WILMER CUTLER PICKERING HALE AND DORR LLP

China Practice Newsletter

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Legal Developments:
Trading and Distribution Rights for Foreign-Invested Enterprises

The amended *PRC Foreign Trade Law* (the "Law," Standing Committee of the People's Congress, April 6, 2004) and the *Administrative Measures for Foreign Investment in the Commercial Sector* (the "Administrative Measures," Ministry of Commerce ["MOFCOM"] April 16, 2004), each effective as of July 1, 2004, constitute major developments in the expansion of trading and distribution rights for foreign-invested enterprises ("FIEs") in China. The amended Law extends full trading rights to all domestic and foreign enterprises and natural persons. From July 1, 2004, trading rights will be granted automatically after completion of a routine filing process without the need for approval or the satisfaction of registered capital, foreign equity ownership, scope of business, prior experience, and other requirements. The Administrative Measures permit establishment of wholly foreign-owned distribution enterprises without geographic restriction beginning on December 11, 2004, abolish the prior registered capital and experience threshold requirements, and allow existing FIEs to expand their scope of business to include distribution rights.

Under the terms of its accession to WTO, China agreed to progressively grant full trading and distribution rights to all types of FIEs subject to exceptions for goods subject to special export quotas and goods reserved for State trading, *e.g.*, chemical fertilizer. Trading refers to "foreign trade", *i.e.*, the import and export of products through Chinese customs, while distribution refers to the sale (wholesale and retail) of products in the PRC domestic market. Until the new legislation came into force, only partial trading and distribution rights were granted to certain types of FIEs. For instance, manufacturing FIEs were permitted to import raw materials and semi-products for self-manufacturing and to distribute self-manufactured products in both the domestic market and international markets, and wholly foreign-owned trading companies ("WFOE Trading Cos") were permitted only in certain special bonded or free trade zones and could not directly engage in foreign trade businesses. In accordance with China's WTO commitments, FIEs are entitled to full trading and distribution rights over a three-year period following China's accession, *i.e.*, by December 11, 2004. In particular, minority foreign-owned joint

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ventures, majority foreign-owned joint ventures, and wholly foreign-owned enterprises ("WFOEs") are entitled to full distribution privileges as of December 11, 2002, December 11, 2003, and December 11, 2004, respectively. However, until promulgation of the amended Law and the Measures, it was unclear how and when China would fully fulfill its commitments in this regard.

TRADING RIGHTS

Prior to July 1, 2004, most FIEs in China were still prohibited or restricted from engaging in full-scale trading activities. Under the amended Law, all legal persons and natural persons (including all types of FIEs and foreign individuals) shall be entitled to engage in foreign trade so long as they are properly registered with the relevant Chinese government authorities. Thus, China now clearly permits expansion of full trading rights to all types of FIEs after July 1, 2004. Such rights also extend to Chinese companies and individuals, providing an excellent example of how foreign governments and businesses spur liberalization of the Chinese economy. Doing so also further dismantles the monopolies enjoyed by designated state-owned trading companies that are widely regarded as inefficient and prone to corruption. However, the amended Law sets out only general principles that may not be straightforward to implement. In all, more than 70 sets of regulations must be amended or newly promulgated.

1. Current Trading Rights of FIEs

Previously, only certain types of FIEs were entitled to trading rights. These included joint venture foreign trading companies ("JV Trading Cos"), WFOE Trading Cos, foreign-invested holding companies ("HoldCos"), manufacturing FIEs, and foreign-invested research and development centers ("R&D Centers"). JV Trading Cos and WFOE Trading Cos are special entities established solely for the purpose of conducting trading and therefore enjoy the most extensive trading rights.

- JV Trading Cos and WFOE Trading Cos

The Interim Provisions on Establishment of Chinese-Foreign Trading Joint Ventures promulgated on January 31, 2003 first authorized foreign investors to establish joint ventures specializing in import and export for an approved range of products. Except for a handful of exceptions created by special approval, such JV Trading Cos can conduct foreign trade business either as part of their ordinary business or on a commission basis and enjoy much broader trading rights than other FIEs in China. However, capital requirements and other standards impose high barriers to establish a JV Trading Co. The current minimum capital requirement is RMB50 million,[1] reduced from the original requirement of RMB100 million. In addition, foreign investors in a JV Trading Co must have engaged in foreign trade business with an average annual trade volume of not less than US$300 million in the three years prior to the application for establishment of the JV Trading Co. Chinese investors must possess foreign trade rights and satisfy the same trade volume requirement. Although a JV Trading Co is entitled to extensive trading rights, very few have been established because of the need for a local partner and the high capital requirement.

WFOE Trading Cos are only permitted in bonded or special free trade zones in Shanghai, Tianjin, Shenzhen, and Xiamen, and the total number of such entities used to be limited by the State Council. The trading activities of WFOE Trading Cos generally are limited to international trade, transit trade, and trade inside the zone or between such zones. They may not directly engage in import and export transactions with domestic enterprises located outside the zones. While physically located inside China, free trade zones are deemed to be outside China for customs purposes. A special agent with foreign trading

[1] Companies established in western China are eligible for certain preferences, including reduced capitalization requirements, and should be able to establish branches in other parts of China after establishment.

rights is required to assist any import/export transaction between WFOE Trading Cos and domestic enterprises outside a zone. Therefore, the trading rights of WFOE Trading Cos are limited in the sense that such rights do not include the right to import and export products through Chinese customs.

