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Kaitlyn Johnson

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Kaitlyn Johnson*

I. Introduction

China's largest Internet companies are turning to the U.S. stock exchange to raise financial capital for expansion.[1] A company raises financial capital by selling shares of ownership of their company to investors on a stock exchange.[2] Typically, an investor buys shares and receives a piece of equity ownership in the company.[3] However, this is not the case for over half of the companies domiciled in the People's Republic of China ("PRC") that are listed on the U.S. stock exchange.[4] The PRC government restricts Foreign Direct Investment ("FDI") in

* J.D. Candidate, Loyola Chicago School of Law, expected May 2016; B.A., Business Administration, University of Washington, 2006.

1 U.S.-China Econ. & Security Rev. Commission Staff Rep., The Risks of China's Internet Companies on U.S. Stock Exchanges 2 (Kevin Rosier, June 18, 2014).

2 *See, e.g.*, Equity Market, INVESTOPEDIA, http://www.investopedia.com/terms/e/equitymarket.asp (last visited Dec. 19, 2013) (Equity market, "[a]lso known as the stock market, . . . gives companies access to capital and investors a slice of ownership in the company."); *Stock Exchange*, Merriam-Webster, http://www.merriam-webster.com/dictionary/stock%20exchange (last visited Dec. 19, 2013) (defining stock exchange as "a system or place where shares of various companies are bought and sold").

3 *See, e.g,*. Marty Schmidt, *Equity: Owner's Equity, Net Worth, and Book Value Explained*, Building Bus. Case (Jan. 10, 2015), https://www.business-case-analysis.com/owners-equity.html.

4 Paul Gillis, *Statistics on VIE Usage*, China Acct. Blog (Apr. 11, 2011, 7:20 PM), www.chinaaccountingblog.com/weblog/statistics-on-vie-usage.html ("42% of U.S. listed Chinese companies use the VIE structure."); *see also Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, Cadwalader (Aug. 10, 2011) http://www.cadwalader.com/resources/clients-friends-memos/understanding-the-vie-structure-necessary-elements-for-success-and-the-legal-risks-involved ("As of April 2011, forty-two percent of Chinese companies listed in the United States have used the VIE.").

many of its economic sectors.[5] To work around these restrictions, China's Internet companies utilize a complicated and highly risky investment method known as a Variable Interest Entity ("VIE").[6]

In recent years, more than one hundred Chinese companies have adopted the VIE structure for their offshore listings to bypass PRC government restrictions.[7] Like many Chinese companies, China's e-commerce Internet giant, Alibaba, adopted the VIE structure to list on the U.S. stock exchange and circumvent PRC laws pertaining to foreign investments.[8] In September 2014, Alibaba became the largest initial public offering ("IPO") in U.S. history.[9] As Alibaba becomes synonymous with "Chinese Amazon," unsuspecting U.S. investors will continue to buy into Alibaba's precarious VIE structure and potentially expose themselves to great risk.[10]

Part II of this article discusses China's economic history that gave rise to the VIE structure as a regulatory loophole to PRC restrictions. China's FDI policy drastically changed under Deng Xiaoping's rule when he initiated economic reform with the Open-Door Policy to encourage foreign investment in China. Despite FDI encouragement, numerous restrictions remained to protect sensitive industries, including the Internet sector. To circumvent these restrictions, Chinese e-commerce giant Alibaba adopted the VIE structure. While VIEs currently permit FDI, the validity of the VIE structure under PRC law remains ambiguous.

Part III of this article examines the regulatory environments in which VIEs operate. Specifically, this section will discuss the modifications to PRC regulations over the years, highlighting blatant regulatory warnings against investment practices that are designed to avoid PRC regulatory scrutiny. PRC regulations and laws govern the contractual relationships on which foreign investors heavily rely in the VIE structure. An investor's understanding of China's regulatory environment is important to fully comprehend the potential risks they face. In the U.S., the Security Exchange Commission ("SEC") has taken limited action in providing ample disclosure of the potential risks involved when investing in VIEs.

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5 Neil Gough, *In China, Concern about a Chill on Foreign Investments*, N.Y. Times (June 2, 2013, 2:15 PM), http://dealbook.nytimes.com/2013/06/02/in-china-concern-of-a-chill-on-foreign-investments/?_r=0.

6 Commission Staff Report, *supra* note 1.

7 Zeng Xianwu & Bai Lihui, *Variable Interest Entity Structure in China*, China L. Insight (Feb. 9, 2012), http://www.chinalawinsight.com/2012/02/articles/corporate/foreign-investment/variable-interest-entity-structure-in-china/.

8 Charles Clover, *Alibaba IPO shows Foreign Investors Able to Skirt Restrictions*, Fin. Times (May 7, 2014, 2:46 PM), http://www.ft.com/intl/cms/s/0/7a8c4816-d5df-11e3-a017-00144feabdc0.html#axzz3OaRsL9dL.

9 Elzio Barreto, *Alibaba IPO Ranks as World's Biggest After Additional Shares Sold*, Reuters (Sept. 22, 2014, 12:46 PM), http://www.reuters.com/article/2014/09/22/us-alibaba-ipo-value-idUSKCN0HH0A620140922; *see also* Econ. Times, http://economictimes.indiatimes.com/definition/IPO, (defining IPO as "initial public offering or IPO is the first sale of stock by a company to the public").

10 *See* Benjamin Pimentel, *Alibaba IPO Faces This U.S. Hurdle: What Is It?*, Market Watch (May 5, 2014, 5:56 PM), http://marketwatch.com/story/alibaba-ipo-sparksexcitment-caution-2014-05-05/.

Part IV evaluates the risks foreign investors face when investing in a VIE. There are two types of legal risks inherent in the Alibaba VIE structure and furthermore, there is limited legal recourse available to foreign investors. First, foreign investors must assess the possibility of the PRC government declaring the VIE structure illegal. Second, foreign investors must consider the risk of underlying contracts being deemed unenforceable under PRC law. In either instance, U.S. investors will have limited recourse available under current law if they lose control over investment rights in the VIE structure. Furthermore, China recently proposed a Foreign Investment Law ("FIL") that will significantly impact foreign investment practices in China. While the new proposed law aims to solve issues inherit to the VIE structure, the ultimate validity of established VIE entities, such as Alibaba, remains uncertain.

