

China Seeks to Update its Legislation to Address Burgeoning E-Commerce Market

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1. Introduction

With increasing internet penetration throughout the country, the e-commerce industry, like other industries in China, is growing at a swift pace. This was recently demonstrated by the online shopping frenzy for Singles Day (光棍节) which is China's 'Anti-Valentine's Day' and takes place on November 11 every year, with RMB 35.01 billion transacted over Alipay alone via Taobao Marketplace and Tmall. However the relevant legislation in China has not kept pace with the new issues thrown up by this astonishing growth. As a result, the Chinese government has, in the past year, released laws, regulations and guidelines focusing on e-commerce consumer protection and unlawful disclosures of personal data¹, and is trying to update previous laws to meet the new challenges of e-commerce with Chinese characteristics.

Recently, China's State Administration of Industry and Commerce ("**SAIC**") issued a draft of the new *Online Commodity Trading and Related Services Administrative Procedures* (网络商品交易及有关服务管理办法) on 11 September 2013 (the "**Draft Online Trading Procedures**"), with the objective of revising and clarifying the *Online Commodities Trading and Related Services Tentative Administrative Procedures* (网络商品交易及有关服务行为管理暂行办法) issued by it on 31 May 2010 (the "**Tentative Online Trading Procedures**"). The aim of the Tentative

Online Trading Procedures was to regulate online commodity trading conduct and to protect consumers and business operators engaging in online trading.

In addition, China's Ministry of Commerce ("**MOFCOM**") also released a draft of the *Online Retailing Conducted on Third-Party Platforms Transaction Rules Administrative Procedures* (网络零售第三方平台交易规则管理办法) on 26 September 2013 (the "**Draft Transaction Rules Procedures**"), which aims to regulate transaction rules stipulated by third-party service platforms (such as Taobao, Yihaodian and so forth). The above-mentioned drafts represent a further attempt to regulate the booming e-commerce industry, while providing a more secure environment for e-commerce. The very fact that these drafts have been issued suggests that there are still a number of unresolved issues relating to e-commerce in China that the current legislative framework is ill-equipped to address.

2. Aims of the Tentative Online Trading Procedures

As noted above, the primary aim of the Tentative Online Trading Procedures was regulation of online behaviour and to protect the parties to a business to consumer online transaction. Among other things, the Tentative Online Trading Procedures required vendors to register using a real-name system and to display their business license information on their websites, so as to give consumers of their products better transparency as to who they were dealing with, and the ability to trace the vendor in the event there was an issue with the product. Vendors and service providers were also required to display accurate and detailed information about their products or services as well as to comply with intellectual property and anti-unfair competition laws (presumably meaning, amongst other things, no selling of fakes and no unlawful bundling of products). Furthermore, online service providers were required to establish a monitoring system to review commodities and service information, report any violation of laws and regulations by online vendors to the local SAIC branch, the Administration of Industry and Commerce ("**AIC**") department and take immediate action to stop such violations.

While the Tentative Online Trading Procedures represented a first attempt at bringing order to the online market place, things have since moved on, and they have become substantially outdated. Further measures and revisions are now needed to adequately protect consumer rights in the

¹ On 25 October 2013, the Standing Committee of the National People's Congress issued an amendment to the 1993 *Consumer Rights and Interests Law* (中华人民共和国消费者权益保护法) ("**Consumer Protection Law**"), with almost half of the clauses in the current law being amended to cover e-commerce. This is the first attempt at amending the 20 year-old Consumer Protection Law. It is notable that Article 10 of the Draft Online Trading Procedures imposes a specific obligation on online product vendors to comply with the Consumer Protection Law, the PRC Product Quality Law and other applicable laws, regulations and rules, and to not prejudice the rights and interests of consumers, thereby providing express linkage between itself and consumer protection legislation. The Ministry of Industry and Information Technology of the PRC issued two rules which became effective in September 2013, namely, (i) the *Protection of Personal Data of Telecommunications and Internet Users Provisions* (电信和互联网用户个人信息保护规定) which were formulated in accordance with the Standing Committee of the National People's Congress' *Decision on Strengthening Network Information Protection* (全国人民代表大会常务委员会关于加强网络信息保护的決定) on 28 December 2012; and (ii) the *Registration of the True Identity Information of Telephone Users Provisions* (电话用户真实身份信息登记规定) (together, the "**Provisions**"). These Provisions outline the standards for the collection and use of personal information, establish specific security protection requirements for personal data collected, and impose financial penalties for violation of the Provisions.

