China Update

1 May 2015

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Legal News

Intellectual Property and Privacy

China's Software Copyright Registrations

The Copyright Protection Centre of China (CPCC) recently issued its 2014 Analysis Report on China's Software Copyright Registration, which reports China registered copyright for 218,784 software programs last year. The four main types of software includes infrastructure software, middleware, applications software, and embedded software, with application software accounting for 72% of the total. Therefore, the software industry is not only rapidly developing, but also increasing awareness of copyright protection among copyright holders.

China's Delays New Technology Policy

China has delayed a policy, which if implemented, would effectively push foreign technology companies out of China's banking sector by enforcing procurement practices favouring domestic products and services. In particular, it encourages China banks to buy technology such as servers and mainframes from Chinese companies, and for companies selling computer equipment to Chinese banks to submit intellectual property and source codes. At stake is billion of dollars of business for major American companies that make the advanced computing hardware and software that crunches numbers for banks across China, including Microsoft, IBM, and Apple who have complained such policies are protectionist. This is part of a wider clash between China and the US over online security and technology policy, and although the American trade groups are cautiously optimistic at the delay, the China Banking Regulatory Commission and the Ministry of Industry and Information Technology said the delay is only due to amendment suggestions from its financial institutions and other parties to ensure compliance with industrial policies and World Trade Organisation rules.

Understanding the Remuneration for Employee Inventors in China

China's State Council Legislative Affairs Office recently released the Draft Regulations on Service Invention (the "Draft") for public comments. The Draft includes several significant provisions that may increase companies' compensation costs in relation to employee-inventions in an attempt to promote innovation and protect the financial and compensation of employee inventors. The recent published Draft consists of a few significant proposals:

- Service inventions that are granted with patent rights or new plant varietal rights requires the employer to pay the inventor(s) an award in the total amount of no less than 200% of the average monthly salary of the employer's on-post staff; and for service inventions that are granted with other intellectual property rights, the total amount of the reward for the inventor(s) shall be no less than the average monthly salary of the employer's on-post staff;
- The four standards provided by the Draft of when the entity must provide remuneration to the related investor(s) upon exploitation of the intellectual property rights including either a sum of money no less than 5% from the operating profit or no less than 3% from the operating profit of exploiting the other intellectual property right; no less than 0.5% from the revenue of exploiting the patent right or the right of new varieties of plants, or no less than 0.3% from the revenue of exploiting the other intellectual property right; or determine a lump sum amount of remuneration to be paid to the inventor; and
- If the employer assigns or licenses the patent rights of service inventions, the employer shall pay remuneration to the inventor(s) a total amount of no less than 20% of the net income from such assignment of licensing.

Employers will have less autonomy and control over their employee's inventions, and will have to respond quickly to employee's claims and decide quickly on issues regarding the ownership and use of an invention, lest it ends up belonging to the employee. Furthermore, the Draft seeks to expand its scope by providing for and regulating over trade secrets and software, which may cause difficulties as employers will have to effectively divide profits related to these intellectual property areas and compensate every involved employee based on their individual contribution. It has been recommended for companies to have well-drafted employee-inventor compensation schemes or policies as well as putting in place an internal system that can handle employee ownership or compensation claims. Therefore, in an attempt to generate more inventions, encourage innovation, and attract and foster more talent, China has revamped the legal framework to protect the rights and interests of employees and their inventions. This move by the State Council Legislative Affairs Office to enforce the Draft Regulations on Service Invention will be a valuable asset as it will provide competitive advantage and contribute to the long-term success of China's economy.

Intellectual Property Rights from a Competition Law Perspective

The State Administration for Industry and Commerce issued the finalised Provisions on Prohibiting the Abuse of Intellectual Property Rights to Preclude or Restrict Competition ("the Provisions") to be effective as of August 1, 2015. The Provisions are a response to widespread concerns that AML is increasingly used in ways that favour Chinese licensees of intellectual property rights in their disputes with foreign licensors, and have recognised that intellectual property and competition law share the same goal of encouraging competition and innovation.

The Provisions include:

- Articles 1-3 specifies the objective and basis of the Provisions, which are to protect market fair competition, encourage innovation, and prevent operators from abusing the intellectual property rights to preclude or restrict competition;
- Articles 4-5 provides for the prohibition of operators from reaching monopolistic agreement during their exercise of the intellectual property rights, as well as providing for the following situations deemed not a monopoly agreement forbidden by the Anti-monopoly Law:
    - The aggregate market share of operators with competing relations in the relevant market affected by the operators' conduct does not exceed 20%, or, at least four substitutable technologies independently controlled by others may be obtained at reasonable costs in the relevant market; or
    - Neither the operator nor the transaction counterparty has a market share exceeding 30% in the relevant market, or, at least two substitutable technologies independently controlled by others can be obtained at reasonable costs in the relevant market;
- Articles 6-11 prohibits operators exercising intellectual property rights from abusing their dominant position in the market to eliminate and restrict competition, and provides five prohibited common abusive conduct including the refusal to license intellectual property rights, imposing transaction restrictions, tie-in sales, and/or attaching unreasonable restrictions and differential treatment;
- Articles 12-13 provides for a list of conduct that is prohibited for patent pools with a dominant position, absent a valid justification, in case they limit or restrict competition;
- Articles 14-16 clarify the analysis principle and framework of anti-monopoly enforcement in the field of intellectual property rights by the AIC organs, and sets forth factors as well as five steps to be adopted when analysing for abuse of intellectual property rights; and
- Article 17 provides for the punishment of the abuse of intellectual property rights by entering into a monopolistic agreement to preclude or restrict competition.

