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Newsletter

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Breakthroughs of Rules in Practice on IPO of Foreign-invested Enterprises at A-share Market (Authors: Loretta LI, Adrian LV, Min LUO)

Since the entry into the WTO, China has gradually loosened up its regulation on IPO of foreign-invested enterprises ("**FIE**") at A-share market. Following the principle of upholding the spirit of the WTO, the formulation of policies strives to realize national treatment of FIEs and further speeds up the opening-up of domestic capital market.

In light of the legal framework of the regulation on FIEs' A-share IPO, *Provisional Regulations on the Establishment of Foreign-invested Companies Limited by Shares* implemented in January, 1995, which for the first time established some rules for the reformation of FIEs from limited companies to companies limited by shares and laid a good foundation for FIEs' going public in following days; *Circular On Relevant Issues of Foreign-invested Companies Limited by Shares* promulgated in 2001 by the General Office of Ministry of Foreign Trade and Economic Cooperation as well as *Some Opinions on Issues Related to Foreign Investment in Listed Companies* jointly issued by China Securities Regulatory Commission and Ministry of Foreign Trade and Economic Cooperation both set up concrete rules regarding FIEs' listing at domestic and offshore security markets, and the latter to a certain extent revised some rules of the former (e.g. the latter no longer requires FIEs to obtain a written consent from Ministry of Foreign Trade and Economic Cooperation for their IPOs.). These rules established the current legal framework for FIEs' listing in domestic security markets with special requirements for FIEs' IPO at A-share market.

Since 2001, a number of other relevant laws and regulations at a national level have been promulgated to serve as supplement and renovation to the above-mentioned legal framework, for example, *Special Provisions on the Content and Format of the Prospectus of Foreign-invested Companies Limited by Shares* issued in 2002, and *Circular Regarding the Relevant Issues on the Administration of Foreign Investment as Involved in the Share Trading Reform of Listed Companies* and *Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors* both issued in 2005.

The last decade has witnessed rapid development of China's capital market. Many of the rules regarding the IPO of FIEs introduced earlier may no longer be suitable with the current capital market and therefore were no longer strictly followed in practice, although not abolished in law. This commentary, from the perspective of case analysis, aims to briefly introduce the implementation of the foregoing rules as well as breakthroughs thereof in practice.

Records for joint annual examination

Item 1 of Paragraph 2 of Article 2 of *Some Opinions on Issues Related to Foreign Investment in Listed Companies* (2001) requires that FIEs shall have passed the joint annual examination for the three years prior to the application for listing.

In many FIEs' legal opinions for listing or prospectus, there are affirmative opinions concerning the company's compliance with the three years' joint annual examination requirement, but cases breaking through this restriction do exist:

Camel Group (**601311, listed on June 2, 2011 in Shanghai Stock Exchange**): it introduced in foreign investment and was reformed into a foreign-invested company limited by shares in January 2010, before which it was a pure domestic enterprise. One year later, it went listed. Since joint annual examination is particularly catered to FIEs, and Camel Group had not even existed as an FIE for three years before being listed, it simply cannot satisfy the requirement of passing three years' joint annual examination. However, it still got listed successfully. None of its prospectus, instrument for sponsorship, legal opinion, or lawyers' working report mentioned this issue;

KMT (002549, listed on January 24, 2011 in Shenzhen Stock Exchange): it was reformed from a sino-foreign joint venture into a foreign-invested company limited by shares in January of 2007. Its lawyers working report only stated that it passed the joint annual examination in 2007 and 2008, without demonstrating whether it has passed three years' joint annual examination.

We consulted some officials of Shenzhen Securities Regulatory Bureau in respect of this issue, and they orally responded that, if the company was entirely reformed into a company limited by shares, then three years' joint annual examination can be calculated consecutively. When being asked about their attitudes on how to treat FIEs which did not exist as FIEs for three years but planned for listing, i.e. whether the ordinary commercial and industrial annual examination before foreign investment is introduced to such FIEs can be reckoned in when calculating the years for which such FIEs have passed the joint annual examination, the officials did not give us a clear response. However, they mentioned that, at present, the requirement for three years' joint annual examination is not strictly applied, and that, considering the disparity of circumstances of different companies, securities regulatory bodies in different places and sponsoring institutions tend to adopt a flexible method on this issue. We further asked several employees working in sponsoring institutions for their comments thereon, and they all expressed that the requirement of three years' joint annual examination is usually subject to the principle of "Substance over Form". In other words, the legislative intent of three years' joint annual examination is to require that pre-IPO FIEs shall be operated lawfully and smoothly for a sufficiently long period of time so as to ensure the maturity of the company. Therefore, it is not to rigidly require companies to exist and be operated in form of FIEs or foreign-invested companies limited by shares for more than three years before their IPOs. This is probably the reason why situation of FIEs such as Camel Group and KMT can be accepted.

Market access

Item 2 of Paragraph 2 of Article 2 of *Some Opinions on Issues Related to Foreign Investment in Listed Companies* (2001) provides that the business scope of FIEs shall comply with the requirements of the *Interim Provisions Guiding Foreign Investment Direction*[1] and the *Industry Catalogue for Guiding Foreign Investment.*

For market access of foreign capital, the NDRC (National Development and Reform Committee) and Ministry of Commerce will occasionally revise the *Industry Catalogue for Guiding Foreign Investment (the "Catalogue")*, and the two departments have also formulated the *Catalogue of Priority Industries for Foreign Investment in Central and Western China* (2008 Revision) to encourage foreign investment in Western China. Meanwhile, to provide convenience for foreign investment, the Department of Foreign Investment Administration of Ministry of Commerce issued the *Manual of Guidance on Administration for Foreign Investment Access* (2008 Edition) to guide foreign investment. In addition, Ministry of Commerce has also promulgated several special provisions concerning different fields of industry, for example, real estate, commercial business, advertisement, printing, newspapers, magazines distribution, etc. The market access requirement is a prerequisite for the establishment of FIEs, and it is an important inspection content of the pre-IPO examination of foreign-invested company limited by shares.

