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HAN KUN LAW OFFICES

Newsletter

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Legal Updates

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Legal Updates

1. Brief Commentary on New Measures for FIE Record-Filings (Author: Han Kun Corporate Team)

On September 3, 2016, the *Decision of the Standing Committee of the National People's Congress on Amending Four Laws Including the Law of the People's Republic of China on Wholly Foreign-owned Enterprises* (the "**Decision**") was adopted at the twenty-second meeting of the 12th National People's Congress. The Decision amends the relevant approval clauses in the four laws,[1] whereby the establishment and alteration of foreign invested enterprises ("**FIEs**") not subject to special administrative measures for foreign investment will only be required to go through a record-filing process rather than case-by-case approvals. The Decision will come into effect on October 1, 2016, by which time the "pre-access national treatment plus negative list" administrative regime for foreign investment, which has been piloted in the free trade zones,[2] will be expanded nationwide.

On the same day, the Ministry of Commerce ("**MOFCOM**") released the *Interim Measures for Record-filing for the Establishment and Alteration of Foreign-invested Enterprises (Draft for Comment)* (the "**Draft**"), for the purpose of soliciting public opinions with a feedback deadline of September 22, 2016. The Draft, as an essential supporting document of the Decision, is also intended to take effect on October 1, 2016.

Abstract of the Draft

The Draft is composed of 5 chapters and 35 articles, generally follows the administrative framework for FIE record-filing that has been trial implemented in the free trade zones,[3] and echoes the state policies of "streamlining administration", "contained deregulation" and "collaborative supervision". The main contents of Draft include:

a. **Record-filing Administration for FIEs outside the Negative List**: FIEs not subject to the special administrative measures for foreign investment (i.e., the negative list), will only be required to go through a record-filing process, rather than to undergo case-by-case approvals. Record-filing with the competent department of commerce (the "**Record-filing Authority**") is not a prerequisite for FIE registration with the Administration for Industry and Commerce ("**AIC**").

[1] Law of the People's Republic of China on Wholly Foreign-owned Enterprises, Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures, and Law of the People's Republic of China on the Protection of the Investments of Taiwan Compatriots.

[2] China (Guangdong) Pilot Free Trade Zone, China (Tianjin) Pilot Free Trade Zone, China (Fujian) Pilot Free Trade Zone and China (Shanghai) Pilot Free Trade Zone.

[3] Measures for Record-filing Administration of Foreign Investment in Pilot Free Trade Zones (for Trial Implementation) promulgated by MOFCOM on April 8, 2015.

b. **Scope of Application**:

i. Wholly Foreign-Owned Enterprises, Sino-Foreign Equity Joint Venture Enterprises and Sino-Foreign Cooperative Joint Venture Enterprises;

ii. Enterprises established by investors in Hong Kong, Macau and Taiwan;

iii. Foreign-Invested Joint Stock Companies;

iv. foreign-invested holding companies, venture capital enterprises and equity investment enterprises.

c. **Matters Subject to Record-filing**: The matters subject to record-filing are FIE establishments and alterations. FIE alterations include: general FIE and FIE investor information changes; changes to equity (shares) and cooperative interests (including pledges of equity); mergers, divisions and terminations; outward mortgages and transfers of property rights and interests in foreign invested companies; early withdrawal of foreign partner investments in Sino-Foreign Cooperative Joint Venture Enterprises; and entrusting the operation and management of the Sino-Foreign Cooperative Joint Venture Enterprises to third parties.

d. **Flexible Timeline for Record-filing**: Record-filing mainly becomes a post-event procedural requirement:

i. record-filing for the establishment of FIEs may be conducted before the establishment (i.e., after obtaining pre-approval for the enterprise name and before issuance of the business license);

ii. record-filing for FIE alterations may be conducted within 30 days after the highest authority within the FIE has adopted the relevant resolution or decision;

iii. FIEs that have been approved and established before the implementation of the new measures will only be required to go through the record-filing process for actual FIE alterations that occur, at which time the FIE's approval certificate will become invalid.

