PwC International Business Reorganisations Network – Monthly Legal Update

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Contents

Welcome

Welcome to the eleventh edition of the PwC International Business Reorganisations (**IBR**) Network Monthly Legal Update for 2016.

The PwC IBR Network provides legal services to assist multinational organisations with their cross-border reorganisations. We focus on post-deal integration, pre-transaction separation and carve outs, single entity projects, and legal entity rationalisation and simplification as well as general business and corporate and commercial structuring.

Each month our global legal network brings you insights and updates on key legal issues and developments relevant to multinational organisations.

We hope that you will find this publication helpful, and we look forward to hearing from you.

In this issue

In our November 2016 issue:

- PricewaterhouseCoopers (Australia) considers the application of labour laws apply to globally mobile employees in light of recent Australian cases; and
- PwC Legal China & NTPS reports on recent reforms to foreign investment laws in China.

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PricewaterhouseCoopers (Australia) – Globally mobile employees: whose labour laws apply?

At a glance

Businesses are moving more of their employees internationally and in new and different ways. The traditional expat arrangement of living and working in a single country for a few years is being replaced by more flexible arrangements, such as assignments of less than one year, rotational assignments and reverse transfers.

These newer types of mobility arrangements are short term, potentially involve working in multiple countries in a short period and may result in employees leaving residences and families in their home countries while they are on assignment.

When implementing these arrangements, it is important to consider which country's labour laws will apply and whether the terms of the assignment will comply with those laws. Specifying that the law of a particular country will apply in a governing law clause will not necessarily be enforceable if the employment has a sufficient connection with another country.

The issue can be further complicated for this new 'peripatetic' type of employee where the work is performed in multiple countries. However, some recent Australasian cases provide guidance as to the factors to take into account when determining which country's employment laws should apply in such cases.

In detail

If an employment relationship is sufficiently connected with a particular country, the labour legislation of that country will generally apply.

As with the *Fair Work Act 2009* (**FW Act**) in Australia, many countries have enacted legislation to provide for minimum employee entitlements and protections. The nature and extent of these laws can vary significantly from country to country. The fact that employees receive mandatory Australian entitlements will always satisfy Australian requirements.

The inclusion of a governing law clause in the terms of the assignment allows the parties to choose the law that will regulate their contractual relationship. However, the parties will not be able to choose the legislated labour laws of country A over the legislated labour laws of country B if:

a the reality of the parties' relationship indicates that the employment is connected to country B; or

b it is in the public interest of country B to enforce the law of country B.

This application of these principles in cases involving peripatetic employees is illustrated in the following Australasian cases.

Fair Work Ombudsman v. Valuair Limited[1]: Australia, Thailand or Singapore?

This was a test case in which the Fair Work Ombudsman commenced proceedings against Valuair Limited, a Singaporean company, and Tour East Ltd (**TET**), a Thai company. Both Valuair and TET employed cabin crew to work for Jetstar on its routes from Thailand and Singapore into Australia. The cabin crew were all based in Singapore or Thailand but their duties included flying to and from Australian ports on Jetstar's international services, as well as working on internal flights between Australian ports.

[1] (No 2) [2014] FCA 759.

The Federal Court was required to determine whether Australian employment laws (namely the FW Act and the *Australian Aircraft Cabin Crew Award* 2010) applied. If so, there was evidence that Valuair and TET had failed to pay the cabin crew in accordance with these Australian requirements. The court applied the following guiding principles:

a a constitutional corporation must have an appropriate and sufficient connection with Australia in order to be considered a 'national system employer' and trigger the application of the FW Act;

b in determining whether an employee is covered by the FW Act and a modern award, a court will consider not only the work being performed by the employee, but also the employment relationship as a whole; and

c it is possible for an employer to have employees who travel in and out of Australia in the performance of their work who are not subject to Australian employment laws.

To determine whether the employment relationship as a whole had a sufficient connection to Australia the court took into account:

a that TET and Valuair were foreign corporations;

b the cabin crew were not residents of Australia;

c the contracts of employment were made outside Australia and were regulated by the laws of Singapore or Thailand;

d wages, and liabilities including tax and social security, were paid outside Australia;

e tours of duty commenced and finished at the home bases outside Australia; and

f the cabin crew only spent a small proportion of their overall working time in Australia.

Based on these factors, the court concluded the relevant employment contracts and the employment relationships were not 'in and of Australia' and accordingly, neither the FW Act nor the award had any application.

Brown v New Zealand Basing Limited[2]: New Zealand or Hong Kong?

