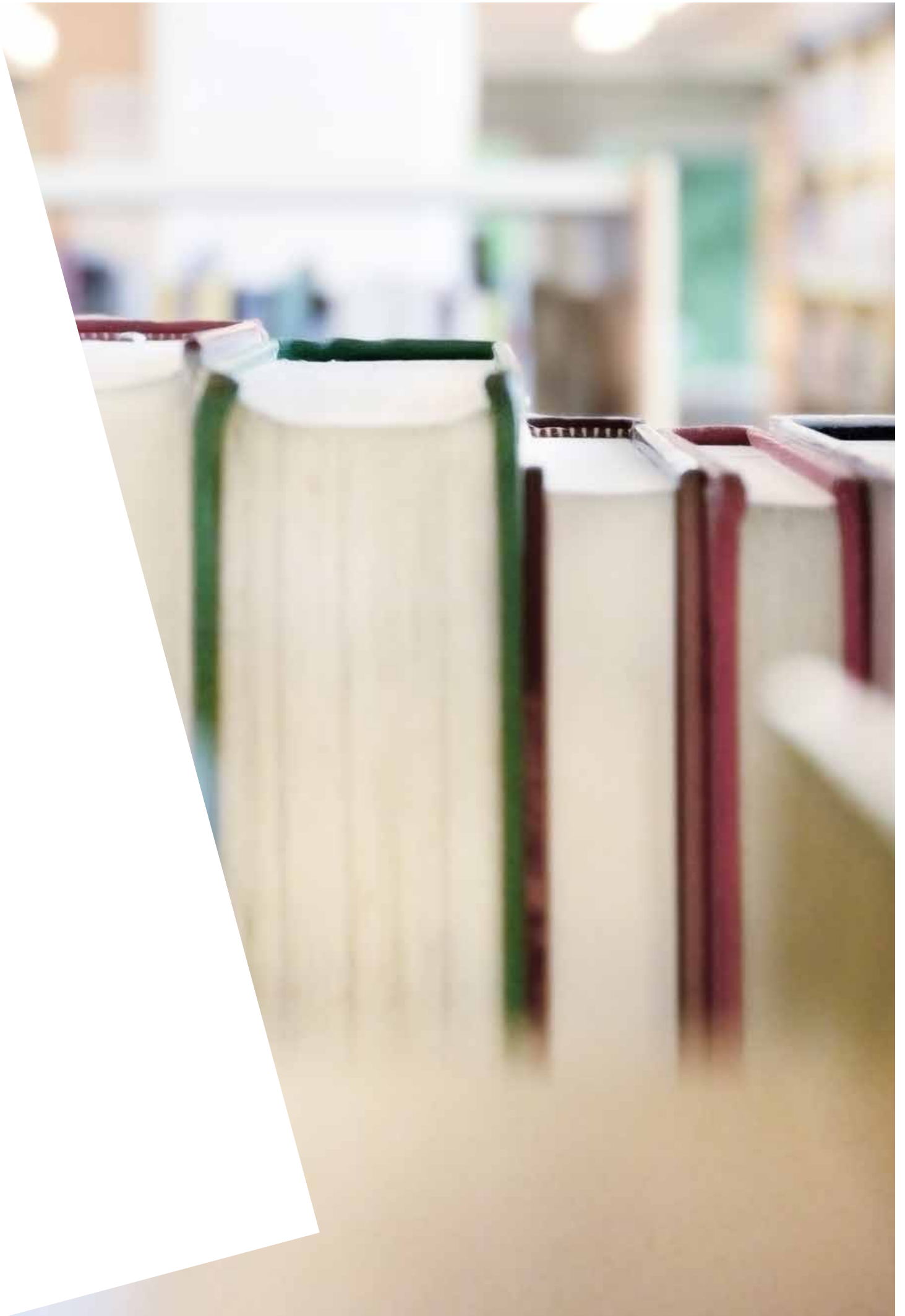
The Shenzhen Intermediate People’s Court’s judgment is clearly not the last word spoken in this case. Indeed, in addition to a potential appeal in China, on 13 April 2018, the District Court of the Northern District of California granted Samsung’s anti-suit injunction application against Huawei. The injunction enjoins Huawei from enforcing the injunction orders issued by the Shenzhen Intermediate People’s Court in China, pending the result of the US litigation, in order to avoid a “hold-up” settlement before the US case is concluded.



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China: Three Cyberspace Courts now online and open for business

Companies active in the TMT sector evidently come across a vast array of internet-related disputes (from e-commerce issues to online IP infringements). A new development in China may help TMT companies with a more flexible and swift dispute resolution. On 9 August and 28 September 2018, the new Cyberspace Courts in Beijing and Guangzhou were officially opened. These new specialized courts, along with their equivalent one that was formed in Hangzhou in August 2017, are meant to tackle the quickly swelling stream of internet-related court procedures in China. The establishment of these specialized courts is an encouraging step for the Chinese internet sector as well as for IP owners: it promises a more flexible procedure, less bureaucracy in obtaining evidence and higher quality judgments, handed down by specialist judges.

Jurisdiction

The establishment of the two new cyberspace courts fits in with the government's policy of encouraging and regulating China's burgeoning e-commerce sector, and comes in the wake of the promulgation of China's [first E-Commerce Law](#), which will soon enter into force.

The rules on the operation of the Cyberspace Courts are enshrined in the Supreme People's Court's Provisions on Several Issues Concerning the Trial of Cases by the Cyberspace Courts, issued on 7 September 2018.

