Hogan Lovells

TMT developments in China

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Editors' Note

The Telecoms, Media and Technology ("**TMT**") sector includes many of China's most successful private companies. These companies thrive due to a combination of innovative business models, products and technologies. At the same time, the TMT space is seen as politically sensitive and hence is subject to heavy government regulation and oversight, ranging from content requirements in relation to the media, foreign investment restrictions in telecoms to government policies to develop 'indigenous innovation.'

In short, the TMT space is at the intersection of business, policy and law, with cutting-edge business models outpacing the regulators who are constantly having to run ever-faster to keep up with them. In this, our first edition of a bi-annual China TMT report, we analyse some of the key developments in the TMT sector over the past few months, looking at the issues from a variety of different angles and perspectives: corporate, regulatory, antitrust, IP and privacy. In short, there is something for everyone in it.

For lawyers, the TMT space provides a whole range of very interesting challenges. At present all eyes are currently on the newly-created Free Trade Zone in Shanghai, to see whether this will provide the long-awaited opening in telecoms, and our first featured article takes a detailed look at the opportunity this represents for businesses that need a telecoms services permit to operate in China.

We hope you enjoy reading it as much as we enjoyed putting it together.

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Hogan Lovells bolsters TMT Practice with leading Hong Kong hire

HONG KONG, 13 January 2014 – Hogan Lovells has recruited Mark Parsons into its Corporate/Commercial team in Hong Kong as a partner with a particular focus on complex commercial transactions and regulatory matters in the TMT sector. Mark is expected to join around the end of January 2014.

Mark was formerly a partner at Freshfields Bruckhaus Deringer in Asia where he led their IP/IT practice and their work in the TMT sector. Within a practice covering a wide range of commercial, regulatory and intellectual property matters, Mark is particularly experienced in the negotiation of multi-jurisdictional outsourcing, technology licensing and distribution agreements, as well as advising on commercial matters in the internet and e-commerce space. Mark also has a well-developed practice advising on Asia's fast developing telecommunications, media and data privacy regulations. Mark is a highly regarded TMT practitioner and is listed in Chambers as a leading individual, where clients reported "He has a very positive and solution-based approach to problems, and is an excellent technician as well."

Mark's hire adds further breadth and depth to Hogan Lovells' leading global Commercial practice and the well-established multi-disciplinary TMT practice across the Asia region.

Commenting on Mark's arrival, Peter Watts and Robert Waldman, global Co-Heads of Hogan Lovells' Commercial practice, said:

"We are delighted that Mark Parsons will be joining us in Hong Kong to strengthen our team. Mark is a leading practitioner in the TMT sector and he brings a unique blend of genuine commercial, corporate and sector experience that perfectly aligns with our practice both in Asia and globally.

Mark's arrival in our TMT sector team comes shortly after that of LA based media and entertainment partner Sheri Jeffrey who also has a significant Asian component to her practice. This underlines our commitment to further enhance our market leading capability serving the TMT sector in Asia and across our global network."

Mark added:

"I am delighted to be joining an outstanding practice in Hong Kong and look forward to working closely with the Hogan Lovells' teams globally to provide our clients with the highest level of support in Asia's increasingly important and dynamic markets."

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Shanghai FTZ shows its hand on telecoms opening up – could this be the long-awaited breakthrough in VATS?

On 6 January 2014, the Ministry of Industry and Information Technology ("**MIIT**") – the internet and telecommunications services regulator – and the Shanghai municipal government jointly issued the *Opinions on Further Opening Value-added Telecom Business Sector to Foreign Capitals in the Shanghai Free Trade Zone* ("**Opinions**"). This short, but significant document provides for the liberalisation of foreign investment in certain types of value-added telecom services ("**VATS**") within the Shanghai Free Trade Zone ("FTZ").

In order to understand the significance of this development, it is necessary to understand some of the history of foreign investment in telecommunications services in China. When China joined the World Trade Organisation ("**WTO**") in 2001, the opening up of telecoms was widely trumpeted as a breakthrough, as previously foreign investment in telecoms had been banned. However post-WTO, the Ministry of Information Industry (now MIIT) took a very restrictive interpretation of China's WTO commitments, which was at odds with that of the EU delegation that had been negotiating the China commitments with the Ministry of Commerce.

The VATS commitments provide for opening up VATS to foreign investment subject to a 50% cap using the "including" formulation, which those on the other side of the table interpreted to mean "including but not limited to" and those from MIIT took to mean "namely." The list of services that follow includes email, voice mail, online information and database retrieval, electronic data interchange, enhanced/value added tax services (including store and forward/store and retrieve, code and protocol conversion and online information) and/or data processing (including transaction processing). MIIT's view, therefore, has been, that services like Internet Data Centres ("**IDC**"), or call centres are outside the scope of China's WTO commitments as are Internet access services, domestic Virtual Private Networks and domestic conferencing services (which China classifies as VATS).

As can be seen from the number of approved Foreign Invested Telecommunications Enterprises ("**FITEs**") on the MIIT website, very few (under 30 and apparently none since 2008) FITEs have been approved by MIIT since China became a member of the WTO. If we interpret the wording of the Opinions strictly, MIIT may still grant app store and store-and-forward services operating permits in a selective fashion, in other words, on a pilot basis.

The table below summarizes the new position on foreign investment in VATS within Shanghai FTZ.

VATS opened up in SH FTZ	Previous restriction on foreign ownership	Restriction on foreign ownership in FTZ	Notes
App store (under Internet information services)[1]	50% cap	No cap	Other information services are still subject to the 50% cap.
Store-and-forward services	50% cap	No cap	
Online data processing and transaction processing (operational e-commerce)	50% cap	55% cap	
Call centres	Not allowed[2]	No cap	This item was not included in China's WTO commitments, and hence was not previously open to foreign investment.
Domestic multi-party communications (i.e. conference call services)	Not allowed[2]	No cap	The same as above
Internet access[3]	Not allowed[2]	No cap	The same as above
Domestic IP-VPN	Not allowed[2]	50% cap	The same as above

The Opinions require that companies applying for operating permits for the VATS listed in the Appendix must register the company and have their infrastructure located within the Shanghai FTZ. However, it is important to note that all services may be made available nationwide, except for Internet access services, which will be confined to the FTZ, which presumably means only subscribers physically located within the FTZ can use the service.

The Opinions state that implementation of the *Foreign-invested Telecom Enterprise Administrative Procedures* ("**FITE Regulations**") promulgated by the State Council with effect from 1 January 2002 will be suspended in the FTZ. This is necessary to allow exceeding the 50% cap on foreign investment in VATS set out in the FITE Regulations.

There is a further breakthrough in that for the first time the Opinions will permit Wholly Foreign-owned Enterprises ("**WFOEs**") to engage in certain VATS services. The news release from MIIT confirms this to be the case (see http://www.miit.gov.cn/n11293472/n11293832/n11293907/n11368223/15825208.html).

The news release provides that the following services will be opened up to WFOEs:

- app stores (under information services)
- store and forward services
- call centres
- domestic multi-party communications
- Internet access.

This is consistent with the table (left) reflecting the position under the Opinions.

The MIIT news release also indicates that new pilot measures are to be promulgated to simplify the approval procedures and shorten the review period in the Shanghai FTZ.

One interesting development is that we understand that Yi Hao Dian[4] has established a Sino-Foreign Joint Venture within the Shanghai FTZ and that the MIIT granted the joint venture an ICP operating permit and an operating permit for online data processing and transaction processing in late 2013. The Opinions give rise to the possibility that MIIT will actually grant VATS operating permits to foreign-invested enterprises established within the Shanghai FTZ on a regular basis. As a result, it is anticipated that more and more multinationals will consider setting up subsidiaries in, or relocation to, the FTZ. However the proof of the pudding is in the eating, and it will be some time before it becomes clear that issuing telecoms operating permits within the FTZ is becoming routine and that this is indeed the breakthrough that industry participants and their advisors have long been waiting for.

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1 Also known as Internet Content Provider or ICP services.

2 However under the Closer Economic Partnership Arrangement ("CEPA") and CEPA IV, qualified Hong Kong Service providers were allowed to set up joint ventures in China to provide the following VATS, subject to a foreign investment cap of 50%: internet data centre services; store and forward services; call centre services; internet access services; content services and domestic IP-based VPNs.

3 Also known as Internet Service Provider or ISP services.

4 One of the largest and fastest growing online retailers in China, majority controlled by Wal-Mart.

Hong Kong regulator fines broadcaster for anti-competitive practices

On 14 June 2012, Hong Kong entered into an era for competition law. That day, the Competition Ordinance was enacted. Since then, however, progress has been slow. At the moment, the Hong Kong government is busy with the establishment of the two new institutions in charge of enforcing the ordinance – the Competition Commission and the Competition Tribunal. The substantive provisions of the Competition Ordinance have yet to come into effect.

While people are waiting for the antitrust regime revolving around the Competition Ordinance to take shape, Hong Kong has witnessed the adoption of one of its first antitrust decisions: in September 2013, the Hong Kong Communications Authority ("**Authority**"), formerly the Broadcasting Authority, issued its decision to sanction Television Broadcasts Limited ("**TVB**") for anti-competitive practices. Its decision was adopted under the Broadcasting Ordinance ("**BO**") – which contains sector-specific antitrust rules – but the implications may be broader. The decision may give a boost to the antitrust "institution building," as the Authority will also have powers to enforce the Competition Ordinance in the broadcasting and telecommunications sectors.

Timeline

The Authority announced the ruling against TVB after a three-year investigation. The investigation was initiated by a formal complaint from Asia Television Limited in December 2009 alleging that certain clauses in TVB's contracts with its artists and singers and certain informal policies and practices pursued by TVB were in violation of the BO.

On 28 August 2010, the Authority decided to launch a full-blown investigation into some of the contractual clauses and policies of TVB, and its final decision was released on 19 September 2013.

On 17 October 2013, TVB appealed the Authority's decision to the Chief Executive in Council. In December, TVB filed an application for judicial review of the decision.

The Relevant Market

The Authority started its analysis by defining the 'relevant markets.' It noted that the case concerned an issue of "two-sided markets," with TV viewers on one side and TV advertisers on the other side. As to the TV viewer side, the Authority ultimately left open the question of which products/services comprise the relevant market. Its analysis assumed that 'all TV viewing' would be the broadest possible relevant market, and focused on that area. The Authority proceeded on the basis of the broad scope of the relevant market as this approach was more favourable for the defendant. It concluded that TVB possessed a dominant position in this broad market as a result of variety of factors. Perhaps most importantly, the Authority found that TVB had a market share above 60% in the 'all TV viewing market.'

As for the TV advertiser side, the Authority found that 'TV advertising' was the relevant market. It examined and ruled out the possibility that other types of advertising – such as advertising through traditional media including cinema, radio, print, billboards and buses, or Internet display advertising – would be in the same relevant market. TVB's share in the TV advertising market was found to be approximately 56-59% from 2006-2009, dropping to 47% in 2010. Again, the Authority looked at other factors such as high entry barriers, substantial sunk costs, brand loyalty, and weak countervailing buyer and supplier power to reach its finding of dominance.