In practice, however, breakthrough cases still exist in companies listed or planned to be listed, for example:

Xiamen Tungsten (**600549, listed on December 7, 2002 in Shanghai Stock Exchange**): exploitation and smelting of tungsten is included in Xiamen Tungsten's business scope. The main purpose of Xiamen Tungsten's listing is to raise capital to exploit tungsten. When Xiamen Tungsten got listed in 2002, the "Catalogue" then in force regarding the exploitation of tungsten only is a restrictive item for foreign investors, but the 2007 and 2011 Catalogue both specified it as a forbidden one. As far as we know at this moment, Xiamen Tungsten is still engaged in tungsten exploitation despite of that.

Law is silent on how to address the situation where the business which an FIE has already been engaged in becomes a forbidden field for foreign investment due to update of the Catalogue (e.g. Xiamen Tungsten Case). However, relevant official from the NDRC has provided some explanations on the 2011 Catalogue during a press conference ("NDRC Explanation")[2] as follows: foreign investment projects approved after the implementation of the new Catalogue shall be carried out according to the new Catalogue; foreign investment projects approved before the implementation of the new Catalogue shall be implemented in accordance with the 2007 Catalogue.

[1] *Interim Provisions Guiding Foreign Investment Direction* was abolished in 2002 by the *Provisions Guiding Foreign Investment Direction*.

[2] Take the advantage of foreign capital structure, promote the change of economic development direction—relevant responsible official of the NDRC's answering to questions from journalists regarding the Industry Catalogue for Guiding Foreign Investment (2011 revision): http://www.sdpc.gov.cn/xwfb/t20111231_454087.htm

Regarding any newly added restrictive (including forbidden) projects in the new Catalogue, if the relevant FIEs has already existed and started operation before January 30, the projects shall comply with the policy of the time when they were approved; however, if the companies intend to raise capital, transfer their equity interests or go public overseas, the new Catalogue shall apply.

If interpreted according to NDRC Explanation only, Xiamen Tungsten did not violate the industrial policies on foreign investment. We have noticed that after Xiamen Tungsten was listed in 2002, it has never made any move regarding raising capital, transfer of equity interests or overseas listing. Although it is hard to prove that it has anything to do with the principle of applying the Catalogue indicated in the NDRC Explanation, observing from the time gap, at least we cannot rule out the possibility that the principle of applying the Catalogue indicated in the NDRC Explanation has actually been performed by authorities of foreign investment before the press conference mentioned above, as a result, since the exploitation of tungsten is forbidden for FIEs by the 2007 and 2011 Catalogue, any activity like raising capital, transferring equity interests or going public overseas, which is proposed after implementation of 2007 Catalogue by an FIE engaging in such industry, may be unable to be approved.

It is true that the NDRC Explanation on the principle of applying the Catalogue is of high significance to practice. Nevertheless, considering that the NDRC Explanation has not been verified by law as binding, it is still subject to discussion in legal aspect as to whether Xiamen Tungsten is a typical and acceptable exception or a breakthrough to establish new rules. Wanders and guesses on why Xiamen Tungsten has not carried out any changes in capital ever since 2002 are still lingering around.

China Moly (**03993, listed on April 26, 2007 in Hong Kong's Stock Exchange; A-share IPO approved on May 11, 2012, not listed yet**): the primary business of China Moly is exploitation and melting of W-Mo. After China Moly was listed in Hong Kong's Stock Exchange, it was approved by Ministry of Commerce in 2007 to change into a foreign-invested company limited by shares due to its H-share composition. Other authorities concerned have also approved it according to law to become a foreign-invested company limited by shares that is entitled to engage in exploitation of W-Mo. However, both of the 2007 Catalogue and 2011 Catalogue have listed the exploitation of W-Mo as a forbidden area for foreign investment. The reason why the IPO of China Moly can be approved is due to the alternative approach by local government. "*Letter Regarding China Moly's application of industrial policies on foreign investment*" issued by the Henan Provincial Commerce Department (Yu Shang Zi Guan Han (2011) No.1) explained China Moly's situation that, since China Moly is a Hong Kong listed company, its reformation into a sino-foreign company limited by shares was primarily for the convenience of policy implementation with respect of commercial and industrial registration, foreign exchange and taxation, and this kind of change should be distinguished from foreign direct investment. In 2008, recognized as an advantageous W-Mo company with an excellent integration of moly resources, China Moly was granted key support according to *Notice of Forwarding Implementation Opinions* on *Molybdenum Resources Integration of Henan Province by* *the Henan Province Land and Resources Department, Development and Reform Committee and Environmental Protection Bureau* (Yu Zheng Ban (2008) No.11) issued by Henan Province People's Government Office and *the Examination Opinions on the Implementation Scheme of Molybdenum Resources Integration of Luoyang, Sanmenxia, Nanyang and Xinyang* (Yu Zi Yuan Zheng He Ban (2008) No.5) issued by Office of Leading Group of Henan Province Mineral Resources Integration. Despite of that, such matter was elaborated in detail in China Moly's A-Share prospectus as an industrial policy risk which might lead to negative impact as state industrial policy may change. China Moly is a special case because state-owned assets constitute a large portion of its capital. Henan Provincial Commerce Department's explanation demonstrated that the Catalogue can be applied differently between foreign direct investment companies and companies reformed into FIEs due to their listing overseas; however, such explanation has no legal basis in the Catalogue or any other regulations. Hence, China Moly may to some extent be deemed as one case that breaks through the A-share IPO rules for FIEs via approval of local government.