- HoldCos and Regional Headquarters

HoldCos now enjoy extensive trading rights, second only to those of JV Trading Cos and WFOE Trading Cos. Under the *Regulations for Establishment of Holding Companies by Foreign Investment* (the "HoldCo Regulations," MOFCOM April 4, 1995 and as amended), a HoldCo can import, on behalf of its FIE investees, machinery, equipment, office furniture, raw materials, components, and spare parts for manufacturing purposes. It can also export products manufactured by its FIE investees. With approval by MOFCOM, a HoldCo can also export, on a commission basis, products manufactured by enterprises other than its FIE investees. By setting up a special internal or external export procurement institution, a HoldCo can purchase products manufactured by its FIE investees and, after systems integration, resell the same in both domestic and international markets. A HoldCo is also permitted to import from its parent a limited quantity of products for sale in China to test or seed the market. More extensive trading rights are available if a HoldCo is upgraded to the status of a regional headquarters of a multinational pursuant to the regulations on encouraging the establishment of regional headquarters promulgated by the Beijing and Shanghai Municipal Governments in 1999 and 2002, respectively. For instance, a regional headquarters has the right to import its parent company's products for domestic sale without any quantity restriction.

In summary, a HoldCo enjoys full trading rights with respect to products traded on behalf of its FIE investees. Special approval is required for a HoldCo to import or export products of unrelated enterprises. However, the establishment of a HoldCo is subject to a high minimum capital requirement (US$30 million) and the requirement that at least three projects be approved or in place, and other requirements apply to the establishment of a HoldCo or regional headquarters. Thus, this structure is available only to larger companies. As of today, more than 300 holding companies and approximately 100 regional headquarters (some 68 in Shanghai and 24 in Beijing) have been established nationwide and are eligible for such trading rights.

- Manufacturing FIEs

Manufacturing FIEs were entitled only to limited trading rights. They are generally permitted to import machinery, equipment, raw materials, and semi-products only for their own manufacturing or operating use, and to export only self-manufactured products. Special approval was needed for a manufacturing FIE to export products manufactured by other companies, provided that such products are not subject to special export quotas or a State export monopoly.

- Foreign-Invested R&D Centers

An FIE R&D Center is an institution that engages in research and development activities. It can be a joint venture, WFOE, or branch office or internal department of a HoldCo or other FIE. Minimum investment of an FIE R&D Center is US$2 million. Like a manufacturing FIE, an FIE R&D Center can import equipment, related technology, and spare parts only for its operating uses. With special approval, an FIE R&D center may import a limited quantity of products from its parent company to test or seed the market for the products that it is developing. It resembles HoldCo in the latter regard.

2. Implications of the Amended Foreign Trade Law

China committed within three years after its WTO accession to grant all enterprises the right to trade in all goods throughout its customs territory except for those goods subject to State trading or which are subject to trade prohibitions. To implement such commitment, the amended Law changed the previous "approval" requirement to a "registration" requirement for an enterprise to gain the right to conduct foreign trade business. Enterprises (including FIEs) can now engage in foreign trade business as long as they are properly registered with the relevant government authority. The amended Law only sets out general principles, but does not further detail the registration procedures or other requirements for an enterprise to qualify as a foreign trade operating enterprise. Nevertheless, it indicates the following significant changes with respect to trading rights:

- No Requirement for Separate Trading Entity

As discussed above, China had required establishment of a trading company to obtain full trading rights, which essentially constituted a "separate entity requirement." However, such separate entity requirement was inconsistent with China's WTO commitment concerning extending full trading rights to all types of FIEs, not just FIE trading companies. The amended Law does not differentiate between particular types of enterprises with respect to the grant of foreign trade rights and thus essentially permits all types of enterprises to gain such rights. As a result, China no longer requires establishment of a separate trading company as a condition for the grant of full foreign trade rights. Therefore, the requirement that JV Trading Cos and WFOE Trading Cos be established to conduct trading for non-self-manufactured products or products of unrelated parties has effectively been abolished.

As indirect support for this conclusion, we note that as of May 1, 2004, pursuant to *the Relevant Opinions Concerning Reform of Market-Access System and Optimization of Economic Development Environment* issued by the Beijing Municipal Administration for Industry and Commerce ("BJ AIC"), the Beijing Municipal Government eliminated the requirement that enterprises be governed by business licenses with narrowly drawn scopes of business. Instead, enterprise business licenses in Beijing (but not in China as a whole) may allow the enterprise to engage in any lawful business, which would obviate any requirement for a specific approval to engage in trade. Moreover, individuals can now engage in foreign trade without the need to establish a company, but such activity would be conducted without limited liability and therefore is unlikely to be popular.

- No Minimum Capital Requirement

Minimum capital requirements should also be eliminated as a condition of obtaining trading rights no later than December 11, 2004 in accordance with China's WTO commitments. Article 8 of the amended Law endorses such commitment by defining a "foreign trade business operator" as any enterprise, organization, or individual that is registered at the relevant administration for industry and commerce ("AIC") and conducts foreign trade business in accordance with "this Law or other laws or regulations." In accordance with Article 8, an FIE may engage in trading provided that it (i) is a business entity duly registered at the relevant AIC; and (ii) has completed the registration/filing process for conducting foreign trade business with the "foreign trade administrative department of the State," which should be MOFCOM or its local counterpart. No minimum registered capital requirement specifically for the trading companies, such as RMB50 million for JV Trading Cos or US$30 million for HoldCos, appears in any provision of the amended Law. Instead, companies with trading rights now only adopt a uniform minimum registered capital requirement for registration of any enterprise with AIC. Such amount is very modest, as low as RMB100,000 under the Company Law. Therefore, the amended Law phased out the high registered capital requirements previously required for companies engaging in the trading business.

- Expansion of Trading Rights

As discussed above, the amended Law extends full trading rights to all types of FIEs and therefore allows existing FIEs to expand their scope of trading rights. Regardless of the nature of an FIE (whether it is a HoldCo or a manufacturing enterprise), it should be permitted to engage in virtually any trading business with respect to products of any enterprise in the future.