The Anti-Competitive Conduct

In terms of anti-competitive conduct, the Authority concluded that TVB restricted competition in the TV programme service market by foreclosing rivals' access to artists and singers, thereby impairing their ability to compete with TVB and raising their costs.

TVB's contracts contained restrictive clauses requiring artists to be totally exclusive to TVB during the contractual period or requiring them to obtain consent from TVB before engaging in outside work. The Authority found that the consent requirement worked as de facto exclusivity. Artists did not frequently apply for consent between 2007 and 2010, perhaps concerned about detrimental effects on their careers at TVB. And, in none of the instances was consent granted for artists working for rival TV stations in Hong Kong.

In short, the Authority held that TVB had "secure[d] for itself exclusive supply of a large portion of an essential input in TV and music programme production, i.e. artistes and singers." Referring to guidelines issued by itself and the European Commission, the Authority examined the degree of "foreclosure" of the exclusivity practice, finding among other things that over 90% of singers in Hong Kong had signed contracts with TVB.

In addition, the Authority held that TVB had put in place so-called "no original voice," "no promotion," and "no Cantonese" policies to back up its exclusivity practices. As such, TVB's contracts with artists prohibited them from performing in other TV stations' programs with their original voices and from attending promotional activities. It also prohibited them from speaking Cantonese on the programs of other TV stations in Hong Kong, a prohibition the Authority found to be "implicitly imposed" rather than spelled out in contractual clauses.

Overall, the Authority seemed to hold that these three policies were ancillary to the main issue, the contractually imposed exclusivity. It held that these ancillary policies "extend the reach of TVB's exclusivity provisions. They create an additional hurdle for other local TV stations…"

The Authority also examined a variety of defences and justifications put forward by TVB, but all of them were rejected.

Sanctions and Remedies

The Authority ordered the adoption of a series of sanctions and remedies. In particular, it

- imposed a fine of HK$ 900,000 (approximately US$ 115,000) on TVB (the maximum penalty for the relevant violations being HK$ 1 million)
- directed TVB to bring the infringement to an end and refrain from repeating or engaging in equivalent conduct going forward
- ordered TVB to communicate to all artists and singers with contracts that it was abandoning the challenged contractual clauses and policies
- requested that TVB report back on the steps it was taking to comply with the decision.

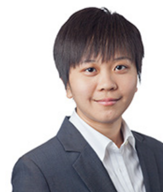
Comments

This decision is one of the first antitrust decisions in Hong Kong. With its adoption, the Authority signals that it is a force to be reckoned with before and after the *Competition Ordinance* is in effect – given its concurrent enforcement powers with the Competition Commission. In a broader sense, the decision may be an indication that Hong Kong authorities are keen to demonstrate their commitment – and ability – to deal with anti-competitive practices.

The decision provides important reading for antitrust aficionados and companies looking for guidance on how to comply with the BO and, perhaps more importantly, the *Competition Ordinance*. There is plenty of information as the full decision of the Authority spans over 115 pages.

The Authority's decision is about abuse of dominance, and focuses to a large extent on contractual exclusivity. In a way, contractual exclusivity is one of the most straightforward examples of potentially exclusionary conduct in situations where foreclosure is significant enough in terms of scope, intensity, and time. The decision's finding that TVB engaged in *de facto* exclusivity is less straightforward but perhaps even more interesting. This seems to be an indication that the Authority takes an effects-based approach, seeing through the form of the alleged restraint.

Finally, it is also interesting to see that the Authority referenced European Union competition law at various points. In its assessment of "dominance," the Authority even explicitly stated that it will pay regard to European case law while bearing in mind that "the law of Hong Kong demands independent interpretation."



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Internet of things: innovation with Chinese characteristics

The Internet of Things ("**IOT**"), or the Internet of Everything, has become a popular buzzword in recent times. But what does it really mean? While there are many definitions, the central premise is that many or most of the everyday objects in our lives, from kitchen appliances to highways to paperclips, can be uniquely identified and linked together into a network using a variety of 'tagging' technologies, thereby sharing data and interacting to make our lives more convenient and efficient. The possibilities are endless – the lock on your office door could be linked to a taxi dispatch system, sending you a cab by the time you step out of the office building; you could have your car send a signal to start running a bath when you get close to home; an incoming phone call could automatically lower the volume on a nearby stereo system; or low inventory in a warehouse could trigger an automatic purchase order via a central purchasing centre.

With estimates of the global private value to be created by the IOT reaching well into the trillions of dollars, the possibilities for the transformational effect it may have on our lives seem boundless. Not to be left behind, the Chinese government has highlighted the IOT as an opportunity for domestic innovation, promoting it vigorously through locally-driven initiatives backed by supportive national policies.

National Policy Support

China's top leadership has provided support and encouragement for the push to bring China to the forefront of IOT development. With the government as the largest consumer in this space, such national support is and will continue to play a critical role. In China, the IOT space falls chiefly within the regulatory ambit of the Ministry of Industry and Information Technology ("**MIIT**"). However, other central ministries are involved in generating the underlying policies and rules as well. Some of the most influential policies may be those that have been in place for many years, such as Circular 18[1] and Circular 4[2] which provide preferential tax policies for the software and integrated circuits industries and which some say may be eventually extended to explicitly include the IOT. The following key policies and rules have been developed to specifically target IOT innovation:

- **12th Five-Year Plan on the IOT[3] (MIIT, November 2011).** This broad statement of support and encouragement for the development of the IOT sector in China sets forth general tasks for the government and private enterprises in the 2011-2015 period including: solving key technological problems, setting standards, cultivating key enterprises, promoting and demonstrating IOT real-world applications, planning the regional distribution of the IOT industry, and ensuring information security.
- **Guidance Opinion on the Orderly and Healthy Development of the IOT[4] (State Council, February 2013).** This general policy document recognizes concrete results already achieved in R&D, standards development, industry cultivation, and technology application; outlines key principles for IOT development, such as harmonious and orderly progress, demand-led development, and security; and calls for near-term breakthroughs by 2015 with pilot applications targeting the agriculture, transportation, logistics, and energy industries.
- **IOT Special Fund Interim Measures[5] (Ministry of Finance, April 2011).** While most financial incentives for IOT development have been pushed from the local level, the IOT Special Fund is a national fund that seeks to promote IOT-related R&D, applications, and services. The Interim Measures describe some of the basic features of the IOT Special Fund. The IOT Special Fund is to be jointly administered by MIIT and the Ministry of Finance, with the former responsible for determining the direction of annual support and supervising projects, and the latter responsible for budgetary management and fund allocation. Grants are generally offered to self-funded projects while loan subsidies support those with bank-loan funding.

1 See Policies on Encouraging the Development of the Software and the Integrated Circuit Industries issued by the State Council on 24 June 2000.

2 See Policies on Further Encouraging the Development of the Software and the Integrated Circuit Industries issued by the State Council on 28 January 2011.

3 See 12th Five-Year Plan on the Internet of Things issued by the MIIT on 28 November 2011.

4 See Guidance Opinion of the State Council on the Orderly and Healthy Development of the Internet of Things issued by the State Council on 25 February 2013.

5 See Interim Measures for Administration of the Special Fund for the Development of the Internet of Things issued by the Ministry of Finance on 6 April 2011.

- **Notice on Properly Implementing the 2013 IOT Special Fund Project Application[6] (MIIT and Ministry of Finance, April 2013).** This document provides greater detail in terms of application procedures and acceptance criteria for the IOT Special Fund. In 2013, the IOT Special Fund is to have supported the following key project areas: (1) IOT systems development projects, including critical features of intelligent industry, intelligent agriculture, intelligent environmental protection, intelligent transportation and logistics, and intelligent security; and (2) key technology R&D and industrialization projects focusing on IOT areas such as the sensing, transmission, and processing of data.

Locally-driven Innovation: Wuxi, IOT Hub
Despite such supportive policies and pronouncements from the central leadership, the main momentum for IOT innovation on the ground has come from local governments. A number of municipalities have made significant investments in this area, with Wuxi clearly at the forefront. In China, the name Wuxi is now synonymous with the Internet of Things and the country's push to be at the cutting edge of developments in this area. Starting from former Premier Wen Jiabao's visit to Wuxi in late 2009, the local and central governments have worked together to establish the 23-square kilometre Wuxi National Internet of Things Innovation and Demonstration Zone.

The innovation and demonstration zone is primarily composed of four parks and one centre: (1) IOT Innovation Park, (2) IOT Industrial Park, (3) IOT Information Services Park, (4) IOT University Science Park, and (5) IOT Application Exhibition Centre.

Government support for the IOT push in Wuxi has included giving priority in government procurement, financial support, simplified and speedy approvals, and easier availability of land.

Statistics of the Wuxi National Internet of Things Innovation and Demonstration Zone
(Statistics reflect data available up until August 2012[7])

- Over 600 enterprises
- Over 100,000 employees
- 31 reputable research institutions
- Over 125 applied demonstration projects
- Nearly RMB 80 billion in IOT industry output.

Opportunities and Challenges
China's commitment to developing the IOT sector presents a unique opportunity for private businesses. As the discussion above suggests, the Chinese authorities will generally welcome companies (both domestic and foreign) investing in the development of the IOT in China.

Chinese officials at both the local and national levels who are cognizant of China's weakness in terms of the technical know-how required to underpin the development of the IOT should, in theory, be keen to attract foreign investment and technology transfer into this industry. However there remain many challenges facing private sector entities seeking to make an impact in China's IOT space.

For instance, the IOT industry in China is currently dominated by large state-owned enterprises and multinational companies which tend to have strong, established relationships with local and central government officials. With the government serving as both the largest customer for the IOT industry and as the biggest backer of IOT innovation, newcomers may find that demand is not necessarily driven by market factors and may struggle to cultivate the necessary relationships with the relevant authorities. National initiatives such as the IOT Special Fund have already drawn criticism for a lack of transparency. Local decision-making may be even more opaque or may be driven by more local concerns.

The IOT development push also raises a range of legal issues including those related to data protection, intellectual property, and antitrust.

Among them, investors should familiarise themselves with the differences between the Chinese patent system and other patent systems, as well as the rules regarding intellectual property ownership when projects receive government support (for example through the IOT Special Fund) or involve collaborative efforts with other companies (from different sectors, for example).

Furthermore, the IOT space by definition requires interoperability between various devices and platforms, which in turn requires clear, common technical standards. In China, the importance of standard-setting processes has increased significantly in recent years. As China does not systematically adopt all international standards and sometimes pushes for the adoption of its own national standards (such as WAPI or TD-SCDMA), companies need to familiarize themselves with domestic standardization processes and institutions, which tend to be more government-influenced than those in the West. China's IOT push may also raise antitrust issues in due course. For example, the possibility of a new wave of 'patent wars' over the exercise of patents comprised in IOT standards cannot be ruled out.