e. **Record-filing Procedures:**

i. the Record-filing Authority will process the filing via the comprehensive foreign investment management information system (hereinafter referred to as the "**Record-filing System**"), which allows for online record-filing to be performed;

ii. if the reported information is complete and accurate, the Record-filing Authority shall complete the record-filing procedure within three working days, and shall release the record-filing results through the Record-filing System and inform the FIEs or their investors online.

f. **Concurrent and Post-Event Supervision**: Although pre-approval for FIE establishment and alterations has been abolished, the Record-filing Authority may conduct supervision concurrent with or subsequent to the filing event, such as regular random inspections, whistleblower-based

inspections, inspections according to the suggestions and feedback by relevant departments or judicial organs, and inspections initiated based on administrative authority. In the meantime, Record-filing Authorities will closely cooperate and enhance information sharing with public security departments, state-owned asset departments, customs departments, taxation departments, industry and commerce departments, and securities, foreign exchange and other relevant administrative departments. If the Record-filing Authority discovers illegal acts by the FIEs or their investors that are not within its jurisdiction, it shall promptly report to the competent authority.

g. **Legal Liability and Consequences**: According to the Draft, FIEs and their investors shall bear legal liability if they violate record-filing obligations, conduct investment and operating activities relating to the industries falling within the negative list, or do not cooperate with the supervision and inspection process. In addition, the credit status of the FIEs and their investors will be recorded in the foreign investment credit file system operated by MOFCOM, and made public via MOFCOM's foreign investment information publicity system.

Brief Commentary

Upon the promulgation of the Decision and the release of the Draft for Comment, the administrative regime of "pre-access national treatment plus negative list" for foreign investment, which has been piloted and tested in the free trade zones, will be formally implemented on a national scale in less than one month. At that time, FIE establishments and alterations that are not subject to the special administrative measures for foreign investment will only be required to go through a standardized and simplified record-filing process, rather than case-by-case approval. Naturally, this is excellent news for FIEs currently falling within the "Encouraged" and "Permitted" categories, which account for the great majority of FIEs in China. In addition, the administrative uncertainty arising from the case-by-case approval regime will also be substantially mitigated. There is no doubt this innovative measure will facilitate the FIE establishment procedures as well as structure the foreign investment regulatory system that is geared to international standards, so as to cultivate a more liberal and transparent investment environment for foreign investors. In addition, the pending release of the negative list for foreign investment is also expected to synergize with the ongoing reform of the market entry negative list that is intended to apply to all types of enterprises nationally. A new mechanism is taking shape by which FIEs will initially be subject to a pre-access negative list that will provide for national treatment, which will result in FIEs then being treated the same as domestic entities during the application of a market entry negative list.

Notably, the Decision and the Draft still insert the negative list mechanism into the current FIE laws, which is reminiscent of the "*Foreign Investment Law of the People's Republic of China (Draft for Comment)*", promulgated by MOFCOM in January, 2015 ("**Draft Foreign Investment Law**"). The Draft Foreign Investment Law is considered to have the historic task of breaking down the current legislative model whereby the trio of FIEs laws and the Company Law are mutually exclusive from

each other, as well as to introduce a series of innovative regulatory mechanisms. The Decision and the Draft promote the negative list regime nationwide without breaking the current legislative model. To some extent, this can be seen as a progressive implementation of some of the innovative measures of the Draft of Foreign Investment Law, while on the other hand signals that certain key reforms proposed in the Draft Foreign Investment Law (e.g., the validity of the VIE structure) are still under advisement or need to be further modified, and there is no timetable for the formal pronouncements on these issues in the near term. Nevertheless, the current promotion of the negative list regime nationwide still has landmark significance for transforming the regulatory framework for foreign investment.

