



HAN KUN LAW OFFICES

Legal Commentary



CHINA PRACTICE • GLOBAL VISION

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Foreign Direct Investment Law

Foreign Invested Enterprise Record-filing System Implemented

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On September 3, 2016, the Standing Committee of the National People's Congress promulgated 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**"). The Decision provides for record-filing in lieu of administrative approval in the case of foreign invested enterprise establishment and alterations for foreign invested enterprises ("**FIEs**") not subject to special administrative measures. On October 8, 2016, the Ministry of Commerce ("**MOFCOM**") issued the *Interim Measures for Record-filing for the Establishment and Alteration of Foreign-invested Enterprises* (the "**Interim Measures**"). On the same day, MOFCOM and the National Development and Reform Commission ("**NDRC**") jointly issued a statement (the "**Joint Statement**"), which clarified that the special administrative measures to be implemented in this case are the restricted and prohibited industry category provisions as well as encouraged industry categories having shareholding and executive management requirements prescribed in the *Catalogue for the Guidance of Foreign Investment Industries (2015 Edition)* (the "**Catalogue**"). The Joint Statement also stated that the relevant provisions currently in force will apply in the case of establishment and alterations resulting from foreign mergers and acquisitions. Based on the foregoing, the Decision-mandated record-filing system now has a clear package of supporting measures, thus making official the implementing of the "pre-access national treatment plus negative list" administrative regime.

Overview

The Interim Measures consist of five chapters and 37 articles and basically follow the foreign investment record-filing administrative framework in China's free trade zones, and carry out the state policies of "streamlining administration," "contained deregulation" and "collaborative supervision." The main content of the Interim Measures includes:

a. Record-filing Administration for FIEs outside of the Negative List

The record-filing process applies to the establishment and alterations of FIEs not subject to special administrative measures for foreign investment. Based upon MOFCOM's interpretation of the Interim Measures, record-filing administration is a notice filing and the filing receipt is not a prerequisite for enterprises to apply for other procedures. FIEs and their investors are responsible for the authenticity, accuracy and completeness of the filing information. The record-filing authorities will only examine the form of the filing information, and collection of the filing receipt after the completion of record-filing is not mandatory. Of particular note is that, for establishment filing, the Interim Measures currently only apply to FIEs resulted from greenfield investment. Foreign investors will continue to be subject to the approval system under the *Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (MOFCOM, 2009 Order No. 6) in the case of foreign mergers and acquisitions that result in establishing FIEs or transforming existing enterprises into FIEs, regardless of whether or not such FIEs are subject to special administrative measures.

b. Scope of Application

The Interim Measures apply to enterprises that include the three traditional forms of FIEs (WFOE, EJV and CJV), and also include PRC enterprises set up by investment-type FIEs (holding companies and venture capital enterprises) within China. Hong Kong, Macau and Taiwan investors are also subject by reference to the Interim Measures (except that Hong Kong and Macau service providers that establish service trade enterprises under the CEPA will continue to comply with the *Provisions for Hong Kong and Macao Service Provider Mainland Investment Record-filings* (for Trial Implementation)). The types of filing enterprises include limited liability companies and companies limited by shares. The Interim Measures apply nationally, and the *Administrative Measures for Pilot Free Trade Zone Foreign Investment Record-filings* (for Trial Implementation) (MOFCOM, 2015 Order No. 12) is thus repealed.

c. Matters Subject to Record-filing

The Interim Measures stipulate that the events subject to record-filing include all applicable FIEs' establishments and alterations. The Interim Measures cover most of the alterations that previously required MOFCOM approval to implement, including increases and decreases to registered capital, changes to equity, entity conversions, changes to business scope, consolidations, separations and terminations. It is worth noting that the Interim Measures do not include FIE equity pledges, which differs from the earlier comment draft version. We understand this to mean that MOFCOM will no longer regulate equity pledges, either by way of record-filing or approval. In addition, for FIEs publicly listed or traded over the National Equities Exchange and Quotations, only when the cumulative shareholding ratio of the foreign investor changes greater than 5% or the foreign investor experiences a change of control position in the FIE, the filing for basic information of the foreign investor or the shareholding change will be needed, further reducing administrative burden on the enterprises.

d. Timing of Record-filing

The Interim Measures stipulate that all record-filing can be undertaken on a post-event basis. Establishment record-filings can be undertaken before establishment (upon pre-approval of the enterprise name and before issuance of the business license), or within 30 days of the issuance of the business license. Enterprise alterations are to be filed within 30 days following occurrence of the event. If laws or regulations have requirements for the effectiveness of an enterprise alteration, the alteration is deemed to have occurred when such legal or regulatory requirements are satisfied. For other alterations that involve a resolution of the highest authority of an FIE, the time the resolution is adopted is when the alteration occurs.