changed marketplace. As a result, the SAIC issued the Draft Online Trading Procedures for public consultation on 11 September 2013. The main proposed changes are outlined below.

2.1. Defined "Online Trading" and "Third-Party Platform"

The Draft Online Trading Procedures specify that "Online Trading" will only refer to transactions involving commodities and services processed through the internet, and not telephone or television sales. Moreover, the Draft Online Trading Procedures define "Third-Party Platform" as a virtual space which publicizes information, and assists parties in conducting online transactional activities based on certain transactional rules. The narrower definitions, which were absent in the Tentative Online Trading Procedures, provide more certainty as to who may be caught under the law.

2.2 Addition of anti-unfair competition provision

In line with the recent investigations and enforcement actions by the National Development and Reform Commission ("NDRC") against market behaviour constituting anti-competitive conduct or unlawful unfair competition, a provision has been added to the Draft Online Trading Procedures focusing on anti-competitive acts, which would attract a penalty of RMB 10,000 to RMB 30,000². The non-exhaustive list of anti-competitive acts is as follows:

- a) unauthorized use of famous trade names, marks and domain names of famous websites, leading to consumer confusion as to the source of the goods or services;
- b) unauthorized use of marks belonging to government departments or social groupings;
- c) offering virtual items as prizes for raffles and lotteries with market values exceeding the permissible amount prescribed by relevant laws and regulations or falsely declaring to have prize;

- d) employing others or colluding with others to perform fictitious transactions that enhance the business reputation of oneself or another;
- e) employing others or colluding with others to provide negative commentary on a competitor's product or service with intent to damage a competitor's business reputation after a transaction;
- f) performing cyber-attacks on a competitor's website or web-pages which prevents a competitor from conducting normal business operation; and
- g) other acts amounting to unfair competition .

Looked at in isolation, the provisions on anti-unfair competition simply contain a shopping list of prohibited activities with a "sweep up" provision at the end to make it open-ended to catch potential new activities or ones overlooked in the Draft Online Trading Procedures.

With such low value monetary fines, it is unlikely the Draft Online Trading Procedures alone will act as a significant financial deterrent for large online vendors. However, this draft legislation must be assessed against the wider legislative and regulatory background, such as the *People's Republic of China Anti-Unfair Competition Law*³ ("AUCL") and the *People's Republic of China Trade Mark Law*⁴ ("Trade Mark Law"), which impose much more stringent penalties than those provided for in the Draft Online Trading Procedures for the same types of anti-competitive activities. For example, under the AUCL, a business operator who engages in anti-competitive lottery activities or intentionally damages a competitor's reputation will be liable in damages for losses caused to the business operators whose rights have been infringed, and/or will be required to give up unlawful gains. Additionally, under the AUCL, business operators selling counterfeit products are liable to a fine of between one to three times the unlawful earnings, revocation of their business licence as well as facing criminal liability. Similarly, under the Trade Mark Law, trade mark infringers are liable to have a punishment of up to five times the unlawful profits imposed on them and criminal sanctions. If the illegal profits cannot be ascertained, a fine of up to RMB3 million may be imposed. There may also be a case to answer under the AML in circumstances where either the infringing company was in a dominant market position or where the relevant activity involved the parties entering into a "monopolistic agreement", such as a cartel agreement.