3. Implementing Regulations

Although the amended Law constitutes a remarkable market-opening measure, FIEs may still encounter difficulties in acquiring expanded trade rights. Some restrictions may apply in particular industries. For instance, the State Food and Drug Administration may prefer a separation between manufacturing and trading or distribution FIEs because each is governed by separate standards, *i.e.*, Good Manufacturing Practices vs. Good Storage Practices. Such distinction would negatively impact foreign investors by forcing them to establish and maintain separate FIEs. In addition to such potential industry-specific restrictions, the amended Law does not in general specify the relevant procedural requirements for registration with the "foreign trade administrative department" nor does it give any guidance on how an existing FIE can gain full trading rights through such a registration process. The amended Law provides only that detailed registration measures shall be formulated by the "foreign trade administrative department of the State."

To establish trading rights for FIEs pursuant to the amended Law, MOFCOM on June 25, 2004 promulgated the *Measures on Registration of Foreign Trade Operators* (the "Registration Measures"), also with effect from July 1, 2004. The Registration Measures provide a clear roadmap with respect to registration procedures through which FIEs may obtain foreign trade rights and lists relevant application documents required for registration.

The following summarizes the registration procedures for an FIE to register for foreign trade (import/export) rights:

- download a registration form from www.mofcom.gov.cn or obtain a hard copy from the local commerce bureau;

- complete the registration form to be signed by the legal representative of the FIE applicant;

- submit to the local commerce bureau the completed registration form together with copies of the applicant's business license, enterprise code certificate, and certificate of approval for establishment of an FIE;

- the local commerce bureau affixes its "filing and registration" chop on the registration form within 5 days after receipt of the above documents if properly completed;

- take the chopped registration form to complete relevant formalities with customs, tax, quarantine and inspection, and foreign exchange authorities within 30 days; otherwise the registration form will automatically be invalidated.

The ease of this procedure is consistent with the simplification and greater transparency of licensing and registration requirements under the Administrative Licensing Law that also went into effect on July 1, 2004. Note that for FIEs that do not have domestic distribution rights (*i.e.*, the right to sell products manufactured by other companies within China), the local commerce bureau will indicate in the "note column" of the registration form that the applicant does not have the right to engage in distribution business with respect to imported products. Consequently, such FIEs may not be able to sell products in the domestic market. The benefit of trading rights is diminished unless accompanied by the grant of distribution rights.

The new procedure seems quite popular as the Beijing AIC, since July 1, has reportedly received approximately 40 applications per day for the grant of foreign trade rights.

DISTRIBUTION RIGHTS

Distribution refers to the resale of products (wholesale and retail) in China's domestic market. Historically, an FIE could obtain distribution rights only through the following methods: (i) establishment as a commercial enterprise to enjoy full distribution rights; or (ii) establishment as a manufacturing enterprise with only partial distribution rights, *i.e.*, the right to sell self-manufactured products in China. However, the right to distribute products of other enterprises and the right to engage in the retail business are not included in the second scenario.

Although foreign investment in China's commercial sector has been permitted on a restricted basis since 1992, approvals were issued very sparingly with extremely stringent limitations on the number of approvals, geographic location, and percentage of foreign ownership. China committed to lift these restrictions as a condition to its WTO accession, granting foreign entities broader domestic distribution rights that would allow independent entry into the China market without requiring equity participation with domestic partners or the services of domestic agents or distributors.

The first important legislative change in the area of distribution rights after China's WTO entry was the issuance of the amended *Catalog for Guiding Foreign Investment in Industry* in March 2002 (the "<u>2002 Catalog</u>"). The 2002 Catalog is essentially a list of foreign investment projects categorized as "encouraged," "restricted," or "prohibited" projects. Projects not listed in the 2002 Catalog are generally considered "permitted." The 2002 Catalog lists the wholesale and retail of "general merchandise" in the "encouraged" category. Wholesale and retail of certain commodities, such as medicine, agricultural products, cigarettes, etc., and the establishment of foreign trade companies are still in the "restricted" category. "Encouraged" projects are generally subject to a higher provincial- or even local-level approval ceiling while "restricted" projects are examined and approved by MOFCOM and other central government departments if they exceed the general provincial-level approval ceiling. By setting out the detailed requirements for foreign ownership and restrictions on the distribution of different products, the 2002 Catalog essentially incorporated the relevant portions of the WTO phase-in schedule into China's domestic legislation.

The promulgation by MOFCOM of the *Administrative Measures on Foreign Investment in the Commercial Sector* (the "<u>Commercial Measures</u>") in April 2004 represents a significant development in the area of distribution rights for FIEs. The Commercial Measures superseded the 1999 *Foreign-Invested Commercial Enterprises Pilot Measures* (the "<u>Pilot Measures</u>"). The Commercial Measures lifted many restrictions on the establishment of a foreign-invested commercial enterprise. More importantly, as provided in the Commercial Measures and as confirmed by our inquiries with MOFCOM officials, existing FIEs may apply for the grant of distribution rights by reference to the relevant provisions of the Commercial Measures. Thus, the Commercial Measures have a great impact not only on FIEs in the commercial sector but also on other types of FIEs, such as manufacturing FIEs, HoldCos, and services FIEs.

1. Comparing the Pilot Measures and the Commercial Measures

Under the Pilot Measures, foreign investors wishing to establish retail or wholesale joint venture commercial enterprises must have conducted business with an average annual product sales volume of not less than US$2 billion or US$2.5 billion, respectively, in the three prior years, and hold total assets valued at not less than US$200 million or US$300 million, respectively, as of the year prior to the application date. Registered capital requirements for such entities were RMB 50 million for a retail joint venture and RMB80 million for a wholesale joint venture (RMB30 million and RMB60 million, respectively, for retail and wholesale joint ventures established in China's central or western regions). The Commercial Measures eliminated the aforementioned threshold requirements for the establishment of foreign-invested commercial enterprises and merely require compliance with minimum registered capital requirements under the Company Law (RMB500,000 for enterprises engaging in wholesale businesses and RMB300,000 for enterprises engaging in the retailing businesses) and the registered capital and total investment requirements under relevant foreign investment laws and regulation. For the first time, establishment of wholly foreign-owned commercial enterprises will be permitted by December 11, 2004, a significant milestone for foreign investment in China.