Part V recommends supplementary actions that may help resolve the fundamental problems of the VIE structure and FDI practices in China. VIEs are currently the only reasonable mechanism to bring foreign investment into China's Internet sector. In an attempt to reduce the risk U.S. investors face when investing in VIEs, the U.S. must engage China to remedy the issues surrounding FDI so that China's Internet industry, and ultimately the Chinese economy, may continue to grow. Moreover, it is not the VIEs themselves, but rather the unclear Chinese government policies that are the true source of the problem. Despite China's recent steps to clarify FDI policies under the proposed FIL, the law lacks clear guidelines for the treatment of existing VIE structure under Chinese law. While FIL is pending further revisions, VIE entities, like Alibaba, should begin to prepare for the legislature's ultimate decision and final approval, and any subsequent effects that may impact their business structures. Once enacted, the proposed law will radically change China's foreign investment landscape.

II. Variable Interest Entities in China

A. History of Foreign Investments Restrictions

Since 1949, the PRC has operated under the unitary rule of the Chinese Communist Party ("CCP").[11] Mao Zedong, chairman of the CCP, strived to achieve a "socialist market economy" during his rule from 1949-1978.[12] During the Maoist-era, China maintained self-sufficiency in the country's trade and commerce and FDI was practically non-existent in the Chinese economy.[13] After the demise of Mao, trade barriers were removed and this change became a key factor

[11] *See* Daniel Chang, *Modernization of the Chinese Legal System: A Brief Historical Review*, N.Z. China Trade Ass'n, http://www.nzcta.co.nz/chinanow-commentary/1517/modernization-of-the-chinese-legal-system-a-brief-historical-review/#sthash.mjn6Em5Z.dpuf (last visited Feb. 13, 2015).

[12] Vivienne Bath, *Foreign Investment, the National Interest and National Security - Foreign Direct Investment in Australia and China*, 34 Sydney L. Rev. 5, 6 (2012) ("China is a one-party unitary state . . . aiming to develop a 'socialist market economy.'").

[13] *See* Jinyan Li, *The Rise and Fall of Chinese Tax Incentives and Implications for International Tax Debates*, Fla. Tax Rev. 669, 670 ("China had no foreign direct investment ("FDI") before 1979.").

in the modernization of the PRC under the rule of Deng Xiaoping.[14] In 1978, Deng Xiaoping led the PRC in economic reform, implementing the groundbreaking Open-Door Policy.[15] The new policy encouraged foreign resources, welcoming FDI to spur economic growth in China.[16]

Despite the progressive policy changes implemented under Xiaoping's rule, protectionism continued to persist in the form of restrictions on foreign investments in specific industries.[17]

FDI guidelines and restrictions are specified in the Catalogue for the Guidance of Foreign Investments Industries ("Catalogue").[18] The Catalogue classifies industry sectors into three categories, designating foreign investment as "encouraged," "restricted" or "prohibited" for each respective industry.[19] Foreign investments are "permitted" in those industries not expressly noted in the Catalogue.[20] Conversely, foreign investors are not permitted to invest in "prohibited" industries under any circumstance.[21] The prohibited industry sectors are typically those deemed by the Chinese government to be strategic and emerging industries, or otherwise those industries that are sensitive for political or national security reasons.[22] The Internet sector, where the VIE structure is prevalently used, is categorized as prohibited, disallowing foreign investments and forbidding foreign ownership in PRC-domiciled companies.[23]

B. Variable Interest Entities

VIE is an investment structure used by many Chinese companies and foreign investors to bypass Chinese government restrictions on FDI.[24] The VIE structure

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[14] Wayne M. Morrison, Cong. Research Serv., RL33534, China's Economic Conditions 1 n.1, 2-3.

[15] Shigeo Kobayashi et al., *The "Three Reforms" in China: Progress and Outlook*, 45 RIM (Sept. 1999), http://www.jri.co.jp/english/periodical/rim/1999/RIMe199904threereforms/.

[16] William I. Friedman, *One Country, Two Systems: The Inherent Conflict Between China's Communist Politics and Capitalist Securities Market*, 27 Brook. J. Int'l L. 477, 478 (2002) ("Deng Xiaoping . . . adopted an 'open door' policy, centering on economic reforms utilizing market mechanisms and foreign resources to speed up the growth and modernization of the economy.").

[17] *See* Shen Wei, *Will the Door Open Wider in the Aftermath of Alibaba? —Placing (or Misplacing) Foreign Investment in a Chinese Public Law Frame*, 42 H.K.L.J. 275, 275 (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2320402 ("Recent years witnessed a rising chorus of complaints from the foreign business community concerning China's protectionist regulatory environment and increasing hostility to foreign multinationals.").

[18] Jane Bu et al., *China's New Foreign Investment Catalogue Comes into Effect*, Morrison Foerster 1 (Jan. 30, 2012), *available at* http://media.mofo.com/files/Uploads/Images/120130-Foreign-Investment-Catalogue.pdf.

[19] *Id.*

[20] *Id.*

[21] Xianwu & Lihui, *supra* note 7.

[22] Commission Staff Report, *supra* note 1, at 4-5.

[23] *See* Sue-Lin Wong, *China Court Ruling Could Threaten Foreign Investments in Country*, N.Y. Times (June 17, 2013, 3:09 AM), http://rendezvous.blogs.nytimes.com/2013/06/17/china-court-ruling-could-threaten-some-foreign-invested-companies/?_php=true_type=blogs_r=0.

[24] Commission Staff Report, *supra* note 1.

is commonly referred to as the Sina-model structure.[25] Sina Corporation was the first PRC-domiciled company to acquire an offshore public listing through a VIE structure in 2000.[26] Since then, foreign investors have replicated the VIE structure in a variety of sectors in China's economy where FDI is either restricted or prohibited under PRC law.[27]

In its most basic form, a VIE is comprised of three entities: an offshore holding company that is listed on the U.S. exchange, a Wholly Foreign-Owned Entity ("WOFE") domiciled in the PRC and an operating business entity domiciled in the PRC.[28] A U.S. investor purchases shares in the offshore holding company, which is usually based in an offshore tax haven such as the Cayman Islands.[29] The offshore holding company owns one hundred percent of the PRC-domiciled WFOE.[30] In effect, the offshore holding company links foreign investors to the operating PRC-domiciled company through complex legal contracts set up by the WFOE.[31] These contractual agreements mimic equity ownership, however do not bestow actual equity ownership in the operating company.[32] Operating control remains within the PRC-domiciled company, presumably to comply with Chinese laws while foreign investors derive economic benefits solely from the contractual agreements.[33]