For FIEs' listing, A+H mode is relatively special, which is commonly operated in such way that, a domestic enterprise first goes public in Hong Kong, and then returns to A-share market. In recent years, many companies choose to adopt this mode, for example, **the Bank of Construction** (**00939, listed on October 27, 2005 in Hong Kong's Stock Exchange; 601939, listed on September 25,2007 in Shanghai Stock Exchange**), **the Bank of Communications (03328, listed on June 23, 2005 in Hong Kong's Stock Exchange; 601328, listed on May 15, 2007 in Shanghai Stock Exchange**), **Beijing North Star (00588, listed on May 14, 1997 in Hong Kong's Stock Exchange; 601588, listed on October 16, 2006 in Shanghai Stock Exchange)**, etc. There is still uncertainty as to whether A+H companies can be treated as FIEs. The *Provisional Regulations on the Establishment of Foreign-invested Companies Limited by Shares* stipulated that, if a foreign investor buys and holds more than 25% of a company's stock, the company shall be a foreign-invested company limited by shares (actually this rule has also been broken through in practice, elaborated below). In this consideration, we understand that, for companies already listed in Hong Kong (not delisted), as long as their proportion of foreign capital exceeds 25%, they should be regarded as foreign-invested companies limited by shares, and therefore shall abide by the industrial policy of FIEs provided in *Some Opinions on Issues Related to Foreign Investment in Listed Companies* (2001) when returning to A-share market. However, in practice, rarely can we see any reference to the Catalogue and its application in lawyers' working report and prospectus of A+H companies (for instance, **Dongjiang Environment (00895, listed on January 29, 2003 in Hong Kong's Stock Exchange; 002672, listed on April 26, 2012 in Shenzhen Stock Exchange), Zijin Mining Group (02899, listed on December 23, 2003 in Hong Kong's Stock Exchange; 601899, listed on April 25, 2008 in Shanghai Stock Exchange), Beijing North Star (00588, listed on May 14, 1997 in Hong Kong's Stock Exchange; 601588, listed on October 16, 2006 in Shanghai Stock Exchange)**). Neither has China Securities Regulatory Commission ever issued any relevant documents on this matter. From our observation to the prospectus, lawyers' working reports and instruments of sponsorship of A+H listing companies, examination on IPO of such companies is generally based on the rules that apply to normal domestic companies. Such phenomenon also implies other pending issues like whether the Catalogue can be differently applied for A+H companies, whether these A+H companies shall be subject to joint annual examination, etc., leaving many questions in practice ambiguous.

Restrictions on company nature

Article 2 of *Provisional Regulations on the Establishment of Foreign-invested Companies Limited by Shares* (1995) provides that "For the purposes of these Provisions, a foreign-invested company limited by shares shall mean an enterprise legal person that is established in accordance with these Provisions with its capital fully consisting of equal shares, its shareholders bearing liabilities to the Company to the extent of their respective subscribed shares, the Company bearing liabilities for the Companies' debts to the extent of its total property, the Chinese Shareholders and Foreign Shareholders jointly holding the Company's shares, and the shares to be acquired and held by Foreign Shareholders being 25% or more of its registered capital."

Some Opinions on Issues Related to Foreign Investment in Listed Companies (2001) requires that FIEs seeking to be listed must be foreign-invested companies limited by shares. Further, in accordance with article 79 of the *Company Law* as well as article 2 and article 6 of *Provisional Regulations on the Establishment of Foreign-invested Companies Limited by Shares,* the shares of foreign-invested companies limited by shares must be held by both Chinese shareholders and foreign shareholders. If the company is established by origination, the number of the originators shall be no fewer than two and no more than 200, half of whom shall have residence in PRC, and at least one of whom shall be foreigner.

So far there has been only one case of wholly foreign owned enterprise ("WFOE") successful going public in the history of domestic capital market: **Min Chankun B (200512, listed on June 30, 1996 in Shenzhen Stock Exchange)**. Since promulgation of the laws and regulations mentioned in this section above, we have not found any other similar case which breaks through the rule that a foreign-invested company limited by shares shall not be a WFOE. However, what deserves attention is that, as it becomes increasingly common for FIEs to be listed in A-share market, WFOEs began to introduce in a small percent of Chinese capital so as to form sino-foreign joint ventures for purpose of going public in domestic market. **Universal Scientific Industrial (601231, listed on February 20, 2012 in Shanghai Stock Exchange)** is one typical case. USI is a company absolutely controlled by foreign capital. Its major shareholder **Global Technology** (a foreign investor) holds 99% of its shares (originally, Global Technology held 100% of USI's equity interests before Global Technology transferred 0.5% thereof respectively to Huansheng Shenzhen and ASE Shanghai, both being domestic companies limited by shares. Huansheng Shenzhen then transferred its own 0.5% equity interests to ASE Shanghai, which, although being a domestic company registered in Shanghai, is actually a wholly-owned subsidiary of ASE Global which is materially controlled by Brothers Zhang (one is Taiwanese and one is Singaporean). Therefore, although before the listing of USI, its equity structure is 99% foreign investment plus 1% domestic capital, substantially speaking, it is an FIE wholly owned by foreign investors). Despite of the fact that WFOEs is restricted from directly being listed now according to law and policy, USI is an example for WFOEs seeking to be listed in A-share market.

In previous years, the possibility for FIEs, of which too large proportion of equity interests is held by foreign investors, to obtain the approval of being listed at A-share market was low. Nevertheless, in recent years, cases of such companies being successfully listed have been increasing. For instance: **Kee Ever Bright Decorative Technology (002464, listed on August 31, 2010 in Shenzhen Stock Exchange)**, foreign capital constituting 98.5% of its share capital before its IPO; **DFAC (601515, listed on February 16, 2012 in Shenzhen Stock Exchange)**, foreign capital constituting 75.1% of its share capital before its IPO; **Vtron (002308, listed on November 27, 2009 in Shenzhen Stock Exchange)**, foreign capital constituting 93% of its share capital before its IPO; **SLAC (approved for IPO on May 3, 2012, not listed yet)**, foreign capital constituting 90.37% of its share capital before its IPO; **IDC (002468, listed on September 8, 2010 in Shenzhen Stock Exchange)**, foreign capital constituting 97.21% of its share capital before its IPO; **HND (002356, listed on February 9, 2010 in Shenzhen Stock Exchange)**, foreign capital constituting 85% of its share capital before its IPO, etc.

Capital composition

1) Article 5 of the *Some Opinions on Issues Related to Foreign Investment in Listed Companies* (2001) provides that, where the proportion of the foreign investment shares in a foreign-invested company limited by shares to its total share capital is less than 25% after its listing and issuance of shares in China, the company shall hand in its approval certificate for an FIE and go through the relevant procedures for change pursuant to the relevant provisions.