This case also concerned the question of which country's employment laws applied to flight crew.

Mr Brown and Mr Sycamore (pilots for Cathay Pacific Airways) each entered into an employment contract with New Zealand Basing Limited, a subsidiary of Cathay, registered in Hong Kong. The laws of Hong Kong were specified as the laws governing the employment of the pilots.

[2] [2014] NZEmpC 229.

Their contracts also provided that they had to retire at 55 years of age. This requirement was lawful in Hong Kong but not in New Zealand. The pilots argued that the laws of New Zealand applied to their employment despite the governing law clause.

The New Zealand Employment Court considered '*the reality of the pilot's employment…not just the contract itself*.' In doing so, the Court had regard to the 'base test' which had been developed and applied in the United Kingdom by the House of Lords in an earlier decision *Crofts* v *Veta Ltd* [2006] UKHL 3 (also involving Cathay Pacific pilots).

Applying the base test, the court had regard to the following:

a the 'home base' of both employees was Auckland, New Zealand;

b neither employee was a resident of Hong Kong;

c the employees' tours of duty began and ended in Auckland;

d the employees were paid a salary (in New Zealand dollars) which reflected the lower cost of living in Auckland as compared to Hong Kong;

e various New Zealand statutes applied to the employees as a result of their employment (for example, the New Zealand *Income Tax Act 2007*); and

f the employees paid New Zealand medical insurance.

The court concluded that the employment of both pilots was connected to New Zealand and New Zealand laws applied. Further, if the court was wrong, there was another basis for reaching the same conclusion. Requiring the employees to retire at 55 years of age was '*a violation of the essential principles of justice because it involves a very serious infringement of a basic human right*.' The court considered discrimination on the basis of age to be inconsistent with '*deeply held values that bear on the very essence of human identity*', and accordingly concluded that the public policy exception should be applied in this case to override the parties' nomination of Hong Kong law as the governing law of the contract.

Holmes v Balance Water Inc. & Ors[3]: Australia or the US?

In this case, Ms Holmes claimed various employee entitlements in the Federal Circuit Court of Australia under the FW Act following the termination of her employment with a US company, Balance Water LLC. Having been employed for approximately five years to work for the Balance Water group's Australian 'start-up' business, Ms Holmes was subsequently employed by the US entity in the group. She worked in the US for almost two months before returning to Australia where she was working when her employment was terminated four months later.

There was no governing law provision in the employment agreement with the US entity but the court found that on the evidence, Ms Holmes had made a deliberate choice to link her employment to the US rather than Australia. Applying the principles from the *Valuair Limited* decision, the court also considered that there was no appropriate connection aligning the employment with Australia or sufficiently linking the employment relationship to Australia because:

a the US entity paid Ms Holmes in US currency (at her request) during the employment; and

b she recorded her employment address as an address in the US and elected to pay US, rather than Australian, taxes.

Notably, the court did not regard the country in which the work had been performed over the six months of her employment as critical. There was never any contractual stipulation as to where she was required to work.

Consequently, the employment relationship had no sufficient connection with Australia and the FW Act did not apply.

Further, given that the US entity was not a national system employer there could have been no transfer of employment under the FW Act when she ceased working for the Australian entity and started working for the US entity.

The takeaway

When transferring staff internationally, carefully consider which country the employment relationship will be connected to, the legislative employee entitlements that may apply under that country's labour legislation and whether those entitlements will be recognised under the intended assignment terms.

Ensure that the assignment terms and conditions are clearly documented in an assignment letter and that it appropriately references any underlying home country employment agreement which may remain on foot during the assignment.

Simply specifying a governing law for international assignees will not avoid the legislative employee entitlements of another country if:

a the reality is that the employment relationship is sufficiently connected with that other country; or

b there are public interest reasons for applying the laws of that country.

Australian employers should also be aware that the FW Act and Fair Work Regulations contain extraterritorial provisions that may apply to Australian employees who are sent by their Australian employers to work for them overseas.

[3] (No 2) [2015] FCCA 1093.

PricewaterhouseCoopers (Australia)

Globally mobile employees: whose labour laws apply?

PwC Legal China & NTPS

Foreign investment enjoys policy benefits in China with the expansion of “negative list” administration mechanism nationwide

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PwC Legal China & NTPS – Foreign investment enjoys policy benefits in China with the expansion of "negative list" administration mechanism nationwide

At a glance

The administration of national treatment plus Negative List mechanism for foreign-invested enterprises' (**FIEs**) access to China, which was previously adopted in the pilot free trade zones, has rolled out nationwide officially.