The *Interim Measures for Record-filing for the Establishment and Alteration of Foreign-invested Enterprises* is set to be formally implemented as of October 1, 2016, by which time the special administrative measures for foreign investment (i.e., the negative list) will also be made public and implemented, which will replace the current *Catalogue of Industries for Guiding Foreign Investment.* However, based on the practice in the Shanghai Free Trade Zone, the negative list may have few differences compared to the current *Catalogue of Industries for Guiding Foreign Investment,* and thus the prospect for the significant expansion of access for foreign investment is not promising. Furthermore, before the debut of the Foreign Investment Law, the negative list regime will still need to be harmonized with a large number of current FIE-related laws and regulations (such as the regulations for FIE equity changes, mergers or divisions, equity interest capital contributions, and mergers and acquisitions by foreign investors), which will be gradually refined in the course of practice and which may also reveal new issues. We will continue to monitor these legislative and regulatory changes.

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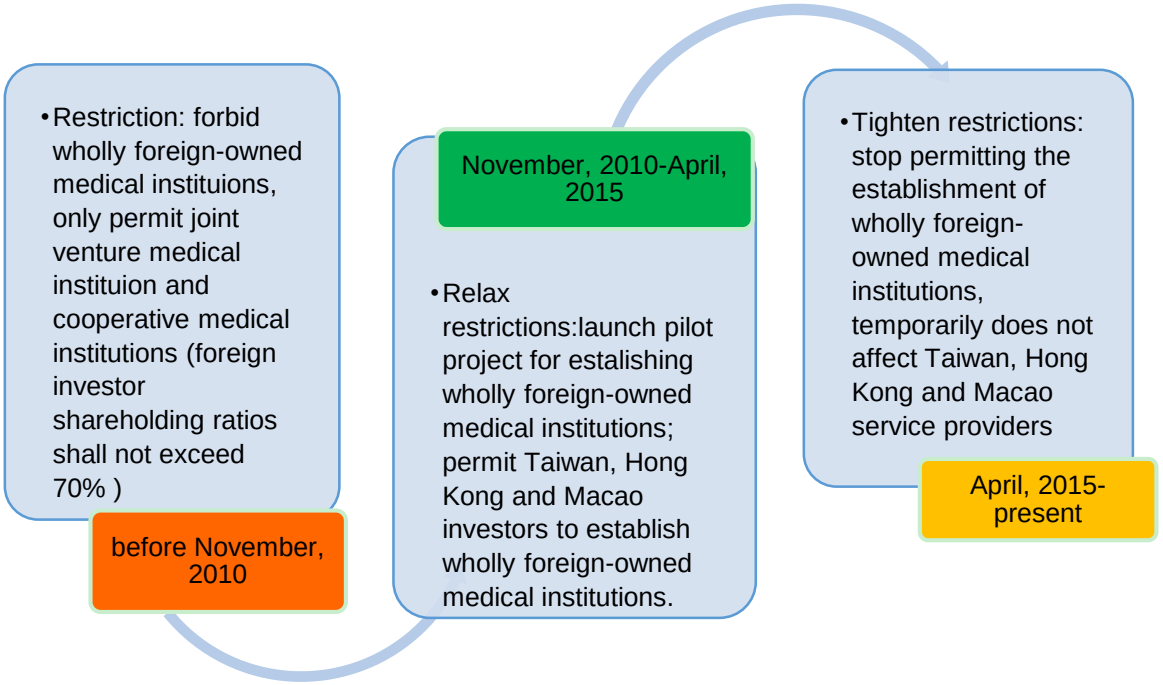
2. Study on Foreign-Invested Medical Institutions (I): Policies (Authors: Huanhao HE, Ruina LIU)

Can foreign investors set up wholly-owned medical institutions in China? This is a question that clients constantly ask when entering the Chinese healthcare industry, and this question is even more complicated when it comes to specific cases. We therefore intend to analyze this issue in terms of regulatory policy and practice by drawing on our experience in assisting multiple foreign institutions to make investments in the domestic healthcare industry. This article is the first of two and will focus on policy analysis.

The PRC government's policies for foreign investment in domestic medical institutions have consistently changed over time. Initially, the PRC government tended to restrict foreign capital from entering the domestic medical industry. At the end of 2010, these restrictions had begun to be

relaxed. In 2015, however, the government again tightened its control over foreign investment in domestic medical institutions. These three stages of the PRC government's position towards foreign investment are roughly shown in the following chart:



"Foreign investors" includes investors outside of China and also investors in Taiwan, Hong Kong and Macao. PRC laws and regulations related to the admission of foreign investment ordinarily apply to foreign investors and then cite applicability to Taiwan, Hong Kong, and Macao. In this case, however, policies related to foreign investment in the healthcare industry not only contain general rules applicable to foreign investors, but also some special rules that are only applicable to Taiwan, Hong Kong and Macao investors.