U.S. investors face major risks from the complexity of the VIE structure and the rudimentary regulatory environment in China.[34] The legal contracts that serve as the basis of the VIE structure are only enforceable in China, where rule of law remains undeveloped.[35] Thus, to an investor, a VIE investment is only as good as the validity of its underlying contractual agreements.[36] These contracts are only binding and enforceable if Chinese courts are willing to uphold them.[37] While

25 Xianwu & Lihui, *supra* note 7.

26 *Id.*

27 *See id.*

28 David Roberts & Thomas Hall, *VIE Structures in China: What You Need to Know*, Topics Chinese L. 1–2 (Oct. 2011), available at http://iis-db.stanford.edu/evnts/6963/TICL_-_VIE_Structures_in_China.pdf (analyzing the components of a basic VIE structure).

29 Dune Lawrence, *China Companies Evading Owner Rule with US Listings Frustrate Regulators*, Bloomberg (Oct. 9, 2011, 4:00 PM), http://www.bloomberg.com/news/2011-10-09/china-companies-evading-rule-with-u-s-listings-stump-regulators.html.

30 Dan Harris, *VIEs in China. The End of a Flawed Strategy*, China L. Blog (Oct. 10, 2011), http://www.chinalawblog.com/2011/10/vies_in_china_the_end_of_a_flawed_strategy.html.

31 *See id.*; Lawrence, *supra* note 29.

32 *See* Lawrence, *supra* note 29.

33 *Id.*; *see also* Harris, *supra* note 30.

34 *See* Steven Davidoff, *Alibaba Investors Will Buy a Risky Corporate Structure*, N.Y. Times (May 6, 2014, 7:46 PM), http://dealbook.nytimes.com/2014/05/06/i-p-o-revives-debate-over-a-chinese-structure/?_r=0.

35 *Id.*

36 Dan Harris, *Crouching Tiger, Hidden Fraud. Clear Speaking On VIEs*, China L. Blog (July 16, 2011), http://www.chinalawblog.com/2011/07/crouching_tiger_hidden_fraud_clear_speaking_on_vies.html.

37 Paul Gillis, *Variable Interest Entites in China*, Forensic Asia, (Sept. 18, 2012), http://www.chinaaccountingblog.com/vie-2012septaccountingmatte.pdf.

listing a company under a VIE structure on the U.S. exchanges is legal in the United States, they can still be considered illegal in China.[38] PRC authorities have yet to formally confirm the validity of the existing VIE structure under PRC law, leaving foreign investors' funds at risk.[39]

C. Alibaba: China's Internet Giant

Alibaba is China's largest online commerce company, hosting hundreds of millions of users and a wide variety of merchants and businesses.[40] Alibaba founder and CEO, Jack Ma, started Alibaba.com out of his apartment in 1999.[41] Today, Alibaba is in the world's fastest growing e-commerce market, handling more business than any other e-commerce company.[42] Last year, the value of all merchandise sold on Alibaba's online sites exceeded $248 billion, more than the volume on eBay and Amazon combined.[43]

Foreign investors flocked to purchase Alibaba stock in their recent IPO on the New York Stock Exchange to raise over $25 billion dollars, making it the largest IPO in U.S. history.[44] Like other Chinese Internet companies, Alibaba utilized the VIE structure to avoid PRC government restrictions.[45] Consequently, Alibaba's stock carries similar risks to other VIE-structured companies.[46]

Alibaba's SEC Form F-1 filing explicitly describes the legal ambiguity of it's VIE structure and the related risks.[47] A section entitled "Risks Related to Our Corporate Structure" bluntly forewarns foreign investors:

> If the PRC government deems that the contractual arrangements in relation to our variable interest entities do not comply with PRC governmental restrictions on foreign investment, or if these regulations or the interpretation of existing regulations changes in the future, we could be subject to penalties or be forced to relinquish our interest in those operations.[48]

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38 *See generally id.*

39 Xianwu & Lihui, *supra* note 7.

40 Marc Lajoie & Nick Sherman, *What is Alibaba?*, WALL STREET J., http://projects.wsj.com/alibaba/ (last visited Feb. 14, 2015).

41 Jillian D'Onfro, *How Jack Ma Went from Being a Poor School Teacher to Turning Alibaba into a $160 Billion Behemoth*, BUS. INSIDER (Sept. 14, 2014, 3:12 PM), http://www.businessinsider.com/the-story-of-jack-ma-founder-of-alibaba-2014-9.

42 Lajoie & Sherman, *supra* note 40.

43 *Id.*; *see also* Vindu Goel et al., *Chinese Giant Alibaba Will Go Public, Listing in U.S.*, N.Y. TIMES (May 6, 2014, 4:48 PM), http://dealbook.nytimes.com/2014/05/ 06/alibaba-files-to-go-public-in-the-u-s.

44 Leslie Picker & Lulu Yilun Chen, *Alibaba's Banks Boost IPO Size to Record of $25 Billion*, BLOOMBERG (Sept. 22, 2014 8:05 AM), http://www.bloomberg.com/news/2014-09-22/alibaba-s-banks-said-to-increase-ipo-size-to-record-25-billion.html.

45 Clover, *supra* note 8.

46 Gregory J. Millman, *Alibaba's IPO Puts VIE Structure in the Spotlight*, WALL STREET J. (Sept. 22, 2014, 9:46 AM), http://blogs.wsj.com/riskandcompliance/2014/09/22/alibabas-ipo-puts-vie-structure-in-the-spotlight/.

47 Alibaba Group Holding Ltd., Registration Statement (Form F-1) 47 (Sept. 15, 2014).

48 *Id.* at 48.

