

DISTRIBUTION

Wholesaling and retailing

China's policy on foreign investment has always emphasized manufacturing projects, particularly those that export. The activities open to foreign-invested enterprises are, however, expanding. One example is the opening up of China's wholesale and retail sectors in recent years.

Foreign investment in wholesale and retail activities is governed by the Measures for the Administration of Foreign Investment in the Commercial Sector (the "Commercial Sector Measures"), which came into force on June 1, 2004. Promulgation of the Commercial Sector Measures represents partial fulfillment of China's WTO obligations to open up its wholesale and retail sectors to foreign investment. Under the Commercial Sector Measures, foreign investors can establish 100% wholly foreign-owned wholesale or retail enterprises beginning on December 11, 2004. However, there is a cap of 49% foreign (not including Hong Kong and Macao) ownership when more than 30 stores are opened and the stores sell the following types of products sourced from different suppliers: books, newspapers, periodicals, pharmaceuticals, pesticides, mulching film, chemical fertilizers, grain, vegetable oil, sugar, cotton, etc. In addition to liberalizing equity restrictions, the Commercial Sector Measures lift all geographic restrictions on foreign-invested wholesale enterprises: such enterprises can be opened anywhere in China.

Foreign-invested wholesalers and retailers are permitted to engage in a fairly broad scope of activities. In addition to wholesaling, foreign-invested wholesalers are permitted to engage in commission agency (excluding auctioneering),

the import and export of merchandise and related ancillary services. Foreign-invested retailers are permitted to engage in retailing, the import of merchandise that they sell, sourcing and procurement of China-produced goods for export, tele-marketing, telephone marketing, mail order sales, Internet sales, vending machine sales and related ancillary services. Some restrictions do remain however, for example, tobacco retailing is prohibited.

Franchise operations

China permits foreign investors to engage in franchising activities through wholly foreign-owned or joint venture commercial enterprises. Cross-border franchising is also permitted.

In order for a foreign investor or foreign-invested commercial enterprise to become a franchisor, the franchisor must have at least two directly-operated stores that have been operating for over one year.

Applications to establish a foreign-invested commercial enterprise to engage in franchising activities must be submitted to the commerce authorities, and a specimen franchise contract must be submitted together with other application materials.

Direct selling

Pursuant to its WTO commitments, China liberalized foreign investment in wholesale and retail distribution away from a fixed location with the promulgation of the Regulations for the Administration of Direct Selling by the State Council and effective from December 1, 2005 (the "Direct Sales Regulations"). Following the promulgation of the Direct

Sales Regulations, China issued implementing regulations to supplement various aspects of the Direct Sales Regulations.

At the same time as the promulgation of the Direct Sales Regulations, China issued the Regulations on the Prohibition of Pyramid Marketing, promulgated by the State Council and effective November 1, 2005 (the “Pyramid Marketing Prohibition Regulations”). The stated aims of the Pyramid Marketing Prohibition Regulations are to ban certain activities which are considered to be harmful to the society and business environment.

“Direct sales” is broadly defined as “a sales method whereby a direct selling enterprise recruits direct sellers, who market products directly to the ultimate consumers other than through a fixed place of business” (emphasis added). The Direct Sales Regulations restrict the products that can be sold using direct sales methods in two different ways. A direct sales enterprise may only sell products that were produced by itself or by its parent or holding company. Additionally, China has limited the overall scope of products that can be sold through direct sales.

The Direct Sales Regulations impose a certain number of requirements on enterprises in China that intend to engage in direct sales in the PRC. The Direct Sales Regulations allow investors (both foreign and local) to expand the business scopes of existing PRC enterprises to include direct sales. MOFCOM is the issuing authority of the Direct Selling Permits. In order to apply for a Direct Sales Permit from MOFCOM, an applicant would have to submit a set of application documents. The application for the Direct Selling Permit must be submitted to MOFCOM through their provincial level counterpart where the applicant enterprise is registered. During the application process, MOFCOM will solicit the opinion of SAIC regarding the application before it decides whether to grant its approval.