Foreign Investors – Bad News, Good News and Bad News Again

Foreign capital began entering PRC medical institutions in the late 1980s. As the reform and opening up deepened, domestic medical and healthcare services become inadequate to meet the growing needs of foreigners. On February 10, 1989, the former Ministry of Health and former Ministry of Foreign Trade and Economic Cooperation jointly promulgated the *Several Provisions on the Establishment of Hospitals or Clinics by Foreigners or Overseas Chinese and the Medical Practice in China by Foreign Doctors (expired)*, which stipulated that overseas Chinese were permitted to establish one or two wholly-owned non-profit pilot hospitals or clinics and foreigners and overseas Chinese were permitted to establish one or two pilot Sino-foreign joint ventures or contractual hospitals or clinics. In each case, approvals should be obtained from the Ministry of Health and Ministry of Foreign Trade and Economic Cooperation. This is a prologue to establishing foreign-invested medical institutions in China.

Following these policies, the government expressly prohibited the establishment of wholly foreign-owned medical institutions for a significant period. The *Interim Measures for the Administration of Chinese-foreign Equity Joint and Cooperative Joint Medical Institutions (*order of Ministry of Health and Ministry of Foreign Trade and Economic Cooperation, [2000] No. 11, hereinafter referred to as "**Interim Measures**"), effective as of July 1, 2000, set forth that foreign investors were only permitted to establish medical institutions in the form of a joint venture or contractual business, and required the domestic shareholding in such investments to be no less than 30%. *Catalogue for the Guidance of Foreign Investment Industries (revised in 1997)* categorized medical institutions as restricted industry and expressly stipulated that domestic shareholders should have control over such institutions. *Catalogue for the Guidance of Foreign Investment Industries (revised in 2002)* still categorized medical institutions as restricted industry but deleted the domestic shareholder control requirement so as to avoid conflicting with the Interim Measures.

In November 2010, *Circular of the General Office of the State Council on Forwarding the Opinions of the National Development and Reform Commission, the Ministry of Health and Other Departments on Further Encouraging and Guiding Non-government Funding for Medical Institutions* (Guo Ban Fa [2010] No. 58) proposed the opening up of medical institutions and categorizing medical institutions as permitted industry. The circular stipulated the phasing out of foreign investor shareholding restrictions in medical institutions and to launch a pilot project for qualified foreign investors to establish wholly foreign-owned medical institutions in China. Subsequently, on January 30, 2012, the *Catalogue for the Guidance of Foreign Investment Industries (Revised in 2011)* was promulgated, which also categorized medical institutions as permitted to foreign investment. On November 13, 2013, *Provisional Measures on the Administration of Wholly Foreign-Owned Medical Institutions in the China (Shanghai) Pilot Free Trade Zone* was entered into force, which expressly stipulated that foreign investors were permitted to establish wholly foreign-owned medical institutions in Shanghai pilot free trade zone. Subsequently, on July 25, 2014, the National Health and Family Planning Commission ("**NHFPA**") and the Ministry of Commerce ("**MOFCOM**") jointly promulgated the *Circular on Carrying out the Pilot Program for the Establishment of Wholly Foreign-Owned Hospitals* (Guo Wei Yi Han [2014] No. 244, hereinafter referred to as "**Circular 244**"), expressly stipulating that foreign investors may establish wholly foreign-owned hospitals through greenfield investment, merger or acquisition in Beijing, Tianjin, Shanghai, Jiangsu, Fujian, Guangdong and Hainan ("**Seven Pilot Provinces/Municipalities**").