In addition to a risky corporate structure, Alibaba uses a preferential stock structure that establishes all decision-making authority with the company's founders in China.[49] Under this particular stock structure, owning shares of the company does not equate to voting rights.[50] According to Alibaba's SEC filing, the preferential stock structure limits foreign investors' "ability to influence corporate matters, including any matters to be at the board of directors level."[51]

A recent controversy between Alibaba and its first major foreign investor, Yahoo, sheds further light on the risks U.S. investors face in buying into Chinese Internet companies under the VIE structure.[52] Yahoo, an American Internet company, became one of Alibaba's largest foreign investors back in 2005 purchasing roughly a 40% stake in the offshore holding company.[53] Through the VIE arrangement, Alibaba's offshore holding company developed Alipay, a Chinese payment-service similar to PayPal.[54] The payment service tool was expected to be a prosperous opportunity for Yahoo as a major investor and shareholder in Alibaba.[55] However, despite being a recognized board member, Yahoo did not have a say in Alibaba's recent decision to split Alipay into a separate entity controlled by solely by Jack Ma.[56]

Jack Ma made the bold, unilateral decision to terminate Alipay's VIE and transfer 70% equity of Alipay from the offshore holding company into a separate entity domiciled in China.[57] Ma defends this controversial decision as a necessary move in order for Alipay to acquire a proper operational license from the People's Bank of China.[58] The People's Bank of China requires that all payment service companies in the country obtain a license to operate.[59] Furthermore, the central bank limited license eligibility only to local entities, leaving rules pertaining to foreign invested-companies ambiguous.[60] Yahoo's foreign ownership in Alipay posed an issue on the company's ability to obtain the government-man-

49 Commission Staff Report, *supra* note 1, at 6.

50 *Id.*; *see generally Alibaba's IPO is Nothing to Celebrate*, BloombergView (Mar. 18, 2014, 3:23 PM), http://bloombergview.com/articles/2014-03-18/alibaba-s-ipo-is-nothing-to-celebrate.

51 Alibaba Group Holding Ltd., *supra* note 47.

52 Commission Staff Report, *supra* note 1, at 5.

53 Andrea Peterson, *An Alibaba IPO Means Lots of Cash for Yahoo to Spend on More Acquisition*, Wash. . Post (May 7, 2014), http://www.washingtonpost.com/blogs/the-switch/wp/2014/05/07/an-alibaba-ipo-means-lots-of-cash-for-yahoo-to-spend-on-more-acquisitions/.

54 *See generally* Loretta Chao, *Alipay Receives China License*, Wall Street J. (May 27, 2011, 12:01 AM), http://www.wsj.com/articles/SB10001424052702304066504576347212434217054?autolog in=ymg=id-wsj.

55 *See id.*

56 *Id.*

57 *Variable Interest Entity (VIE) Structure for Foreign Investment in the PRC May Face Challenges*, King & Wood Mallesons (Nov. 2001), http://www.kingandwood.com/article.aspx?id=china-bulletin-2011-11-02; *see also* Steven Millward, *Tough-Talking Jack Ma Admits Acting Unilaterally in Alipay Controversy*, TECHINASIA (July 7, 2011, 2:15 PM), https://www.techinasia.com/jack-ma-alipay/.

58 Millward, *supra* note 57.

59 Chao, *supra* note 54.

60 *Id.*

dated online payment license.[61] However, Yahoo claims that it was not aware of the transfer for more than six months after the transaction was completed.[62]

After months of dispute, Alibaba and Yahoo announced that they settled the disagreement.[63] While the agreement reached allows Yahoo to share in the future gain of Alipay, analysts are not convinced the settlement is enough to compensate Yahoo for the loss of Alipay's value to the Alibaba portfolio.[64]

This recent controversy shows the potential risks foreign investors, such as Yahoo, face by investing in a VIE.[65] The VIE arrangement and preferential stock structure made Alipay's undisclosed transfer possible, leaving Yahoo in the dark about a key business decision.[66] Beyond the risks within the company structure, foreign investors must rely on China's judicial system to enforce the contractual agreements which are the foundation of the VIE structure.[67] The CCP-controlled judicial system combined with China's unreliable regulatory environment poses even greater risks when foreign investors seek to secure their rights in disputes with Chinese entities.[68]

III. Regulatory Environment

A. China's Regulatory Environment

Alibaba expressly acknowledges in its SEC filings "there are substantial uncertainties regarding the interpretation and application of the current and future PRC laws, rules, and regulations."[69] The PRC government has never formally confirmed the validity of the VIE structure under PRC law.[70] Moreover, a series of regulatory decisions over the years have left the validity of the VIE structure in question.[71]

Prior to the introduction of the VIE structure, China Unicom introduced another work-around joint venture – China-China Foreign Structure ("CCF structure") – in 1994 to circumvent FDI restrictions.[72] Four years later, the CCF

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61 Millward, *supra* note 57.

62 Chao, *supra* note 54.

63 *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER (Aug. 10, 2011) http://www.cadwalader.com/resources/clients-friends-memos/understanding-the-vie-structure-necessary-elements-for-success-and-the-legal-risks-involved.

64 *Id.*

65 *See id.*

66 *See id.*

67 *See* Gillis, *supra* note 37.

68 *See generally* Understanding the VIE Structure, supra note 4.

69 Solomon, *supra* note 34.

70 Xianwu & Lihui, *supra* note 7.

71 *Id.*

72 *MOFCOM's New Security Review Measures (Announcement No. 53)*, CADWALADER, WICKERSHAM & TAFT LLP at 2; *see also* Gordon G. Chang, *China Can Expropriate Alibaba's Business — And It Just Might*, FORBES (May 11, 2014), http://www.forbes.com/sites/gordonchang/2014/05/11/china-can-expropriate-alibabas-business-and-it-just-might/.

structure was declared illegal by the Chinese government.[73] Unicom was forced to dissolve their corporate structure, triggering unfavorable consequences for Unicom's ejected foreign investors.[74] A similar situation could unfold for more foreign investors as FDI work-around structures continue to be monitored closely.[75]

Recent PRC regulations have increased both in the number and the complexity of requirements imposed on foreign investors looking to acquire enterprises or assets in China.[76] These new regulations raise questions regarding the validity of the VIE structure used by Chinese companies looking to evade FDI restrictions.[77]

In 2011, the State Counsel, PRC's highest administrative body, issued the Notice on Establishing a Security Review System for Acquisition of Domestic Enterprises by Foreign Investors ("Circular 6").[78] Circular 6 established an extensive government review process for foreign investors and Chinese companies that are susceptible to control of a non-PRC investor.[79]

To help implement Circular 6, China's Ministry of Commerce ("MOFCOM") promulgated *Measures on the Security Review System of Foreign Investors Merging and Acquiring Domestic Enterprises, Announcement No. 53* (the "M&A Rules").[80] MOFCOM is responsible for formulating policy on foreign trade, export and import regulations, consumer protection, as well as foreign direct investments.[81] Of particular importance to the VIE structure, Article 9 of the M&A Rules reads:

> With regard to the merger and acquisition of domestic enterprises undertaken by foreign investors, the authorities should judge whether such transaction is subject to the security review based on the essential content and actual impact of the transaction. Foreign investors shall not avoid M&A security review through any means, including but not limited to commissioned shareholdings, trusts, multi-level investments, leases, loans, contractual control, and overseas transactions.[82]

73 Chang, *China Can Expropriate Alibaba's Business — And It Just Might*, FORBES (May 11, 2014).

74 *Id.* at 1.