The Commercial Measures retain the earlier limit on the maximum term of commercial enterprises of 30 years (40 years for those established in China's central or western regions). However, there is no prohibition on extensions of the term, and the limitation is phrased as "in general," indicating that there may be latitude for longer terms.

The Pilot Measures limited revenues that may be extracted by foreign investors through trademark licenses, technology licenses, and other ancillary services to 0.3 percent of total sales (excluding VAT) per year for up to ten years, and limited imported products to 30 percent of all goods sold by the commercial enterprise, but these restrictions were lifted by the Commercial Measures. These changes may work to the foreign investor's advantage, particularly if the foreign investor has no plans to source its products from local manufacturers.

2. Permissible Scope of Activities

The Commercial Measures establish four activities in which commercial enterprises may engage: commission agent services, wholesale trade service, retail services, and franchising. Under Article 9 of the Commercial Measures, the scope of business of a foreign-invested commercial enterprise permits a retail operator to engage in retail sales (which include sales as an agent or by consignment), export domestic products, import products for its own retail operations, and other related operations. A wholesale operator may engage in domestic wholesale of products and may arrange for the export of domestic products (auctions excluded), import and export of products, and other related operations. A commercial enterprise will continue to be subject to all import/export quotas and license requirements and must obtain all necessary approvals.

A commercial enterprise may, upon approval, engage in one or more types of sales operations and the Commercial Measures require in general that goods to be sold by a commercial enterprise shall be specified in its scope of business. Subject to compliance with the Commercial Measures, other existing FIEs will be permitted to amend their scope of business so that they may also engage in such activities. The implication of this principle is very important and represents a broad reform with respect to FIE distribution rights. Regardless of the nature of an FIE, whether it provides services, conducts manufacturing, or engages in investment activities, such FIE may be able to distribute products for all enterprises either on a commission basis or as part of its ordinary business. According to the Measures, joint ventures are already permitted to amend their scope of business to expand relevant distribution rights and WFOEs will also be permitted to do so from December 11, 2004.

The Commercial Measures also allow foreign investment in franchising without any restriction on foreign ownership. Thus, franchising was opened up to foreign investors by June 1, ahead of China's WTO commitments. However, because foreign investors (aside from qualified Hong Kong or Macau investors, as discussed below) are not permitted to establish retail stores outside of provincial capitals and their equivalents prior to December 11, 2004, this geographic restriction will still be applicable to franchises. Nonetheless, allowing foreign-invested commercial enterprises to establish franchise arrangements is a significant development.

Distribution rights are still restricted in such "pillar" industries as the automotive, chemical fertilizer, cigarette, salt, petroleum refining, petrochemical, medical device, and pharmaceutical industries.

3. Legal Compliance

Earlier drafts of the Commercial Measures were made available to and comments sought from major industry players, some of whom objected to the proposed system of ranking foreign investors based on their records for legal compliance and linking the issuance of approvals to such rankings. Many in the industry pointed to the potential repercussions that such a system might have on the business goodwill and reputation of these companies, as implementation would essentially mean the blacklisting of major multinational retailers who were early entrants into the China market.[2] As a consequence, the Commercial Measures make no mention of such a ranking system, which presumably was eliminated to alleviate the concerns of these industry players. Instead, Article 6 more generally provides that foreign investors shall be in good standing and shall have a clean legal record, and encourages foreign investors with relatively strong economic capabilities, advanced commercial operational management experience and marketing expertise, and extensive international sales networks to invest in commercial enterprises. MOFCOM officials have stated that notwithstanding MOFCOM's action to address industry concerns, the change does not signify a waning of the government's intention to maintain rigorous control over commercial enterprises to ensure compliance with legal requirements.

4. Approval Procedures

A foreign investor wishing to establish a commercial enterprise or to open up new stores must comply with the following procedures.

- To establish a commercial enterprise, the following materials must be submitted:

    1) Application

    2) Feasibility Study Report (signed by each investor)

    3) Joint Venture Contract (not required for establishment of a WFOE) and Articles of Association

    4) Bank documents certifying creditworthiness (copy), registration certificate (copy) and legal representative certificate (copy) for each investor (individual foreign investors must provide a photocopy of their personal identification document)

    5) Audit report of each investor for the past year issued by an accounting firm

    6) State-owned assets evaluation report (if state-owned assets are to be contributed to the enterprise by a Chinese party)

    7) Catalogue of goods to be imported and/or exported

    8) Names of proposed directors with letters of appointment from the investor(s)

    9) Notice of preliminary approval of enterprise name issued by the State Administration for Industry and Commerce

    10) Evidence of land use rights and/or lease contract (not required for stores whose area does not exceed 3,000 sq. m.)

    11) Document attesting to conformity of store with municipal master plan and municipality's requirements for commercial development

Any of the above documents that are not executed by the legal representative must be accompanied by an authorization signed by the legal representative. Please note that the requirement to submit a catalogue of goods to be imported and exported places a premium on making the catalogue sufficiently broad to cover all contemplated goods. Moreover, under Article 14 of the Commercial Measures, all license contracts, management contracts, and service contracts must be submitted with the application. This allows the approval authority to review the terms and conditions of such contracts.

[2] Most violations by these companies appear to involve foreign ownership thresholds, which will no longer apply after December 11, 2004, although others involve direct marketing sales methods.

- If a commercial enterprise wishes to establish additional retail store(s), the following materials must be submitted:

  1) Application

  2) If amendments are required, the amended Joint Venture Contract (not required for a WFOE) and Articles of Association

  3) Feasibility study report concerning establishment of additional store(s)

  4) Board resolutions approving establishment of additional store(s)

  5) Audit report of the commercial enterprise for the past year issued by an accounting firm

  6) Capital verification report (copy)

  7) Registration certificate (copy) and legal representative certificate (copy) for each investor

  8) Evidence of land use rights and/or lease contract (not required for stores whose area does not exceed 3,000 sq. m.)

