

Interim Regulations on Capital Contribution by Equities in Foreign Invested Enterprises

October 25, 2012.

Minister of Commerce (“MOFCOM”) released the Interim Regulations on Capital Contribution by Equities in Foreign Invested Enterprises (“FIE”) (hereinafter the “Interim”) on September 21, 2012, which came into effect on October 22, 2012.

The Interim was promulgated after the public comments collection in May 2011 and over one year’s research on relevant issues by MOFCOM. The Interim includes the major issues as follows:

1. Transactions for the Purpose of the Interim

Transactions that domestic or foreign investors execute for the establishment or change of a FIE (“Foreign Invested Company”ⁱ) in China by means of capital contribution of equities which they hold in a domestic company (“Equity Company”ⁱⁱ) include:

- a. Set up a new foreign invested company (“FIE”);
- b. Transform a domestic company into a FIE by increasing the registered capital of the domestic company;
- c. Change the equities of a FIE by increasing the registered capital of the FIE.

2. Restriction on the Equities to be Contributed

The Equity Company cannot be contributed under the following circumstances:

- a. The registered capital of the Equity Company has not been fully contributed;
- b. The equities to be contributed have been pledged;
- c. The equities to be contributed have been legally foreclosed or frozen;
- d. The equities cannot be transferred according to the articles of association or contract of the Equity Company;
- e. The equities of the FIE cannot be contributed if the FIE doesn’t pass the annual inspection;
- f. The equities of real estate company, foreign invested company for investment and foreign invested venture capital company cannot be transferred;
- g. The share transfer has not been approved by the Chinese authorities;
- h. Other circumstances.

3. Evaluation of Equities

The equities to be contributed shall be evaluated by domestic evaluation institutions. The final price of transaction and equity contribution may be negotiated by parties according to the equity evaluation report. However, the price of the actual equity

contribution shall not be higher than the price of the equity evaluation concluded in the report.

4. Restriction on the Proportion of Contribution by Equities and Total Investment Amount

The total capital contribution by equities and other non-monetary properties shall not be more than 70%, which is consistent with the rule regulated in the Company Law of China (issued in 2005)

The total investment amount of Invested Company shall be calculated based on its registered capital (including contribution by equities) and following the same calculation formula in the regulations on the proportion for joint venture companies in China.

5. Application Documents for Transactions of Contribution by Equities

- a. Application letter for the contribution by equities and the agreement;
- b. Shareholding proof of the shareholder;
- c. Business license copy of the Equity Company;
- d. Approval Certificate of the Equity Company if it is a FIE and the proof of passing the annual inspection of FIE;
- e. Equity evaluation report;
- f. Legal opinion letter regarding item d and e above, which shall be issued by a law firm;
- g. Other application documents for the establishment or change of the FIE;
- h. Approval documents for the share transfer if necessary;
- i. Other relevant documents.

6. Approval Authorities

MOFCOM and its provincial commercial departments shall be in charge of the approval regarding transactions of the contribution by equities.

If the approval authority is different from that of the Equity Company, when the Invested Company's approval authority receives the application documents, it should inquire the opinions of the Equity Company's approval authority. The Equity Company's approval authority shall respond whether it accept the application or not within 20 days after receiving such inquiry. Any response over 20 days shall be regarded as the acceptance.

7. Registration Change of the Equity Company

After the application of the contribution by equities is approved, the Equity Company shall:

- a. If the Equity Company is not a FIE, it shall apply for the change of the shareholder from the previous investor to the Invested Company according to Interim Regulations on the Investment in China by FIE (issued in 2000);
- b. If the Equity Company is a FIE and it still has the foreign shareholder(s) after the equity contribution, it shall apply for the change of shareholder from the previous investor to the Invested Company with relevant authorities according to the Interim Regulations on the Investment in China by FIE and Regulations on Change of Equities of FIE (issued in 1997);
- c. If the Equity Company is a FIE and it has no foreign shareholder after the equity contribution, it shall apply for cancelling or changing the Approval Certificate with relevant authorities according to Regulations on Change of Equities of FIE and Interim Regulations on the Investment in China by FIE.

8. Registration Change of the Invested Company

After the registration change of the Equity Company, the Invested Company shall also apply for the registration change by submitting the following documents:

- a. Statement of the change of equity of the Domestic Equities;
- b. Business license of the Equity Company after the change of equity;
- c. Capital verification report of the contribution by equities issued by qualified verification institutions;
- d. New Approval Certificate of the Equity Company if it is still a FIE after the change of equity;
- e. Approval of re-investment in China of the FIE issued by the provincial authorities if the Equity Company is not a FIE but its business scope involves restricted areas according to Catalogue of Industries for Guiding Foreign Investment (latest version in 2011).

9. Transactions of Contribution by Equities which Involves Chinese Listed Companies and State Owned Enterprises ("SOE")

Transactions of contribution by equities involving Chinese listed companies shall comply with corresponding regulations regarding security supervision, security transaction, security registration and settlement, etc.

If the foreign investor is involved in the orientate offer of shares or share transfer of Chinese listed companies by using its equities held in the Equity Company as the consideration, such transaction shall also apply the Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors (issued in 2006).

10. Merger and Acquisition ("M&A") of Domestic Enterprises by Foreign Investors and Security Review

If the transaction of contribution by equities belongs to M&A transaction, it shall apply to Regulations on M&A of Domestic Enterprises by Foreign Investors (latest version in 2009) together with the Interim.

If transactions of contribution by equities involve circumstances mentioned in the Notice on the Establishment of Security Review System for M&A of Domestic Enterprises by Foreign Investors (issued in 2011), the foreign investor shall apply for the security review with relevant authorities.

11. Equity Swap

If the foreign investor conducts the equity swap with other investors by using the Equity Company, it shall comply with rules of restrictions on equities to be contributed and equity evaluation in the Interim, as well as Regulations on Change of Equities of FIE and Regulations for M&A of Domestic Enterprises by Foreign Investors.

Comments

Before the promulgation of the Interim, Measures on Management of Registration of Contribution by Equities (issued in 2009) were applicable for the management of such matters. Notwithstanding, the Measures only stipulated rules on transactions of contribution of equities into domestic enterprises rather than transactions related to FIEs. Now the Interim brings a new mechanism for the investors especially for foreign investors to establish legal entities for the development of business or expansion of businesses in China. The way of contribution by equities will provide more alternatives and flexibility for the investment in China, and it will release the burden of cash contribution for such investment. Meanwhile, the Interim also stipulates the specific documents for the application of contribution by equities and approval authorities.

However, even though the Interim provides the possibility of contribution by equities for FIE transactions, it is still not complete. At least the following issues are not clear or regulated in the Interim:

1. Timeline of contribution by equities during the establishment or registration change of the FIE;
2. The specific contents or requirements which shall be included in the capital verification report of contribution by equities issued by qualified verification institutions;
3. The official procedure of registration with different approval authorities regarding transactions of contribution by equities;
4. The remedy if the application of transactions of contribution by equities is rejected;
5. Priority of the authority's approval if different authorities have opposite opinions on the same application.

Rules on such issues mentioned above need further clarification or supplement. Therefore, the Interim is expected to be further improved by the issuance of the formal regulations on capital contribution by equities in FIE and other relevant legislation shall be followed by other supplementary rules.

UB & Co Limited

ⁱ It refers to the FIE which is contributed by equities for its establishment or registration change mentioned in Part 1.

ⁱⁱ It refers to a company established in China in which the investors hold equities and the investors may contribute these equities to the FIE for the establishment or registration change. It can be either a fully domestic Chinese company or a FIE.