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FIE Reform Scraps Approval, Streamlines Regulation

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While China's move to a filing regime benefits most foreign-invested enterprises, other approval requirements require careful attention.

Since foreign investment in PRC companies became permitted in 1979, the Ministry of Commerce (MOFCOM) and its predecessors were the frontline regulators in approving the establishment of foreign-invested enterprises (FIEs). This regime has been profoundly transformed by the Decision on Revising Four Laws, Including the «PRC Wholly Foreign-owned Enterprise Law» (NPC Decision) adopted by the Standing Committee of the People's National Congress on September 3, 2016.

Since the NPC Decision came into effect on October 1, 2016, an FIE engaged in a business that is not subject to restrictions or measures for “special access administration” does not require MOFCOM approval for its establishment or for subsequent changes. These non-restricted FIEs only need to record file with MOFCOM.

This development reduces the time and complexity of establishing a non-restricted FIE. Foreign investors need to focus on a different set of key considerations in structuring FIEs than under the previous approval regime, and pay close attention to MOFCOM's remaining powers over businesses subject to special access administration and over antitrust and national security aspects of foreign investment.

A smoother path for FIEs

The NPC Decision only amends a single article in each of the laws governing the three traditional types of FIEs—the wholly foreign-owned enterprise (WFOE), equity joint venture (EJV) and cooperative joint venture (CJV)—which changed the approval regime to a filing regime. To implement the new filing process, MOFCOM adopted the Tentative Measures for the Administration of the Record Filing of the Establishment of, and Changes to, Foreign-invested Enterprises (Filing Measures), and jointly released with the National Development and Reform Commission (NDRC) Announcement [2016] No.22, which defines businesses subject to special access administration as being those (i) listed in the “restricted” or “prohibited” categories of the Foreign Investment Industrial Guidance Catalogue (Amended in 2015) and (ii) listed in the “encouraged” category but subject to foreign shareholding limits or requirements for senior management.

Filing requirement

Under the Filing Measures, filing with a local authority under MOFCOM will be required for specified matters in relation to WFOEs, EJVs and CJVs as well as foreign-invested companies limited by shares, foreign-invested investment type companies (holding companies), and foreign-invested venture capital investment and “equity investment” enterprises. Equity investment enterprises refer to onshore private equity and venture capital funds, which are often organized as foreign-invested limited partnerships. Although MOFCOM has no authority over the establishment of partnerships, which only need to be registered with the local counterparts of the State Administration for Industry and Commerce (SAIC), the Filing Measures apparently extend MOFCOM’s powers to cover partnerships as well.

The matters that only require MOFCOM filing are:

- The establishment of a non-restricted FIE;
- A change in basic company particulars of a non-restricted FIE (name, registered capital, form of organization, term of operation, category of business, business scope, total investment, legal representative, ultimate controlling shareholder, etc.);
- A change in basic information regarding the investors of a non-restricted FIE (name, nationality, subscribed capital contribution, country of origin of funds, etc.);
- Transfer of equity interest in a non-restricted FIE (other than a transfer that represents a less than five percentage point change in the aggregate holding of foreign investors in a non-restricted FIE that is a listed company);
- The merger, division or dissolution of a non-restricted FIE;
- The creation and enforcement of security interests over assets of a WFOE;
- The early recovery of investment by the foreign investor of a CJV; and
- The entrustment management of a CJV.

Investors should note that an offshore transaction resulting in a transfer of actual control over a non-restricted FIE triggers a filing requirement, although the FIE or its direct shareholders may not be parties to the transaction.

Procedure and content

Timing: The filing for the establishment of a new non-restricted FIE can be made either during the period between the date the company name is reserved with the SAIC and the date the business license is issued or within 30 days after the business license is issued. A change in the registered particulars of a non-restricted FIE or its shareholders must be filed within 30 days after the change.

Procedure: All filing is online. The local MOFCOM authority will conduct a cursory review of the documents to check, among others, the completeness and accuracy of information submitted and may request further explanation or information, which must be provided within 15 business days. In this step, MOFCOM may also decide that the transaction triggers a national security review. If the authority is satisfied with the information submitted, it will complete the filing within three business days and issue a receipt.

Documentation requirements: The materials required for the MOFCOM filing have been simplified to include:

1. The standard filing form;
2. The name reservation notice or business license (as applicable);
3. An undertaking with respect to, among others, completeness and accuracy of information provided;
4. Necessary authorization documents in relation to the filing and signing of relevant documents; and
5. A certificate of incorporation or ID of the foreign investor or the legal representative of the non-restricted FIE.