e. Record-filing Procedures

All filings are to be made online. Filers complete and submit forms and supporting documents through the comprehensive foreign investment management system. The record-filing authorities can provide online feedback in case any record-filing information is incomplete or inaccurate, or if additional information is required. The results of the filing information are published through the filing system.

f. Administrative Oversight and Legal Liability

While the pre-event approval system is abolished, MOFCOM has strengthened the oversight and administration of record-filing. The competent MOFCOM department may carry out oversight and examinations through conducting random inspections, based on tips, and upon their own initiative, etc. The competent MOFCOM departments will share information with other administrative departments and timely inform such departments of illegal conduct for which the departments are responsible. Information regarding the integrity of the FIE and its investors will be entered into the foreign investment credit file system. The Interim Measures provide that FIEs and their investors who violate filing obligations, invest in restricted or prohibited areas, or refuse to cooperate with inspections will be subject to legal liability, and filers who do not cooperate with inspections or who refuse to comply with punishment decisions will be publicized.

Commentary

The issuance of the Interim Measures marks the beginning of the formal implementation of the negative list system on a national basis. Since that time, FIE establishments and alterations that are not subject to special administrative measures have been changed from an “case-by-case approval” to a more standardized and convenient filing process. FIEs covered under the record-filing system can undertake business activities upon obtaining a business license and no longer require authorization from the competent MOFCOM department. The FIE approval certificate that has been in place for many years will also be replaced by a FIE establishment filing receipt and a FIE alteration filing receipt.

Specifically, the Interim Measures greatly reduce the information and documents required to be submitted compared to the previous approval system. At the establishment filing stage, investors or promoters need only to complete basic information for the enterprise to be established. The documents required to be submitted at this stage also include only the name pre-approval documents or the business license, the letter of undertaking executed by all investors (or promoters), the investors (or promoters) qualifications or personal identifications, and the relevant entrustment documents. For alterations, the filing enterprise needs only to complete a form to reflect the changed item, submit the filing enterprise's business license, the filing enterprise's signed letter of undertaking, and the qualifications or personal identifications of the investors or legal representative involved in the change. The record-filing authority will only conduct a non-substantive examination of the record information. The documents required under the previous approval system are no longer required, such as the articles of association, joint venture contracts, equity transfer agreements, capital increases and reduction agreements, consolidation or separation agreements, etc. This change is undoubtedly positive for foreign investors in order to more flexibly arrange investment and business transactions, since they will no longer need to be concerned about the attitude of the relevant approval department. At the same time, eliminating the review and approval of articles of association and contracts means that approval will no longer constitute a condition for such documents to be legally effective. This development will help to eliminate uncertainties in practice regarding the validity of contracts when the documents have not been approved, promoting the security and predictability of transactions.

The current negative list system, however, remains at a transitional stage. Special administrative measures, a key to the negative list system, have not been separately introduced. The special administrative measures in this case have been implemented by referencing the Catalogue, and thus areas accessible to foreign investment have not been substantially broadened. At the same time, the Catalogue, as a guide to industry access, is relatively general. Specific regulatory measures to be adopted for restricted industries are unclear and the possible reforms to the examination and approval system under the new regulatory regime have not yet been addressed. Also, in terms of investment projects, FIEs engaging in investment projects must still obtain approval or conduct filings, based on their industry and the project size, pursuant to the *Administrative Measures for Foreign Investment Project Approvals and Record-filings* (NDRC, 2014 Order No. 20).

Despite the foregoing, the implementation of the negative list is a very important milestone in remolding the administration of foreign investment in China. This reform is linked to the ongoing reform of the market access negative list system which is applicable to all types of enterprises in China. After reforms are completed, foreign investment will be subject to the foreign investment negative list system and, subsequently, FIEs will be subject to the market entry negative list system the same as all other types of market players (including state-owned enterprises and private enterprises). The full implementation of the negative list system will

greatly reduce the government's administrative intervention, release market vitality, and promote the function of the market in playing a decisive role in resource allocation. At present, the basic laws for FIEs have been revised and the procedural process of the record-filing has been established. However, the legacy of the examination and approval system that has lasted for nearly three decades is still present in a large number of administrative regulations, department regulations, and normative documents. A thorough implementation of the negative list system will require the relevant departments to actively engage in a complete review and update of the laws and regulations in light of the changed regulatory framework.

● **Important Announcement**

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