75 *Id.*

76 Cadwalader, *supra* note 63, at 2.

77 *Id.*

78 *Id.*

79 Robert Lewis, *Investors at the Gate*, 26 INT'L FIN. L. REV. 36, 36 (2007) (noting the "spectacular and well-publicized demise" of the CCF structure); Leontine D. Chuang, Comment, *Investing in China's Telecommunications Market: Reflections on the Rule of Laws and Foreign Investment in China*, 20 NW. J. INT'L. L. & BUS. 509, 510 (1999) (calling the birth, development, and demise of the CCF structure an ill-fated and a perfect example of the lack of clarity in the PRC's investment law).

80 Cadwalader, *supra* note 63, at 2.

81 Ministry of Commerce Peoples Republic of China, *Mission Statement*, MOFCOM (Dec. 7, 2010), http://english.mofcom.gov.cn/column/mission2010.shtml.

82 Announcement No. 53 of 2011 of MOFCOM Concerning the Provisions of the MOFCOM for the Implementation of the Security Review System for M&A of Domestic Enterprises by Foreign Investors (promulgated by the Min. of Com., Aug. 25, 2011, effective Sept. 1, 2011) (China), *available at* http://english.mofcom.gov.cn/sys/print.shtml?/policyrelease/aaa/201112/20111207869355.

Arguably, the VIE structure is subject to foreign investors obtaining "actual control" of the PRC-domiciled company by engaging in "overseas transactions" and exercising "contractual control."[83] The PRC government, as a result, is free to interpret the M&A Rules as a clear indication that the VIE structure is designed to avoid the PRC regulatory restrictions.[84] Consequently, many people question how much longer the VIE structure can survive under these new regulations, which appear to target these types of investment structures.[85] The vague wording of the rules could give PRC regulators greater discretionary powers when determining the validity and legality of VIEs.[86] In 2013, the Supreme People's Court of China, China's top judicial body, ruled that contractual agreements in VIE arrangements were clearly intended to circumvent Chinese regulations and were equivalent to "concealing illegal intention with a lawful form."[87]

Foreign investment policy will continue to change as the VIE structure gains traction as China's economy continues to grow and more FDI restricted industries seek financial capital.[88] According to MOFCOM spokesman Shen Dayang, MOFCOM is considering new rules for VIEs.[89] Dayang acknowledged the absences of current laws or regulations in place to regulate VIEs, and stated that MOFCOM and other related government agencies are studying ways to regulate such investments.[90]

B. Role of the SEC in Regulating VIEs Listed in the US

U.S. regulatory authority on VIE structures and their validity is limited to warning investors of the potential risks.[91] All publicly-held companies in the U.S., including VIEs, are subject to the regulation of the SEC.[92] The SEC was

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83 Gough, *supra* note 5.

84 *Id.*

85 *See* Steve Dickinson, *VIEs in China. The End of a Flawed Strategy*, CHINA L. BLOG (Oct. 10, 2011), *available at* http://www.chinalawblog.com/2011/10/vies_in_china_the_end_of_a_flawed_strategy.html (stating that the contractual arrangements on which the various VIEs are based are in clear violation of Chinese law).

86 Kathrin Hille, *Foreign Internet Presence in China to Face Scrutiny*, FIN. TIMES (Sept. 1, 2011, 5:23 PM), http://www.ft.com/intl/cms/s/2/7f8645e2-d493-11e0-a42b-00144feab49a.html#axzz1Wb8B6ccg (noting that the vague wording of the rules could give regulators greater discretionary powers).

87 Gough, *supra* note 5.

88 Roberts & Hall, *supra* note 28, at 7.

89 Lawrence, *supra* note 29.

90 *Id.*

91 *See generally The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*' U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/whatwedo.shtml#intro; Thomas B. Hatch et al., *China's Forbidden Investment: Emerging Legal Risks for Investors Who Deal with Chinese Variable Interest Entity (VIE) Structures*, ROBINS, KAPLAN, MILLER & CIRESI LLP (Mar. 1, 2012), http://www.rkmc.com/resources/articles/china-s-forbidden-investment (describing the claim in the Orient Paper lawsuit that while the VIE contractual arrangement is disclosed in the Form 10-K filing, the disclosure was so buried that it did not adequately inform the shareholders).

92 *See US Securities and Exchange Commission (SEC)*, DELOITTE, http://www.iasplus.com/en/resources/regional/sec (last visited Jan. 2, 2015), (discussing the role of the SEC, quoting "In the United States, the public capital markets are regulated primarily by the US Securities and Exchange Commission (SEC), a national government agency.").

created in the wake of the Great Depression and adopted the core mission of protecting investors, maintaining fair, orderly, and efficient markets and facilitating capital formation.[93] The SEC also carries the responsibility of informing the public about investments via corporate disclosure.[94]

The risks of investing in VIEs are described in detail in SEC filings.[95] Companies are required to disclose all material information in periodic filings with the SEC.[96] Information is considered material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[97] Risk factors are considered material and are typically disclosed under the section "risk factors" in the SEC filing.[98] However, disclosure of risk may still be considered inadequate for investor awareness in the complex and substantial risks pertaining to VIEs.[99]

The VIE structure poses controversial issues, and the SEC must sufficiently investigate companies such as Alibaba to ensure proper disclosure and compliance with securities regulations.[100] On the eve of the Alibaba IPO, US Senator Bob Casey, urged the SEC to look further into the risks of companies using the same VIE structure as Alibaba.[101] In his letter to the SEC, Casey called upon the SEC to redouble its efforts to investigate companies using the VIE structure.[102] Alibaba revealed its correspondence with the SEC after the IPO.[103] The federal regulators focused on questions pertaining to Alibaba's ownership structure and affiliations with outside companies.[104] Overall, the SEC asked eighty-six ques-

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93 *See* Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 368 (2008).

