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Han Kun Newsletter

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Legal Updates

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1. Commentary on Supreme Court's Guiding Opinions on Similar Cases

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On July 27, 2020, the Supreme People's Court published the *Guiding Opinions on Unifying the Application of Law and Strengthening the Research of Similar Cases (for Trial Implementation) ("**Guiding Opinions**")*. The *Guiding Opinions* signal a significant move made at the national level to ensure the consistency of judicial practice in China. Notably, the *Guiding Opinions* provide a clear definition, scope, and hierarchy for similar cases, which serve as essential guidance for China's judiciary. Among the similar cases the *Guiding Opinions* define, *de facto* binding effect is given only to guiding cases published by the Supreme People's Court, while other similar cases serve only as references for adjudication (Article 9). Aside from this, the *Guiding Opinions* also specify when and how the research of similar cases should be conducted (Articles 2-3, and 5-11), and request lower courts to take measures to enhance case research work (Articles 12-13). The *Guiding Opinions* will become effective on July 31, 2020 (Article 14).

Among the high courts, the Beijing High People's Court and the Jiangsu High People's Court have also published guidelines on the research and use of similar cases. On December 2, 2019, the Beijing High People's Court published the *Guiding Opinions on Standardizing the Exercise of Discretion in Civil Disputes to Ensure the Unified Application of Law (Trial) ("**Beijing High Court Opinions**")*. The Jiangsu High People's Court published on July 14, 2020 the *Stipulations on Establishing Mandatory Similar Case Search Report Mechanism (Trial) ("**Jiangsu High Court Stipulations**")*. While the *Beijing High Court Opinions* provide detailed mechanisms enabling the use of similar cases, the *Guiding Opinions* and the *Jiangsu High Court Stipulations* provide more general and high-level guidance.

Definition, scope and hierarchy of similar cases (Articles 1, 4, and 9)

The *Guiding Opinions* explicitly limit the scope of similar cases to those decisions which have become effective. It is also provided that similar cases should have similarities with the pending case in terms of basic facts, issues in dispute, application of laws, etc. (Article 1).

As to the scope of similar cases, Article 4 of the *Guiding Opinions* specifies that the scope of similar cases generally includes: (1) guiding cases published by the Supreme People's Court; (2) typical cases published the Supreme People's Court and cases in which the Supreme People's Court has rendered an effective judgment; (3) reference cases published by the high people's court of the province and cases in which the high court has rendered an effective judgment; and (4) cases in which an effective judgment has been rendered by the court reviewing the pending case or its immediately superior court. That is, similar cases cover all "exemplary cases" which the Supreme People's Court and all high courts have published and effective decisions rendered by the Supreme People's Court and all high courts.[1] Meanwhile, Article 4 also provides that "[e]xcept for guiding cases, priority for research shall be given to decisions and cases occurring within the past three years; where similar cases are found among those in the preceding order,

[1] Note: we use the term "exemplary cases" to refer to three types of cases, including the guiding cases and typical cases published by Supreme Court, and reference cases published by high courts.

no further research is required." That is, except for guiding cases, relative priority is given to those similar cases decided within the past three years and in the order described in Article 4.

Article 9 also provides that, among the similar cases, binding effect is given only to guiding cases which are not in conflict with the most recent laws, administrative regulations, and judicial interpretations (Article 9). Other similar cases only serve as reference for adjudication (Article 9).

When and how to conduct similar case research (Articles 2-3, and 5-11)

The *Guiding Opinions* limit mandatory similar case research to the following four situations: "(1) the case is to be submitted to the assembly of professional (presiding) judges or the judicial committee for discussion, (2) there are no clear adjudicating rules or unified adjudicating rules have not yet been formulated, (3) the president of a court or the chief judge of a tribunal requests similar case research in accordance with his authority on adjudication supervision and administration, and (4) other cases for which similar case research is necessary" (Article 2). This language is to ensure that, on one hand, similar case research is conducted in significant and controversial cases and, on the other hand, courts are allowed to forgo similar case research in certain routine cases, which may ensure more flexible use of similar case research.

Meanwhile, the *Beijing High Court Opinions* request that similar case research be conducted in all ordinary civil cases. It thus appears that the Supreme People's Court intends to give the lowers courts and local courts more discretion in determining the extent to which similar case research is required.