Conclusion

The development of the IOT should be an inherently cooperative phenomenon that by its very nature brings together companies and individuals from very different sectors of the economy, and very different parts of the world. For lawyers and businesses, the challenges will relate to achieving interoperability and common standards that will allow such cooperation to function on a technical level and allow the IOT to operate seamlessly across borders and cultures, taking into account differing political and cultural sensitivities. For example, China has on the one hand historically welcomed the commercial possibilities of the Internet, but on the other hand it has been concerned about the Internet's potential to spread dissent and political unrest. At the same time, the Internet in most other jurisdictions has been a much more free-wheeling and less controlled and monitored space. Hence, China will likely be heavily focused not just on the technical interactions between things, but also on the content of their interactions.

Against this background, linking everyday objects into a network of things, while holding out immense promise and potential, will likely bring forth many new and interesting challenges for lawyers and for businesses. One thing is certain: the rewards for whoever succeeds in unlocking the potential of the IOT will be enormous.

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6 See of the General Office of the Ministry of Industry and Information Technology and the General Office of the Ministry of Finance Circular on Properly Implementing 2013 IOT Special Fund Project Applications issued on 27 April 2013.

7 See Construction Summary of Wuxi National Internet of Things Innovation and Demonstration Zone, http://www.wuxi.gov.cn/zfxxgk/szfxxgkml/gzbg/bmgzzj/6191432.shtml.

Rewards and remuneration for employee service inventions: the Shanghai Higher People's Court issues new guidelines

The draft *Rules on Service Inventions* ("**Draft Service Rules**") published by the State Intellectual Property Office ("**SIPO**") in November 2012 caused widespread discussions and consternation amongst corporations to the point where a number of them were reconsidering their research and development ("**R&D**") strategies for China.

While those draft regulations were being further considered, the Shanghai Higher People's Court issued its *Guidelines on the Adjudication of Disputes Involving Rewards and Remuneration for the Inventors or Designers of Service Invention Creations* ("**Shanghai Guidelines**") on 25 June 2013. The Shanghai Guidelines have no binding effect per se, but as a matter of judicial practice, they will likely be followed by lower courts in Shanghai, and are generally of persuasive value to other courts nationwide.

Unlike the Draft Service Rules, which propose a number of highly controversial provisions such as default minimum rewards and remuneration that are both higher than, and inconsistent with, those provided in the *Patent Law Implementing Regulations*, first effective 1 July 2001 as subsequently amended ("**Implementing Regulations**"), the Shanghai Guidelines clarify some fundamental issues and have generally been welcomed by industry and intellectual property ("**IP**") practitioners. We highlight some of the more salient provisions of the Shanghai Guidelines below.

Statutory Remuneration Relating to Assigned Patents Similar to that for Licenses

Under the People's Republic of China Patent Law ("**Patent Law**")[1], and the Implementing Regulations, employers must pay reasonable rewards and remuneration to inventor-employees. The amount payable may be agreed by the parties, but if there is no agreement, the following statutory minimum default amounts apply:

- within 3 months upon grant of the patent, the reward is RMB 3,000 for an invention patent and RMB 1,000 for a utility model patent or design patent
- upon commercialization of the patent, if the patent is exploited by the employer, the remuneration to be paid is the following: annual payments of not less than 2% of the operational profit for invention patents or utility model patents, and annual payments of not less than 0.2% for design payments, or a lump sum based on these percentages

- upon commercialization of the patent, if the patent is licensed by the employer, the remuneration to be paid by the employer to the inventor-employee is no less than 10% of the royalties received.

The Patent Law and the Implementing Regulations do not stipulate a statutory standard of remuneration if an employer assigns a service invention outright. Article 10 of the Shanghai Guidelines addresses this issue and provides that the statutory remuneration for an assigned service invention is determined with reference to the licensing-related provisions of the Patent Law and the Implementing Regulations – i.e., 10% of the assignment consideration.

The Shanghai Higher People's Court somewhat deviates from the Law on Promoting the Assignment of Scientific and Technological Achievements which suggests that no less than 20% of the income generated from an assignment of a technological achievement shall be paid to personnel who made significant contributions to the achievement. While still in force, that law was promulgated back in 1996 and may seem out-of-date. How these provisions will be reconciled is yet to be seen.

Agreements Prevail over Statutory Standards

Articles 2, 3, and 4 of the Shanghai Guidelines essentially echo the Patent Law. They provide that the form and amount of the reward and remuneration may be agreed by employee and employer through bilateral agreements or stipulated in lawfully-enacted company policies, and that these agreements or company policies prevail over statutory standards. Most importantly, the Shanghai Guidelines recognize that if the rewards and remuneration are paid in monetary form, then the agreed amount may be above or below the statutory amounts. Adding flexibility, the Shanghai Guidelines provide that remuneration can be determined according to the average invention value in the R&D field concerned. The Shanghai Higher People's Court considers such an approach to allow businesses to avoid complex and relatively costly calculation processes.

The Shanghai Guidelines further provide that the forms of reward and remuneration can be varied and include: monetary reward, shares, options, promotions, raises, paid leave, and so forth. All these are permissible as long as the reasonableness requirements in the Patent Law are satisfied. Remuneration can also be made in a lump sum payment.

1 Adopted by the Standing Committee of the National People's Congress on 12 March 1984 and with effect from 1 April 1985, as subsequently amended.

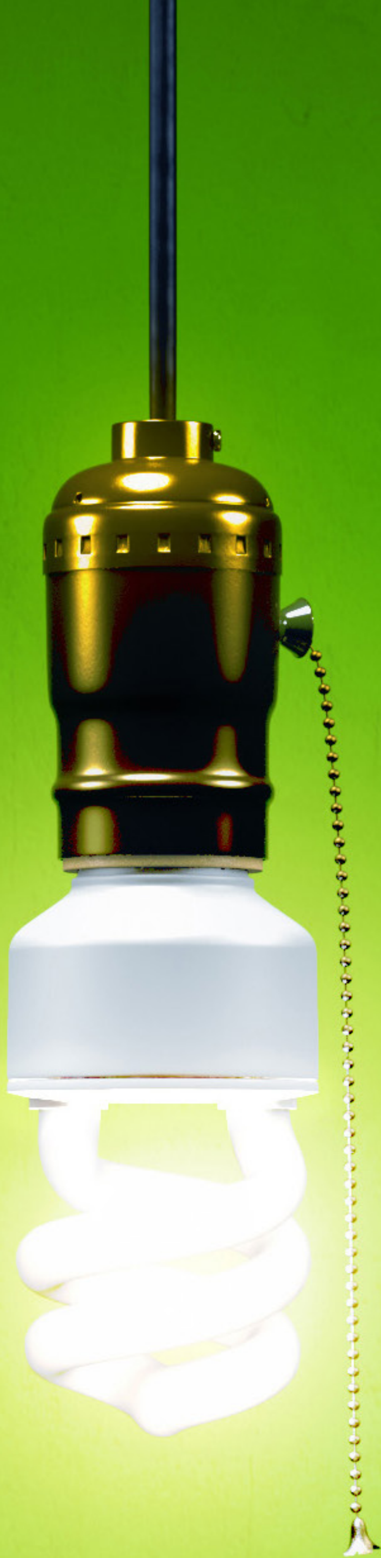
Reward and Remuneration Standards agreed between Employee and Employer are Deemed Reasonable

The key tone set by the Patent Law is that agreements between employees and their employers (if any) prevail over the statutory default amounts. Despite this, companies are concerned whether agreements between employees and employers regarding remuneration and reward may be challenged as unreasonable at some point. To some extent, Article 6 of the Shanghai Guidelines addresses these uncertainties. It stipulates that, under normal circumstances, such agreements are deemed reasonable. Only if the amounts agreed upon are extremely low and obviously unreasonable will the court determine the reward and remuneration based on the specific circumstances of the case at hand.

A particularly interesting point is that the Shanghai Guidelines recognize "the operational independence of a business and the need to respect the autonomy of the will of the parties concerned." Even if the agreed amounts are considered unreasonable in the sense of the Patent Law, the Shanghai Guidelines reject blindly applying the statutory standards. Instead, they provide that the court should determine the amounts according to the circumstances of the case at hand, because the very existence of an agreement already excludes the application of statutory standards. This is an important and welcome clarification.

Commissioned Inventions, Joint Inventions, and R&D

Another major clarification brought by the Shanghai Guidelines relates to commissioned or joint R&D projects. While the Shanghai Guidelines have reiterated that parties to commissioned or joint R&D projects may agree on the ownership of any inventions developed, they further clarify that, if a company 'A' owns the patent rights to the commissioned or jointly developed invention that was completed by an employee(s) of a company 'B', neither company 'A' nor 'B' is necessarily liable for paying rewards and remuneration. According to Articles 11 and 12, the inventor or designer of a service invention may only claim reward and remuneration for the invention if he/she is employed with the company that owns the patent rights. This is in contrast with Article 16 of the Patent Law, which leaves it open to interpretation as to whether the company that is granted the patent rights, or the company that is granted the patent rights and is also the employing company, should pay the remuneration.



Clarification on Applicability of the Patent Law/ Implementing Rules

The Shanghai Guidelines clarify that the provisions on rewards and remuneration apply to all inventions completed in China, regardless of whether a patent is filed in China or overseas.

Disputes by Inventors Classified as Patent Disputes

Another article of interest is the clarification that disputes relating to service invention remuneration and rewards are classified as patent disputes, and fall within the jurisdiction of the corresponding people's court. This alleviates some companies' concerns regarding the labour tribunals' possible influence and jurisdiction to preside over these types of claims, as the labour tribunals are often said to be very employee-friendly.

Conclusion

The Shanghai Guidelines have been widely welcomed by both domestic and foreign companies – particularly those that have established or are heavily invested in R&D centres in China. In the meantime, we also await the next iteration of the Draft Service Rules, which we hope will include some of the clarifications found in the Shanghai Guidelines.

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Resale of mobile communications services back on the menu in China: but only a few seats left at the table

Notwithstanding the high hopes surrounding China's entry into the World Trade Organization ("**WTO**") in 2001 with a commitment to open up both its basic telecommunication services ("**BTS**") and value-added telecommunication services ("**VATS**")[1], the actual opening up of China's telecommunications industry has fallen short of foreign investors' expectations. The primary government authority regulating the telecommunications and Internet industries in China is the Ministry of Industry and Information Technology ("**MIIT**"), which so far has adopted a fairly protectionist stance with regard to opening these markets to overseas operators.

Ten years after China's WTO debut, telecom services – whether BTS (e.g., fixed line and mobile network communication services) or VATS (e.g., broadband access services) – are almost exclusively provided directly or indirectly by one or more of China's three main state-controlled telecommunications carriers: China Telecom, China Mobile, and China Unicom (collectively, ("**Chinese Telecommunications Carriers**"). All three have enjoyed phenomenal growth and are counted as amongst the world's largest telecommunications carriers, a status cultivated by a protectionist MIIT to the detriment of consumers.

Given the virtually unassailable position now held by the Chinese Telecommunications Carriers and with an eye to the future of the telecommunications industry, MIIT has recently shown signs of gradually loosening its grip on BTS, although not where foreign investment is concerned. In this article, we examine the changes to the regulatory environment in the mobile communications resale services sector which reflect this approach. We begin with a brief background of the regulatory environment in China's telecommunications industry.