  9) Document attesting to conformity of store with municipal master plan and municipality's requirements for commercial development

Any of the above documents that are not executed by the legal representative must be accompanied by an authorization signed by the legal representative.

Documents should be submitted to the relevant provincial-level counterpart of MOFCOM, *i.e.*, the commerce bureau or the commission on foreign economic relations and trade ("COFERT"),[3] which will examine the documents and will make a decision as to whether to verify or reject the application within 30 days after receipt of a complete application. Upon verification, the commerce bureau or COFERT will forward all documents to MOFCOM for examination and approval. MOFCOM will make its decision within three months after receipt of all application materials, and will issue a Foreign-Invested Enterprise Approval Certificate upon approval. Article 10(2) of the Commercial Measures requires MOFCOM to provide an explanation of its reasons for rejecting an application.

The Commercial Measures permit MOFCOM to delegate its approval authority to its provincial-level counterpart for foreign-invested retail enterprises that wish to file an application to establish stores (with certain exceptions with respect to products) in the province where the retail enterprise is located, provided that one of the following conditions is met: (i) the area of a single store is less than 3,000 square meters and the number of stores does not exceed three, and the total number of same type of stores established in China by the foreign investor via this retail enterprise does not exceed 30; or (ii) the area of a single store is less than 300 square meters and the number of stores does not exceed 30, and the total number of same type of store established in China by the foreign investor via this retail enterprise does not exceed 300. In this situation, the relevant commerce bureau or COFERT will issue final approval and forward the application to MOFCOM for the record.

Within a month after receipt of the Foreign-Invested Enterprise Approval Certificate, the investors shall take the approval document to SAIC for issuance of a business license. To improve the chances for a speedy approval, we generally recommend that draft documents be submitted to the approval authority for an informal review before formal submission.

[3] Sometimes known as commissions on foreign trade and economic cooperation or COFTECs. In some provinces, COFERTs have been renamed commerce bureaus to be consistent with the new name of the ministry.

The above application procedures for establishment of a commercial enterprise should also apply to amendments of business scope by other FIEs for the grant of new distribution rights or expansion of existing distribution rights.

CONCLUSION

Full trading rights are extended to all types of FIEs under the amended Law and the Registration Measures. Thus, an FIE wishing to engage in foreign trade activities can immediately apply for the grant of such rights by going through a registration process set out in the Registration Measures. Such a registration process takes no more than five days and the formalities are rather simple (*e.g.*, the registration form only needs to be signed by the legal representative of the applying FIE, rather than by the investor(s) of the FIE). With respect to distribution rights, full rights, including the right to resell (wholesale and retail) products of other companies in China either on a commission basis or as a part of one's own business, are now extended to all types of FIEs, except for WFOEs (which will have to wait until December 11, 2004). After December 11, 2004, subject to limited exceptions, any qualifying FIE may engage in the sale of products of domestic or foreign companies without legal and geographical restriction.

The following chart summarizes China's WTO commitments on trading and distribution rights and its implementation of these commitments as of today.

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DISTRIBUTION SERVICES		
DISTRIBUTION RIGHTS	**WTO COMMITMENTS**	**IMPLEMENTATION OF COMMITMENTS**
A. Commission Agents' Services (excluding salt, tobacco) B. Wholesale Trade Services (excluding salt, tobacco)	Section 4 of the Schedule of Specific Commitments on Services, Annex 9 to the Protocol on the Accession of the People's Republic of China.	Relevant PRC Regulations: (1) Sino-foreign Equity Joint Venture Law, Sino-foreign Cooperative Joint Venture Law, Wholly Foreign-owned Enterprise Law and their respective implementing Regulations (as amended, collectively the "FIE Regulations," State Council and MOFCOM, from 1979 to 2001); (2) Interim Provisions Governing the Establishment of Companies of an Investment Nature by Foreign Investors (the "Interim Holding Company Provisions," the Supplementary Provisions to the Interim Holding Company Provisions and the Supplementary Provisions (2) to the Interim Holding Company Provisions (collectively, the "HoldCo Regulations," MOFCOM, from 1995 to 2001, amended by the HoldCo Decision on April 7, 2003); (3) Decision to Amend the Interim Provisions Governing the Establishment of Companies of an Investment Nature by Foreign Investors and Their Supplemental Provisions (the "HoldCo Decision," MOFCOM, promulgated on March 7, 2003 and effective as of April 7, 2003, superseded by the HoldCo Regulations on March 13, 2004); (4) Regulations on Establishment of Companies of an Investment Nature by Foreign Investors (the "2004 HoldCo Regulations," MOFCOM, promulgated on February 13, 2004 and effective as of March 13, 2004); (5) 2002 Catalog for Guiding Foreign Investment in Industry (the "2002 Catalog," MOFCOM, March 4, 2002); (6) Notice on Relevant Issues Regarding the Experimental Establishment of Foreign-Invested Logistics Companies (the "Logistics Co Notice," MOFCOM, promulgated on June 20, 2002 and effective as of July 30, 2002); (7) Foreign-Invested Commercial Enterprises Pilot Measures (the "Pilot Measures," MOFCOM, promulgated and effective as of June 25, 1999 and superseded by the Commercial Measures on June 1, 2004); (8) Administrative Measures on Foreign Investment in the Commercial Sector (the "Commercial Measures," MOFCOM, promulgated on April 16, 2004 and effective as of June 1, 2004); (9) Measures on Administration of Foreign-Invested Distribution Companies for Books, Newspapers and Magazines (the "Distribution Co Measures," State Press and Publication Administration and MOFCOM, March 17, 2003).

