

**Recent Changes in China's Laws
Provide Greater Access for Foreign Businesses**

By Akana K.J. Ma
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For U.S. companies there has never been a more accommodating regulatory climate in China. Following its admission to the WTO, China has issued many laws and regulations allowing greater access by foreign companies to the China market. Two laws may be of particular interest to U.S. companies wishing to expand operations into China. One law streamlines the approval process for foreign companies wishing to import and distribute foreign-produced goods. The other law provides incentives so that foreign companies will continue to see Hong Kong as a gateway to greater China.

I. Increased Domestic Access for Offices of Foreign Companies

In 2005, China's Ministry of Commerce issued regulations making it much easier for foreign companies to render services and import and distribute products in China. Previously, foreign companies doing business in China had been restricted by a cumbersome and multi-step process that often involved representative offices, manufacturing joint ventures or manufacturing wholly foreign-owned enterprises ("WFOE"), and separate entities for service operations. Until recently, the WFOE was the entity most commonly used by foreign investors seeking to do business in China, but this corporate structure is still hampered by a narrow business scope that usually does not allow the distribution of third-party products within China.

A. New Distribution Rights In China

Recently, the most important change in China's regulations allows foreign companies to establish a Foreign Invested Commercial Enterprise ("FICE"). Foreign investors may now conduct wholesaling, retailing, and franchising of foreign products in China through a single entity - the FICE. Under prior regulations, a WFOE could not engage in distribution activities without significant additional approvals. In 2005, the Ministry of Commerce amended these rules to allow WOFEs to expand their business scope to include distribution, upon approval. In contrast, FICEs do not require additional approval to engage in distribution and may conduct simultaneous wholesale, retail and franchise activities. Thus, FICEs are quickly becoming the business entity of choice for foreign companies engaged in business on multiple levels.

B. Reduced Capital Contributions

While the amount of capital required for a FICE depends on whether the entity will be conducting retail or wholesale business, both types of FICEs usually require less registered capital than a WFOE. A retail FICE typically requires at least US\$36,000 of registered capital, and a wholesale FICE requires approximately US\$60,000. However, it is common for local authorities to increase the minimum capitalization amount required.

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C. Simplified Registration Procedure

As is the case with many administrative filings in China, the registration process for an FICE varies depending upon the particular demands of local officials and may take as much as several months. Typically, the required documentation includes the application, a feasibility study, audited reports for the investor's most recent financial year, and bank statements of creditworthiness. Provincial authorities might then submit the application to the Ministry of Commerce, but in recent months the central government has granted local officials increasing power to finalize the process.

II. Increased Access to China for Foreign Companies with Offices in Hong Kong

Fifteen years ago nearly any foreign company wishing to establish business ties in China would have done so through Hong Kong. Today that is no longer the case – Hong Kong is facing stiff competition from Shanghai, which many now consider to be China's premier commercial center. However, with the passage of a series of laws, the national government is hoping that Hong Kong will remain one of China's most important gateways.

Between January 1, 2004 and January 1, 2006 China has implemented three phases of the Closer Economic Partnership Arrangement ("CEPA"), a series of laws and regulations that takes account of World Trade Organization rules and permits easier access to Chinese markets for Hong Kong-made products and Hong Kong-based companies.

Under CEPA, hundreds of categories of "Made in Hong Kong" products are exempt from tariffs when exported to China. Similarly, CEPA reduces or removes geographical, financial, and ownership restraints on foreign trading companies and service providers doing business in China through Hong Kong.

Therefore, the implications for U.S. exporters are great – companies with existing offices and operations in Hong Kong may be able to ship products into China duty free, provided certain product-origin requirements are satisfied. And U.S. companies who had previously not entered the China market can now do so through a city with more well-established commercial customs and familiarity with international trade than other areas of China.

The zero import tariff may be an opportunity for U.S. companies to produce goods in Hong Kong with higher value-added content or substantial intellectual property input. Examples of industries that may benefit most include proprietary technology products (such as medicines and some electronics), edible products (such as luxury processed foods), and high fashion and stylish apparel accessories.

A. Trade in Manufactured Goods

While many manufacturers in Hong Kong will continue to use mainland China as their main production base, others may consider revitalizing existing facilities or setting up new production lines in Hong Kong to take advantage of CEPA. These industries are likely to be high-end consumer products having a strong design element that can command higher prices to offset the higher production costs in Hong Kong. In recent years, the Hong Kong government has maintained that the “Made in Hong Kong” label instills more confidence in product quality among mainland consumers. If true, Hong Kong companies should examine starting a new product line of premium products or new brands in Hong Kong to target the higher end of the mainland market. If such higher end products include proprietary technologies, formulae or inventions, then foreign investors may prefer investing in a wholly-owned venture in Hong Kong where many consider respect for IP assets to be higher than in mainland China.

I. Conclusion

The combination of these two Chinese legal reforms - the introduction of the FICE company form, plus Hong Kong’s new duty free status - provides foreign companies with unprecedented access to China’s markets. When compared to prior choices under older regulations, the FICE has become the business entity of choice for foreign businesses combining import, export, and distribution activities in China. And now with passage of CEPA, Hong Kong is again an attractive location for the establishment of foreign operations.

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