As to territorial jurisdiction, the cyberspace courts have cross-regional jurisdiction over all 'cyberspace cases' (see categories below) that have a "genuine connection" (e.g. location of contract, location of damage etc.) with respectively Beijing, Hangzhou and Guangzhou.

As to material jurisdiction, the cyberspace courts will handle a broad variety of cases mainly including:

- E-commerce disputes (including purchase contract disputes, product liability disputes, service contract disputes)
- Online copyright disputes (including the unlawful dissemination of films, music and other copyrighted works);
- Online defamation disputes;
- Domain name disputes; and
- Online loan contract disputes.

The Higher People's Courts have the power to further broaden these categories for the cyberspace courts within their jurisdiction.

The cyberspace courts act as Basic People's Courts. This means that appeals against judgments from the Cyberspace Courts can be brought before the IP Courts, for IP cases such as copyright infringements, or before the Intermediate People's Courts, for all other cases.

Procedure

The most striking aspects about the Cyberspace Courts are the much more flexible procedural and evidential rules.

The whole procedure, from the case filing until the publication of the judgment, takes place online except in cases where off-line hearing is necessary. Online video-conference hearings are permissible. Procedural steps such as case filing and acceptance, evidence exchange, court hearings, service of judgments etc. can be conducted online through the courts' online litigation platform.

To this end, the Cyberspace Courts will make use of blockchain technology. According to a recent [announcement](#) by the Hangzhou Cybersecurity Court, the judicial blockchain system is composed of three layers. The first layer is the core blockchain software, which allows users to keep record of electronic data, the second layer is a chain that offers reliable services like real-name authentication, electronic signatures, time stamps and data access, while the third layer will be blockchain applications run by a judicial alliance of notaries, judicial examination centers and courts.

Another innovation by the newly established Cyberspace Courts are the relaxed evidential rules. Evidence, the authenticity of which can be proven through reliable technological means, such as electronic signatures, electronic time stamps, blockchain etc. will no longer need to be notarized (and potentially also authenticated by a Chinese consulate for evidence gathered abroad), as would be the case in a normal court proceeding. This would mean a substantial reduction in time and costs spent by parties in cyberspace procedures.

Conclusion

The establishment of the specialized Cyberspace Courts is hailed by the industry as a big step forward, and the Cybersecurity Courts are expected to become popular litigation venues.

As an illustration, on its first day of operations, the Beijing Cyberspace Court already received over 200 new cases. The first case it officially accepted is a high-profile copyright infringement case, filed by a video-sharing company against a large content provider, claiming damages of over CNY 1 m (app. USD 150,000).

It is particularly hoped that the Cyberspace Courts may bring the same professionalism to internet-related litigation as the [specialized IP Courts](#) did with IP litigation in China. The new courts are also welcomed for their simplified procedures and reduction of red tape in the face of the ever-increasing caseload of internet-related cases in China.



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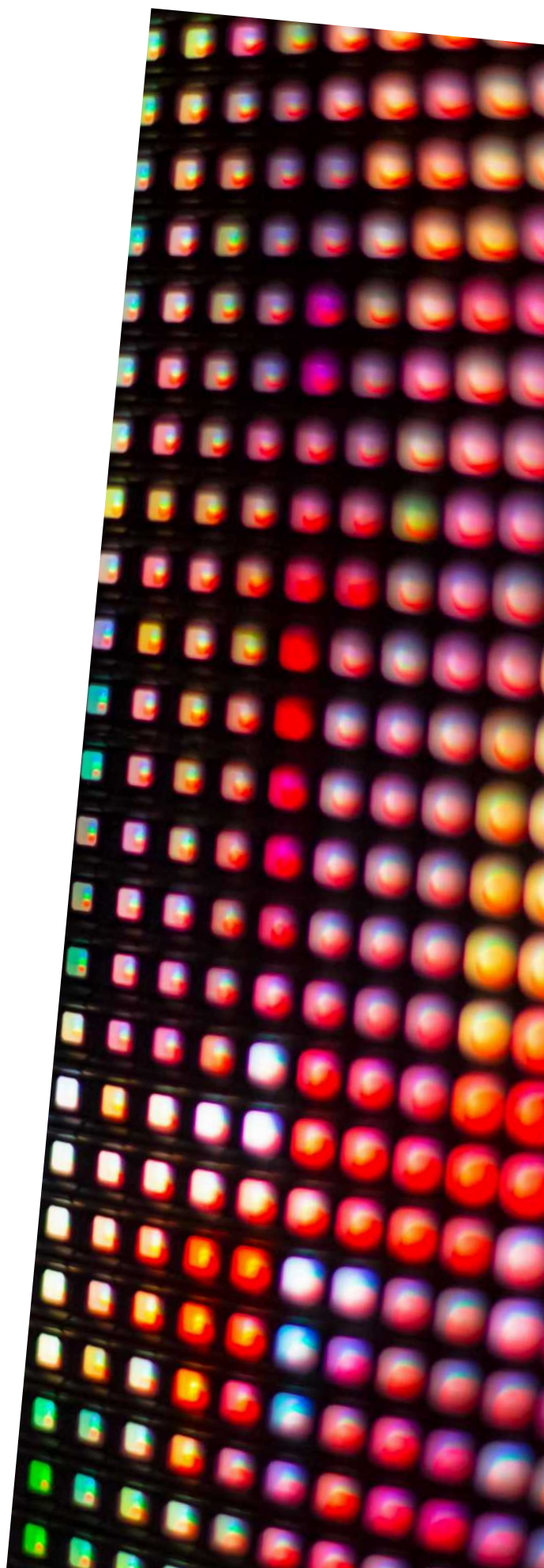
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