	• Within **one year** after China's accession to the WTO, foreign service suppliers may establish joint ventures [**minority ownership**] to engage in the commission agents' business and wholesale business of all imported and domestically produced products, except for those products, such as books, newspapers, magazines, pharmaceutical products, pesticides and mulching films, chemical fertilizers, processed oil and crude oil.	• 2002 Catalog: Joint ventures with **foreign minority ownership** no later than **December 11, 2002** (one year after accession), excluding services with respect to books, newspapers, magazines, pharmaceutical products, pesticides and mulching films, chemical fertilizers, processed oil and crude oil. Logistics Co Notice: Joint venture logistics company with **foreign minority ownership** permitted from **July 30, 2002**; such logistics companies can engage in businesses such as import/export, transportation, storage, processing, packaging, distribution, etc.; such logistics companies are first permitted in Jiangsu, Zhejiang, Guangdong, Beijing, Tianjin, Chongqing, Shanghai and Shenzhen Special Economic Zone. FIE Regulations: Manufacturing FIEs can distribute self-manufactured products. HoldCo Decision: From April 7, 2003, HoldCos can distribute products of their overseas parents in domestic market on a market-test basis. HoldCo Regulations: HoldCos can distribute products manufactured by its investee entities both domestically and internationally; from March 23, 2004, HoldCos qualified as regional headquarters are allowed to distribute products manufactured by its offshore parent company pursuant to the 2004 HoldCo Regulations. Pilot Measures: From **June 25, 1999**, joint venture commercial enterprises with **foreign minority ownership** permitted to engage in wholesale businesses. <u>Major Restrictions</u>: Manufacturing FIEs cannot distribute non-self-manufactured products; HoldCos are subject to a minimum registered capital requirement of US$30 million and cannot distribute third party products other than those of its investee entities; logistics companies with foreign minority ownership are subject to a minimum registered capital requirement of US$5 million and are only allowed in Beijing, Tianjin, Shanghai, Chongqin, Zhejiang, Jiangsu, Guangdong and Shenzhen Special Economic Zone; commercial enterprises with foreign minority ownership engaging in wholesale businesses are subject to a minimum registered capital requirement of RMB80 million (RMB60 million if established in central and western China), their foreign and Chinese investors are subject to capital and performance threshold requirements and they can only be established in capital cities of provinces and autonomous regions, municipalities directly under the central government, municipalities with independent planning authority and special economic zones. <u>Conclusion</u>: Schedule for commitments generally already met.

	• Foreign service suppliers will be permitted to engage in the distribution of books, newspapers, magazine within **three years** after China's accession.	• 2002 Catalog: Foreign service suppliers will be permitted to engage in the distribution of books, newspapers and magazines no later than **December 11, 2004** (three years after China's accession). The Distribution Co Measures: **Minority foreign-owned** joint ventures, majority foreign-owned joint ventures and wholly foreign-owned enterprises are permitted to engage in the **wholesale** of books, newspapers and magazines from **December 11, 2004**, subject to the following conditions: (i) companies engage in wholesale have a minimum registered capital requirement of RMB30 million; (ii) foreign and Chinese investors are able to engage in distribution independently and have clean legal records; (iii) operating term no longer than 30 years. <u>Conclusion</u>: Commitments on schedule to be met.
	• Foreign service suppliers will be permitted to engage in the distribution of pharmaceutical products, pesticides and mulching films within **three years** after China's accession.	• 2002 Catalog: Foreign service suppliers will be permitted to engage in the distribution of pharmaceutical products, pesticides and mulching films no later than **December 11, 2004** (three years after China's accession). Commercial Measures: Foreign-invested enterprises can engage in the wholesaling of pharmaceutical products, pesticides and mulching films after **December 11, 2004**. <u>Conclusion</u>: Commitments on schedule to be met.
	• Foreign service suppliers will be permitted to engage in the distribution of chemical fertilizers, processed oil and crude oil within **five years** after China's accession.	• 2002 Catalog: Foreign service suppliers will be permitted to engage in the distribution of chemical fertilizers, processed oil and crude oil no later than **December 11, 2006** (five years after China's accession). Commercial Measures: Foreign-invested enterprises can engage in the wholesaling of chemical fertilizers, processed oil and crude oil after **December 11, 2006**. <u>Conclusion</u>: Commitments on schedule to be met.
	• Within **two years** after China's accession to the WTO, **foreign majority** ownership will be permitted and **no geographic** or **quantitative restrictions** will apply.	• 2002 Catalog: joint ventures with **foreign majority ownership** no later than **December 11, 2003** (two years after accession). Pilot Measures: **Before June 1, 2004** (i) **only foreign minority ownership** is permitted in enterprises engaging in the wholesaling (including retail enterprises which also engage in wholesaling); (ii) **geographic restrictions**: foreign-invested wholesaling enterprises are only permitted in capital cities of provinces and autonomous regions, municipalities directly under the central government and special economic zones; (iii) foreign investors wishing to establish wholesaling joint venture commercial enterprises must have conducted business with an average annual product sales volume of not less than US$2.5 billion in the three prior years, and hold total assets valued at not less than US$300 million as of the year prior to the application date. Registered capital requirements for such entities are RMB80 million for a wholesaling joint venture (RMB60 million for wholesaling joint ventures established in China's central or western regions).