The aforementioned provision is in conformity with the principle established in the *Provisional Regulations on the Establishment of Foreign-invested Companies Limited by Shares*, which states that the proportion of foreign capital in a foreign-invested company limited by shares shall exceeds 25%, but such principle has been frequently broken through in practice. Different from the foregoing circumstances, such breakthrough is based on regulation reform itself. On December 30th, 2002, Ministry of Foreign Trade and Economic Co-operation, State Administration of Taxation, Minister of the State Administration for Industry and Commerce, and State Administration of Foreign Exchange jointly issued the *Notice Concerning the Relevant Issues on Strengthening the Approval, Registration, Foreign Exchange Control and Taxation Administration of Foreign-funded Enterprises*. On March 7th, 2003, the above-mentioned authorities again jointly issued *Interim Provisions for Foreign Investors to Merge Domestic Enterprises*. On April 24th, 2006, Minister of the State Administration for Industry and Commerce, Ministry of Commerce, General Administration of Customs, and State Administration of Foreign Exchange jointly issued *Implementation Opinions on Some Issues Concerning Law Application for the Administration of Examination and Approval and*

Registration of Foreign-invested Companies. These provisions all confirm that, for FIEs of which the proportion of foreign capital is less than 25%, their business licenses shall be imprinted with the wording of "proportion of foreign capital less than 25%", rather than denying their status as FIEs. In practice, this approach is widely applied in FIEs planned to be listed, examples of which including but not limited to:

Guangxun Technology (002281, listed on August 21, 2009 in Shenzhen Stock Exchange): Ministry of Commerce approved Guangxun Technology to entirely change into a foreign-invested company limited by shares of which the proportion of foreign capital is less than 25% by issuing the "*Letter Regarding Consent of Wuhan Guangxun Technology Co., Ltd's Alteration into a Foreign-invested Company Limited by Shares of Which the Proportion of Foreign Capital is Less Than 25%*" (Shang Zi Pi [2004] No.1231).

Shaanxi Province Natural Gas (002267, listed on August 13, 2008 in Shenzhen Stock Exchange): on September 16th, 2005, Ministry of Commerce approved Shanxi Province Natural Gas to reform into a foreign-invested company limited by shares of which the proportion of foreign capital is less than 25% by issuing the "*Ministry of Commerce's Reply on Approval of Shanxi Province Natural Gas's Reformation*" (Shang Zi Pi [2005] No.2066).

Other examples of which the proportion of foreign capital in a pre-IPO FIE being lower than 25% include **ZOJE (002021, listed on July 15, 2004 in Shenzhen Stock Exchange)** (foreign capital constituting only 1%), **Xiamen Tungsten (600549, listed on December 7, 2002 in Shanghai Securities Exchange)** (foreign capital constituting only 16.17%), **Sanhua (002050, listed on June 7, 2005 in Shenzhen Stock Exchange)** (foreign capital constituting only 9%), **Venustech (002439, listed on June 23, 2010 in Shenzhen Stock Exchange)** (foreign capital constituting only 22.55%), **Camel Group (601311, listed on June 2, 2011 in Shanghai Stock Exchange)** (foreign capital constituting only 14.18%), **Jingxing Paper (002067, listed on September 15, 2006 in Shenzhen Stock Exchange)** (foreign capital constituting only 11%), **Guangdong Weihua (002240, listed on May 23, 2008 in Shenzhen Stock Exchange)** (foreign capital constituting only 20.83%), **Jinling Holdings (601007, listed on April 6, 2007 in Shanghai Stock Exchange)** (foreign capital constituting only 10%), etc.

Additionally, in accordance with Item 3 of Article 2 of the *Circular Regarding the Relevant Issues on the Administration of Foreign Investment as Involved in the Share Trading Reform of Listed Companies* jointly issued by Ministry of Commerce and China Securities Regulatory Commission on October 26, 2005, as well as Article 21 of *Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors* jointly issued by Ministry of Commerce, China Securities Regulatory Commission, State Administration of Taxation, Minister of the State Administration for Industry and Commerce, and State Administration of Foreign Exchange on December 31, 2005, in situation where the proportion of foreign capital in a listed FIE decreases due to disposal of shares by foreign shareholders, the foregoing principle that the company shall hand in its FIE approval certificate for proportion of foreign capital therein becoming lower than 25% is not strictly applied, either. In reality, for listed FIEs in which foreign capital constitute less than 25% but more than 10% of the total share capital, the FIE approval certificate can be retained, and only in situation where the proportion of foreign capital reduces to less than 10% shall the FIE approval certificate be de-registered. There are usually two ways to operate in practice:

(a) when the foreign shareholders dispose of their shares which results in the proportion of the foreign capital in a listed FIE reducing to less than 10%, local authority concerned will often issue a document named "*Reply Regarding XX Company's Change of Equity and Withdrawal of FIE Approval Certificate*", and the company will release a document named "*XX Stock Company—Announcement Regarding the Company's No Longer Holding the FIE Approval Certificate*". For example, **Guangdong Weihua (002240, listed on May 23, 2008 in Shenzhen Stock Exchange), GEEC (002045, listed on May 23, 2005 in Shenzhen Stock Exchange), Jinling Holdings (601007, listed on April 6, 2007 in Shanghai Stock Exchange), Jingxing Paper (002067, listed on September 15, 2006 in Shenzhen Stock Exchange), Sanhua (002050, listed on June 7, 2005 in Shenzhen Stock Exchange)**, etc. The FIE approval certificates of these companies were handed in after their proportion of foreign capital reduced to less than 10%;

(b) a listed FIE changes into a domestic company only until all of the foreign capital thereof is sold out., e.g., **ZOJE (002021, listed on July 15, 2004 in Shenzhen Stock Exchange).** After it went listed, its foreign shareholder who is a Japanese named Zuoteng Xiuyi sold out all of his shares therein at Shenzhen Small and Medium-sized Enterprise Board in 2006, since when, ZOJE has no longer had any foreign capital and therefore been a domestic company. Further, ***ST Greenland (002200, listed on December 21, 2007 in Shenzhen Stock Exchange), Sichuang Shengda (000835, listed on June 25, 1999 in Shenzhen Stock Exchange), Welltech (002058, listed on August 2, 2006 in Shenzhen Stock Exchange)** and others all changed their status from FIE after foreign shareholders thereof sold out all their shares therein in 2010.

2) Item 3 of Paragraph 2 of Article 2 of *Some Opinions on Issues Related to Foreign Investment in Listed Companies* (2001) provides that, after listing and issuance of shares, the proportion of the foreign investment shares to the total share capital shall be at least 10%.