Regulatory Background

In China, telecommunication services are divided for regulatory purposes into two main categories: BTS and VATS. The provision of either BTS or VATS in China requires the service provider to obtain a BTS operating permit ("**BTS Permit**") or a VATS operating permit ("**VATS Permit**") respectively, each of which is issued by MIIT at the central level or through its local branches. The types of telecommunication services falling under BTS and VATS are listed in the *Circular of the Ministry of Information Industry on the Readjustment of the Classification Catalogue of Telecommunication Services* ("**Telecommunications Catalogue**") issued by the predecessor of the MIIT, the most recent version of which came into force on 1 April 2003 ("**2003 Telecommunications Catalogue**"). In line with China's WTO commitment, foreign investors are only permitted to apply for a BTS Permit or VATS Permit via establishing a joint venture foreign-invested telecommunications enterprise ("**FITE**") with a Chinese partner. In terms of shareholdings in the FITE, in line with China's WTO commitments, foreign investors can only own up to 50% of a VATS provider and up to 49% of a BTS provider.

Notwithstanding the letter of the law, MIIT has adopted a protectionist stance and has used its discretionary interpretational authority to limit the number of FITEs established to some 20 FITEs since China's WTO accession[2], all in the VATS area. The requirements and process for establishing a FITE are extremely complex and time-consuming. Meanwhile, it is relatively simple for a domestic capital entity in China (i.e., an entity whose shareholders are all Chinese nationals or China-incorporated entities) to obtain VATS Permits for many services in the 2003 Telecommunications Catalogue. MIIT has also consistently interpreted China's WTO commitments in the most restrictive manner possible, thereby limiting the services which it considers as being open to foreign investment. Combined with the cash-rich positions of the Chinese Telecommunication Carriers who feel able to buy in any new technologies they need and are not motivated to do any form of joint venture with a foreign operator that might cannibalise their booming domestic revenues, this adds up to a difficult environment for foreign investors seeking opportunities in China's huge market. It explains why many have resorted to legally more questionable workarounds such as the variable interest entity ("**VIE**") structure or a variant.

Classification of the Resale of BTS under the Telecommunications Catalogue

The resale of BTS was classified as a hybrid service in the prior version of the Telecommunications Catalogue issued by MIIT in 2001 ("**2001 Telecommunications Catalogue**"). It was classified as BTS, but to be administered by reference to VATS. Under the 2001 Telecommunications Catalogue, BTS services include basic voice and data telecommunications services

1 See the Telecommunications Regulations, promulgated by the State Council and effective 25 September 2000, Art. 8.

2 Source: MIIT website. This shows 28 approved FITEs and none since 2008.

including fixed network domestic direct dialling and local services, mobile telecommunication services, and Internet. Therefore, resale of BTS includes resale of mobile communications.

There was a flurry of interest from foreign investors at the time the 2001 Telecommunications Catalogue was issued. The reference to 'administered by reference to VATS' was interpreted by some as meaning you could do simple resale with a VATS Permit: The reaction of MIIT's predecessor at the time was one of exasperation at the bombardment of inquiries from foreign investors. Given that China had made no specific WTO commitment to open up resale, the authority's position then was that it was not open to foreign investment. The 2001 Telecommunications Catalogue, as with all of its successors, should be read not as a list of what is open to foreign investment, but more as a list of services China recognises as being subject to permitting requirements for domestic participants. What is open to foreign investment depends on MIIT's interpretation of China's WTO commitments.

Then, in 2003, MIIT issued the 2003 Telecommunications Catalogue removing resale of BTS from the Telecommunications Catalogue altogether. This appears to have been a calculated move by MIIT to protect the Chinese Telecommunications Carriers from both domestic and foreign competition. Considering that the China Telecommunications Carriers were looking to expand and list overseas, it was perhaps justified by the desire to maximise the value of the State's holdings on listing overseas, making it an inconvenient time to allow other service providers (domestic or otherwise) to enter the market and reduce their market shares. After its disappearance from the 2003 Telecommunications Catalogue, it was unclear if the resale of BTS and mobile communications were permitted under Chinese law.

After ten years of silence on the point, new rules issued by MIIT in quick succession within just five months point to a limited liberalisation and have reinvigorated interest in resale. We discuss these in turn below.

Resale Services Notice

The first critical development was the issuance of the *MIIT Circular on Soliciting Public Opinions on the Pilot Program for Mobile Communications Resale Services (Draft for Soliciting Comments)* on 8 January 2013 by MIIT ("**Draft Resale Services Circular**"). After slightly more than four months of internal reviews and consideration, the Draft Resale Services Circular was finalised and MIIT issued the *Pilot Program for Mobile Communications Resale Services* effective 17 May 2013 ("**Resale Services Circular**").

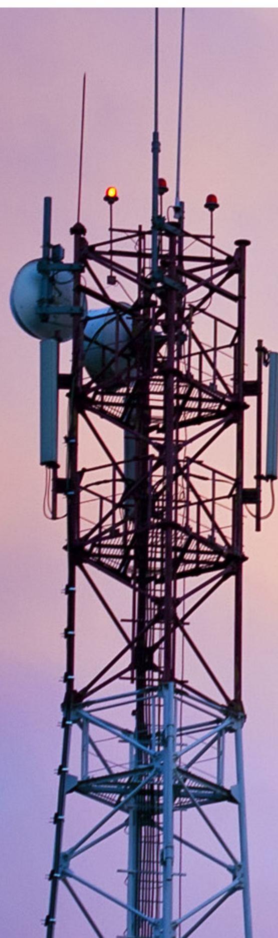
It is important to note at the outset that the Resale Services Circular refers only to the resale of *mobile communications services* as opposed to (the much broader) BTS. The Resale Services Circular defines resale of mobile communications services as the purchase of mobile communications services by a reseller from a BTS provider who owns a mobile network whereby the reseller repackages the services under its own brand and sells the services to the end users (commonly known as a mobile virtual network operator or "**MVNO**" arrangement). As a reseller, it does not need to own the network on which the mobile communications services are provided (the cost of building such a network in China nowadays would likely be prohibitive), but is required to set up a customer service system and other support systems (e.g., billing). This requirement comes as no surprise, as the added value from a reseller is essentially derived from better 'soft skills' such as customer service.

The key distinction between the Draft Resale Services Circular and the Resale Services Circular is the provisions on the capital structure of the service provider. Under the Draft Resale Services Circular, the service provider had to be a Chinese capital privately-owned company (中资民营公司). It was unclear in the Draft Resale Services Circular whether it meant that the company must be wholly owned by Chinese shareholders (i.e., a domestic company) or if the Chinese shareholders must hold a majority interest. The wording in the Resale Services Circular clarifies this point. Under the Resale Services Circular, instead of a Chinese capital private company, the wording now refers to a privately-owned company (民营企业). The Resale Services Circular further specifies that the private capital company needs to be a company established in accordance with relevant Chinese laws and which has private investors holding 50% or more of its capital, with the largest single investor being a private investor. This clearly does not preclude a tie-up with an incumbent. It precludes Hong Kong, Taiwan, Macao and other foreign investors from investing in the private capital company, but there is a carve-out for private capital companies which are listed abroad. In this case, foreign capital cannot exceed 10% or more of the shareholding capital and the largest shareholder

must be a Chinese investor. This very narrow exception means that foreign investors are essentially excluded from the market. This is disappointing news for Chinese consumers, as no privately-owned company in China will have experience in this kind of business. One wonders whether this will lead foreign investors into VIE structures to participate in the MVNO trial (discussed below).

Both the Draft Resale Services Circular and the Resale Services Circular state that the mobile communications resale business is classified as a Class II BTS, but shall be administered by reference to the provisions on VATS (similar language as in the 2001 Telecommunications Catalogue). Importantly, they clarify that the reference to VATS means the service provider will need to submit the application materials and fulfil the conditions applicable to an applicant for VATS under the *Measures for the Administration of Telecommunication Services issued by MIIT* effective 10 April 2009, and the *Telecommunications Regulations*. This is helpful as neither the 2001 Telecommunications Catalogue nor the Draft 2013 Telecommunications Catalogue (defined below) expand on or explain the meaning of 'administered by reference to VATS.'

Apart from the shareholding requirements, the Draft Resale Services Circular and the Resale Services Circular also list a number of requirements which include specific requirements for the composition of personnel (imposing significant fixed overhead on potential MVNOs); and mandate the establishment of a specialized customer service department, security management department, and service quality management system. The agreement between the reseller and the BTS service provider (i.e., one of the Chinese Telecommunications Carriers) cannot contain any exclusivity clauses (i.e., you cannot prevent others from tying up with one of three incumbents by entering into an exclusive arrangement), as this would essentially close the resale market to competition and shut out participants. There is also a requirement for disputes to be mediated by the competent telecommunications authority, which is basically the local MIIT. This makes it difficult for privately-owned MVNOs given the historic ties between MIIT and the Chinese Telecommunications Carriers.



Telecommunications Catalogue 2013

The second critical development in MIIT's limited liberalisation was the issuance of a draft of the revised *Telecommunications Services* Classification Catalogue by MIIT on 24 May 2013 ("**Draft 2013 Telecommunications Catalogue**"). The Draft 2013 Telecommunications Catalogue represents a wholesale update to the 2003 Telecommunications Catalogue which was widely seen as hopelessly out-of-date.

The Draft 2013 Telecommunications Catalogue has reinserted the resale of BTS as a Category II-type BTS and also included, as a sub-category, the resale of mobile communications as follows:

> "Resale of basic telecommunication services:
>
> Resale of basic telecommunication services refers to the purchase of telecommunications services or lease of network facilities by the commercial service provider from other operators who have the right to operate basic network infrastructure facilities, whereby the telecommunications services are repackaged under the commercial service provider's own brand and sold to the customers.
>
> Resale of mobile communications services:
>
> Resale of mobile communications services refers to the purchase of mobile communications services by the commercial service provider from operators who have the right to operate mobile network basic infrastructure facilities on a wholesale pricing basis, whereby the telecommunications services are repackaged under the commercial service provider's own brand and sold to the end customers.
>
> The mobile communications resale services operator does not set up its core network and service nodes but can set up its billing and service management platforms. The service is provided through the network of an operator which has the right to operate mobile network basic infrastructure facilities."

Curiously, there is no reference in the language in the Draft 2013 Telecommunications Catalogue to resale being administered by reference to the VATS requirements. That said, VATS requirements will at the very least apply to the resale of mobile communications services due to the Resale Services Circular. It may be that a reference to VATS will be included in the final version of that catalogue.

One Step at a Time

The inclusion of the resale of BTS and resale of mobile communications services in the Draft 2013 Telecommunications Catalogue as well as the issue of the Resale Services Circular within a span of one month should be seen as overall positives for the market. Still, it remains to be seen how enthusiastically incumbents embrace this development, risking their own market shares. Experiences in other markets suggest negotiations with the incumbents will not be easy. Consumers will benefit from some limited competition amongst service providers which will hopefully create downward pressure on prices. Nonetheless, there is little in this for foreign investors, as MIIT will likely only open the doors gradually once it believes vested domestic interests are safe.

