

How Does the <Foreign Investment Law> Impact the Current Corporate Governance of EJV in China?



ASIA

■ INTRODUCTION

After ten years of brewing and waiting, the Foreign Investment Law of the P.R.C. and its implementing regulations (the “FIL”) have been officially effective as of January 1, 2020, which repealed definitively the three fundamental laws governing foreign invested enterprises (“FIEs”) in China for more than twenty years:

- the Law of the P.R.C. on Sino-foreign Equity Joint Ventures (the “EJV Law”);
- the Law of the P.R.C. on Sino-foreign Contractual Joint Ventures (the “CJV Law”); and
- the Law of the P.R.C. on Wholly Foreign-Owned Enterprises (the “WFOE Law”)

As a consequence, the corporate governance of all FIEs should now abide by the Company Law of the P.R.C (the “Company Law”) or the Partnership Enterprise Law of the P.R.C (the “Partnership Enterprise Law”).

The below table summarizes the main changes on the corporate governance of an EJV brought about by the implementation of the FIL and how the current EJV should adapt to the new regulatory regime.

No.	Corporate Governance Matters	Before the FIL	After the FIL
1	The highest authority	Board of Directors (“BOD”)	Shareholders’ meeting
2	Voting rights required for the important matters	Unanimously agreed upon by the Directors present or represented at the board meeting	Passed by shareholders holding two-thirds or more of the voting rights
3	Voting rights	Each director has one vote	Unless otherwise specified in Articles of Association (“AOA”), shareholders shall exercise their voting rights in proportion to their respective capital contributions
4	Legal representative	Chairman of the BOD (“Chairman”)	Chairman/Executive Director/General Manager (“GM”)
5	Number of Directors	≥3 Directors to compose the BOD	3-13 Directors to compose the BOD or One Executive Director



6	Election of Directors/Executive Director	The Directors are appointed directly and respectively by the shareholders in proportion to their capital contribution	The Directors/Executive Director are/is elected by the Shareholders' meeting
7	Term of office of the Directors/ Executive Director	4 Years	3 Years
8	The candidate of the GM/ Deputy GM	The candidates of the GM and Deputy GM shall be proposed respectively by the foreign shareholder and the Chinese shareholder	No restriction

■ CHANGES OTHER THAN CORPORATE GOVERNANCE CHANGE

Besides the above aspects in relation to the corporate governance, the FIL simplifies the formalities in relation to EJV's incorporation and subsequent modifications and it grants also more liberty to the shareholders in relation to the disposal of their own rights. For instance:

- COFCOM record filling and information reporting: the EJVs not engaged in the industries on the Negative List have no more need to conduct the record filling with the Ministry of Commerce ("COFCOM"). Instead, the Administration for Market Regulation ("AMR") will be in charge of forwarding to the competent COFCOM the initial, change or deregistration information reported by each EJV through the online Enterprise Registration System and the National Enterprise Credit Information Publicity System.
- Profit distribution: According to the EJV Law, the net profits of the EJV shall be distributed to the parties in proportion to their respective equity in the registered capital, while the Company Law authorizes the shareholders to unanimously agree on other distribution mechanism.
- Equity transfer: The EJV law requires the unanimous agreement of all the other shareholders if one shareholder intends to transfer all or part of its equity interest. While according to the Company Law, the consent of more than half of the other shareholders is enough. In addition, an existing shareholder which is opposed to the equity transfer should be deemed to have given its consent to the contemplated equity transfer if it does not proceed to the acquisition of the relevant equity by itself. The Company law also allows the shareholders to make exceptions on the above equity transfer rules in the AOA which would give more freedom to the shareholders with regards to the disposal of their equity in the EJV.

■ SUGGESTIONS

Although the FIL grants a transition period of 5 years for the existing FIEs to adapt its corporate governance and revise their AOA in accordance with the Company Law/Partnership Enterprise Law, it is recommended to the FIEs in particular the EJVs to start the preparation work as early as possible. The foreign shareholders can take the opportunity not only to adjust and optimize the internal governance structure of the EJV, but also to rebalance the relationship with the Chinese partners.



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However, with regards to the change of the voting mechanism for the important matters of the EJV, the foreign shareholders which hold the majority equity ($\geq 2/3$) may face the challenges raised by the Chinese shareholders who would fight for their veto right on the decision of these important matters. DS is available for solving this kind of corporate deadlock for the foreign parties.

DS has been closely following up the laws and regulations lately effective in China. For any further information regarding the reform, please feel free to contact us for detailed advice.



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