The difference between this provision and Article 5 of the *Some Opinions on Issues Related to Foreign Investment in Listed Companies* mentioned above is that the latter regulates the proportion of foreign capital after listing of FIEs while the former sets up a prerequisite for FIEs' IPO. In other words, if the expected proportion of foreign capital in an FIE after it goes listed will drop to less than 10%, then in principle it shall not be permitted to go listed. However, this rule has been broken through in practice, too. Besides, our case study shows that, in many lawyers' working reports for pre-IPO FIEs, even if *Some Opinions on Issues Related to Foreign Investment in Listed Companies* is mentioned, reference to such "10%" rule can be seldom seen.

ZOJE (002021, listed on July 15, 2004 in Shenzhen Stock Exchange): ZOJE was listed on July 15th, 2004 as a foreign-invested company limited by shares, before when, its foreign shares held by Zuoteng Xiuyi only constituted 1% of the company's total share capital. After the share trading reform thereof, such percentage further dropped to 0.56%.

Guangxun Technology (002281, listed on August 21, 2009 in Shenzhen Stock Exchange): its foreign shareholder GONG-EN GU (from Taiwan) held 4.8% of its company shares before the listing, and 2.01% at present.

Jingxing Paper (002067, listed on September 15, 2006 in Shenzhen Stock Exchange): in June of 2001, Jingxing Paper changed into a sino-foreign joint venture from a domestic enterprise. 11% of its shares were transferred to two Japanese companies. In September of 2001, Jingxing Paper was entirely reformed into a company limited by shares. In September of 2006 after Jingxing Paper went listed, the proportion of foreign capital therein was 7.17%.

Conclusion

Through studying the prospectus, legal opinions, lawyers' working reports, instrument for sponsorship, sponsoring working reports of FIEs that were successfully listed, we found out that many of the rules (particularly from the aspect of formality) which were enacted for the listing of FIEs have been broken through. For instance, the rule requiring proportion of foreign capital after listing to be not lower than 10% has hardly been mentioned in IPO documents now. For the rules regarding industrial policy and joint annual examination, simple disclosure is mainly adopted. In today's environment where the requirements for FIEs' listing are becoming relaxed, the authorities concerned are paying more attention to issues that could possibly exert material impact to the capital market, such as whether companies are involved in connected transaction, whether the operation of companies is independent and complete, whether there exists horizontal competition, whether the equity structure is reasonable, etc.

Legal Updates

1. Clarified Operating Rules for RMB Settlement Business in Relation to Foreign Direct Investment (Authors: Kelvin GAO, Rachel CHEN, Amanda HU)

On October 13, 2011, the People's Bank of China promulgated the *Measures for Administration of RMB Settlement Business in Relation to Foreign Direct Investment* (the People's Bank of China Circular [2011] No. 23) (hereinafter referred to as the "**Measures**") to regulate the RMB settlement business operated by financial institutions in the banking industry in relation to foreign direct investment. On June 14, 2012, PBOC promulgated the *Notice of Clarified Operating Rules on RMB Settlement Business in Relation to Foreign Direct Investment* (Yin Fa [2012] No. 165) (hereinafter referred to as the "**Operating Rules**") to further clarify the rule in relation to the Measures. This newsletter introduces and summarizes these operating rules.

Firstly, the Operating Rules clarify the opening, deposit and use of certain common accounts for RMB capital funds in foreign direct investment.

#	Use of Capital Funds	Measures	Operating Rules
1.	Upfront Expenses	Under the principle of dedicated account for special use, a dedicated deposit account for upfront expenses in RMB shall be opened for depositing RMB funds used to pay for upfront expenses relating to the investment project and such account may not be used for the receipt and payment of cash.	One overseas investor may only open one dedicated deposit account for upfront expenses in RMB, the name of which shall be the name of the depositor plus "upfront expenses", and such account shall be a current account. If the overseas investor is an overseas individual, such individual may apply to open an RMB bank settlement account for individuals for the dedicated deposit of upfront expenses. The capital funds in the above dedicated accounts for upfront expenses in RMB shall not be used in the bidding, auction and listing of a piece of land or in the real estate industry.
2.	Registered Capital	• Under the principle of dedicated account for special use, a dedicated deposit account for RMB capital funds shall be opened to deposit the RMB registered capital remitted by the overseas investor or the RMB capital contribution paid by the overseas investor, and such account may not be used for the receipt and payment of cash. • If an overseas investor makes capital contribution with both RMB fund and fund in foreign exchange, the exchange rate between RMB and the foreign currency shall be the central parity rate of RMB published by PBOC on the date of registered capital verification.	• A newly established foreign-invested enterprise shall, upon presentation of its incorporation approvals issued by the competent commercial authority, open a dedicated deposit account for RMB registered capital with a local bank. One set of incorporation approvals may only be relied on for the opening of one dedicated deposit account for RMB registered capital, the name of which shall be the name of the depositor plus "registered capital". • A foreign-invested enterprise which intends to increase its registered capital shall, upon presentation of its registered capital alteration approvals issued by the competent commercial authority, open a dedicated deposit account for RMB registered capital with a local bank. One set of alteration approvals may only be relied on for the opening of one dedicated deposit account for RMB registered capital, the name of which shall be the name of the depositor plus "registered capital".