This period of opening up, however, did not last long. On April 10, 2015, *Catalogue for the Guidance of Foreign Investment Industries (Revised in 2015)* was implemented, and again categorized medical institutions as restricted industry and stipulated that foreign-invested medical institutions may only operate in the form of a joint venture or cooperative. On April 8, 2015, the General Office of the State Council promulgated the *Circular on Issuing the Special Administrative Measures (Negative List) for Foreign Investment Access to Pilot Free Trade Zones*, effective since May 8, 2015, which also categorizes medical institutions as restricted industry. Since the negative list is applicable to

the free trade zones in Shanghai, Guangdong, Tianjin and Fujian, this meant the end of the policy permitting the establishment of wholly foreign-owned medical institutions in the Shanghai free trade zone.

Since Circular 244 has not yet been formally abolished, does this mean wholly foreign-owned hospitals are still allowed to be established in the Seven Pilot Provinces/Municipalities? We are afraid that the answer should be no.

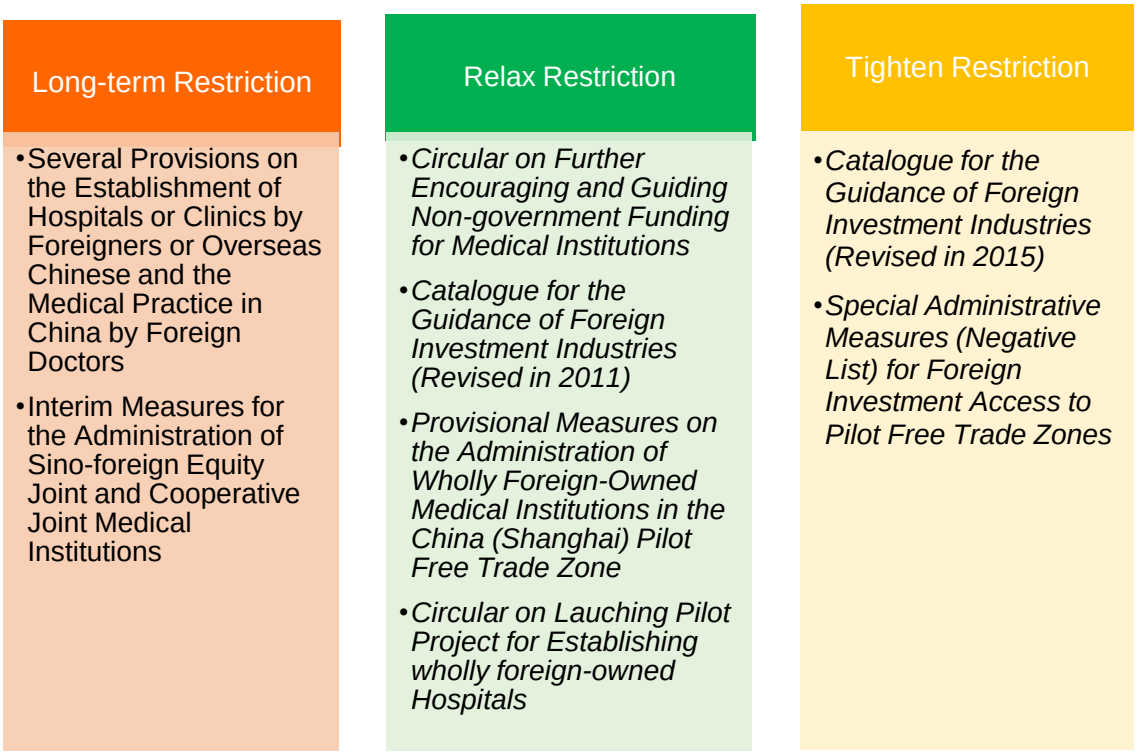
- First of all, in terms of legal provisions, Circular 244 was promulgated based upon the *Catalogue for the Guidance of Foreign Investment Industries (Revised in 2011)*, which categorized medical institutions as permitted industry. Since the Catalogue has been further revised and the updated version has been approved by the State Council, the Circular 244 pilot program has lost its policy and legislative foundation.

- Secondly, in terms of practical operations, we consulted with certain competent provincial and municipal healthcare and commercial administrations who also believe the new policy supersedes the Circular 244 pilot program.