Therefore, the issuance of the Provisions is a signal of the importance of regulating over the abuse of intellectual property rights in the anti-monopoly enforcement. Not only do the Provisions enhance the operability of the relevant laws, but it also provides better protection for properly exercising intellectual property and a better environment for competition and innovation.

Beijing IP Court Statistics

The Beijing Intellectual Property Court, which started operation on 6 November 2014, has accepted 2400 cases and concluded 587 cases from its date of inception until 20 March 2015. In this figure, trademark cases accounted for the highest proportion of 71% among the first instances, whereas copyright cases accounted for the highest proportion of 76% among the second instances.

<u>Consumer Protection</u>

Charity Law Aims at Boosting Public Trust

China has prepared a draft law for charities to register directly with the government, making it easier for charities to raise funds by exempting charities from taxes and waiving taxes for donors. In response to the lack of enthusiasm due to the public's mistrust of charities, the draft law will provide charities with more means to raise funds from the public, including setting up donation boxes, through charity events, and allowing foreign charities to be registered if in cooperation with Chinese charities.

Corporate and M&A

Foreign companies at Risk From Proposed Chinese Law

Foreign companies and several Chinese Internet companies with US stock exchange listings using a VIE (variable interest entity) structure in China to do business in sectors of the economy where foreign investment is restricted by the Chinese government may soon be rendered illegal under a law proposed by the Ministry of Commerce of the People's Republic of China. The proposed law will be drawing a simpler distinction between sectors where foreign investors will get the same treatment as Chinese investors, and a negative list of restricted and prohibited sectors where only companies controlled by Chinese nationals can operate, even if structured as VIEs. Therefore, the proposed legislation will remove ambiguity by legalising some VIE operations controlled by Chinese nationals, and determine others as being completely illegal. The draft law is anxiously awaited, as VIEs have been used prolifically for foreign investment across numerous restricted industries in China for many years.

CBRC Revised Guidelines on Acquisition Financing

The CBRC recently revised the Guidelines on Acquisition Financing to facilitate the development of the M&A loan market in China. The key changes under qualifications and conditions include:

- The Guidelines now apply to commercial banks, policy banks, local branches of foreign banks and finance companies of enterprise groups;
- Requirements are 100% loan loss specific reserve adequacy ratio and the general reserve balance of not less than 1% of concurrent loan balance have been removed such that a bank may provide M&A loans if, on an on-going basis:
  - It has a sound risk management system and an efficient internal control mechanism;
  - Its capacity adequacy ratio is not less than 10%;
  - All other regulatory indices meet applicable regulatory requirements; and
  - It has a professional team responsible for M&A loan due diligence and risk assessment;
- A M&A loan amount cannot exceed 60% of the total acquisition price and the term of the loan should not exceed 7 years; and
- The security requirements for M&A loans do not have to be more stringent than security for other loans, provided the security that is proportionate to the risks associated with the M&A loan.

The key changes to provide for enhancing risk management include:

- Having a system to statistically analyse M&A loans in accordance with regulatory requirements;
- Reporting to CBRC the concentration limit on a per-borrower, group customer, industrial, national or jurisdictional basis;
- Ascertaining the leveraged ratio of M&A loans and ensuring reasonable funding by equity contribution; and
- Strengthened due diligence and after lending loan management and supervision.

The Revised Guidelines have relaxed lender qualification requirements, permitted longer loan tenor and higher loan-to-acquisition price ratio, as well as emphasising on risk assessment and internal controls to guard against non-performing loans and fraudulent transactions. Therefore, this healthy development of the onshore M&A loan market in which loans are granted based on commercial rather than policy reasons means there will be more opportunities for every market participant.

China's Easing Plan to Assist Debt Restructuring

China's central bank is planning to launch an innovative credit-easing program in a response to Beijing's struggle to solve the country's local-government debt problems, which has resulted in a surge in the amount of capital leaving China's shores. The People's Bank of China (PBOC) will allow Chinese banks to swap local-government bailout bonds for loans in order to bolster liquidity and boost lending, marking a major shift in the policies of Chinese banks, which usually rely on Internet rates and banks' reserve requirements to regulate money supply.