#	Use of Capital Funds	Measures	Operating Rules
		• If a foreign investment company, a foreign-invested venture capital enterprise, a foreign equity investment enterprise or a foreign-invested partnership engaging in investment as its core business uses RMB to conduct investment activities in China in accordance with the law, the enterprise in which it invests shall apply to open a dedicated deposit account for RMB capital funds, to be used specifically for depositing RMB registered capital or contributed capital and handling the relevant fund settlement business, and such account may not be used for the receipt and payment of cash.	• The above dedicated account is an current account, but the capital funds deposited into such account can be re-deposited as fixed deposit up to one year; • The accrued debit amount of a foreign-invested enterprise's RMB capital funds dedicated account shall not exceed the amount specified by relevant governmental approval or filing document; • By reference to the regulations applicable to foreign-invested enterprises, a foreign-invested partnership shall open its RMB capital funds dedicated account with the company information brief issued by the competent registration authority or online request result print copy which records the partnership's capital contribution subscribed for or actually paid in by its partners and was stamped by a request chop of the registration authority.
3.	Merger and Acquisition Capital	If a foreign-invested enterprise is established through the merger or acquisition of a domestic enterprise by an overseas investor with RMB, the Chinese shareholder of the domestic enterprise that is merged or acquired shall apply to open a dedicated deposit account for the merger and acquisition conducted in RMB, to be used specifically for depositing the RMB funds remitted by the overseas investor for the merger or acquisition, and such account may not be used for the receipt and payment of cash.	• If a foreign-invested enterprise is established through the merger or acquisition of a domestic enterprise by an overseas investor with RMB, the Chinese shareholder of the domestic enterprise that is merged or acquired shall apply to open a dedicated deposit account for the merger and acquisition conducted in RMB by its incorporation approvals issued by the competent commercial authority. Each Chinese shareholder may only apply to open one such dedicated deposit account by one set of approvals, the name of which shall be the name of the depositor plus "merger and acquisition capital". • If the Chinese shareholder is a domestic individual, such Chinese shareholder may apply to open an RMB bank settlement account for individuals for the

#	Use of Capital Funds	Measures	Operating Rules
			dedicated deposit of merger and acquisition capital in RMB. • After the merger or acquisition deal, the capital funds deposited into the above dedicated deposit account for merger and acquisition capital in RMB may be used in accordance with the law, and there is no need to report the details of the domestic uses of such capital funds for filing purpose.
4.	Foreign-invested Enterprise's Equity Transfer Payment	If an overseas investor pays the consideration for equity transfer in RMB to the Chinese shareholder of a foreign-invested enterprise in China, the Chinese shareholder shall apply to open a dedicated deposit account for equity transfer conducted in RMB, to be used specifically for depositing the RMB funds remitted by the overseas investor as the consideration for equity transfer, and such account may not be used for the receipt and payment of cash.	• If an overseas investor pays the consideration for equity transfer in RMB to the Chinese shareholder of a foreign-invested enterprise in China, each Chinese shareholder shall apply to open a dedicated deposit account for equity transfer conducted in RMB by its capitalization alteration approvals issued the competent commercial authority. Each Chinese shareholder may only apply to open one such dedicated deposit account by one set of approvals, the name of which shall be the name of the depositor plus "equity transfer". • If the Chinese shareholder is a domestic individual, such Chinese shareholder may apply to open an RMB bank settlement account for individuals for the dedicated deposit of equity transfer payment in RMB. • After the equity transfer, the capital funds deposited into the above dedicated deposit account for equity transfer conducted in RMB may be used in accordance with the law, and there is no need to report the details of the domestic uses of such capital funds for filing purpose.

#	Use of Capital Funds	Measures	Operating Rules
5.	Overseas Loan	• A foreign-invested enterprise shall, upon presentation of the RMB loan contract, apply to open a general RMB deposit account, to be used specifically for depositing the RMB funds borrowed from abroad. • If a foreign-invested enterprise uses RMB to repay the principal and interest of its overseas RMB loans, it may directly process the repayment through the bank upon presentation of such materials as the loan agreement, the letter of payment order and the evidence on tax payment. • The amount of RMB and foreign exchange loans borrowed by a foreign-invested enterprise from its overseas shareholders, its affiliated enterprises within the same group and overseas financial institutions shall be combined for calculating the total scale of the loans.	• A foreign-invested enterprise shall not borrow RMB funds from abroad until after its registered capital has been fully and timely paid in. The interest rate of such loans shall be voluntarily determined by and between the borrower and lender in accordance with the business principle and within a reasonable range. However, a foreign-invested real estate enterprise cannot borrow RMB funds from abroad. • For a foreign-invested enterprise, one overseas RMB loan may only open one general RMB deposit account to be used for the receipt and payment of funds, and such account shall be a current account. • Except for a foreign-funded investment company, a foreign-invested financing leasing company and other special foreign-invested enterprises, the total scale of the loans borrowed by a foreign-invested enterprise shall not exceed the difference between its total investment amount and registered capital as approved by competent national authority. • The total scale of the overseas RMB loans borrowed by a foreign-invested enterprise shall be calculated according to the actual accrued amount. If the term of an overseas RMB loan borrowed by a foreign-invested enterprise is extended, the first extension shall not be included in calculating the enterprise's total scale of overseas RMB loans, while the following extensions shall all be included. As for the guarantees extended by overseas institutions or individuals to domestic banks which list a foreign-invested enterprise as the beneficiary, the actually performed part of the RMB loan shall be calculated into the total scale of overseas RMB loans. If a

#	Use of Capital Funds	Measures	Operating Rules
			foreign-invested enterprise increases its capital converted from overseas RMB loans, such loans shall not be calculated into the total scale of overseas RMB loans. • When combining and calculating the total amount of RMB loans and foreign exchange loans, the exchange rate shall be the central parity rate of RMB published by PBOC on the date of the loan agreement.
6.	Reinvestment Capital	If an overseas investor uses the RMB funds acquired through RMB profit distribution, early recovery of investment, liquidation, reduction of capital, equity transfer, etc. to reinvest in China or to increase the registered capital, the overseas investor may deposit the RMB funds into the dedicated deposit account for the use of RMB for reinvestment.	The name of the dedicated deposit account for RMB investment capital opened by an overseas investor shall be the name of the depositor plus "reinvestment capital".

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Secondly, the Operating Rules also stipulate that the use of RMB funds deposited into a dedicated deposit account for RMB capital funds and a general deposit account for overseas RMB loans by a foreign-invested enterprise shall fall within the approved business scope, and shall not be used for the investment in securities and financial derivatives, entrusted loans, or purchase of financial management products or non owner-occupied property. For a non investment foreign-invested enterprise, the RMB funds may not be used for re-investment in China. However, RMB funds deposited into a dedicated deposit account for RMB capital funds and a general deposit account for overseas RMB loans may be used for repayment of domestic or overseas loans.

Additionally, capital funds deposited into a dedicated deposit account for RMB capital funds and a general deposit account for overseas RMB loans shall not be transferred to an RMB deposit account of the same name, except for payment as salaries and enterprise's fund of disbursement for travelling, small amount of purchase and expenses.