Disclosure of ultimate shareholder information: Unlike the previous regime, the MOFCOM Filing Measures mandate disclosures regarding a non-restricted FIE's ultimate controlling shareholder and foreign investor. The information required includes the basic information (such as its name, place of incorporation and contact details), the type of entity and the form of control (through ownership of shares or voting rights or other forms of major influence over operational decisions, human resources, finances and technology).

Application to existing FIEs: FIEs established before the MOFCOM Filing Measures came into effect are treated as non-restricted FIEs if they do not conduct a restricted business. The MOFCOM Filing Measures do not prescribe a procedure for existing FIEs to be classified as non-restricted FIEs. Instead,

when an existing FIE undergoes a change that requires either approval from or filing with MOFCOM, it may make a filing instead of applying for approval if it does not operate in a restricted industry. In practice, FIEs (and their shareholders) should ascertain their status as non-restricted FIEs with MOFCOM before proceeding with a transaction that would otherwise be subject to approval.

Foreign investment in restricted industries

The NPC Decision and the MOFCOM Filing Measures do not change the regime governing FIEs in restricted industries. All approval requirements under existing law will continue to apply, unless and until current laws and regulations are further revised.

It had been anticipated that the list of restricted industries would be based on the negative list applicable to China's four free trade zones, but ultimately the joint announcement by NDRC and MOFCOM has not adopted this approach. As a result, the regime for establishing FIEs in the free trade zones remains more liberal than in the rest of China, as the negative list applicable in the free trade zones is less restrictive than the Foreign Investment Industrial Guidance Catalogue.

Key considerations

Remaining approval requirements

The NPC Decision and the Filing Measures substantially simplify the approval of non-restricted FIEs. However, under the current regulatory regime, even non-restricted FIEs could require approval from the NDRC or its local counterparts or from an industry regulator. There is no indication yet that the rules governing these approvals will be amended so as to align their requirements with those of the filing regime for non-restricted FIEs.

Also, MOFCOM remains a key approval authority for transactions that require filing of a business concentration under the PRC Anti-Monopoly Law or national security review under MOFCOM's Tentative Provisions on Matters Relevant to the Implementation of the System for Security Review of Acquisition of Domestic Enterprises by Foreign Investors. Parties to such transactions must proactively apply for review before completing the deal, although completion would technically be possible without a prior application. Failure to comply with these regulations may result in severe consequences to the parties and the transaction itself.

M&A implications

Not only the establishment, but also the acquisition, of non-restricted FIEs has been simplified by the Filing Measures. MOFCOM approval is no longer a condition to closing a transfer of equity interest in a

non-restricted FIE, as the required filing can be made after closing. In practice, however, the parties will often require that the change in shareholding is registered with the SAIC as a condition to closing.

Announcement 22 specifies that the existing regulations governing a foreign investor's acquisition of a PRC company, other than an FIE, continue to apply. Accordingly, under the Provisions for the Acquisition of Domestic Enterprises by Foreign Investors (Revised) (M&A Provisions) such acquisitions must be approved by MOFCOM, and the sale and purchase agreement for the transaction must be submitted for review. The M&A Provisions also require the purchase price to be based on independent appraisal and paid in full within three months after completion (which can be extended to up to one year after completion with MOFCOM approval). This regime applies even if the target company does not operate in a restricted industry. Another important aspect of the M&A Provisions, its restrictions on round-trip investments by PRC investors, also seems to remain untouched.

Towards a new FDI regime

In January 2015, MOFCOM had released a consultation draft of a new PRC Foreign Investment Law that would entirely replace the existing laws governing EJVs, CJVs and WFOEs. It was expected that this law would be submitted to the National People's Congress in 2018. The NPC Decision has implemented one of the key reforms proposed in the draft Foreign Investment Law—the adoption of a filing regime for non-restricted FIEs—earlier than expected.

Other aspects of the draft Foreign Investment Law have not yet been addressed. In particular, it contained a broad definition of foreign investment which captured variable interest entities (VIEs) and companies with indirect foreign shareholders as FIEs. Asset acquisitions, real estate purchases and contractual control transactions with foreign parties were also included in the proposed definition of foreign investment.

While the partial implementation of the draft Foreign Investment Law by the NPC Decision is a welcome development, the exact pace of progress towards this more comprehensive reform remains to be seen.

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