- Of course, strictly speaking, there should be no direct conflict between the old and new laws. We recommend that the government resolve this conflict as soon as possible.

Considering that the *Catalogue for the Guidance of Foreign Investment Industries (Revised in 2015)* significantly reduces restricted categories and relaxes restrictions on the foreign investor shareholding ratio in multiple industries, the categorization of medical institutions as restricted industry again causes us to believe that the authorities are unlikely to permit foreign investors to establish wholly foreign–owned medical institutions in China in the near future.

On September 3, 2016, the Standing Committee amended the *Law of the People's Republic of China on Wholly Foreign-owned Enterprises* and other three laws, stipulating that the establishment of foreign-invested enterprises that are not subject to special State admission management rules shall be subject to a filing rather than approval process. The State Council is to formulate or approve the special admission management rules, and the decision will become effective October 1, 2016. It remains to be seen whether the special rules will repeat the relevant provisions in the *Catalogue for the Guidance of Foreign Investment Industries* or instead provide a new national negative list based upon the existing free trade zone list.



Special Treatment for Taiwan, Hong Kong and Macao Investors

Compared with foreign investors, Taiwan, Hong Kong and Macao investors appear to enjoy more preferential policies in relation to investing or establishing medical institutions in mainland China:

- On January 1, 2009, *Supplementary Provisions II to the Interim Measures for the Administration of Sino-foreign Equity Joint Venture Medical Institutions and Sino-foreign Contractual Joint Venture Medical Institutions (Order of Ministry of Health and Ministry of Commerce No. 61)* was put into force, which expressly stipulated that Hong Kong and Macao service providers were permitted to set up wholly foreign-owned clinics in Guangdong without restrictions as to the total investment amount.

- According to *Mainland-Hong Kong Closer Economic Partnership Arrangement* and *Mainland-Macao Closer Economic Partnership Arrangement* ("**CEPA**"), NHFPA and MOFCOM jointly promulgated the *Tentative Measures for Administration of Foundation of Wholly-Controlled Hospitals in Mainland China by Hong Kong and Macao Service Providers (Wei Yi Zheng Fa [2010] No. 109, the "**Circular 109**")*, stipulating that Hong Kong and Macao service providers may set up wholly foreign-owned hospitals in Shanghai, Fujian, Guangdong, Hainan and Chongqing. The permitted regions shall expand to all municipalities directly under the Central Government and provincial capital cities since April 1, 2012.

- According to the *Cross-strait Economic Cooperation Framework Agreement("**ECFA**")*, NHFPA and MOFCOM also jointly promulgated *Tentative Measures for Administration of Foundation of*

*Wholly-Controlled Hospitals in Mainland China by Taiwan Service Providers (Wei Yi Zheng Fa [2010] No. 110, the "**Circular 110**")*, stipulating that Taiwan service providers may set up wholly foreign-owned hospitals in Shanghai, Jiangsu, Fujian, Guangdong and Hainan beginning on January 1, 2011.

- On December 30, 2013, NHFPA and State Administration of Traditional Chinese Medicine jointly promulgated the *Several Opinions on Accelerating the Operations of Medical Institutions with Social Capital (Guo Wei Ti Gai Fa [2013] No.54)*, which stipulated that Taiwan, Hong Kong and Macao service providers may establish wholly foreign-owned hospitals and expand to all cities at or above the prefectural level in China, provided that the approvals of the provincial health departments are obtained. The application of the regulation is also subject to local restrictions.

Pursuant to above policies, on December 13, 2011, the first wholly Taiwan-owned hospital, Landseed International Hospital, was founded in Shanghai. On January 1, 2013, the first wholly Hong Kong-owned hospital, C-MER (Shenzhen) Dennis Lam Eye Hospital, was founded in Shenzhen, Guangdong.

Unlike the situation in the Seven Pilot Provinces/Municipalities, the *Catalogue for the Guidance of Foreign Investment Industries (Revised in 2015)* expressly stipulates that "if there are other provisions in the CEPA, ECFA and the supplementary agreements, and the free trade zone agreements or investment agreements concluded and signed by and between China and other relevant countries, such provisions shall prevail." Therefore, we can infer that the establishment of wholly foreign-owned medical institutions by Taiwan, Hong Kong and Macao investors will not be affected by the new policies.