² On 1 August 2013, China celebrated the fifth anniversary of the *People's Republic of China Anti-Monopoly Law* (中华人民共和国反垄断法) ("AML") coming into effect. For the most part of the AML's first five years of enforcement, the NDRC has maintained a low profile, mainly only investigating and penalizing blatant cartels and monopolies. However, in 2013, NDRC appeared to shift up several gears and the NDRC's regulatory enforcement focus appears to have shifted to aspects of retail price maintenance and excessive pricing practices. For more information regarding NDRC's recent decisions, please see "NDRC Actions Show Broadened Scope of Antitrust Enforcement in China" http://www.hoganlovells.com/files/Publication/dfa1516e-6775-4258-9746-16bbe9a6ff4c/Presentation/PublicationAttachment/a2ca0d22-74bd-4192-a6dc-0a713aaa773f/ACER%20Alert_NDRCS%20Antitrust%20Crackdown%20Continues%20and%20its%20Scope%20Broadens_Sep%202013.pdf and "Antitrust hangover in the liquor industry – Chinese white liquor producers fined for setting distributors' resale prices" See also "Antitrust Enforcement Against Abuse of IPRs and Anti-Competitive Conduct in the High Technology Sector – An Update from China" <http://ehoganlovells.com/rv/ff000e613233f55f7b0c731af94e8f1d5c7e9673>.

³ *People's Republic of China Anti-Unfair Competition Law* (中华人民共和国反不正当竞争法), effective 2 September 1993.

⁴ *People's Republic of China Trade Mark Law* (中华人民共和国商标法), effective on 1 March 1983, and amended in 22 February 1993, 27 October 2001 and on 30 August 2013. The latest version of the Trade Mark Law shall come into effect on 1 May 2014.

The AUCL, Trade Mark Law and AML are laws promulgated by the Standing Committee of the National People's Congress and thus will rank above the Draft Online Trading Procedures⁵. Therefore, the Draft Online Trading Procedure alone may not be able to deliver a big enough 'punch' to deter the big players from engaging in anti-competitive acts. However, it may still be possible to rely on the overlap with existing, higher-ranking legislation within the Chinese legislative hierarchy which has more severe penalties and real "teeth".

2.3 Powers of the SAIC

The Draft Online Trading Procedures also added a provision outlining the powers of the SAIC when conducting investigations on suspected illegal online transactions or services, namely to:

- a) enter business premises and conduct onsite investigations;
- b) conduct investigations and question suspects;
- c) access data, documents, contracts and accounts;
- d) seize products, tools, equipment and so forth relating to the unlawful online business and products or service transactions; and
- e) shut down the business premises of places where unlawful online product or service business is being carried on.

These powers granted to the SAIC are not new. Under the AML, the AUCL, Trade Mark Law, the SAIC also has extensive powers to enter the "relevant premises" (which may be interpreted to include residences), conduct on-site investigations, remove documents and other evidence (including data from computers) and question suspects or witnesses. Given the low monetary punishments in the Draft Online Trading Procedures, these additional SAIC powers may not be a deterrent *per se*, but may act as an indirect deterrent, as the party engaging in the suspect activities may be concerned about what else SAIC will find while exercising these powers, such as breaches of the AML or AUCL (where 'bigger guns' are available).

2.4 Clarification and increased penalties for real-name registration system

The Tentative Online Trading Procedures stipulate that all online service providers are required to verify the true identity of online vendors. For individual vendors who are eligible to

register with the SAIC or its local branch, the AIC, the online service provider is required to build archives to record their true identities and to verify and update these archives on a regular basis. Other legal persons or organizations are required to register with the AIC and are required to prominently display or provide a link to their business license on their website.

The Draft Online Trading Procedures have clarified the above real-name registration system requirements, specifically stipulating that individual online vendors are allowed to engage in online transactions despite not having a business license from the AIC. However, they are only allowed to do so through a third-party transaction platform, and must register with the third-party transaction platform using their real names, thus giving the consumer greater protection and greater vendor 'traceability'. Failure to abide by these provisions will attract a fine between RMB 10,000 and RMB 30,000.