China Unicom and China Telecom reportedly submitted 21 companies as their "partners" for resale services (none of which appears to be a FITE). MIIT issued licenses to 11 companies to start trials of reselling certain mobile services in December 2013. The pilot is now expected to officially begin in early 2014.

Rarely have we seen such a business opportunity of this magnitude open up overnight in the Chinese telecommunications industry, and hence we imagine that competition for places on the trial was fierce. Presumably none of the selected companies will have independent experience of operating this type of business given that it has only just opened up; the Chinese consumers might ultimately be better served if joint venture FITEs were able to participate in the trial. Still, foreign investors can take some comfort from the fact that even this small step forward is likely to constitute a stepping stone before MIIT will feel comfortable with a wider opening up of the market.

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China seeks to update its legislation to address burgeoning e-commerce market

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 2013. Singles' Day is China's 'anti-valentine's day' and takes place on 11 November every year, with RMB 35.01 billion transacted over Alipay for Taobao Marketplace and Tmall on 11 November 2013. 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 data, and is trying to update previous laws to meet the new challenges of e-commerce with Chinese characteristics.

Recently, the State Administration for Industry and Commerce ("**SAIC**") issued a draft of the new *Online Commodity Trading and Related Services Administrative Procedures* on 11 September 2013 ("**Draft Online Trading Procedures**") with the objective of revising and clarifying the *Online Commodity Trading and Related Services Tentative Administrative Procedures* issued by it on 31 May 2010 ("**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, the Ministry of Commerce ("**MOFCOM**") released a draft of the *Online Retailing Conducted on Third-Party Platforms Transaction Rules Administrative Procedures* on 26 September 2013 ("**Draft Transaction Rules Procedures**"), which aims to regulate transaction rules stipulated by third-party service platforms. 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 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.

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 B2C 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 product and service information, report any violation of laws and regulations by online vendors to the local Administration for 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 moved on, and the rules have become considerably outdated. Further measures and revisions are now needed to adequately protect consumer rights in the changed marketplace. As a result, SAIC issued the Draft Online Trading Procedures for public consultation in September. The main proposed changes are outlined below.

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

The Draft Online Trading Procedures specify that "Online Trading" will only refer to transactions involving products and services processed through the Internet, not via 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.

Addition of Unfair Competition Provision

The Draft Online Trading Procedures contain a provision prohibiting acts of unfair competition, a violation of which would attract a penalty of RMB 10,000 to RMB 30,000. The provision contains a laundry list of prohibited activities – ranging from unauthorised use of famous trade names to intentional damage of the reputation of a competitor's business or product to

cyber-attacks on competitors' websites. The list is accompanied by a "catch-all" provision at the end to introduce flexibility and allow new activities or others that have been overlooked to be included.

With such low monetary fines, it is unlikely that the Draft Online Trading Procedures alone will significantly deter large online vendors from engaging in acts of unfair competition. However, these draft rules must be assessed against the wider legislative and regulatory background, including laws such as the Anti-Unfair Competition Law ("**AUCL**") and the *People's Republic of China Trademark Law* ("**Trademark Law**") which impose much more stringent penalties than those provided for in the Draft Online Trading Procedures for the same types of illegal activities. For example, under the AUCL, a business operator who engages in unfair 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 between one- to three-times the unlawful earnings, revocation of their business licence, as well as potential criminal liabilities. Similarly, under the Trademark Law, trademark infringers may receive a punishment of up to five times the unlawful profits imposed on them and be liable for criminal sanctions. If the illegal profits cannot be ascertained, a fine of up to RMB 3 million may be imposed. There may also be a case to answer under the *People's Republic of ChinaAnti-Monopoly Law* ("**Anti-Monopoly Law**") in circumstances where either the infringing company was in a dominant market position or where the relevant activity involved the parties entering into a "monopoly agreement" such as a cartel agreement.

The AUCL, the Trademark Law and the Anti-Monopoly Law are laws promulgated by the Standing Committee of the National People's Congress and thus will rank above the Draft Online Trading Procedures, which are lower-ranking departmental rules. 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 unfair or anti-competitive conduct. However, it may still be possible to rely on the overlap with existing, higher-ranking legislation within the Chinese legislative hierarchy which involves more severe penalties and has real "teeth."

SAIC's Powers

The Draft Online Trading Procedures also added a provision outlining the powers of SAIC when conducting investigations on suspected illegal online transactions or services, including the power to enter business premises and conduct on-site investigations, question suspects, access data and accounts, seize relevant products and equipment, and shut down business premises where unlawful online product or service business is carried on.

These powers granted to SAIC are not new. Under the AUCL, the Trademark Law and the Anti-Monopoly

Law, 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 AUCL or the Anti-Monopoly Law (where more far-reaching sanctions are available).

Clarification and Increased Penalties for Real-name Registration System

The Tentative Online Trading Procedures stipulated that all online service providers are required to verify the true identity of online vendors. For individual vendors who are eligible to register with SAIC or its local branches, 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 local AIC and are under an obligation 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 can attract a fine between RMB 10,000 and 30,000.

Obligations of Third-party Platforms

Third-party platform operators are specifically regulated 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 adopting specifically delineated measures such as adopting platform security technologies and measures, supervising information regarding products and services sold on their platform, taking actions to curtail unlawful activity, setting up a mechanism for resolving disputes between consumers and vendors, generating a customer-generated review system, and setting up a special fund to compensate customers whose legal rights have been 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).

Increased Punishments

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

- the penalty has been increased from less than RMB 10,000 to an amount between RMB 10,000 to 30,000 for any loss or mishandling of personal data, failure to cooperate with authorities in investigating violations by online vendors; and providing a fair and impartial forum for consumers to review and post comments on goods and/or services
- 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
- 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
- failure by a third-party transaction platform to provide adequate transaction rules and management of its transaction platform may be subject to the imposition of 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. Unfortunately, the penalties imposed in the Draft

Online Trading Procedures alone may still be too low to significantly influence the big players. Perhaps, with additional powers given to 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. Nonetheless, the amendments made to the Draft Online Trading Procedures are not revolutionary. When viewed against the wider background of competition, anti-corruption and data protection laws, which contain more severe penalties, the Draft Online Trading Procedures themselves may simply be seen as consumer-friendly legislation that does not pack much of a punch.

That said, 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 the difficulty 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 that third-party platforms establish transaction rules with vendors may be a further 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 activity.

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 in their transaction rules basic rules as well as rules for obligations and risk allocation, intellectual property protection, credit ratings, consumer rights protection, information and real-name system disclosure, handling unlawful information, resolving transaction disputes, handling violations, etc.

These seem to be fairly common-sense measures which a set of professionally drafted transaction rules would be likely to cover. Thus, this suggests that not all online third-party platforms have these basics in place. Under the Draft Transaction Rules Procedures, any third-party platform provider that 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 the public's comments. However, third-party platforms are made accountable by being required to respond to the public's opinions and make their responses publicly available. In addition, third-party platform providers must publish the adopted rules or revisions (trade secrets excluded) in a prominent place on their 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, third-party platform providers must register and file their 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 may file a report with their local MOFCOM office. This gives consumers the right to report violations, thus introducing a public supervision concept. Failure to abide by the Draft Transaction Rules Procedures may lead to the imposition of a penalty between RMB 10,000 to 30,000.

The Draft Transaction Rules Procedures are the first administrative regulation targeted at governing the transaction rules of third-party platform providers; they are almost certainly a reaction to certain market behaviour and consumer reaction to that behaviour. They represent a further attempt by the government to

tighten the rules relating to e-commerce by regulating the behaviour of third-party platform providers. However, while the Draft Transaction Rules Procedures 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.

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 ("the world's factory") 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. This 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. 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 persist, indicating that bolstering consumer trust remains the more challenging goal. Consumers will need to see more enforcement action on the ground against violators to achieve the latter objective.

What is beyond any doubt, based on the Singles' Day trading performance, is the depth of demand for online transactions 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 transaction providers in monitoring online trading activities while giving consumers powers to protect their rights and interests through a reporting mechanism for violations. It is envisaged that these new measures, once enacted, will boost confidence amongst Chinese consumers. Still, whether they are enough to overcome the distrust of the Chinese consumer of e-commerce, borne out of harsh experience, 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 RMB 30,000, it is difficult to predict whether these new drafts, in and of themselves, will really help consumers combat the unlawful behaviour of certain online vendors and third-party platforms that 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. 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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Antitrust enforcement against abuse of IPRS and anti-competitive conduct in the high technology sector: an update from China

On 26 April 2013, the State Administration for Industry and Commerce ("**SAIC**") – one of China's three antitrust law enforcement bodies – noted on its website that it had held a meeting with certain industry participants to obtain feedback on the latest draft *Regulation on the Prohibition of Conduct Eliminating or Restricting Competition through Abuses of Intellectual Property Rights* ("**Draft IPR Abuse Regulation**"). In a conference at Peking University on 28 April, SAIC officials gave additional comments on the draft regulation.

The request for feedback on the draft regulation is just the latest in a series of developments related to antitrust enforcement in the field of intellectual property rights ("**IPRs**"). It also illustrates the ever-increasing impact of antitrust law on the high technology sector more generally. In this article, we discuss the development of the Draft IPR Abuse Regulation as well as judgments by the Guangdong High People's Court in the *Qihoo 360 v. Tencent* case and by the Shenzhen Intermediate People's Court in the *Huawei v. InterDigital* dispute.

The Draft IPR Abuse Regulation

SAIC has been drafting guidance on how the Anti-Monopoly Law ("**AML**") should be applied in the IPR context for some time; at least one of the prior drafts was circulated informally for comments. Perhaps the most important change to the latest draft, when compared with the preceding draft, is that SAIC now envisages adopting a regulation (a 'departmental rule') as opposed to guidelines. Whilst the guidelines would have applied to IPR-related activities across the board, the scope of the regulation (if enacted) would be confined to SAIC's regulatory jurisdiction – i.e., anti-competitive agreements between companies and abuses of a dominant market position by a single company which do not directly relate to pricing conduct. Price-related conduct related to IPR falls under the remit of the National Development and Reform Commission, and is not meant to be directly covered by the Draft IPR Abuse Regulation.

The scope of activities caught by the Draft IPR Abuse Regulation is relatively broad, covering the use, licensing, assignment, and enforcement of patents, trademarks, copyrights, and trade secrets and is non-exhaustive in nature. In short, all the main classes of IPRs are caught. Generally speaking, the Draft IPR Abuse Regulation focuses more on abuse of dominance than anti-competitive agreements. The Draft IPR Abuse Regulation provides some safe harbors for the latter, i.e., 20% total market share in the relevant technology or product market affected if the parties to the IPR-related agreement are competitors, and 30% if they are not. For abuses of dominance, the Draft IPR Abuse Regulation outlaws the following types of practices, provided that certain conditions are met:

- refusal to license
- tying an IPR with other IPRs or products
- the imposition of 'unreasonable restrictions' when licensing IPRs.

Beyond the specific licensing context, the setting of 'unreasonable conditions' can similarly be illegal under the *Anti-Unfair Competition Law*, and no showing of dominance is required under that law.