94 Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984) (identifying the disclosure requirement as one of the two basic component of the US securities law); *see also* The Investor's Advocate, *supra* note 91, at 1 (explaining that the SEC "requires public companies to disclose meaningful financial and other information to the public" in order to make sure that "all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it").

95 Gillis, *supra* note 37.

96 Steven M. Davidoff, *In Corporate Disclosure, a Murky Definition of Material*, N.Y. TIMES (Apr. 5, 2011, 5:57 PM), http://dealbook.nytimes.com/2011/04/05/in-corporate-disclosure-a-murky-definition-of-material/ (explaining that public companies in the United States must periodically file reports disclosing all material information with the Securities and Exchange Commission).

97 *Id.*

98 Steve Dickinson, *VIEs in China. The End of a Flawed Strategy.*, CHINA L. BLOG (Oct. 10, 2011), http://www.chinalawblog.com/2011/10/vies_in_china_the_end_of_ a_flawed_strategy.html.

99 Hatch et al., *supra* note 91 (describing a situation where the VIE contractual arrangement is disclosed in the Form 10-K filing, but the disclosure was so buried that it did not adequately inform the shareholders).

100 Michael J. De La Merced, *On Eve of Alibaba's I.P.O., Senator Urges S.E.C. to Look at Risks in Some Chinese Offerings*, NEW YORK TIMES (Sept. 17, 2014), http://dealbook.nytimes.com/2014/09/17/on-eve-of-alibabas-i-p-o-senator-urges-s-e-c-to-look-at-risks-in-some-chinese-offerings/.

101 *Id.*

102 *Id.*

103 Telis Demos, *Five Questions SEC Posed to Alibaba*, WALL STREET JOURNAL (Oct. 17, 2014), http://blogs.wsj.com/moneybeat/2014/10/17/five-comments-about-structure-that-the-sec-had-for-alibaba/.

104 *Id.*

tions to Alibaba in its first round of examinations, twice the number of questions that a typical U.S. IPO received in 2013.[105]

The SEC could further improve corporate filing disclosures to fulfill its mission of helping the investing public to make informed investment decisions.[106] However, that may not be enough to adequately protect foreign investors from the major risks based in the complexity and purpose of the VIE structure, as acknowledged by the U.S.-China Economic and Security Review Commission (the "Commission").[107] The U.S. Congress created the Commission to study the national security implications of our economic relationship with China.[108] The Commission suggests that if the VIE system collapse and Chinese shareholders choose not to honor the VIE contractual agreements the consequences could result in a multi-billion dollar loss to U.S. investors.[109] To combat the possible damage, the SEC should engage in investigative work on the ground in China so it is better able to inform and educate U.S. investors of the risks involved with the VIE structure.[110]

IV. VIE Risk Assessment

A. Ambiguous Legal Status of the Alibaba VIE

While the VIE structure has been used to avoid the PRC's FDI restrictions for over a decade, experts and observes have called it the "single biggest time bomb" in the U.S. market.[111] There are two types of legal risks inherent in the Alibaba VIE structure and limited legal recourse available to foreign investors.[112] The two legal risks investors face in the Alibaba VIE are the validity of the corporate structure and the validity of the contracts that are the foundation of the VIE structure.[113]

While the VIE structure may eventually be declared valid, legal and enforceable by the PRC government, the currently presumed validity of the Alibaba VIE structure could prove contrived and U.S. investors' funds could become worth-

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105 *Id.* (according to a study by law firm Proskauer Rose LLP).

106 De La Merced, *supra* note 100.

107 *Id.*

108 *Id.*

109 *Id.*

110 *Id.*

111 Millman, *supra* note 46.

112 *See generally* Stan Abrams, *The VIE Meta-Narrative: Illegal vs. Invalid*, CHINA HEARSAY (Oct. 13, 2011), http://www.chinahearsay.com/the-vie-meta-narrative (distinguishing the concept of the VIE investment structure being declared illegal and that of particular VIE contracts being unenforceable); *see also* J. Gray Sasser, *China Risk Factor Hiding in Plain View: A Brief Analysis of Variable Interest Entities (VIEs) Under Chinese Law*, TENN. CORP. NEWSL. (Nov. 2012), *available at* http://www.frostbrowntodd.com/resources-1527.html (discussing the regulatory risk of the PRC government's outlawing the structure and the operational risk of bifurcating ownership and control).

113 Steven M. Davidoff, *Fraud Heightens Jeopardy of Investing in Chinese Companies*, NEW YORK TIMES (Apr. 24, 2012), http://dealbook.nytimes.com/2012/04/24/fraud-heightens-jeopardy-of-investing-in- chinese-companies (noting the two ways a VIE investment could go wrong).

less.[114] Experts have argued that the Chinese government is hesitant to make a definitive statement on the legality of the VIE structure as it continues to the benefit China's economy.[115] However, recent PRC regulatory actions on both the local and national level support the argument that a general nullification of the VIE structure is gradually more likely.[116]

At the local government level, certain provincial authorities have banned the creation of new VIEs. In March 2011, local authorities banned a company, Buddha Steel, from forming a VIE with a local steel plant, stating that the structure disobeyed current Chinese management policies related to foreign invested enterprises and went against public policy.[117] This ban implies that the VIE structure is of great concern to China's public policy and sheds light on future rulings on the legality of the structure.

At the national level, recent legal and regulatory decisions indicated VIE contacts might come under scrutiny if the Chinese government so chooses.[118] In 2013, the Supreme People's Court, the PRC's top judicial body, ruled that contractual agreements under consideration in the Chinachem case, similar in effect to VIE structures, to be illegal.[119] The court determined that the contractual agreements set up between Chinachem, a Hong Kong business, and China Minsheng Banking Corp., a PRC-domiciled company were clearly intended to circumvent Chinese regulations and were actions based on illegal intentions.[120] The ruling was an indication that complicated investment schemes will not be respected if they are structured to evade the clear intentions of Chinese law.[121] The court's ruling was the latest indication that China's long assumed tolerance of overseas capital finding its way into the economy's restricted sectors may be waning.[122] While the contracts in this particular situation were fundamentally different, the Court's holding raises the possibility of Chinese courts taking a similar position in Alibaba's VIE structure.[123]

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114 John Ford, *No One Who Bought Alibaba Stock Actually Owns Alibaba*, THE DIPLOMAT (Sept. 24, 2014), http://thediplomat.com/2014/09/no-one-who-bought-alibaba-stock-actually-owns-alibaba/.