		Commercial Measures: **Foreign majority ownership** is permitted from **June 1, 2004** with **no geographic** or **quantitative restrictions**. <u>Major Restrictions</u>: As of December 11, 2003, geographic restrictions still existed; foreign majority ownership was not permitted in the joint venture wholesaling enterprises; the wholesaling enterprises are subject to high threshold requirements. <u>Conclusion</u>: Commitments not met.
	• **None**, within **three years** after accession, except for chemical fertilizers, processed oil and crude oil within **five years** after accession	• 2002 Catalog: Wholly foreign-owned enterprises no later than **December 11, 2004** (three years after accession). Commercial Measures: **Wholly foreign-owned enterprises** are permitted from **December 11, 2004**; threshold requirements for the establishment of foreign-invested commercial enterprises under the Pilot Measures were eliminated and the only requirements are (i) compliance with minimum registered capital requirements under the Company Law (RMB500,000 for enterprises engaging in wholesaling) and (ii) the registered capital and total investment requirements under relevant foreign investment laws. <u>Conclusion</u>: Commitments on schedule to be met.
C. Retailing Services (excluding tobacco)	• Foreign service suppliers may supply services only in forms of joint ventures (note: essentially **foreign minority ownership**) in five Special Economic Zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) and six cities (Beijing, Shanghai, Tianjin, Guangzhou, Dalian and Qingdao). In Beijing and Shanghai, a total of no more than four joint venture retailing enterprises are permitted respectively. In each of the other cities, no more than two joint venture retailing enterprises will be permitted. Two joint venture retailing enterprises among the four to be established in Beijing may set up their branches in the same city (i.e. Beijing). Upon China's accession to the WTO, Zhengzhou and Wuhan will be immediately open to joint venture retailing enterprises.	• 2002 Catalog: **Foreign minority ownership** in joint ventures is permitted no later than **December 11, 2002** (one year after accession), except for the retailing of books, newspapers, magazines, pharmaceutical products, pesticides and mulching films, chemical fertilizers and processed oil. Pilot Measures: From **June 25, 1999**, foreign-invested retailing enterprises are permitted in capital cities of provinces and autonomous regions, municipalities directly under the central government and special economic zones; foreign investors wishing to establish joint venture retailing enterprises must have conducted business with an average annual product sales volume of not less than US$2 billion in the three prior years, and hold total assets valued at not less than US$200 million as of the year prior to the application date; registered capital requirements for such entities are RMB 50 million for a retail joint venture (RMB 30 million for retailing joint ventures established in China's central or western regions). <u>Conclusion</u>: Commitments already met.

	• Within **two years** after China's accession to the WTO, **foreign majority control** will be permitted in joint venture retailing enterprises and **all provincial capitals**, **Chongqing** and **Ningbo** will be open to joint venture retailing enterprises.	• 2002 Catalog: **Foreign majority ownership** is permitted no later than **December 11, 2003** (two years after accession). Pilot Measures: **Before June 1, 2004**, (i) for chain stores with more than three outlets, **only foreign minority ownership** is permitted (Chinese ownership must be more than 51%), except for those with special approval of the State Council; and (ii) for chain stores with less than three outlets, foreign majority ownership is permitted, subject to a 65% ownership limitation. Commercial Measures: **Foreign majority control** is permitted in retailing enterprises from **June 1, 2004**; companies can only be established in capital cities of provinces and autonomous regions, municipalities directly under the central government, municipalities with independent planning authorities and special economic zones before December 11, 2004; no geographical limitations after December 11, 2004. <u>Major Restrictions</u>: As of December 11, 2003, foreign majority ownership was NOT permitted for chain stores with more than three outlets; it is unclear whether foreign majority control is permitted in the retailing enterprises until June 1, 2004; other restrictions on the foreign majority control. <u>Conclusion</u>: Schedule for commitments generally already met.
	• Foreign service of all products, except for: • the retailing of books, newspapers and magazines within **one year** after accession,	• 2002 Catalog: Foreign service suppliers will be permitted to engage in the retailing of all products, except for: • the retailing of books, newspapers and magazines in which foreign service suppliers will be permitted to engage no later than **December 11, 2002** (one year after accession). Distribution Co Measures: Minority foreign-owned joint ventures, majority foreign-owned joint ventures and wholly foreign-owned enterprises are permitted to engage in the retailing of books, newspapers and magazines from **May 1, 2003** subject to the following conditions: (i) companies engage in the retailing of books, newspapers and magazines have a minimum registered capital requirement of RMB5 million; and (ii) foreign and Chinese investors with clean legal records are able to engage in distribution independently. <u>Major Restrictions</u>: Foreign investment is permitted in the retailing of books, newspaper and magazines only after May 1, 2003. <u>Conclusion</u>: Commitments not met.
	• the retailing of pharmaceutical products, pesticides, mulching films and processed oil within **three years** after accession, and	• 2002 Catalog: Foreign service suppliers will be permitted to engage in the retailing of pharmaceutical products, pesticides, mulching films and processed oil no later than **December 11, 2004** (three years after accession).

		Commercial Measures: Foreign invested enterprises can engage in the retailing of pharmaceutical products, pesticides, mulching films and processed oil after **December 11, 2004.** <u>Conclusion</u>: Commitments on schedule to be met.
	• retailing of chemical fertilizers within **five years** after accession.	• 2002 Catalog: Foreign service suppliers will be permitted to engage in retailing of chemical fertilizers which no later than **December 11, 2006** (five years after accession). Commercial Measures: Foreign invested enterprises can engage in the retailing of chemical fertilizers only after **December 11, 2006**. <u>Conclusion:</u> Commitments on schedule to be met.
	• **None**, within **three years** after accession, except for:	• 2002 Catalog: Wholly foreign-owned enterprises will be permitted no later than **December 11, 2004** (three years after accession). Commercial Measures: **Wholly foreign-owned enterprises** permitted from **December 11, 2004**; threshold requirements for the establishment of foreign-invested commercial enterprises under the Pilot Measures were eliminated and the only requirements are (i) compliance with minimum registered capital requirements under the PRC Company Law (RMB300,000 for enterprises engaging in retailing) and (ii) the registered capital and total investment requirements under relevant foreign investment laws. <u>Conclusion</u>: Commitments on schedule to be met.
	• retailing of chemical fertilizers, within **five years** after accession;	• 2002 Catalog: retailing of chemical fertilizers is permitted after **December 11, 2006**. Commercial Measures: retailing of chemical fertilizers is not permitted before **December 11, 2006**. <u>Conclusion</u>: Commitments on schedule to be met.
	• chain stores which sell products of different types and brands from multiple suppliers with more than 30 outlets. For such chain stores with more than **30 outlets**, **foreign majority ownership** will **not** be permitted if those chain stores distribute any of the following products: motor vehicles (for a period of **five years** after accession at which time the equity	• 2002 Catalog: **Foreign majority ownership** is not permitted in chain stores with more than **30 outlets** which engage in the retailing of motor vehicles (foreign service suppliers will be permitted to engage in the retailing of motor vehicles no later than **December 11, 2006**), books, newspapers, magazines, pharmaceutical products, pesticides and mulching films, chemical fertilizers, processed oil and crude oil. Commercial Measures: For chain stores with more than **30 outlets** which engage in the retailing of different types and brands from multiple suppliers, **foreign minority ownership** only is permitted if such chain stores engage in the retailing of motor vehicles (permissible no later than **December 11, 2006**), books, newspapers, magazines,