It is also stipulated that the presiding judge should be responsible for the authenticity and accuracy of similar case research, and designated databases include **China Judgements Online** and **Database of Chinese Trial Cases** (Article 3). The approaches that may be used include keyword search, related rules search, related cases search, etc. (Article 5). The presiding judge is required to compare the cases searched with the case he is handling to decide whether there exist any similar cases (Article 6). For those cases in which similar case research is mandatory, certain forms of a report are required, which can either be an explanation or a special report and should be archived as part of the case file (Article 7). It is also requested that, during the research process, the report specify items including the researcher, timing, platforms used, approach, result, holdings of the similar cases, issues of the pending case, etc. (Article 8). For criminal cases, the court should specify in its decision whether a guiding case presented by a party can be used and for other types of similar cases, the court may specify this through an explanation (Article 10). The *Guiding Opinions* also clarify which mechanism should be implemented if the similar cases differ on the application of law (Article 11).

Measures to enhance similar case research (Articles 12-13)

Lower courts are encouraged to take measures to enhance similar case research, including to provide trainings, enhance R&D, and establish databases (Article 12). Lower courts are also required to periodically summarize their work related to similar case research, which should be published within the court systems and filed to a higher court for recording (Article 13).

In conclusion, we foresee similar cases playing an important role in future judicial practice in China—a concept similar to, yet distinct from, *stare decisis* under the common law.

2. First Unconditional Approval Granted to Merger Filing Involving VIE Structure-related Concentration of Undertakings

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On July 16, 2020, the Anti-Monopoly Bureau of the State Administration for Market Regulation ("**SAMR**") granted **unconditional approval** for the concentration of undertakings arising from a joint venture established between Shanghai Mingcha Zhegang Management Consulting Co., Ltd. and Huansheng Information Technology (Shanghai) Co., Ltd. (the "**Mingcha Zhegang case**"). The approval decision was published on SAMR's website on July 22. SAMR, in granting unconditional approval, is seen as having indicated its position that concentrations of undertakings which involve variable interest entity ("**VIE**") structures can also be reviewed and cleared. In the future, merger filings involving VIE structures may become a "new normal"; so far, however, leading Internet companies in China, which typically have VIE structures, have not been seen making merger filings.

Han Kun has received many inquiries from enterprises since the Mingcha Zhegang case was accepted for merger review on April 20, 2020. Below, we will share our observations in response to five common questions.

What makes transactions involving VIE structures so special? Why was widespread interest aroused when the case was accepted for merger review and approval granted?

As is widely known, VIE structures represent a legal gray area under Chinese foreign investment law. Before the institutional reform in 2018, rumors circulated that the Ministry of Commerce, then the competent review and approval authority for merger filings, was unwilling to approve transactions involving VIE structures, thus indirectly recognizing the legitimacy of VIE structures. The rumors seemed to be verified by several cases, for example: Sina's proposed acquisition of Focus Media[2] was aborted because it failed to pass antitrust review; and Wal-Mart's acquisition of Yihaodian[3] was granted conditional approval which prohibited Wal-Mart from engaging in value-added telecommunications services through a VIE structure operated by Yihaodian.

Following the 2018 institutional reform, it is generally believed that SAMR is relatively more motivated and capable of resolving issues related to antitrust reviews of VIE structure-related transactions. In the Mingcha Zhegang case, SAMR clearly disclosed in a simple case publicity form that the transaction involved a VIE structure, signaling to the public that enterprises may file VIE structure-related transactions with SAMR.

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[2] According to reports, in 2009, Sina finally abandoned the plan to acquire Focus Media because it failed to obtain approval from the Ministry of Commerce for the transaction. Insiders speculated that the reason the Ministry of Commerce delayed acceptance of the declaration of concentration of undertakings was because the transaction involved VIE-structured parties. See: http://companies.caixin.com/2009-06-10/100052619.html; http://tech.163.com/09/0929/16/5KD1LO69000915BF.html.

[3] In 2012, the Ministry of Commerce conditionally approved Wal-Mart's acquisition of 33.6% equity in Niuhai Holdings (i.e. Wal-Mart's acquisition of Yihaodian). According to the Ministry of Commerce's decision for this case, Walmart would obtain control over online direct sales (without involving a VIE structure) to Yihaodian after the transaction was completed, but would be prohibited from engaging in value-added telecommunications services operated by Yishiduo through the VIE structure.

What does the approval of the Mingcha Zhegang case imply? What factors need to be considered going forward when evaluating whether to make a merger filing for a VIE structure-related transaction?

The approval of the Mingcha Zhegang case increases certainty when making a merger filing for VIE structure-related concentrations of undertakings.