2.5 Obligations of third-party platforms

Third party platform operators are also regulated specifically under the Draft Online Trading Procedures, thereby linking them to the Draft Transaction Rules Procedures. Third party platform operators are also required to be registered with the AIC. They are required to provide a sound online transaction environment and to protect consumers' interests by:

- a) adopting necessary technologies and measures to ensure that their platforms are secure, reliable and free from spam;
- b) collating and supervising information on products and services sold on the platform. If the third-party platform finds that information posted by vendors is in violation of AIC rules, the third-party platform must report to the local AIC authorities and take measures to stop the vendor from posting misleading information;
- c) taking appropriate action against vendors to stop activities that infringe the trade marks of third parties;
- d) establishing a mechanism to resolve disputes between consumers and vendors. The third-party platform shall take all measures to assist consumers, including acting as mediator between consumers and vendors. If a consumer wishes to seek redress through other channels, the third-party platform must provide genuine registration information on vendors to consumers;
- e) establishing a fair and objective consumer-generated review system, to allow consumers to rate the vendor and its products;

⁵ Which are lower-ranking departmental rules (部门规章).

- f) reporting to local AIC on any unlawful activity by vendors and actively cooperating with the AIC in the event of an investigation; and
- g) establishing a special fund to compensate consumers when their legal rights are infringed.

In addition, a third party platform operator is under an obligation to enact transaction rules between the third party platform operator and vendors that clearly outline their respective rights, duties and obligations. This emphasis on transaction rules demonstrates a clear intent on the part of the Chinese authorities to delegate the duties of monitoring online trading activities to third party platform providers. The specific requirements regarding third party platform transaction rules are further detailed in the Draft Transaction Rules Procedures (discussed below).

2.6 Increased punishments

The Draft Online Trading Procedures impose stricter monetary penalties than the Tentative Online Trading Procedures, namely:

- a) the penalty has been increased from up to RMB 10,000 to an amount between RMB 10,000 to RMB 30,000 for any loss or mishandling of personal data⁶;
- b) the penalty has been increased from up to RMB 10,000 to an amount between RMB 10,000 and RMB 30,000 for failure to cooperate with authorities in investigating violations by online vendors;
- c) business operators providing a forum for consumers to review and post comments on goods and/or services must ensure the forums remain impartial and fair, otherwise a fine between RMB 10,000 to RMB 30,000 may be imposed on them;
- d) those who receive benefits from online vendors to advertise products and services on their social media sites will be required to disclose the benefits

received, otherwise a fine of up to RMB 10,000 may be imposed;

- e) failure to display clearly the information pertaining to services or products including their names, categories, quantities, prices, quality, shipping fees, forms of payment and methods, and return or exchange methods may attract a fine up to RMB 10,000; and
- f) failure by a third-party transaction platform to provide adequate transaction rules and management of its transaction platform may attract a fine between RMB 10,000 to 30,000.

The Draft Online Trading Procedures reinforce and clarify the obligations of third-party platform providers to monitor the trading behaviour of online vendors and protect data. The penalties imposed in the Draft Online Trading Procedures remain low. Perhaps, when used in combination with additional powers given to the SAIC to conduct investigations, seize products and shut down businesses, the Draft Online Trading Procedures may provide a greater stick to persuade business operators to comply with the new law.

Overall, however, the amendments made to the Draft Online Trading Procedures are not revolutionary. When viewed against the wider background of anti-competition, anti-corruption and data protection laws which contain more severe penalties, the Draft Online Trading Procedures itself may simply be seen as consumer-friendly legislation that does not pack much of a punch.