Summary of Policies related to Foreign-invested Medical Institutions

In summary, except for Taiwan, Hong Kong and Macao investors, foreign investors are currently prohibited from establishing wholly foreign-owned hospitals nationwide (including in free trade zones and the Seven Pilot Provinces/Municipalities). The new policies related to foreign-invested medical institutions are summarized in the following chart:

Different Foreign Investor Qualification Review Standards - Another Interesting Difference

Both Circular 109 and Circular 110 expressly stipulate that Taiwan, Hong Kong and Macao service providers applying to establish wholly foreign-owned hospitals in mainland China must "have direct or indirect experience in medical care investment and management and satisfy either of the following requirements: (1) they are able to provide any advanced hospital management experience, management model and service model; or (2) they are able to provide internationally leading medical technologies." Besides this, the Interim Measures also provide that "the Chinese and foreign parties to a joint venture medical institution or a cooperative medical institution shall have direct or indirect experience in medical and healthcare investment and management, and shall meet one of the following requirements: (1) they are able to provide internationally advanced managerial experience in managing medical institutions, modes of management and modes of services; (2) they are able to provide internationally cutting-edge medical technologies and equipment; or (3) they can complement or make up for the inadequacy of local medical service capacity, medical treatment technologies, funds and medical facilities."

We can see that, aside from the flexible "complement" condition that was added to the Interim Measures, all three laws require foreign investors to have direct or indirect experience in healthcare investment and management. However, although the requirement equally applies to joint-venture medical institutions, cooperative medical institutions and wholly foreign-owned medical institutions, review procedures for establishing these three forms of medical institutions are not the same. With respect to establishing joint venture medical institutions and cooperative medical institutions, it is not mandatory for foreign investors to submit materials evidencing they have direct or indirect experience in healthcare investment and management. However, with respect to wholly foreign-owned medical institutions, such materials are required to be submitted and will be strictly examined. Thus, foreign investors that do not have direct or indirect experience in medical care investment and management cannot establish wholly foreign-owned medical institutions in the name of Taiwan, Hong Kong and Macao investors. Such investors may, however, be able to set up joint venture medical institutions or contractual hospitals so long as their shareholding ratios do not exceeding 70%.

In addition to the differences in review standards among Circular 109, Circular 110 and the Interim Measures as mentioned above, different local authorities may in practice also have different requirements for the three different forms of medical institutions：

	Application materials	Joint venture medical institutions and cooperative medical institutions	Wholly foreign-owned medical institutions established by Taiwan, Hong Kong and Macao investors
1.	Application for Establishing Medical Institutions	√	√
2.	Project Proposal	√	√
3.	Feasibility Study Report	√	√
4.	Incorporation Certificate, Certificate of Legal Representative Identity, Proof of Bank Credit	√	√
5.	Project Site Report, Lease Certificate for Project Use Land, Project Construction Plan	√	√
6.	Appraisal report confirmation documents for proposal to invest in state-owned assets by the State-owned Assets Management Department	√ (if applicable)	N/A
7.	Certificate of the service provider	×	√
8.	Documents evidencing that service providers are able to provide advanced hospital management experience, management methods and service methods or internationally leading medical technologies.	×	√

In addition to the basic review materials listed in the above table, local examination and approval authorities may require Taiwan, Hong Kong and Macao investors to provide additional documents to prove that they are service providers who engage in substantial business operations, such as the Profits Tax Returns and Notices of Assessment and Demand for Tax Payment for the last three years and Tax Returns for Salary and Pension of Employees in Hong Kong. With respect to qualifications for service providers, please refer to the CEPA and ECFA.

Regulations and policies related to foreign-invested medical institutions are still under development and are subject to the influence of the economic environment and macro policies. We will continually observe this issue. As the laws and regulations change, we also note some notable cases have arisen in judicial practice which we will discuss further in the next article.

Important Announcement

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