

Good-bye to the past, time for the new chapter of WFOE/JV



ASIA

■ WFOE/JV¹ AFTER FIL -- THE END OR A NEW CHAPTER?

We have often heard some sayings like “WFOE IS DEAD” or “JV IS ENDED” in the P.R.C. these days. Such so-called dead or end of WFOE/JV actually come from the context that the particular laws governing WFOE and JV (“**Three Laws governing the FIEs²**”) have now been replaced by the Foreign Investment Law of the P.R.C. (including its implementing regulations, the “**FIL**”) since January 1, 2020. As a result, those particular rules applying to WFOE/JV under the Three Laws governing the FIEs will no longer exist and WFOE/JV will mainly be governed by the Company Law of the P.R.C. («**Company Law**»), same as with the Chinese-owned company.

However, such change above does not mean that the exiting WFOE/JV would now be discarded or the foreign investors could no longer set up a new WFOE or JV in the P.R.C. The truth is:

1. the exiting WFOE/JV can still survive, provided that the FIL requires some adjustments to be made to their corporate governance as well as other matters but with their respective legal form unchanged, following the rules under the Company Law within 5 years after January 1, 2020 (“**Transition Period**”),
2. foreign investors can still establish a new WFOE/JV, provided that the references shall now be made to the Company Law instead of the Three Laws governing the FIEs.

Therefore, such change above truly means a new chapter for WFOE/JV has opened which actually would bring more autonomy and advantages to WFOE/JV.

■ A NEW AND BETTER CHAPTER FOR WFOE/JV INDEED!

The new FIL has opened a new and better chapter for WFOE/JV, for instance, the new principles established by the FIL brings much more advantages and convenience to WFOE/JV. By adapting the Company Law, WFOE/JV could enjoy the same treatments and flexibilities on the corporate governance with the Chinese-owned company. For the JV especially, the changes of the corporate governance brought by the Company Law could reduce the occurrence of the deadlock as the Company Law grants much more discretion to the shareholders rather than giving excessive protection of interests of minority shareholders under the former legal regime governing the JVs.

■ WFOE/JV AFTER FIL MAIN CHANGES IN WFOE/JV

The table below provides a summary of the main changes in the organization and governance of WFOE/JV resulting from the effectiveness of the FIL:

¹ JV refers to Equity Joint Venture. This newsletter does not address Contractual Joint Venture.

² Three Laws governing the FIEs refer to the Law of the P.R.C. on Sino-foreign Equity Joint Ventures, the Law of the P.R.C. on Sino-foreign Contractual Joint Ventures and the Law of the P.R.C. on Wholly Foreign-Owned Enterprises.

N°	Matters	WFOE before the FIL	JV before the FIL	WFOE/JV After the FIL	Art. in the Company Law
1	Supreme authority	The board of shareholders or shareholders' general meeting	Board of Directors ("BOD")	The board of shareholders ³ or shareholders' general meeting	36 and 98
2	Voting rights required for 4 important decisions ⁴	Two-thirds or more of the voting rights	Unanimously agreed upon by the Directors present or represented at the board meeting	Two-thirds or more of the voting rights	43 and 103
3	Voting rights	Unless otherwise specified in Articles of Association ("AOA"), shareholders shall exercise their voting rights in proportion to their respective capital contributions	Each director has one vote	For the limited liability company: Unless otherwise specified in AOA, shareholders shall exercise their voting rights in proportion to their respective capital contributions; For the company limited by shares: one vote per share	42 and 103
4	Legal Representative	General Manger (the "GM") or Chairman of the BOD or Executive Director	Chairman of the BOD	General Manger or Chairman of the BOD or Executive Director	13
5	Number of Directors	3 to 13	≥3	For the limited liability company: 3 to 13 For the company limited by shares: 5 to 19	44 and 108
6	Appointment of Directors/ Executive Director	Appointed by the board of shareholders or general meeting of shareholders	Appointed directly and respectively by the shareholders by taking into account of their respective capital contribution	Appointed by the board of shareholders or the general meeting of shareholders	45 and 108

³ In a limited liability company, the supreme authority is the board of shareholders; in a company limited by shares, the supreme authority is the shareholders' general meeting

⁴ Amendment to the articles of association of the company, increase or reduction of registered capital, and company merger, division, dissolu-