Having said that, the Draft Online Trading Procedures are not without value. A significant contribution of the Draft Online Trading Procedures is the clarification of the real-name registration system which addresses a serious issue with vendor identity and which represents one of the key elements for consumer protection in e-commerce. After-sales customer services have proved in practice to be particularly inadequate, as consumers who wish to return or repair products, launch complaints or receive technical support are often hampered by difficulties in identifying the original seller. The real-name registration system will hopefully create a credit and disclosure system to address problems that arise from counterfeiting, inferior product quality, misrepresentation, fraud, and other types of behaviour that may harm consumers. Further, the requirement for third-party platforms to establish transaction rules with vendors may provide an additional incentive to comply with the new legislation, as it gives third-party transaction platforms contractual powers to terminate registration agreements in the event the vendor has engaged in illegal activities.

⁶ The increased penalties for loss or mishandling of personal data are in line with those set out in the Provisions, where they also range from RMB 10,000 to 30,000. Under the *Regulating of the Internet Information Service Market Several Provisions* (规范互联网信息服务市场秩序若干规定) effective on 15 March 2012, Internet Service Providers will also be subject to a fine of RMB 10,000 to 30,000 for failure to safeguard the information uploaded by users, or for modifying, deleting, disclosing and transferring personal information without authorization. For more information, please see "Making Sense of China's New Privacy Laws and Draft Internet Privacy Regulations" and "New law on internet services addressing competition and personal information protection" which can be found by following the links below:
<http://www.hldataprotection.com/2013/06/articles/consumer-privacy/making-sense-of-chinas-new-privacy-laws/> and
http://www.hoganlovells.com/files/Publication/a57c75f0-32ca-4a22-a897-e9b3d200264c/Presentation/PublicationAttachment/1d8e080a-6a6d-40f3-81a6-6ae4946a345e/Hogan_Lovells_China_Corporate_Alert_March_2012.pdf. For a more general overview of data privacy laws, see "China Turns Up The Heat in the Battle Against Abuses of Personal Data"
<http://ehoganlovells.com/rv/ff0011be93a3f9407f3e295ea54e8b05a8761789>.

3. Online Retailing Conducted on Third-Party Platforms Administrative Procedures Transaction Rules

On 26 September 2013, MOFCOM released the Draft Transaction Rules Procedures, which propose to regulate the transaction rules set by third-party platform providers. Unlike the Draft Online Trading Procedures which are essentially an update of existing rules, the Draft Transaction Rules Procedures appear to cover new legislative ground, no doubt prompted by numerous consumer complaints.

The Draft Transaction Rules Procedures require third-party platform providers to include the following in their transaction rules:

- a) basic rules for transactions;
- b) rules for obligations and risk allocation;
- c) rules for intellectual property protection;
- d) rules for credit ratings;
- e) rules for consumer rights protection;
- f) rules for information and real-name system disclosure;
- g) rules for handling unlawful information;
- h) rules for disputed transactions resolution and handling of violations;
- i) rules for application, scope and term of transaction rules; and
- j) rules for modification of transaction rules.

These seem to be essentially common sense measures which a set of professionally drafted transaction rules would be likely to cover: the implication is that not all online third-party platforms have these basics in place. Under the Draft Transaction Rules Procedures, any third-party platform provider who wishes to adopt or modify its transaction rules must display the transaction rules or the revisions thereof on its website for at least 15 days for the solicitation of public opinion. Reasonable measures must be taken to ensure the relevant parties are aware of the transaction rules and the revisions and all comments made by the public must be published for a reasonable period after expiry of the solicitation period. There is, however, no requirement for the third-party platforms to take into account comments from the public. However, third-party platforms are made accountable by being required to respond to the public's opinions and by making their responses publicly available. In addition, the third-party platform provider must publish its adopted rules or revisions (trade secrets excluded) in a prominent place on its website for 15 days before implementing the rules or the

revisions. Any new rule that would significantly affect online vendors will require a transition period before being implemented. Furthermore, the third-party platform provider must register and file its transaction rules and revisions, together with public comments received and responses made to the public comments, with MOFCOM through its online system, within 30 days of the implementation of the rules or the revisions. Any person who believes that the transaction rules of a third-party platform provider do not comply with the Draft Transaction Rules Procedures has the right file a report with their local MOFCOM office, thus introducing a public supervision concept. Failure to abide by the Draft Transaction Rules Procedures will attract a penalty of between RMB 10,000 and RMB 30,000.

