

## Update

# Walmart ups its stake in Chinese on-line retailer Yihaodian

"I am always impressed with their depth of knowledge - they are smart, creative and always careful to satisfy Chinese legal requirements."

Chambers Asia-Pacific 2012

"Fluent in English and Mandarin, Shanghai-based Brinton Scott continues to lead on corporate transactions. 'He is very good at what he does, he is very approachable and knows how to direct traffic at the firm. I have a lot of confidence in him,' according to clients."

Chambers Asia-Pacific 2012

Walmart, the global retail giant, recently announced that it had increased its investment in Yihaodian, one of China's leading e-commerce retailing platforms, from 20% to 51%. Chinese e-commerce laws and regulations are in a constant state of flux and for retailers or e-retailers who want to tap into this lucrative market the implications of getting this wrong can be very severe.

In his statement regarding the increase, Neil Ashe, President and CEO of Walmart Global eCommerce, said "Our further investment in Yihaodian demonstrates that [Walmart is] committed to investing in China in a key growth industry and developing all that goes with it: logistics, infrastructure, innovative talent and new technologies ..."

E-Commerce has exploded in recent years in China ... and retailers are keen to try to capture a share of this market. According to a report issued by Boston Consulting Group, "China's e-commerce industry is expected to surpass 750 billion yuan (US\$118 billion) in gross merchandise value for 2011 and it is expected to become the world's largest e-commerce market in 2015."

Against these promising commercial developments, however, the Chinese legal regime for foreign retailers wishing to pursue e-commerce remains complex and challenging. There are a number of issues that impact on how to structure an e-commerce business in China

including what approvals are necessary and whether e-commerce is even possible for certain products.

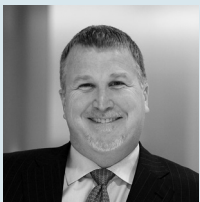
The main structural question is whether to use an existing retail subsidiary established in China (a foreign invested commercial enterprise or "FICE") or a contractual arrangement with a domestic Chinese company. In both cases, there is still a lack of clarity and consistency of interpretation in relation to the relevant e-commerce regulations.

### Using a FICE

Logically it makes sense for foreign retailers that already have a retail FICE in China to use the FICE to, in addition to running their retail stores, also run their e-commerce business. After all, the products sold online are likely to be the same or similar to those sold in retail outlets and the basic principle is that a FICE can also make online sales of its approved products. Certain types of products, however, are subject to specific

#### Further information

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restrictions and may require special approvals and licenses or even be “off limits” for foreign retailers –e.g., books and CDs are examples of products to which such restrictions apply.

Assuming that the products are not “off limits,” the key question then is whether the FICE’s e-commerce activities qualify as “non-commercial” or “commercial.” Broadly, the distinction seems to be between selling “self-owned” products vs. acting as an agent or intermediary for a third party’s products for a fee. For “commercial” e-commerce, a separate ICP license is required from the Ministry of Industry and Information Technology (“MIIT”) and a FICE can only obtain the ICP license if its foreign shareholders own less than 50% of it. By contrast, “non-commercial” e-commerce only requires an ICP registration with the MIIT—and no joint venture is required. Accordingly, interpretation is key.

Unfortunately, there is no clear consensus between different regulatory authorities and, more particularly, no consistency of interpretation between different locations:

- On one hand, the Ministry of Commerce (“MOC”) treats online sales of approved products as a valid part of a duly established FICE’s business and, therefore, non-commercial in nature.
- On the other hand, some provincial level MIITs take the view that an ICP license is a must for any and all e-commerce activities that a FICE undertakes—whilst other provincial level MIITs take the alternate view that a non-commercial registration will suffice.

This is extremely important because many FICEs are set up with 100% foreign investment (i.e. with no domestic Chinese partner), which means that they may be blocked from doing e-commerce because their corporate structure makes them ineligible to obtain the ICP license. In addition, if the FICE gets this wrong,

the penalties can be severe, including confiscation of profits, fines and, in serious circumstances, a revocation of business license.

As a result, many foreign retailers still struggle over whether they can legally engage in e-commerce in China by filing for a “non-commercial” ICP registration only. This situation also creates a potential problem for foreign retailers looking to expand across China, even if their e-commerce activities seem to be permitted in some locations.

#### Using a Contractual Arrangement

As an alternative to using a FICE and having a direct ownership structure, some foreign investors employ a variable interest entity (“VIE”) model for their e-commerce activities in China. This is a contractual arrangement which is structured so that the foreign retailer conducts its e-commerce through a purely domestic entity in China that is commercial ICP licensed. Once again, however, there is a lack of both detail and clarity in legislation with regard to such arrangements and, in particular, whether a foreign retailer is permitted to have de facto control over the e-commerce activities under the contractual structure.

While this arrangement appears to avoid some of the potential issues associated with using a FICE directly, it should still be approached with care.

Anyone looking to commence e-commerce activities in China will want to take counsel before implementing any plans. If you operate or plan to operate a retail business in China and have any questions regarding the content of this note or retailing in China in general, please contact Brinton Scott in our Shanghai office or David Wyatt in our London office. As a major legal service provider in the region, Clyde & Co has advised numerous foreign retailers to establish and run their businesses in China - including assisting them to set up e-commerce operations.