115 Daniel Goodman, *Is China Really About To Clamp Down On The Corporate Structure Used For Big American IPOs?*, BUSINESS INSIDER (Sept. 21, 2011), http://www.businessinsider.com/will-china-really-clamp-down-on-vies-2011-9 (discussing how the PRC government has largely ignored the use of VIEs because it was either not aware, didn't care, or found the activity useful at the time).

116 Robert Lewis, *China Watch: A Foreign Lawyer's View from the Inside*, LAWYER (Oct. 19, 2011), http://www.thelawyer.com/china-watch-a-foreign-lawyers-view-from-the-inside/1009862.article ("The elephant in the room is that the relevant regulators could step back, look at the structure in the entirety, collapse it down to its essentials and declare it to be in violation of the applicable foreign investment restrictions and close it down.").

117 Thomas M. Shoesmith, *PRC Challenge to Variable Interest Entity Structures?*, PILLSBURY 2 (Mar. 31, 2011), http://www.pillsburylaw.com/siteFiles/Publications/ChinaAlertPRCChallenge toVIEStructures_03_31_11pdf.pdf.

118 *Id.*

119 Chang, *supra* note 72.

120 Gough, *supra* note 5.

121 *Id.*

122 *Id.*

123 *Id.*

Furthermore, arbitration rulings in Shanghai on VIE structures have come to the same result.[124] Since 2010, Shanghai's arbitration board has invalidated two variable interest entities that foreign companies initially adopted to control PRC-domiciled businesses.[125] One case involved an online game company in which the arbitration panel applied China's contract law to reach the same conclusion as the Supreme Court in the Chinachem case, stating that the VIEs were illegally and intentionally "concealing with a lawful form."[126] The PRC government is starting to attack the VIE structures and the other ways that people have used legal form to get around the substance of what Chinese law says you can't do.[127] China's civil law system gives the court's decision no binding legal precedent; however, these rulings are still symbolically significant for the foreign investors and the future of Alibaba.[128]

B. Proposed Foreign Investment Law

Recently, China took significant steps toward addressing the ambiguity surrounding the VIE structure. On January 19, 2015, MOFCOM published a draft of Foreign Investment Law ("FIL") for public comments.[129] The proposed law will govern all foreign investment activity in China, which includes entities controlled by foreign investors via contractual relationships.[130] Thus, VIE entities are included within the FIL scope.[131] The proposed FIL will tighten the administration of contractual arrangement between foreign investors and the PRC domiciled VIE entities.[132] When the new law becomes effective, ninety-five companies currently listed in the U.S. with VIE structures, including Alibaba, could face legal challenges.[133]

The draft FIL redefines "foreign investment" as any form of arrangement that exerts foreign "actual control" over the PRC domiciled business.[134] Therefore, if the PRC government determines that "actual control" of a company is in foreign

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124 *Id.*

125 Gough, *supra* note 5.

126 *Id.*

127 *Id.*

128 Gough, *supra* note 5; *see also* Christopher Beddor, *The Alibaba IPO and How Chinese Companies Bypass Foreign Investment Decisions*, CKGSB KNOWLEDGE (Sept. 1, 2014), *available at* http://knowledge.ckgsb.edu.cn/2014/09/01/china/the-alibaba-ipo-and-how-chinese-companies-bypass-foreign-investment-restrictions/.

129 Elvin C. Ouyang, *China Redefines Its Foreign Investment Law*, GLOBAL RISK INSIGHTS (Feb. 15, 2015), http://globalriskinsights.com/2015/02/china-redefining-foreign-investment-laws/.

130 Woon-Wah Siu, Jenny Sheng, & David A. Livdahl, *China Issues Draft Foreign Investment Law*, PILLSBURY 1-2 (Feb. 12, 2015), *available at* http://www.pillsburylaw.com/siteFiles/Publications/AlertFeb2015ChinaChinaIssuesDraftForeignInvestmentLaw.pdf.

131 Dezan Shira, *China Releases Draft of Foreign Investment Law, Signaling Major Overhaul for Foreign Investment*, CHINA BRIEFING (Jan. 21, 2015), http://www.china-briefing.com/news/2015/01/21/breaking-news-china-releases-draft-foreign-investment-law-signaling-major-overhaul-foreign-investment.html.

132 Siu, *supra* note 130, at 4.

133 Ouyang, *supra* note 129.

134 *Id.*

hands, then the VIE contractual control will be recategorized as "foreign investment" and governed by the newly proposed law.[135] Consequently, for companies that can prove the VIE is in "actual control" under Chinese legal persons, the proposed law suggests legal recognition of the contractual control in VIEs.[136] This new change will bring peace of mind to foreign investors because regulatory risks associated with VIEs may be significantly reduced as a result of legal recognition.[137]

There is, however, slight hesitation on how FIL should deal with existing VIE entities.[138] A handful of suggestions are pending public comment.[139] In accordance with notes in the FIL draft, the legislatures will likely take one of the following suggested approaches: (i) An existing VIE entity can continue its operation as long as it files a statement of de facto control by Chinese investors with the Approving Authority after the Foreign Investment Law takes effect; (ii) an existing VIE can continue its operation only it if is acknowledged by the Approving Authority to be under de facto control by Chinese investors, or (iii) an existing VIE entity can continue its operation only if the foreign investors obtain approval from the Approving Authority after the Foreign Investment Law takes effect.[140]

If the legislature elects to move forward with suggestion (ii) or (iii), which requires either absolute de facto control by Chinese investors or foreign investor approval from Approving Authority, companies currently utilizing the VIE structure, like Alibaba, will essentially be inhibited and China's growing Internet industry will suffer as a result.[141] Alternatively, the Chinese economy could benefit from approving suggestion (i) or by implementing a middle-ground option that allows for a three to five year grace period for VIE entities to restructure their business models.[142]

Substantial uncertainties exist with regards to how the proposed law may impact foreign investments in China, corporate structures, corporate governance and business operations of PRC-domiciled companies.[143] The proposed FIL is an ambitious undertaking, and once enacted, the law will radically change the foreign investment landscape of China.[144]

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135 *Id.*

136 *Id.*

137 *See id.*

138 Siu, *supra* note 130, at 5.

139 *Id.*

140 *Id.*

141 *Id.*

142 *Id.*

143 Christopher W. Betts, Will H. Cai, Z. Julie Gao, Gregory G.H. Miao, & Alexandra J. Yin, *China's MOFCOM Aims to Fundamentally Change the Legal Landscape on Foreign Investments*, SKADDEN (Feb. 2015), https://www.skadden.com/insights/chinas-mofcom-aims-to-fundamentally-change-the-legal-landscape-on-foreign-investments.