The Draft Transaction Rules are the first administrative regulation targeted at governing the transaction rules of third-party platform providers; they are almost certainly a reaction to market behaviour and consumer reactions to that behaviour. They hint at the fact that there are issues with the current transaction rules of certain third-party platform providers. However, while the Draft Transaction Rules demonstrate a positive and laudable attempt to protect consumers of online goods and services, the fines seem very modest and may be too low to make a difference to the bottom line of the larger third-party platforms.

4. Concluding Thoughts – What is the Significance of the New Legislation?

China has placed consumption at the core of its new five year plan as a means of sustaining growth in its economy as it transitions from a manufacturing-based model to a more service and consumption-driven economy. The biggest barrier to e-commerce in China is simply lack of trust in cyberspace and cyberspace vendors, due to consumers having had unreliable or unpleasant experiences in this regard. These 'bad apples' also make it more difficult for legitimate, compliant vendors and third-party trading platform operators to persuade Chinese consumers to use their services.

Many Chinese consumers also appear to have been unable to have enjoyed any meaningful recourse against online vendors who have sold defective products or services and given false or unreliable contact information – hence the rather odd-sounding requirement that online vendors have to register using their real names. Only when confidence in Chinese cyberspace is restored can e-commerce (and hence e-consumerism) achieve its full potential in China (which is clearly enormous). This goal can only be realised if adequate legal rules are in place to regulate and foster development of e-commerce and, more critically, the rules are enforced and the punishments imposed act as a deterrent to other would-be online fraudsters or fly-by-night operators. While the current amendments represent a worthy attempt to achieve the former, anecdotally at least, issues relating to breach of contract, delivery, misrepresentation of products and low product quality still persist, thereby indicating that bolstering

consumer trust remains the more challenging longer-term goal: Chinese consumers will need to see more enforcement action on the ground against violators to rebuild trust.

What is beyond any doubt, based on the Singles Day trading performance, is the depth of demand for consumer-led e-commerce in China. The overall aim of the Draft Online Trading Procedures and Draft Transaction Rules Procedures is to provide a fairer and more competitive trading environment, with a focus on safeguarding consumer rights. Most notably, the abovementioned draft measures illustrate a delegation of supervision duties to third-party platform providers in monitoring online trading activities, as well as giving consumers rights to protect their interests through a reporting mechanism for violations. It is envisaged that these new measures, once enacted, will boost confidence amongst Chinese consumers, but are they enough to overcome the mistrust by the Chinese consumer of e-commerce borne out of harsh experience? That remains to be seen.

The question comes down to whether legislation by itself is enough to change behaviour. If there was clear evidence of consistent enforcement against violators, then that would send a strong message that the non-compliant will be weeded out and shut down. Given that the fines all seem to come in below RMB30,000, it is difficult to predict whether the new legislation will really help consumers to combat the unlawful behaviour of certain online vendors and third-party platforms who do not act lawfully or responsibly. Those vendors and platform operators who wish to build consumer trust and a reputation for compliance in cyberspace over the longer term will no doubt seek to comply with the new legislation, regardless of the size of the punishments. The issue is the small group of vendors and platform operators who wrongfully see the internet as a way to make money without consequences or responsibility. At the end of the day, consumers may still have to rely on the 'bigger guns', namely other more general legislation, which may not be specifically targeted at e-commerce, to seek redress against this group rather than the legislation likely to result from the Draft Online Trading Procedures and the Draft Transaction Rules Procedures.

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