It was popularly believed that transactions involving VIE structures would be subject to a high degree of uncertainty if submitted for antitrust review. Thus, in practice, parties to a VIE structure-related concentration of undertakings transaction would adopt various methods to circumvent antitrust review by preventing the transaction from constituting a notifiable transaction, such as by making a concession in control rights to avoid the transfer of control or by other methods. However, regardless of the method, this approach could increase transaction costs or cause the transaction parties not to fully realize their original transaction objectives.

SAMR, in granting approval for the Mingcha Zhegang case, will undoubtedly bring major benefits to prospective parties to VIE structure-related transactions, because the parties can consider retaining transaction structures which permit the transfer of control and obtain antitrust clearance. Despite the convenience the Mingcha Zhegang case may bring, transaction parties should still keep in mind that the filing process, once initiated, could require considerable time and effort and could also delay the transaction, depending on the circumstances. Thus, transaction parties should account for the time required for the merger filing and review process when designing their transaction timelines.

After the Mingcha Zhegang case, will SAMR only focus on competition aspects of a concentration of undertakings and not other compliance aspects? How should such uncertainties be resolved?

In our understanding, SAMR will focus on competition aspects when reviewing concentrations of undertakings, but this does not mean that SAMR will forgo reviewing other compliance aspects of the transaction. According to the *Notification Form for Anti-trust Review of Concentration of Undertakings*, the filer must still explain "the compliance information of the transaction and of the parties to the concentration in China." Specifically, "the compliance information of the transaction" means "information regarding whether the transaction complies with PRC laws, regulations, rules, and relevant regulations and policies," and "compliance information of the parties to the concentration in China" means "information regarding whether the parties to the concentration and their affiliates have any pending issues or compliance issues related to entity establishment, operation management, foreign investment approval and industry admittance supervision in China."

It can thus be seen that filers need to make truthful disclosures to SAMR, regardless of whether the proposed transaction itself or an undertaking to the concentration involves a VIE structure. Among the two, SAMR will more likely challenge a proposed transaction which itself involves a VIE structure as opposed to transactions such as the Mingcha Zhegang case, which involved a VIE-structured undertaking. This is because a VIE-structured transaction could be used to bypass foreign investment restrictions. Note that this conclusion is merely theoretical in nature and remains to be confirmed in practice.

Regarding the uncertainty of compliance issues arising from a transaction itself, when designing a transaction involving a VIE structure, the following factors can be comprehensively considered in determining the final transaction structure and filing with SAMR where the circumstances constitute a notifiable transaction:

1. whether a transfer of control is necessary to realize the purpose of the transaction;
2. whether the transaction meets the merger filing thresholds;
3. the transaction schedule;
4. the competition implications of the transaction;
5. the impact of potential penalties on the validity of the transaction and the reputation and economic interests of the transaction parties, such as fines and revoking of the transaction;
6. the willingness of other transaction parties, etc.

If a transaction encounters insurmountable obstacles during the antitrust review, the filers may consider withdrawing the filing and altering the transaction structure to an extent that no longer requires a filing (for example, the relevant party abandons control), so as to complete the transaction as originally planned.

The Mingcha Zhegang case, a simple procedure filing, took 88 days to complete, why did it take so much longer than the average for simple procedure filings?

The Mingcha Zhegang case took 88 days from case acceptance until SAMR granted unconditional approval, which is far longer than the average review time for simple procedure filings of about 15 days. Does this mean that the review of concentrations of undertakings that involve VIE structures will not be treated normally?

It is understood that the delay in the case review process was mainly due to competition issues, rather than VIE issues. According to the case publicity form, two relevant markets were defined in the case, the "Chinese catering industry information technology application product and service market" and "Chinese catering service market." However, it seems that both these relevant markets could be further segmented, considering the fairly ambiguous boundaries of the "Chinese catering industry information technology application product and service market" and the scope of the "Chinese catering services market" exceeds that defined in case precedents[4]. Furthermore, a third party may have raised objections during the publicity period, which would have caused the simple case to enter a second phase of review.

What future changes will Mingcha Zhegang case bring to the transactions market?

After the Mingcha Zhegang case was placed on file and publicized, we observed that companies have closely watched the development of the case. Besides traditional merger and acquisition transactions,

[4] For example, in the case of "Yum China Holdings Co., Ltd.'s acquisition of equity in three companies including Huang Jihuang Group (Hong Kong) Co., Ltd." publicized in 2019, the relevant market was defined as "hot pot catering services," a segment further divided from "catering services."

investors participating in the financing of emerging companies, which rarely involved filings in the past, are also raising requests for antitrust transaction terms. Another reason for companies to attach greater importance to antitrust filings is due to a proposed increase in penalties for failure to file notifiable transactions, which are raised to 10% of an undertaking's prior year revenue in a draft amendment to the Anti-Monopoly Law.

