Industrial Policy and Foreign Investment in the Media Industry of China

China's industrial policy of foreign investment in the media industry is like a pendulum – sometimes perceived as a little flexible, but often perceived as restrictive.

However, China is obliged to fulfill its WTO commitments and gradually open parts of its media industry to foreign investors. On the other hand, it has to consider its national security and other social and economic issues. China has promulgated regulations prohibiting foreign investment in certain sectors.

For example, on 28 September 2009, three governmental departments of China jointly issued new rules prohibiting foreign investors from directly or indirectly investing in the online game industry.

<u>Foreign Investment Industrial Guidance Catalogue and the Media Industry</u>

The foreign investment industrial policy of China is spelt out in the document jointly stipulated by the National Development and Reform Commission and the Ministry of Commerce (the two most important governmental authorities of foreign investment) named *Foreign Investment Industrial Guidance Catalogue (“the Catalogue”)*

From 1 December 2007, the new version of the catalogue (“2007 version”) replaced its previous 2004 version and there is direct impact on the media industry accordingly.

Industries are divided into three categories in the 2007 version, namely (1) encouraged category; (2) restricted category; and (3) prohibited category. Foreign investments in industries falling under the first two categories are permitted while investments in the third are strictly prohibited.

Media industry can be categorized under “encouraged”, “restricted” and “prohibited”. Projects under the section of "cultural, sports and recreational industries" is grouped under the “encouraged” category and is contained in section 12 of the Catalogue. They can also fall under the restricted category in section 14 as well as under the prohibited category of the Catalogue respectively.

The following business activities of the media industry category are contained in the 2007 version:

1. Radio station, television station, radio and television channels and frequencies.
2. News website, audio and video websites.
3. Publishing and distribution of audio and video products, books, newspapers and other publications.
4. Audio and video programme production, film production.

<u>Foreign Investment in TV and Radio Stations</u>

TV and radio stations are under the media industry.

Subject to the 2007 version, foreign investors are prohibited to invest in TV and radio stations. The implications are, perhaps, political and national security.

Other Restrictions on Media Industry Investments

Foreigners can participate in the operation of performing auditoriums, theatres and other likewise places. Such business ventures are encouraged. Foreigners have to establish joint venture entities with Chinese parties. Only the Chinese parties can be the majority shareholders.

Foreign investments in the following industries are permitted but restricted:

1. Production of radio and television programmes.
2. Construction and operation of cinemas and theatres.
3. Agencies set up for performing artists

Under 1, only the cooperative joint venture structure is allowed, which means that the form of equity joint venture is not permissible. For 2 and 3, foreign investors may structure it either as an equity joint venture or cooperative joint venture. The foreign party in either form of joint venture has to be a minority shareholder.

No Way In? There May Be -- Restricted and Prohibited Categories

Foreign investment control in China can be imposed both at regulatory level and subjected to authority review and approval. Such review and approval can be as unpredictable as the recent snowy onslaught in China.

Relevant governmental authorities, especially the National Development and Reform Commission and the Minister of Commerce, by exercising their wide discretion, may determine whether or not to approve foreign investment on the basis of policy demands, macro-control and other issues.

Is it ever possible to invest beyond the restricted line or invest in prohibited industries? Yes and there is always a "but".

Special structures can be tailored to the demands of foreign investors who are eager to invest in industries categorized as either "restrictive" or " prohibited"in China.

Corporate group structures can be set up using contractual mechanism to control the operating companies in China without legal shareholdings. The directing minds can be shadow directors. This structure, based on operational and financial control through contracts by offshore parent company, is sometimes referred to as "variable interest entity" ("VIE") structure.

VIE structure is not uncommon in the foreign investment environment in China, especially in the areas with shareholding percentage ceiling. However, its legitimacy remains a grey area. Some government departments have voiced their disapproval of such structure.

Nevertheless, there is laxity in enforcement and imposition of penalty. Some companies continue to fully utilize the advantages of such structures. They have discounted the legal risks. They have to be handled in a delicate manner and there are lawyers in China who have such expertise in creating such deals. It may be part and parcel of doing business in the investment landscape of China.

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