Lastly, the Operating Rules further specify the bank's duty of supervision in RMB settlement business in relation to foreign direct investment. The Operating Rules explicitly stipulate that the bank shall submit relevant RMB receipt and payment information to the RMB cross-border receipt and payment information management system within five (5) working days after handling the RMB settlement business relating to foreign direct investment and in a timely, accurate and complete manner. At the same time, the Operating Rules require that the PBOC and State Administration of Foreign Exchange establish an information sharing mechanism for relevant business of foreign direct investment.

2. Commentary on Draft Amendment to the PRC Labor Contract Law (Authors: Hualing GAO, Li LUO)

Since the implementation of the PRC Labor Contract Law (the "**Labor Contract Law**") on January 1, 2008, labor dispatch, as an important aspect governed by the law, has also become a major issue in practice. After the Labor Contract Law came into force, there has been a sharp increase in the number of labor dispatch companies, many of which are low quality and with irregular operations. This not only damages the legal rights of employees dispatched, but also has negative impact on regular employment and labor contract system.

To solve these problems and further standardize the labor dispatch system, the 27th Session of the Standing Committee of the Eleventh National People's Congress deliberated the Draft Amendment to the PRC Labor Contract Law (the "**Draft Amendment**"), and published the Draft Amendment on its website for public comments on July 6, 2012.

Compared to the Labor Contract Law, main revisions proposed by the Draft Amendment are:

Raise threshold for establishment of labor dispatch companies

The proposed minimum amount of registered capital for establishment of a labor dispatch company has been doubled, increasing from not less than RMB500,000 to not less than 1 million. The Draft Amendment also explicitly requires a labor dispatch company to establish a lawful labor dispatch management system. In addition, it stipulates that a labor dispatch company shall obtain approval from its local labor administrative department before it can register with its local Administration of Industry and Commerce.

Equal pay for equal work

The Daft Amendment adds that the labor contract entered into between a labor dispatch company and the dispatched employee and the labor dispatch agreement between the dispatch company and the accepting company, shall specify or agree that remuneration to the dispatched employees shall comply with the principle of equal pay for equal work. The Draft Amendment further indicates that labor dispatch companies and accepting companies shall both observe this principle.

Strictly limit scope of employee dispatch positions

The Draft Amendment prescribes that labor dispatch shall only apply to temporary, auxiliary, or substitute positions, and further define these positions: temporary positions refer to the positions with a term of not longer than six (6) months; auxiliary positions refer to positions that serve the main business positions; substitute positions refer to positions that can be performed by dispatched employees in replacement of permanent employees during the period when such employee are out of work for study, vacations or other reasons.

Impose punishment on illegal acts

The Draft Amendment sets forth that where a company operates labor dispatch business without license, its business shall be banned by labor administrative department, the illegal income be confiscated, and it shall be imposed a fine of not less than one time but no more than five times the illegal income, or may be imposed a fine of up to RMB 50,000 if there is no illegal gain. It further prescribes that where the dispatch companies or accepting companies breach the law, it shall be fined at a rate of not less than RMB5,000 but not more than RMB1, 0000 per person; under the current law, the rate is not less than RMB1,000 but not more than RMB5,000 per person. The business license of dispatch companies can be revoked by the labor administrative department.

Transitional provisions

For the purpose of smooth transition from old system to new system, the Draft Amendment prescribes that where accepting companies are using the dispatched employees when the Amendment officially comes into force, the labor dispatch companies and accepting companies shall adjust in accordance with the Amendment; for those labor dispatch companies established before the implementation of the Amendment, they shall apply for and obtain a license or approval from the labor administrative department and complete change registration with local AIC. Specific measures shall be stipulated by the State Council separately.

To sum up, main changes proposed by the Draft Amendment are aimed at further standardizing the labor dispatch system, strengthening the administration over labor dispatch companies and enhancing the supervisory duty of labor administrative departments. However, the Draft Amendment also brings ambiguities in some respects, e.g., lack of definition on what constitute main business positions.

The deadline for comments to the Draft Amendment has lapsed. It remains to be seen which changes the official version of the Amendment will finally bring.

3. CSRC's Draft Measures for Employee Stock Ownership Plans of Listed Companies (Authors: Loretta LI, Lan LI)

On August 4, 2012, China Securities Regulatory Commission ("**CSRC**") published the *Interim Measures for Employee Stock Ownership Plans of Listed Companies (Draft for Comments)* (the "**Draft for Comments**") formulating on main contents, implementing procedures, management modes, information disclosure and other aspects in regard of employee stock ownership plans of listed companies. The Draft for Comments is a new exploration and regulation about incentive mechanism of listed companies after the *Administrative Measures for Equity Incentives of Listed Companies (Trial) (Zheng Jian Gong Si Zi [2005] No.151)* (the "**Administrative Measures**") released by CSRC in late 2005. This article briefly introduces the contents of the Draft for Comments and comparison between the Draft for Comments and the Administrative Measures.

The "Employee Stock Ownership Plans" in the Draft for Comments refers to an institutional arrangement that listed companies entrust part of salary, bonus and other cash remuneration payable to their employees to asset management institutions to purchase stocks of the listed companies themselves from the secondary market and keep long-term possession, under which the corresponding interest of shares will be allocated to the employees in accordance with agreements.

Main contents:

1) Fund source of employee stock ownership plans

The Draft for Comments stipulates that the fund used in employee stock ownership plans per year is salary, bonus and other cash remuneration payable to employees of listed companies in recent 12 months. On that account, adhering to the principle of free will and autonomy, the Draft for Comments grants the listed companies a right to make their own decisions on whether to carry out an employee stock ownership plan and its specific contents and employees a right to decide whether to participate in the employee stock ownership plans.

2) Limitation on the sum of fund

Since the fund used in employee stock ownership plans is the cash remuneration payable to employees, in order to diversify risks reasonably, the Draft for Comments stipulates that the sum of fund for employee stock ownership plans shall be no more than 30% of such employee's total cash remuneration and no more than 1/3 of the family financial assets of such employee. To comply with such limitation, the Draft for Comments establishes explanation duties for both the employees who intend to take part in employee stock ownership plans and the listed companies that plan to carry out the employee stock ownership plans. Before joining in employee stock ownership plans, the employees shall introduce the status of their family financial assets and the listed companies shall fully disclose risks of employee stock ownership plans. The upper limitation of the interest of shares that a specific employee receives shall be evaluated and approved by listed companies based on the asset status disclosed by such employee.