Although no new concentrations involving VIE structures have been filed for merger review within the last 88 days after the filing of the Mingcha Zhegang case, we expect that there will be increased and increasingly diverse filings involving VIE structures, to the extent that VIE structure-related filings may even in the near future become a "new normal." However, it remains unclear and to be further observed how SAMR will handle cases where transaction parties fail to file notifiable transactions due to VIE issues, especially those which have been reported and are under investigation.

As mentioned above, we expect the SAMR's unconditional approval of the Mingcha Zhegang case to soon bring significant and positive changes to the transactions market, considering the Anti-Monopoly Bureau has achieved remarkable results in accelerating the review of concentrations of undertakings in recent years and because normal review and clearance of VIE structure-related filings will assist enterprises in reducing transaction costs and better realizing their transaction objectives.

3. CSRC to Overhaul Mutual Fund Manager Rules

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On July 31, 2020, the China Securities Regulatory Commission ("**CSRC**") issued consultation drafts of the *Administrative Measures for Publicly-Offered Securities Investment Fund Managers* (*《公开募集证券投资基金管理人监督管理办法(征求意见稿)》*) and the *Provisions on Issues Concerning the Implementation of the Administrative Measures for Publicly-Offered Securities Investment Fund Managers* (*《关于实施<公开募集证券投资基金管理人监督管理办法>有关问题的规定(征求意见稿)》*)[5] (collectively the "**Draft Rules**"). The Draft Rules are revised versions of earlier consultation drafts issued by CSRC on May 17, 2013[6].

The Draft Rules are intended to apply to both fund management companies ("**FMCs**") and other asset management institutions that are allowed to obtain mutual fund licenses, including wealth management subsidiaries of commercial banks ("**WMSs**"), securities firms' asset management subsidiaries, insurance asset management companies and private securities investment fund managers ("**PFMs**") registered with the Asset Management Association of China ("**AMAC**"), all of which are collectively referred to as "**Mutual Fund Managers**".

This article is focused on the key aspects that may affect the business strategies of foreign asset management firms to set up, make equity investments in, mutual fund management platforms (such as FMCs, WMSs and securities firms) in China, or to apply for mutual fund licenses in the future via existing PFM WFOEs.

Requirements for FMC shareholders

The Draft Rules propose to classify shareholders of FMCs into three types: (i) shareholder with no more than 5% stake, (ii) non-major shareholder with more than 5% stake, and (iii) major shareholder with more than 5% stake, each of which is subject to different regulatory/qualification requirements. For example, the Draft Rules add negative requirements for any shareholder with no more than 5% stake and increase the net capital requirement for any non-major shareholder holding more than 5% stake. It is also worth noting that the definition of "major shareholder" ("主要股东") of an FMC is "the largest shareholder with more than 5% stake" under the Draft Rules, rather than "the largest shareholder with no less than 25% stake" under the current FMC rules.

The Draft Rules also provide further specific requirements for foreign shareholders of an FMC. For example, foreign shareholders are required to comply with relevant regulatory indicators in their local jurisdictions in the past three years, hold leading positions in the past three years in international markets in respect of assets under management, income, profits and market share, and maintain high credit statuses for the past three years.

[5] Please see the details at: http://www.csrc.gov.cn/pub/zjhpublic/zjh/202007/t20200731_380932.htm.

[6] Please see the details at: http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201305/t20130517_228404.htm.

Further, under the Draft Rules, subject to limited exceptions, the lock-up period is 48 months for major shareholders of FMCs (i.e. the largest shareholder with more than 5% stake) and the lock-up period is 36 months for non-major shareholders of FMCs with more than 5% stake. By contrast, the current FMC rules only require major shareholders of FMCs (i.e. the largest shareholder with no less than 25% stake) to hold their shares for three years.

The Draft Rules also require FMC shareholders to report to CSRC on an ad hoc basis under certain situations (including changes to its financial status), which indicates regulators' intention to strengthen the oversight of FMC shareholders.

PFM as Mutual Fund Manager

Based on the Draft Rules, a PFM is allowed to apply for a mutual fund license if it satisfies the applicable requirements provided in the Draft Rules. The Draft Rules also provide some general principles on how to handle existing private fund management business for a PFM which has obtained a mutual fund license. In addition, the Draft Rules clearly provide that a PFM with a mutual fund license (among other types of Mutual Fund Managers) may convert to an FMC upon CSRC approval, which is expected to provide more clarity on the means of conversion.