	imitation will have been eliminated), and books, newspapers, magazines, pharmaceutical products, pesticides and mulching films, chemical fertilizers, processed oil and crude oil. • The foreign chain store operators will have the freedom of choice of any partner, legally established in China according to China's laws and regulations.	pharmaceutical products, pesticides and mulching films, chemical fertilizers, processed oil and crude oil. <u>Conclusion</u>: Commitments on schedule to be met. • 2002 Catalog, Pilot Measures and Commercial Measures: No provisions with respect to restrictions on choice of the Chinese partner, but no restrictions are known to exist. <u>Conclusion</u>: Commitments presumably fully implemented.
D. Franchising	• Within **three years** after China's accession to the WTO, none.	• 2002 Catalog: foreign investment will be permitted no later than **December 11, 2004** (three years after accession). Commercial Measures: franchising permitted from **June 1, 2004**. <u>Conclusion</u>: Commitments on schedule to be met.
E. Wholesale or retail trade services away from a fixed location.	• Within **three years** after China's accession to the WTO, none.	• 2002 Catalog: foreign investment will be permitted no later than **December 11, 2004** (three years after accession). Commercial Measures: None. <u>Conclusion</u>: Commitments on schedule to be met.

DISTRIBUTION SERVICES		
TRADING RIGHTS	**WTO COMMITMENTS**	**IMPLEMENTATION OF COMMITMENTS**
Right to trade	Article 5 of the Protocol on the Accession of the People's Republic of China.	Relevant PRC Regulations: (1) Pilot Interim Provisions on Establishment of Chinese-Foreign Foreign Trade Joint Ventures (the "<u>JV Trading Co Pilot Provisions</u>", MOFCOM, promulgated on September 30, 1996 and superseded by the JV Trading Co Provisions); (2) Interim Provisions on Establishment of Chinese-Foreign Trading Joint Ventures (the "<u>JV Trading Co Provisions</u>", MOFCOM, promulgated on January 31, 2003 and effective as of February 31, 2003); (3) amended Foreign Trade Law (the amended "<u>Law</u>", Standing Committee of the National People's Congress, promulgated on April 6, 2004 and effective as of July 1, 2004); (4) Measures on Registration of Foreign Trade Operators (the "<u>Registration Measures</u>", MOFCOM, promulgated on June 25, 2004 and effective as of July 1, 2004).
	• Three year phase-in period: Within **one year** after China's accession, joint venture enterprises with **minority foreign ownership** will be granted full trading rights with respect to all goods through the customs territory of China, except for goods which continue to subject to state trading. Such right to trade shall be the right to import and export goods. Such goods shall be accorded national treatment in respect of their internal sale, offering for sale, purchase, transportation, distribution or use, including their direct access to end-users.	• JV Trading Co Pilot Provisions: **Foreign minority ownership** was permitted in joint venture trading companies from **1996** (before China's accession). <u>Major Restrictions</u>: minimum registered capital of RMB100 million for a JV trading co, foreign investor's global revenue in the preceding year not less than US$5 billion; foreign investor's average annual trading volume with China in the preceding three years not less than US$30 million; foreign investor's total investment in China not less than US$30 million and with a representative office for three years or more; Chinese investor has foreign trade rights; Chinese investor's average annual import/export volume in the preceding three years not less than US$200 million (with export volume of not less than US$100 million); Chinese investor has more than three overseas subsidiaries and branches with an average annual overseas revenue of not less than US$10 million; geographical restrictions to Shanghai Pudong and Shenzhen Economic Zone. <u>Conclusion</u>: Commitments on schedule to be met.

	• All foreign individuals and enterprises, including those not invested or registered in China, shall be accorded treatment no less favorable than that accorded to enterprises in China with respect to the right to trade.	• Amended Law: national treatment accorded to foreign individuals and enterprises as a general principle. <u>Conclusion</u>: Commitments fully implemented on July 1, 2004 before the deadline.

	• Within **two years** after China's accession, joint venture enterprises with **majority foreign ownership** will be granted full trading rights with respect to all goods through the customs territory of China, except for the goods which continue to subject to state trading. • Within **three years** after China's accession, all enterprises in China shall have the right to trade in all goods through the customs territory of China, except for the goods which continue to subject to state trading. • All foreign individuals and enterprises, including those not invested or registered in China, shall be accorded treatment no less favorable than that accorded to enterprises in China with respect to the right to trade.	• JV Trading Co Provisions: JV trading co with **majority foreign ownership** permitted after **December 11, 2003** (two years after China's accession). <u>Major restrictions</u>: Minimum registered capital requirement of RMB50 million (RMB30 million for companies established in central and western China); foreign investor has an average annual trade volume of not less than US$300 million (US$20 million for companies established in central and western China) in the preceding three years; Chinese investor must possess foreign trade rights and satisfy the same trade volume requirement. <u>Conclusion</u>: Commitments on schedule to be met. • Amended Law and Registration Measures: all enterprises and individuals eligible for foreign trade rights; the previous "approval" requirement changed to a "registration" requirement for grant of the trading rights; existing enterprises allowed to expand their scopes of business to include trading rights; no separate trading companies requirement; no minimum registered capital requirement. <u>Conclusion</u>: Commitments fully implemented on July 1, 2004 before the schedule. • Amended Law: national treatment accorded to foreign individuals and enterprises as a general principle. <u>Conclusion</u>: Commitments fully implemented on July 1, 2004 before the deadline.