

### Impact of Chinese Foreign Investment Law on WFOEs

The National People's Congress of PRC passed the new *Foreign Investment Law* (FIL) on 15.03.2019, which will come into effect on 01.01.2020. It will replace three of the special laws currently applicable to foreign investment. We had already reported its impact on particularly joint ventures in detail in our last newsletter.

In this issue we will explain in detail the adjustment required under the FIL for organizational structure of wholly foreign-owned enterprises ("WFOEs"). Below you will find an overview on differences prior to and after implementation of the FIL.

legal basis	Wholly Foreign Owned Enterprise	Equity Joint Venture	Contractual Joint Venture
Until now	Law on Wholly Foreign-Owned Enterprises, Company Law	Sino-Foreign Equity-JV Law, Company Law	Sino-Foreign Cooperative JV Law
In future	Company Law or Partnership Enterprise Law, depending on legal form		

The *Law of PRC on Wholly Foreign-owned Enterprises* (1986) contains no mandatory rules on the organizational structure of a WFOE. The prescribed organizational structure applied to Chinese companies under the company law was not applied to WFOEs before 2006. As a result, the organizational structures of WFOEs incorporated before 2006 ("old WFOEs") sometimes vary widely.

After the revised company law entered into force on 01.01.2006, a regulation, named "*Implementation Opinion on Issues concerning Application of Law for Administration of Examination and Approval and Registration of Foreign-Investing Companies of 24.04.2006*" was issued, which clearly provided that the organizational structure prescribed in the company law applied to WFOEs. Accordingly, all WFOEs established after 2006 have an organizational structure that complies with the company law.

For old WFOEs founded before 01.01.2006, an adjustment of their organizational structure took place on purely optional basis. This optional adjustment was governed by a *Circular* issued by the State Administration for Industry and Commerce ("SAIC") on 26.05.2006. At some locations, on the occasion of certain events (such as increases of registered capital), local authorities have requested old WFOEs to amend their Articles of Association in accordance with current company law. However, there are still a number of old WFOEs whose organizational structure does not comply with the company law. In the following table you will find a comparison of the

organizational structure of a WFOE according to the company law and of old WFOEs before 2006.

Organizational structure of a WFOE	WFOEs established after the <i>Company Law</i> of 2006 (came into force on 01.01.2016, last revised in 2018)	Old WFOEs established before 2006
Highest Organ	Shareholders' meeting	Shareholders' meeting or Board of Directors, depending on Articles of Association
Board of Supervisors or Supervisor	Yes	Depending on Articles of Association, not mandatory requirement
Legal Representative	Chairman of the Board/Executive Director or General Manager, depending on Articles of Association.	Chairman of the Board/Executive Director or General Manager, depending on Articles of Association.

According to the FIL, the organizational structure and internal governance of all foreign-invested companies - including old WFOEs – shall be governed uniformly by the company law in the future.

**Who has to act?**

According to the new FIL, existing WFOEs can retain their previous structure for 5 years after implementation of the FIL. Detailed implementation rules are to be drawn up by the State Council. This means that at the latest after 5 years an adjustment of the structure (if necessary) should be carried out.

Particularly affected are the old WFOEs whose organizational structure has not yet been adapted to current company law.

Apart from the organizational structure, WFOEs should also have their Articles of Association checked timely for compliance with current company law. This is particularly recommended considering the fact that regulations on foreign investment have been changed in various ways (such as liquidation, cancellation of approval procedures for the majority of investment projects, etc.) within recent years, for which the provisions/wordings in the Articles of Association have to be reviewed and amended accordingly.