The Draft IPR Abuse Regulation also mentions that exclusive grant-back obligations of improvements to the technology without justifiable reasons, prohibitions to challenging the validity of the underlying IPR or on using competing technology after the expiry of the licensing term, and the requirement to pay royalties after expiry of the IPR (as well as other yet-to-be defined clauses) can be 'unreasonable restrictions.' Many of these types of clauses may already potentially be unenforceable or subject to challenge under the *People's Republic of China Contract Law* ("**Contract Law**"), under which technology contracts that unlawfully monopolize technology, impede technological progress or infringe upon the technological achievements of others are void. These provisions in the Contract Law, in a Supreme People's Court Interpretation on disputes involving technology contracts and in the rules applicable to the import or export of technologies apply even in the absence of dominance. In a way, the proposed new rules in the Draft IPR Abuse Regulation would not represent a paradigmatic shift of the state of the law in China, although a violation of the regulation would trigger the sanctions under the AML – e.g., fines in the amount of 1% to 10% of the perpetrator's annual revenues – rather than simply giving rise to an enforceability and invalidation issue.

In any event, particularly if a company believes it has a dominant market position, its licensing agreements will need to be robust enough to withstand a much greater degree of legal scrutiny than before.

The Draft IPR Abuse Regulation also defines and contains specific rules on the operation of patent pools, the setting and implementation of standards involving patents, and on the operations of 'collective copyright management organizations' (in Europe mainly referred to as "collecting societies"), all of which have the potential to give rise to antitrust issues (as has been seen in other jurisdictions).

In addition, the draft regulation also contains a broadly worded 'abuse of rights' clause, prohibiting an IPR holder in a dominant market position from issuing infringement warning letters against companies when their "conduct manifestly does not constitute an infringement of intellectual property rights."

The *Qihoo 360 v. Tencent* Judgment
On 20 March 2013, the Guangdong High People's Court reached its decision in the high-profile *Qihoo 360 v. Tencent* case. The two leading Chinese software/Internet companies – Qihoo 360 (whose main strength lies in anti-virus software) and Tencent (whose flagship product is QQ, an instant messenger service) – have been playing out their dispute in a variety of fora, including the courts in Beijing and Guangdong and with certain government authorities.

The question before the Guangdong High People's Court was whether Tencent had abused its dominant market position in violation of the AML. The court found that it had not. In a lengthy opinion, the court held that plaintiff Qihoo 360 had failed to define the relevant market properly and also rejected Qihoo 360's claim that Tencent was dominant in the instant messaging market. Despite having dismissed the plaintiff's arguments on market definition and dominance – and effectively concluding that Tencent had not breached the AML – the court went on to determine whether Tencent's conduct could potentially be abusive. The reason for doing so was to provide guidance to companies in the Internet industry. Interestingly, the court found that Tencent's conduct would indeed amount to 'exclusive dealing' – a type of conduct that is prohibited for companies in a dominant position – not tying.

The Guangdong court's judgment is now on appeal, before the Supreme People's Court, which conducted the first hearing, with live internet broadcast, on 26 November 2013.

Although China is essentially a civil law jurisdiction and hence court judgments do not have precedential value, the *Qihoo 360 v. Tencent* judgment may nonetheless be of interest to companies involved in other cases in the high technology sector. For example, the court's analysis regarding the definition of the relevant product market is particularly noteworthy: first, the court examined the arguments of the economists acting for the plaintiff in quite some detail. Second, it relied quite heavily on a decision by the European Commission, in *Microsoft/Skype*, a merger case, which Europe's General Court upheld on appeal on 11 December 2013. Third, it emphasized the dynamic nature of Internet-related markets and held that the analysis of the market should not exclusively date back to the time *before* the lawsuit was filed. Fourth, the court got very close to recognizing that competition in the Internet space takes place between platforms, not individual products: "in the development of the Internet industry until today, the choice of any free product or service to attract users is merely a different method of building up a platform, but the essence of competition is competition between Internet companies to develop value-added services and the advertisement business on the basis of their own application platforms."

The judgment by the Guangdong court contains similarly interesting language on the definition of the relevant geographic market, which it found to be worldwide in scope, and the analysis of dominance, finding, for example, that "due to the particular market conditions of the Internet industry, market shares cannot be used as a decisive factor to determine a business operator's dominant market position."

The *Huawei v. InterDigital* Judgments

A few weeks earlier, on 4 February 2013, the Shenzhen Intermediate People's Court issued two rulings in the dispute between Huawei and InterDigital.

InterDigital holds patents that are essential to implementing 2G, 3G and 4G mobile telecommunication standards, and the dispute essentially centered around the terms on which Huawei can use the patents. In July 2011, InterDigital filed actions before the International Trade Commission in the United States and the District Court in Delaware against Huawei, ZTE and Nokia, alleging patent infringement. In December 2011, Huawei filed two lawsuits in Shenzhen – the location of its headquarters – inter alia claiming that InterDigital had violated the AML.

According to the Shenzhen Intermediate People's Court, InterDigital breached its obligation to license its standard essential patents ("SEPs") under fair, reasonable and non-discriminatory ("FRAND") terms to any company that wanted to implement the relevant standards, as it had promised to the European Telecommunications Standards Institute. The court found that in seeking an injunction to ban Huawei from selling products in reliance on those patents in the United States and requesting Huawei to pay compensation for damages by filing complaints with the International Trade Commission and the Delaware District Court – while the negotiations with Huawei to license the SEPs were still on-going – InterDigital violated its FRAND obligation.

The court held the FRAND breach – together with InterDigital's licensing offers – to be a means to extract excessive royalties from Huawei, and condemned it as an abuse of dominance in violation of the AML. Moreover, the Shenzhen court also held that InterDigital's licensing of SEPs with the licensing of non-essential patents in its portfolio constitutes illegal tying.

Finally, in the other judgment issued on the same day, the court reportedly ruled that the FRAND rate for InterDigital's 2G, 3G, and 4G essential Chinese patents should not exceed 0.019% of the actual sales prices of Huawei's products incorporating the patent technology.

InterDigital appealed the two judgments, but the Guangdong High People's Court dismissed the appeals on 16 and 21 October 2013.

Subsequently, InterDigital reported becoming the target of an investigation by the National Development and Reform Commission based on similar claims of AML violations in relation to its licensing activities. Around Christmas 2013, InterDigital and Huawei were reported to have entered into a settlement of most of their disputes.

Conclusions

The Draft IPR Abuse Regulation will likely be further amended before it becomes law. By focusing the draft on areas within its scope of competence, notably anti-competitive agreements and abuses of dominance that are not related to pricing, SAIC is likely trying to avoid the scope for regulatory overlap and possible 'turf battles' with other AML enforcement bodies.

Meanwhile, proving dominance in Chinese courts has been a difficult task. Taking a positive viewpoint, it is interesting to note that the Guangdong High People's Court looked to European Union case law and went beyond simple market shares when making a ruling on dominance in the Internet industry.

In the *Huawei v. Inter Digital* dispute, the ruling by the Shenzhen Intermediate People's Court may have been one of the very first cases worldwide – if not the first – that actually determined a specific FRAND royalty fee. More generally, these recent developments indicate that patents essential to technology standards have increasingly become a focus of the authorities and courts in China. On top of SAIC's Draft IPR Abuse Regulation and the verdict of the Shenzhen Intermediate People's Court in *Huawei v. InterDigital*, the Standardization Administration of China has recently released draft rules on the process of setting national standards, which would in part bring the Chinese system closer to international practice while maintaining some distinct Chinese characteristics.

Against this background, it appears that antitrust claims – whether used as a 'shield' or a 'sword' – are likely to become a prominent feature of high technology-related litigation in China for the foreseeable future. This requires companies to update their licensing agreements, other contracts, and compliance policies and consider antitrust issues when drafting IPR-related agreements to stay within the bounds of the fast-changing legal framework.

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Will the merger of SARFT and GAPP end the turf war over control over the internet?

On 18 March 2013, several famous China Central Television news presenters were seen taking souvenir pictures of the "State Administration of Radio, Film, and Television" plaque on the gate of the government agency's office building located at Fuxingmenwai Street, in central Beijing. Soon after, on 24 March 2013, the plaque was replaced with one bearing the new, longer, and even more difficult to pronounce (or abbreviate in English) moniker "The State Administration of Press, Publication, Radio, Film, and Television."

Pursuant to the 2013 State Council Organizational Reform and Functional Changes Plan adopted at the 12th session of the National People's Congress, the General Administration of Press and Publication of the People's Republic of China ("GAPP") and the State Administration of Radio, Film, and Television ("SARFT") are merged into a single body, to be known as the State Administration of Press, Publication, Radio, Film and Television ("SAPPRFT").

Background

GAPP historically has overseen and regulated print media such as books, newspapers, and magazines, along with published audio and video products. Broadcast media – i.e., radio, television, film, and online video programs – have historically been regulated by SARFT. GAPP was founded in 2001, while SARFT was formed as a result of the 1998 institutional reform. Both pre-dated the explosion in the use of the Internet as a tool for disseminating information and entertainment-related content to the public. With the emergence of the Internet as a form of new media, the relevant government agencies including GAPP and SARFT grappled with each other when it came to regulating Internet publication and broadcasts.

The merger seems to be an attempt to resolve the 'turf wars' between GAPP and SARFT. However, resolving the conflicts between the two government agencies represents only part of the overall picture. The reality is that China's Internet industry is heavily overregulated and there is a pressing need to redefine roles and demarcation lines between the plethora of regulatory bodies with oversight over cyberspace in China. In addition to GAPP and SARFT, another key regulator is the Ministry of Culture ("MOC"). The tentacles of other agencies, such as the Ministry of Industry and Information Technology ("MIIT") and even the State Internet Information Office, also reach into this area.

This article gives a brief overview of the role of the key players in the past as well as the impact of the merger on China's Internet industry.

The Key Players

MOC – Internet Cultural Activities. MOC is responsible for the administration of Internet cultural activities – note that China considers the Internet and the activities thereon as cultural – which are defined as providing "Internet cultural products" (as further defined below) and related services, including producing, reproducing, importing, publishing, or broadcasting Internet cultural products; and sending cultural products through information networks such as the Internet or mobile networks to computers, telephones, mobile phones, TV sets, game players, or Internet cafés for browsing, reading, using, or downloading.

Internet cultural products are defined in relevant regulations as cultural works produced, disseminated, or circulated via the Internet, including online music, online games, online shows and plays (programs), online performances, online works of art, online cartoons produced solely for the Internet, and works of art, cartoons, and so forth reproduced or disseminated through the Internet.

Internet cultural activities are categorized into profit-making and non-profit-making activities. The operation of profit-making Internet cultural activities in China means the operator needs to obtain an Internet cultural operation permit which is issued by MOC, while non-profit-making activities only require record filing with MOC. Profit-making Internet cultural activities not only include charging Internet users for providing Internet cultural products or related services, but also publishing on-line commercials (in return for a fee paid by advertisers) while allowing users to access the content without charge.