7	Term of office of the Directors / Executive Director	3 years (renewable)	4 years (renewable)	3 years (renewable)	45 and 108
8	Appointment of the GM/Deputy GM	Appointed by the BOD or Executive Director.	Appointed by the BOD based on the candidates proposed respectively by the foreign shareholder and the Chinese shareholder	Appointed by the BOD or Executive Director.	49
9	Reserves to be withdrawn from the after-tax profit and allocated to different funds annually	<p>The reserve funds, employee incentive and welfare funds should be withdrawn from the after-tax profit yearly. The withdrawal ratio of the reserve fund shall not be less than 10% of the after-tax profit until the aggregate sum reaches 50% of the registered capital.</p> <p>The proportion of employee incentives and welfare funds is determined by the board of shareholders or shareholders' general meeting which can be zero in practice.</p>	<p>The reserve funds, employee incentive and welfare funds and enterprise development funds should be withdrawn from the after-tax profit yearly.</p> <p>The proportion of reserve funds, employee incentive and welfare funds and enterprise development funds is determined by the BOD which can be zero in practice.</p>	The statutory surplus reserve funds shall be withdrawn yearly from the after-tax profit with the ratio of 10% until the aggregate sum of the statutory surplus reserve reaches 50% of the registered capital.	166



10	P r o f i t distribution ⁵	The net profits will be distributed in accordance with the proportion of their paid-in contributions of the registered capital unless otherwise agreed by the shareholders unanimously.	Net profits of the EJV shall be distributed to the parties in proportion to their respective equity in the registered capital	For the limited liability company: the net profits will be distributed in accordance with the proportion of their paid-in contributions of the registered capital unless otherwise agreed by the shareholders unanimously. For the company limited by shares: unless otherwise provided by the AOA, the net profits will be distributed by the shareholding ratio of the shareholders.	34 and 166
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To sum up:

- Only few changes required for WFOE which has already complied with the Company Law.
- Major changes required for JV regarding allocation to statutory reserve funds and in particular the governance with the risk for the minority shareholders to lose certain statutory rights (e.g. right to appoint senior executives, veto right on certain matters).

■ OTHER ADVANTAGES BROUGHT BY THE FIL

Apart from the changes listed above, the FIL also brings significant advantages for foreign investment, including:

- **National Treatment:** foreign investments in sectors falling outside the scope of the “negative list” can enjoy national treatment, which means that foreign investors in such sectors will be no less favorable than those applied to domestic investors.
- **Investment Protection:** the FIL requires that administrative agencies and their staff should keep confidential of the business secrets of the foreign investors and their WFOE/JV obtained in the course of performing duties and shall not use administrative means to force any transfer of technology.
- **Preferential Treatment:** the FIL expressly provides that the state and local governments can take preferential measures within their statutory powers to formulate foreign investment promotion policies.
- **Convenience for Administrative Formalities:** WFOE/JV no longer need to obtain a receipt issued by the Commission of Commerce (“COFCOM”) as the proof of completion its obligation of record-filing for their incorporation or any subsequent change. Instead, they can easily complete their reporting obligation by sending the information online. Please refer to https://www.dsavocats.com/mailling/Asia%20News/DS_The%20Information%20Reporting%20Mechanism%20for%20Foreign%20Invested%20Enterprises.pdf for more details regarding a detailed introduction on this Information Reporting System.
- **Expanded Scope of Potential Cooperators:** the new FIL enlarges the scope of potential cooperators a foreign investor can establish an JV with, for instance, the FIL allows the Chinese natural person to become the shareholder of a JV, which provides more flexibility for the foreign investor to find the Chinese partner and expand the way of the cooperation.

⁵ In practice, the opening bank of a WFOE/JV or the SAFE may require that the dividends shall be distributed in proportion to the contributions of each parties.



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■ DS SUGGESTIONS

Although the FIL grants a transition period of 5 years for the existing WFOE/JV to be adapted to the Company Law, it is recommended to start the preparation work as early as possible.

Indeed, for JVs, prior to the launch of negotiations with the other shareholders aimed at modifying the articles of association and the old joint venture contract, it is important for a shareholder to carry out a careful and in-depth assessment regarding its fundamental interests, position, negotiating power, the quality of its relationship with the other shareholder(s), the current actual situation of the JV, problems encountered in the past, and whether or not there is a need for in-depth changes to the rules of governance, and more particularly the voting rights of each shareholder. It is certain that one of the key points to negotiate is the potential new allocation of decision-making power through voting rights, a majority shareholder who has two-thirds or more of the voting rights is likely to face the opposition of the minority shareholder who will certainly fight to retain its existing veto right.

DS Avocats has been closely following up on the FIL as well as the Company Law, and has been focusing on foreign investment in China for over thirty years. We can assist shareholders to negotiate over and prepare new shareholders' agreements as well as articles of association, and further smooth the transition.



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