144 *See id.*

V. Suggestions Moving Forward to Mitigate Risk

While the status of the validity and legality of Alibaba's VIE structure still remains uncertain, the issue must be addressed. The Chinese economy will continue to grow at a rapid rate and China's Internet and technology sectors will become a substantial factor in the global economy. If the validity of foreign investment in the Internet and technology sectors remains questionable, it can develop into a larger problem for either side: the Chinese economy or U.S. foreign investors. If the PRC government moves forward to approve FIL, and ultimately rules the contractual relationships invalid or the structure entirely illegal, this could potentially result in a massive loss of U.S. investor funds. For those companies that have already adopted the VIE structure, their current business structure would presumably dissolve, and company ownership would remain with the Chinese partners, leaving the contractual agreements connecting U.S. investors to economic benefits in limbo or non-existent. This outcome could significantly impact the Chinese economy, as it would deter foreign investors from contributing financial capital to two of China's largest economic sectors, Internet and technology.

Despite the risks discussed, VIEs are the only current reasonable mechanism to bring foreign investment into China's Internet sector.[145] Likewise, it is not the VIEs themselves that are the true source of the problem, but instead the PRC government policies and legal system.[146] The regulatory policies and rudimentary legal system hinder potential economic growth within China, and are the root cause of the risk foreign investors face when subsidizing Chinese Internet companies.[147] The U.S. must engage China to remedy the fundamental problems pertaining to the validity and legality of the VIE structure.[148]

In response to the proposed FIL, companies and foreign investors must monitor the legislation process closely in order to mitigate regulatory risks that will result from FIL.[149] In the meantime, it is recommended that companies begin to examine and adjust their management structure, and prepare documentation to prove "actual control" by Chinese investors.[150]

In comparison, the U.S. has a global competitive advantage in services, especially in information and communication technology ("ITC") and digitally-distributable services.[151] According to a U.S. Department of Commerce study in 2011, ITC made up over 60% of U.S. service exports and 17% of overall exports, with demand stemming from European and East Asian markets.[152] Yet U.S. exports to China in the ITC sector have remained extremely low. In 2012, less than

145 Commission Staff Report, *supra* note 1, at 9.

146 *Id.*

147 *Id.*

148 *Id.*

149 Ouyang, *supra* note 129

150 *Id.*

151 *Id.*

152 Commission Staff Report, *supra* note 1, at 9.

3% of U.S. exports in digital services were bound for China.[153] This trade imbalance is in large part due to China's restriction on the free flow of information over the Internet.[154] Moreover, the PRC government requires that Internet companies' ownership majority remain with Chinese nationals, and that the company itself is domiciled in China.[155] These restrictions are in large part the reason VIEs exist so companies can list on the U.S. exchanges.[156] Eliminating these restrictions would reduce a Chinese company's need to establish a VIE.[157]

Furthermore, China's restricted financial markets make it difficult for Chinese firms to obtain necessary capital domestically.[158] As a result, Chinese Internet companies looking to expand and raise funds have little choice but to use the VIE structure to obtain foreign capital.[159] China's restricted financial markets not only create unnecessary risk for investors by driving Chinese companies to adopt the VIE structure, but it also limit the potential growth of Chinese Internet companies that could more efficiently access capital by listing domestically.[160] By loosening financial markets, China would make more domestic capital available, reducing the need for China's Internet companies to utilize the VIE structure.[161]

As discussed, China's legal system remains underdeveloped and often times corrupt under the rule of the CCP.[162] VIEs are inherently risky because the legal contract which are the foundation of the VIE structure are only determined binding and enforceable under Chinese law.[163] Foreign investors have difficulty seeking remedy for any grievance in the Chinese judicial system.[164] China taking action to improve its legal system and rule of law would give investors relief knowing that they would be able to fairly file complaints through the Chinese legal system.[165]

While China's regulatory policy and its supporting government agencies have implied the VIE structure to be illegal in China, the Chinese government in practice has allowed the VIE structure to endure.[166] The current legal ambiguity of the VIE structure continues inherent risks born unto foreign investors contributing financial capital to companies who have previously adopted the structure.[167] Future clarification from the Chinese government regarding the legal status of the

153 *Id.*

154 *Id.*

155 *Id.*

156 *Id.*

157 Commission Staff Report, *supra* note 1, at 10.

158 *Id.*

159 *Id.*

160 *Id.*

161 *Id.*

162 Commission Staff Report, *supra* note 1, at 10.

163 *Id.*

164 *Id.*

165 *Id.*

166 *Id.*

167 Commission Staff Report, *supra* note 1, at 10.

VIE structure via FIL will significantly impact the foreign investment landscape in China.

VI. Conclusion

The VIE structure today remains a risky investment for U.S. investors and a precarious work-around tool for Chinese companies such as Alibaba. At this juncture, the VIE is the only viable tool for China's Internet and technology companies to raise sufficient financial capital in order to remain a competitive player in the global economy. For that reason, it is suspect that China would not declare the VIE structure illegal in its entirety, as it continues to contribute to and benefit its overall economy. However, the newly proposed law may suggest otherwise. FIL has the power to paralyze the VIE structure as it exists today, and many Chinese Internet companies, like Alibaba, that have gained traction in the fastest growing e-commerce market in the world will experience future ramifications as China's Foreign Investment Law materializes.

As VIEs continue to play a key feature of China's growing economy, the PRC must address the fundamental problems that directly impact the existence and continuation of the VIE structure. In turn, the U.S. and the SEC should instigate a more thorough disclosure of the risks involved when investing in a VIE to properly educate and inform the U.S. investors and general public. Alibaba and their foreign investors remain secure for the time being, but the Chinese government, VIE entities, and foreign investors must promptly take action before the VIE "time-bomb" runs out of time.