SARFT – Online Audio-Visual Programs. SARFT, meanwhile, is responsible for the administration of the publication of audio-visual programming delivered through the information network (i.e., the Internet). According to relevant regulations, audio-visual programs consist of moving pictures or continuous sounds which are shot and recorded by movie cameras, video cameras, recorders, and other audio-visual equipment. An Internet audio-visual programming service refers to the making, redaction, and integration of audio-visual programs, the provision of the programs to the general public via the Internet, as well

as the provision of services allowing users to upload and disseminate the programming online.

Until now, a permit for publication of audio-visual programs through an information network has had to be obtained in order to screen audio-visual programs on the Internet, such as the services provided by video-on-demand operators (the permit is not required for municipal-level radio and TV stations and central-level news agencies). In addition, other licenses may be required depending on the specific category of audio-visual programs. For instance, given the sensitivities involved, an Internet news information service license issued by the State Internet Information Office is required in order to screen audio-visual programs about current events and political affairs on the Internet.

GAPP – Internet Publication. Publication of materials on the Internet is also subject to approval by GAPP. Historically and according to relevant regulations, "publication" has meant the publication, printing or reproduction, importation, and distribution of books, newspapers, periodicals, audio and video products, electronic publications, and so forth.

Internet publication refers to the online publication of works by Internet information service providers – also known as Internet content providers ("ICPs") – which are self-authored or written by others, or to the uploading of such works onto the Internet for public viewing, browsing, reading, use, or download. Pursuant to the *Interim Provisions on the Administration of Internet Publication* ("Interim Provisions")[1], "works" mainly includes (i) the contents of published books, newspapers, periodicals, audio and video products, electronic publications, or works published on other media; and (ii) reedited or redacted works of literature, art and natural science, social sciences, and so forth. Hitherto, engaging in Internet publication activities has required an Internet publication permit issued by GAPP.

Overlapping Authority of the Three Regulators

Theoretical Analysis. It is fairly clear from the above description that, in the Internet context, the concepts of "Internet cultural products," "online audio-visual programs," and "works" overlap with each other.

It is difficult to determine in practice whether an Internet publication should be treated as a form of Internet cultural activity. By definition, online audio-visual programs such as online music videos, online performances, and online videos of plays would fall within the scope of Internet cultural products. Therefore, the publication of these materials would require the relevant permits from both SARFT (permit for publication of audio-visual programs through an information network) and MOC (Internet cultural operating permit).

In addition, Internet cultural products and online audio-visual programs which meet the originality test may be recognized as "works" under the *Copyright Law*[2]. However, as indicated above, under the Interim Provisions, the scope of works requiring an Internet Publication Permit is narrowed down to certain intellectual works. In addition, it is hard to determine whether Internet cultural products or online audio-visual programs fall within the scope of 'works' regulated under the Interim Provisions, the publication of which would require GAPP Internet publication permits; based on the *Draft Provisions on the Administration of Online Publications* issued by GAPP on 18 December 2012 ("Draft Provisions") for public comment, it can be anticipated that the scope of works will be expanded to include more products, such as games, cartoons, and audio visual products (note that there is some uncertainty in how the Draft Provisions will be impacted by the merger between SARFT and GAPP).

In the Draft Provisions, online works were categorized into the following three types: (i) original digital works such as words, pictures, maps, games, cartoons and audio-visual literary products in the literature, arts, and sciences; (ii) digital works containing the same contents as their printed version; and (iii) digital works produced by way of editing, compilation, and collection.

This new categorization of "works" reflects GAPP's intention to assert its authority over the administration of online publications of games, cartoons, and audio-visual products. This would potentially have led to further overlap and tensions with MOC and SARFT. The likelihood of an ugly three-way tug-of-war between GAPP, MOC, and SARFT in a very public forum may well have been the catalyst for the merger. As explained below, there have been various clashes between MOC and GAPP in the online gaming space, which came to a head in the case of the hugely popular online game World of Warcraft.

1 Issued by GAPP on 27 June 2002, with effect from 1 August 2002.

2 Promulgated by the Standing Committee of the National People's Congress on 7 September 1990 and further amended on 27 October 2001 and on 26 February 2010.

Practical Example #1: Online game administration. The administration of the online gaming industry has been the battleground for the various authorities seeking to exert regulatory control over the Chinese cyberspace. The battle between MOC and GAPP over the rights to regulate the online gaming industry has itself become something of a drama. GAPP regulates online games as Internet publications, but MOC also imposes administrative licenses in this space, deeming online games to be Internet cultural products. Before the World of Warcraft dispute (described below), in addition to holding an Internet cultural operation permit and an Internet publication permit, an online gaming operator was also required to apply for a product-specific license from MOC and GAPP respectively for the release of any online game.

The World of Warcraft dispute in 2009 brought the dispute in online gaming administration between MOC and GAPP into sharp focus. World of Warcraft is an online game created by Blizzard Entertainment which NetEase imported into China. NetEase submitted product license applications to both MOC and GAPP. After obtaining MOC's product license but before GAPP issued its license, NetEase released the game for online commercial publication. GAPP then announced that World of Warcraft was being operated unlawfully and ordered a shut-down of NetEase's operations. MOC and GAPP then argued back and forth over the issue, each declaring that it had ultimate authority over the matter.

A cease-fire was called after the State Commission Office for Public Sector Reform ("**SCOPSR**") issued Interpretations[3] splitting the administrative powers between MOC and GAPP over online games as follows: Taking the view that online games are Internet cultural products, the Interpretations provide that MOC is responsible for overall administration of the online gaming industry with a particular focus on the content of online games to ensure compliance with the Chinese government's ideological policies (meaning that MOC is responsible for the overall administration, industry planning, industrial base planning, project construction, exhibition, trading and market supervision of the online gaming industry). In turn, GAPP's product license is

3 The Circular on Printing and Distributing the Interpretations of Certain Provisions Regarding Animations, Online Gaming and Comprehensive Law Enforcement of the Culture Market issued by the Ministry of Culture, the State Administration of Radio Film and Television and the General Administration of Press and Publications by the State Commission Office for Public Sector Reform, promulgated by SCOPSR, effective from September 16, 2009.

required with respect to the publication/release of online games, but MOC's licensing requirements vary depending on whether the game is domestically produced or imported. As a result, the operator of a domestically-produced online game is required to obtain a product license from GAPP and file the product information with MOC after its publication/release. For imported online games, the operator still needs to apply for product licenses separately from both MOC and GAPP before the release. This sets the bar higher for bringing imported online games into China.

Despite SCOPSR's efforts to split the administrative powers between MOC and GAPP, the online gaming industry remains subject to unnecessary joint administration and oversight from both MOC and GAPP. This increases the compliance costs for market players and delays the introduction of new products into the market. In reality, despite the merger, we have not noticed any actual integration of the approval processes of both SARFT and GAPP in this area. Even the websites of the two authorities remain separate from each other. It has been reported in the media that the overall integration plan is expected to be released by the end of June 2013.

Practical Example #2: Online animation administration. Before the merger of SARFT and GAPP, the animation industry was under the joint administration of three market regulators.

MOC was responsible for the administration of the animation industry, overseeing industry planning, industrial base planning, project construction, exhibition and trading activities and market supervision. In addition, animation enterprises which met MOC's requirements were able to enjoy preferential tax treatment. SARFT oversaw the administration of film and television animation, online animated films and television programs, and online audio-visual animation programs. At the same time, GAPP was responsible for the approval of the publication of animation books, newspapers, periodicals, and video products.

It remains to be seen how the merger will impact this distribution of roles, and whether overlapping aspects will be more clearly delineated.

Impact of the Merger

It was hoped that the merger of SARFT and GAPP would lead to a rationalisation of the overlapping jurisdictions of the various authorities involved in the licensing of, and exercise of regulatory supervision over, certain areas of China's Internet industry. As the merger remains a relatively recent development and the government is still in the early stages of implementation, the actual impact in practice remains to be seen. Regardless of the impact of the merger, evidence suggests that a lot of work remains to bring order to this overregulated space and provide respite for both foreign and domestic business trying to make sense of the myriad regulatory requirements.

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China turns up the heat in the battle against abuses of personal data

Despite the apparent side-lining of the draft *Personal Data Protection Law* ("**Draft Personal Data Law**"), which has been circulating since 2006 but appears to have little prospect of becoming law in the foreseeable future, China has nonetheless been very busy stepping up the battle against the abuse of personal data from a legislative perspective in recent years.

As China does not have a single comprehensive data protection law, many actions that historically relate to personal data protection have been brought under different guises, such as actions for infringement of rights to reputation or rights to image under the *General Principles of Civil Law* first effective 1 January 1987 (as amended) ("**GPCC**"). In fact, rights to privacy can be traced back to the *People's Republic of China Constitution* ("**Constitution**") which treats a citizen's communications (e.g., telephone conversations, letters, emails) as private information. Other regulations such as the *Telecommunications Regulations and the Internet and E-Mail Services Administrative Measures* ("**E-mail Measures**") reflect the language of the Constitution in their respective domains.

Until recently, those whose rights to privacy had been infringed upon were limited to relying on Article 140 of the *Opinions of the Supreme People's Court on Several Issues Concerning the Implementation of the General Principles of Civil Law (Trial)* ("**Supreme People's Court Opinions**"), which provides that "disseminating the privacy of another person" is regarded as damage to that person's right to reputation (rather than a direct infringement or invasion of privacy) as well as various other disparate provisions in laws, administrative regulations, and other rules relating to areas as diverse as banking, medical services, and the protection of minors and HIV-infected persons. Many of the provisions that come closest to general data protection provisions are set out in rules related to consumer protection such as the *Shanghai Municipality Protection of the Interests of Consumers Regulations* effective 1 January 2003.

Recent Key Legislative Developments

In terms of employers' data protection obligations towards their employees, the main set of rules is the *Regulations on Employment Service and Employment Management* ("**Employment Information Regulations**")[1] which govern the protection of personal information of employees. Employers in China now have an obligation to maintain the confidentiality of their employees' personal information. According to the Employment Information Regulations, an employer must keep its employees' personal information confidential and must obtain an employee's written consent if the employer wants to make the employee's personal information public.

The Employment Information Regulations do not clearly define the employee's "personal information," a term that appears to vary by industry. Officials we spoke with suggested that the scope of the term would be left to the discretion of the labour authorities on a case-by-case basis. However, one should note that China's Internet and telecommunications industry regulator, the Ministry of Industry and Information Technology ("**MIIT**"), promulgated rules in 2011 defining "personal information" within the telecoms space (see below).

A legislative landmark was achieved when China amended the *People's Republic of China Criminal Law* (the "**Criminal Law**") in 2009, such that it is now a criminal offence for "government or private sector employees in the financial, telecommunications, transportation, medical, or other such like sectors to sell or otherwise unlawfully provide the personal data that has been obtained by them in the course of performing their work duties to third parties, or for any person to obtain such information by means of this or other unlawful means." This section of the Criminal Law does not, however, provide guidance on how to construe "personal data" or what would constitute the "unlawful provision" of personal data. Subsequent to this development, China went a step further when the *Tortious Liability Law,* effective 1 July 2010, specifically cited rights to privacy as one of the group of protected personal and property rights on which a tortious claim may be based.