3) Duration period

To ensure the long-term and consecutive effect of employee stock ownership plans, the Draft for Comments provides that the duration for employees' possession of stocks shall be no less than 36 months commencing from the listed companies announce the accomplishment of stocks purchasing for such employee stock ownership plan. In the duration period of employee stock ownership plans, listed companies may implement the employee stock ownership plans on a regular basis by a year, a quarter or a month, or without any regular plans.

4) Issues to be specified in the employee stock ownership plans

The Draft for Comments enumerates the issues which shall be set forth in employee stock ownership plans, including scope and qualifications of employees who may participate, implementing procedures and specific management modes, disposal measures of the interest of shares held by employees after expiration of the employee stock ownership plans, representatives of the holders of the employee stock ownership plans or assets management institutions' selection, etc. In addition, the Draft for Comments clearly stipulates that employees have the rights to possess, use, benefit from and dispose the interest of shares obtained through employee stock ownership plans according to provisions thereof. Where employees intend to withdraw from employee stock ownership plans in advance, the equity of such employees shall be disposed according to the provisions of their employee stock ownership plans.

Management modes

Employee stock ownership plans shall be managed by independent third-party institutions. The listed companies shall entrust their employee stock ownership plans to trust companies, insurance asset management companies, security companies, fund management companies and other qualified asset management companies.

The Draft for Comments specifies the independence of asset management institutions and the independence of fund used in employee stock ownership plans. Asset management institutions shall neither manage the employee stock ownership plans of themselves or listed companies controlled by them, nor those of their controlling shareholders, actual controllers, and companies under the same control with them. The Draft of Comments emphasizes the independence of asset management companies is to prevent employee stock ownership plans from being utilized to conduct insider dealings, manipulate security market and other security fraud behaviors.

The independence of fund used in employee stock ownership plans is reflected in the fund shall be isolated from other assets managed by asset management institutions as well as their fixed assets. And if asset management institutions have to make liquidation, the entrusted fund shall not be categorized as liquidation properties. Aforementioned provision aims at strengthening the safty of the fund of employee stock ownership plans.

Implementing procedures and information disclosure

The Draft for Comments stipulates that the drafts of employee stock ownership plans shall be proposed and submitted by Boards of Directors of listed companies to general meeting of shareholders. Listed companies shall disclose resolutions of Boards of Directors, abstracts of draft, opinions of independent directors, asset management agreements and legal opinions within 2 business days upon approval of drafts by Boards of Directors. The resolutions of general meeting of shareholders shall be passed by more than half of voting right held by shareholders attending the meeting. Within 2 business days after the employee stock ownership plans are approved by general meeting of shareholders, listed companies shall go through formalities of information disclosure with stock exchanges.

The Draft for Comments not only stipulates the information disclosure duty in the preparatory stage of employee stock ownership plans, but also in the process of purchasing stocks of listed companies and duration period of employee stock ownership plans, such as listed companies shall issue an announcement per month in connection with the time, number, price, method and other specific information of purchasing stocks by asset management institutions; listed companies shall make disclosure for amendment of key issues which require approval of general meeting of shareholders in employee stock ownership plans; and the disclosure duty of listed companies in regular reports.

Comparison with the administrative measures

The Draft for Comments and the Administrative Measures both are documents of incentive mechanisms stipulated and published by the CSRC. The two documents specify the same limitations on the percentage of total amount of stocks involved in employee stock ownership plans (or in equity incentive plans) against the total capital stock of listed companies, which are total amount of shares under the employee stocks ownership plans (or under the equity incentive plans) of a listed company shall not exceed 10% of the total capital stock of the listed company and the interest of shares obtained by an employee individually shall not exceed 1% of capital stock of the listed company. However, the Draft for Comments stipulates that the total amount of stocks involved in employee stock ownership plans shall be calculated separately, excluding stocks acquired by employees prior to initial public offering of the companies, stocks purchased by employees from the secondary market and stocks obtained through equity incentive plans. This means that a listed company may adopt an employee stock ownership plan and an equity incentive plan at the same time, under which circumstance, in compliance with the above limitation, the total amount of stocks involved in the two plans shall not exceed 20% of the total capital stock, and equity acquired by any individual through such two plans shall not exceed 2% of the total capital stock of the listed company in total. There is no contradiction between the two plans and listed companies may carry out both at the same time.

The major differences between employee stock ownership plans stipulated in the Draft for Comments and equity incentive plans stipulated in the Administrative Measures are set forth as follows:

	Equity Incentive Plan	**Employee Stock Ownership Plan**	**Differences**
Source of Stocks	Issue stocks to the incentive recipients; repurchasing company shares; or other means as permitted by the laws and administrative rules and regulations	Purchase stocks of listed companies from the secondary market	Employee stock ownership plan shall not issue new stocks to employees.
Incentive Recipients	The directors, supervisors, senior executives and key technicians (business personnel), as well as other employees who should be granted the equity incentive in the opinions of the listed companies, except for the independent directors.	Employees of listed companies, including management personnel	Employee stock ownership plan has a wider scope, which may cover all employees of listed companies.
Regulatory Approaches	Besides duty of information disclosure, listed companies are required to file the plan for record with the CSRC, who may raise objection within 20 business days upon application. Where an objection is raised by the CSRC, the equity incentive plan cannot be implemented.	Listed companies only have the duty of information disclosure.	The employee stock ownership plan is not required to be filed for record with CSRC, which is more convenient than the equity incentive plan.

If the employee stocks ownership plan under Draft for Comments is implemented smoothly, it will (1) play a positive role to listed companies by adding a new method of employee incentive and (2) benefit the secondary market since the stocks involved can only be purchased from secondary market instead of issuing new shares to the employees. Furthermore, employee stock ownership plans provide employees opportunities to take part in appraising the inherent value of listed companies which favors in reflection of real value of their stocks. The parts of stocks held by employees under employee stocks ownership plan will promote the diversity of ownership structure of listed companies to some extent and improve their corporate governance structure.

Important Announcement

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