Business News

China's Aggressive Cut in Bank's Reserve Requirement Ratio

In its biggest move since late 2008, the People's Bank of China slashed the reserve requirement-ratio by a full percentage point, as well as offering an array of targeted reserve requirements cuts aimed at helping small businesses and farmers. This latest move, which released approximately ¥1.5 trillion into the banking system, was fuelled by the government's announcement that the first-quarter economic growth is 7% from a year earlier, which is the worst performance in six years, as well as China's bankers lowering the borrowing costs for companies struggling to adjust to a weaker economy. With the economy sliding closer to deflation, China has entered into an aggressive monetary easing cycle, with more easing measure to take place including more cuts, accelerated infrastructure spending and property policy relaxation.

China's Attempt to Shore Up Growth

In an effort to tackle economic slowdown amid concerns of a possible slip in the first quarter, the Chinese government has announced a package of relief measures including a cut on industrial electricity prices and resource taxes on iron ore, and the elimination of official fees for firms, to stimulate businesses and prop up the real economy against increasing downward pressure. In addition to this, there will be interest rate and deposit reserve ratio cuts, more reform measures, a six-month campaign to eliminate unreasonable administrative fees for approvals, guild memberships and market access, and an initiative to streamline administration and delegate powers to allow easier market access and less governmental interference, therefore ultimately moving towards a better business environment and promote entrepreneurship.

Expanding the Clearing Market for Bank Cards

Foreign companies including American Express Corp, MasterCard Inc. and Visa Inc. hope to enter China's ¥-denominated bank card clearing market worth $73 trillion a year. The State Council have recently published framework rules, which provides for foreign clearing service to join the market by applying for licences, and includes requirements such as setting up Chinese branches or acquiring a local partner, and a requirement of a registered capital of at least ¥1 billion to qualify for bank card clearing facilities in China. Therefore, China hopes to consequently add more brands, provide more competition, provide a better service for Chinese consumers, and accelerate China's payment market reforms and innovations.

China Rail Group and Africa Signs Deals

In its latest move in the New Silk Road Initiative, a strategy to build infrastructure around the developing world, a Chinese-state owned rail company signed a $5.5 billion worth of contracts in Africa to build an intercity rail line in Nigeria and to develop a residential real estate in Zimbabwe. Financing this project may come from China's foreign exchange reserves by injecting $62 billion in into the country's non-commercial policy banks, which are to play a key role in supporting the New Silk Road Initiative.
China's 'One Road, One Belt' strategy includes plans to build roads, railways, ports, natural gas pipelines and other infrastructure stretching into Southeast Asia, the Middle East, and through central Asia to Europe to create a demand for China's industrial exports in the face of overcapacity at home. In addition to this, the 21st Century Maritime Silk Road and the Silk Road Economic Belt are expected to drive sales to Chinese train manufacturers, port operators and electricity products, and China's two other rail groups are engaged in a merger aimed at creating a globally competitive giant. However, there has been controversy surrounding such investment deals, mainly because of concerns over transparency and corruption at Beijing's largest state companies.

Australia Supports Qantas-China Eastern Airlines Alliance

Australia's government is supportive of the proposed alliance between China Eastern Airlines and Australian carrier Qantas, as it will have a positive effect on the Australian economy and is consistent with their aviation policy settings, which are designed to support Australia's consumers, tourism industry and economy. While the Australian Competition and Consumer Commission hinted its disapproval for the plans because the alliance would give China Eastern and Qantas an increased ability and incentive to limit capacity and/or increase airfares, the Department of Infrastructure and Regional Development criticised their narrow focus, and stated that consideration should be on the operations of the wider Australia-China market.

Domestic Brands Given Overseas Safeguards

The State Council of China unveiled new measures aimed at ensuring the quality of Chinese products sold overseas, as there are concerns over quality and intellectual property rights over such merchandise. A three-year plan will address key products exported to Africa, Arab nations, Latin American and countries along the Silk Road Economic Belt and 21st Century Maritime Silk Road, and improvements will be made on cross-border law enforcement, including monitoring, evidence collection and judicial assistance, all key parts of a nationwide drive to prevent violations of intellectual property rights and to target producers of counterfeit goods.

China's E-commerce Market Globalised

China's online shopping borders are being blurred as e-ecommerce giants forge global links between China's online shoppers with international markets. The Chinese government have encouraged these cross-border sales by setting up bonded warehouse zones for orders currently in Shanghai, Zhengzhou, Ningbo, Hangzhou, Chongqing, and Guangzhou, but soon to expand with orders skyrocketing. The benefits for Chinese consumers ordering online are qualitative and quantitative, because not only does it offer more selection, but these legitimate sales options are a reliable alternatives to China's gray market, and a lower tax rate are offered on items than if they were buying on the mainland.