In December 2011, MIIT promulgated the *Regulating the Internet Information Service Market Order Several Provisions* ("**Internet Information Service Provisions**") which became effective on 15 March 2012. The Internet Information Service Provisions apply to entities in China providing information services through the Internet – also known as Internet content providers (or "**ICPs**") or engage in related activities, and have a special focus on protecting Internet users' legitimate expectation of privacy from perceived abuses.

1 Issued by the Ministry of Labour and Social Security (the predecessor to the Ministry of Human Resources and Social Security), effective 1 January 2008.

2 Jointly issued by the General Administration of Quality Supervision, Inspection and Quarantine and the Standardization Administration of China, effective 1 February 2013.

The Internet Information Service Provisions contain rules on the treatment of "users' personal information," which is defined as "any information associated with a user which, either independently or when combined with other information, is able to identify such user" (our emphasis). The rules, among other things, provide limitations and consent requirements on ICPs for the collection and dissemination of personal information.

More recently China passed the *Guidelines of Personal Information Protection within Information System for Public and Commercial Services on Information Security Technology* ("**Guidelines**")[2], governing the protection of personal information in general. The Guidelines are intended to regulate all organizations and entities with respect to the protection of personal information (except for government bodies that exercise any public administration function). The Guidelines contain a set of rules and principles for the collection, processing, transferring and deletion of personal information on "computer information systems" (as opposed to other data storage media in hard copy form). The Guidelines constitute recommended standards rather than mandatory standards, and a company may choose to adopt the Guidance in whole or in part. However, they are as close as China currently gets to data protection best practices and hence worthy of consideration by companies with operations in China, as they provide a taste of things to come.

Under the Guidelines, personal information is defined very broadly to be "any computer data relating to a specific natural person which can be processed by an information system and which is capable of identifying such natural person, either individually or in conjunction with other information." The Guidelines set out two categories of personal information: "sensitive personal information" (i.e., information that, if divulged, may have negative implications on the owner of the information) and "general personal information" (i.e., everything other than sensitive personal information). The collection and use of "sensitive personal information" requires the owner's express consent, and evidence of such consent must be kept. The collection and use of "general personal information" requires implied consent (that is, where the owner raises no objection to its collection). In either case, express consent is required to transfer any personal information outside China under these non-mandatory guidelines.

In parallel to these developments, there has been a notable trend for local legislation such as the *Jiangsu Province Information Regulations*[3] which seem to be designed to fill in the perceived gap in the law left by the failure of the draft *Personal Data Protection Law* to gain traction.

It is against this background that two additional major pieces of legislation on the collection and use of personal data by network services providers, enterprises, other institutions, and even individuals have emerged. It is notable how the emphasis remains very much on regulating the conduct of service providers despite the raft of prior legislation in this regard, suggesting the problem persists.

The Personal Information Provisions and the Network Information Protection Decision

The *Provisions on Protection of Personal Information of Telecommunications and Internet Users* ("Personal Information Provisions") were released by MIIT on 16 July 2013 and came into force on 1 September 2013. The Personal Information Provisions follow a decision by the National People's Congress Standing Committee – the *Decision on the Strengthening of the Protection of Network Information* ("Network Information Protection Decision") – that came into force on 28 December 2012. In terms of their relationship, the Network Information Protection Decision is a top-down 'helicopter' view that sets out the framework and provides overarching principles with regard to personal data protection. However the scope of application of the Network Information Protection Decision is very wide, as it regulates the collection and use of "personal electronic information" of network service providers and by all other enterprises and institutional organizations in the course by their operations, and requires that the collection and use of personal electronic personal data must be on the basis of informed consent and information owners must be notified about the purpose of data collection, the method and the scope. Policies in relation to the collection and use of electronic personal information must be made public. The Personal Information Provisions follow the same principles, but are much more detailed.

The Personal Information Provisions address the collection and use of the personal information of individual users such as passwords, names, date of birth, addresses, account numbers and so forth by providers of telecommunications services and Internet information services within China ("Service Providers"). The Personal Information Provisions include standards, security measures, and penalties concerning collection, use of information, and violations in respect thereof by Service Providers and third parties engaged to handle collection and use of such information (i.e., outsourcing).

Key Obligations and Penalties under the Personal Information Provisions

The Personal Information Provisions set out a number of security measures regarding collection and use of personal information which Service Providers must adopt to prevent disclosure, damage, and loss of personal information.

These measures include:

- limiting the right to access to users' personal information to certain employees only
- ensuring safe storage
- maintaining records of staff who handle user data
- setting internal policies on data collection and use
- training staff on personal information protection.

Service Providers are also required to formulate rules on the collection and use of personal information of users, which must be displayed at their business premises, websites, etc.

Unlike the Network Information Protection Decision, under which enforcement through the imposition of (fairly vague) penalties is uncertain without further implementing legislation, the Personal Information Provisions are more concrete and specific. Penalties are linked to Service Providers' level of implementation of rules and security measures. Fines of up to RMB 10,000 may be imposed for failure to formulate or display rules, or to set up a mechanism for user complaints. Other breaches may lead to fines between RMB 10,000 and 30,000. The Personal Information Provisions also refer to potential criminal liability, presumably referring to criminal data protection violations set out in the Criminal Law.

3 Issued by the Standing Committee of the Jiangsu Province People's Congress, effective 1 January 2012.

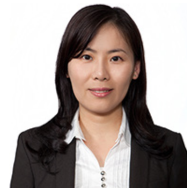
Conclusion: Practical Implications of the New Rules

It has been suggested that one of the reasons why the drafting of the Draft Personal Data Law appears to have been side-lined and has fallen off the legislative calendar is because there was no consensus among key stakeholders as to whether China was ready for, or even needed, a 'full-on' law on data protection. Yet some consumers in China, who have to live with very high levels of spam on mobile telephones and in email accounts, may beg to differ. Nonetheless, China's legislative machine appears to have been notched up a gear in recent years in response to concerns regarding the issue, although there seems to be substantial overlap between that legislation that has surfaced. China's decision to enforce the Criminal Law provisions on data protection in certain recent high-profile cases is the clearest indication that China increasingly views data protection as a serious issue.

The increase in legislation in this area must be understood against the backdrop of mounting public discontent with Service Providers' use of personal data. While responsive to such concerns, the Personal Information Provisions have drawn criticism for lacking teeth. Critics argue that even a fine of RMB 30,000 is miniscule in comparison to revenues of major operators that tally into the billions of RMB, and it has been suggested that the purpose of these regulations is more to head off public discontent than a genuine effort to protect personal information.

Some note that the provisions regarding reputational damage – alluded to in the Network Information Protection Decision, for example – may be more potent.

While the Personal Information Provisions certainly appear to have important business implications for entities falling within the definition of "Service Provider" and are more specifically discussed in this article, the Network Protection Decision has implications for all enterprises collecting data in China. These businesses will now be required to comply with the core principles of "lawfulness, appropriateness, and necessity" when collecting personal electronic data of individuals while engaging in business activities. They will also, henceforth, need to specify the method and scope of collection and use and obtain the consent of the subject of the data collection. That is a significant change, and as more data protection-related legislation and regulations surface, domestic and foreign-invested enterprises in China may need to regularly review their data collection models and practices.



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New rules released by SAFE simplify payments under cross-border IP transactions and technology imports/exports

On 24 July 2013, the State Administration of Foreign Exchange ("**SAFE**") released the *Guidelines for Foreign Exchange Administration of Trade in Services* ("**Guidelines**") and its implementation rules, the *Detailed Rules for Implementing Guidelines for Foreign Exchange Administration of Trade in Services* ("**Implementation Rules**"), both of which took effect on 1 September 2013. While these two sets of rules cover many areas, this article specifically examines how they will affect cross-border intellectual property ("**IP**") transactions, such as payments for trademark licensing or for the import/export of technologies.

Overall, the Guidelines and the Implementation Rules simplify the documentation requirements for remitting royalty payments outside of China; the requirements are further simplified if the amount of the transaction is less than or equal to USD 50,000.

Yet how these regulations will be put into practice by different banks and regions remains to be seen.

Historically, in order to remit funds overseas as part of an IP transaction such as a license of IP rights, the trademark/patent license had to be record-filed with the Trademark Office and the State Intellectual Property Office ("**SIPO**"), amongst other requirements. This was cumbersome and resulted in clients incurring extra costs, especially when the licenses related to intra-group transactions or when the license was intended to be for a short period. Our enquiries since 1 September 2013 do indicate that there is now less of a need to record-file licenses and so forth for the sole purpose of remitting royalties overseas.

Under the new Guidelines, the procedures are streamlined as follows:

For Payments USD ≤ 50,000

Under the Implementation Rules, if the amount of the transaction is less than or equal to USD 50,000, the onshore payor is generally no longer required to submit transaction documents to the remitting bank for approval of conversion and remittance. However, SAFE has requested that the bank continue to review such documents and conduct "reasonable" checks if the nature of the funds is unclear.

This means that no official confirmation of the record-filing of the underlying transaction should be necessary for remitting out royalties where the amounts are less than or equal to USD 50,000. However, the Implementation Rules also provide that, where a party intentionally splits transactions, it shall be penalised.

The term "intentionally splitting transactions" is defined as where, for the purpose of evading foreign exchange administration, an onshore payor (or payee), engages in repeated foreign exchange payments (or receipts) with the same overseas payee (or payor) on the same day, every other day, or for a number of consecutive days. Where a violation has occurred, the foreign exchange administrative authority may impose a fine on the evading party of up to 30% of the total evaded amount. In short, while there is less scrutiny of transactions involving amounts below or including USD 50,000, there are punishments for abuses of the more relaxed rules.

For Payments > USD 50,000

For payments in a transaction that exceed USD 50,000, and depending on the nature of the payment, Article 6 of the Implementation Rules sets out the documents that should be submitted to the remitting bank for completion of the remittance:

- For payments of royalties and licensing fees, the onshore payor needs to submit (a) the underlying contracts and (b) invoices (or other kind of payment notices).
- For payments for technology imports or exports, the onshore payor needs to submit (a) the underlying contracts and (b) invoices (or other kind of payment notices). If the technology import or export involves technologies that are in the restricted category, the payor is further required to submit the "technology import and export license" issued by the Ministry of Commerce.

What this means is that record-filing at the Trademark Office or SIPO is no longer necessary for a trademark or a patent license to facilitate remitting out. Under the old rules, a certificate of license record-filing was a pre-requisite for the banks to make the remittance (despite the fact that failure to record-file does not invalidate the underlying license).

In addition to the above, the remitting bank will still need to see the tax clearance certificate, a document issued by the relevant tax authority providing evidence that any withholding tax in relation to the royalty or licensing fees has been paid.

Although the new rules do not specifically set out the documentation requirements in relation to payments for outright assignments of IP rights, we expect that the banks will process such transactions in line with the requirements for license payments.

Conclusion

The new rules simplify the process for converting and remitting out royalty payments for cross-border IP-related transactions. Informal enquiries with banks so far indicate that banks have already drawn up and issued their respective internal procedures on how to implement the Guidelines and the Implementing Rules. Companies are therefore still advised to consult with their remitting banks to ensure that they are aware of any specific operational requirements imposed by the bank to avoid any delays in processing.

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Notes

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