WMS as Mutual Fund Manager

The Draft Rules also allow any qualified WMS to apply for a mutual fund license, which is a novel initiative. Based on the current WMS rules, WMSs may issue public wealth management products that are regulated by the China Banking and Insurance Regulatory Commission ("**CBIRC**"). If a WMS also obtains a mutual fund license from CSRC, its asset management business would be regulated by both CSRC and CBIRC, whose regulatory regimes are expected to be further clarified.

Following the *11 Measures on Further Opening-up the Financial Industry (《关于进一步扩大金融业对外开放的有关举措》)* issued by Office of the Financial Stability and Development Committee on July 20, 2019[7], foreign asset management firms may set up foreign-controlled joint venture WMSs with a level-1 WMS of a commercial bank. In the meantime, foreign asset managers are also allowed to establish wholly-owned FMCs since April 1, 2020. Considering WMSs can also apply for mutual fund licenses and the trend of more overlapped business scope between FMCs and WMSs, foreign asset managers may want to further consider how to optimize their presence in China.

Rule of "One control, One participation, One license（一参一控一牌）"

The Draft Rules specifically allow a single shareholder to concurrently control an FMC and another type of Mutual Fund Manager (such as a WMS with a mutual fund license) while participating in another FMC, or the shareholder is allowed to have one controlling stake in a non-FMC Mutual Fund Manager and hold participating (minority) stakes in two FMCs. Foreign asset managers may further plan their onshore equity investments accordingly, to make the best of the relevant platforms and resources.

[7] Please see the details at: http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3863019/index.html.

Impact on FMC establishment application

Once the Draft Rules become formal rules, they will generally apply to all the outstanding FMC applications already submitted to CSRC before the effective date unless the applications were submitted before July 2016 but yet to be approved. As a result, for the WFOE FMC applications, CSRC may require the relevant applicants to submit supplemental documents to comply with the Draft Rules. Foreign asset managers considering to set up WFOE FMCs are also advised to take into account all the new requirements applicable to FMCs and their shareholders earlier than later at the preparation stage.

FMC subsidiaries

Based on the current FMC rules, an FMC may set up specialized subsidiaries to provide services to the FMC, such as private fund management business, fund distribution, private equity fund management business and IT services. Notably, according to the Draft Rules, FMC subsidiaries can engage in business broader in scope than under the current FMC rules, including mutual fund management, private asset management, investment advisory services, pension financial services, and fund distributions, etc.

The Draft Rules also provide specific requirements on setting up FMC subsidiaries (including financial requirements such as net capital, AUM and risk reserve funds), how to manage FMC subsidiaries and how to deal with the FMC subsidiaries during exit procedures.

FMC personnel requirements

Compared to the current FMC rules, the Draft Rules impose stricter requirements on FMC personnel. For example, the Draft Rules provide that (i) where the total stake of a single shareholder and its affiliates exceeds 50% or the major shareholder is a natural person, the number of independent directors can be no fewer than 1/2 of the total directors on the board; while the current FMC rules generally require FMCs to have no fewer than three independent directors and the number of independent directors can be no fewer than 1/3 of the total directors; (ii) FMC applicants are required to have at least 30 employees while the current FMC rules only require 15; (iii) where an FMC sets up a board of supervisors, the number of the employee representative supervisors can be no fewer than 1/2 of the total number of the board of supervisors, which is stricter than the current requirements under the PRC Company Law (i.e. 1/3).

Data transfer

Consistent with the current FMC rules, the Draft Rules require FMCs to segregate business and key client information from their shareholders. The Draft Rules further prohibit any individual or entity from transferring offshore any documents and materials related to securities business without approval from CSRC and other competent regulators. This is one of the aspects which will require special attention for foreign asset managers proposing to set up WFOE FMCs.

While there is no timetable for issuance of the final rules, the revision of the current FMC rules is included in CSRC's legislation plan for 2020[8]. Therefore, it is highly likely that the Draft Rules will be finalized and

[8] Please see details at: http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202004/t20200417_373996.html.

promulgated within this year. Once the Draft Rules become effective, they will replace the existing FMC rules, namely the *Measures for the Administration of Securities Investment Fund Management Companies* *（《证券投资基金管理公司管理办法》）*, the *Provisions on Issues Concerning the Implementation of Measures for the Administration of Securities Investment Fund Management Companies* *（《关于实施<证券投资基金管理公司管理办法>有关问题的规定》）* and the *Interim Provisions on Public Securities Investment Fund Management Business Engaged by Asset Management Institutions* *（《资产管理机构开展公募证券投资基金管理业务暂行规定》）*.

We will continue to monitor the development of the Draft Rules and work with industry players to make submissions in the consultation period.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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