In this article, we will introduce the applicable scope, procedures and timelines and supervision requirements of the record-filing administration mechanism of FIE as well as share our observations on the trend of subsequent policies on foreign investment and takeaways for FIE's to do business in China.

In detail

Abstract

In order to implement the reform of the approval mechanism for foreign investment addressed in Communiqué of the Third Plenary Session of the 18th Central Committee of the CPC, the Standing Committee of National People's Congress (**NPC**) of China passed the *Decision of the Standing Committee of NPC Regarding the Amendment of Four Laws, including PRC Law on Wholly Foreign-owned Enterprises* (the **Decision**) in September 2016.

The Decision amended the relevant provisions regarding administrative approval matters in the prevailing three Foreign-invested Enterprises Laws and *the Investment Protection of Taiwanese Compatriots of PRC*, which has already come into effect since 1 October 2016.

The Decision specifies the establishment and alteration of FIE (including Hong Kong, Macau, Taiwan investment companies), if not related to items in the "special administrative measures regarding FIEs' permission to China" (the **Negative List**), will be subject to record-filing procedures instead of the existing approval measures (the **Record-filing administration mechanism of FIE**).

On 8 October 2016, the *Interim Provisional Measures for the Record-filing Administration on the Establishment and Alteration of FIE* (the **Provisional Measures**) was released by the Ministry of Commerce (**MOC**) and became effective. The Provisional Measures provide the applicable scope, record-filing procedures, supervision and inspection measures as well as legal liabilities in relation to the record filing administration mechanism of FIE.

On the same day, the head of the Department of Treaty and Law of the MOC gave an official interpretation on the Provisional Measures specifying the applicable scope (including the scope of Negative List), determining the ultimate controlling person of FIE, record-filing institutions, procedures and system as well as the interim and post-supervision in relation to the record-filing administration mechanism of FIE. Since then, the reform of the record-filing administration on the establishment and alternation of FIE has been finally launched.

The Decision and Provisional Measures implies that the administration of national treatment plus Negative List mechanism for FIEs' access to China, which was previously adopted in the pilot free trade zones, has rolled out nationwide officially.

In this article, we will introduce the applicable scope, procedures and timelines and supervision requirements of the record-filing administration mechanism of FIE as well as share our observations on the trend of subsequent policies on foreign investment and takeaways for FIE's to do business in China.

Development of FIE's investment administration in China

Foreign investors investing in the Mainland have always been regulated by a series of laws and regulations that are only applicable to foreign investors and their investment activities.

A foreign-invested enterprise, no matter it is actually controlled by domestic or foreign enterprises or natural persons and regardless of its investment scale and field, is generally required to obtain the pre-approval from the in-charge department of commerce for its establishment, equity transfer, capital increase or decrease as well as its termination and liquidation.

From October, 2013, the Central Government has successively piloted the administration of national treatment plus Negative List mechanism for the access of foreign investments in the four pilot free trade zones. Investment fields outside the Negative List have been administered under the record-filing administration mechanism based on the principle that the treatment of foreign investment shall be equivalent to domestic investment. After the three-year trial run, foreign investments have been greatly simplified and standardised by adopting the record-filing administration mechanism and the trial reform has obtained remarkable achievements.

Based on this, starting from 1 October 2016, the "Negative List" administration mechanism of FIE will be rolled out nationwide under the reform model of "generally-applicable record-filings and pre-approvals under the Negative List".

It is worth noting that, in January 2015, the Ministry of Commerce released the *Law of the People's Republic of China on Foreign Investment* (the **Foreign Investment Law (Exposure Draft)**) among which, the reform of the access of foreign investments was addressed. The Foreign Investment Law (Exposure Draft) put forward the "Negative List" administration mechanism and the interim and post-supervision on foreign investment, which echoes the reform measures adopted in the Decision and Provisional Measures.

It can be said that the record-filing administration mechanism of FIE pursued by the Decision is an attempt to reform based on the Foreign Investment Law (Exposure Draft). Given the complexity of the legislative procedures in China and controversial issues in the Foreign Investment Law (Exposure Draft), such as determination of the ultimate controlling person of the foreign investment, legality of VIE structure, etc., we believe the Foreign Investment Law (Exposure Draft) will unlikely be promulgated in the near future. Nevertheless, the implementation of the reform measures under the Foreign Investment Law (Exposure Draft) step by step appears to be the trend of the forthcoming reform of the administration mechanism of foreign investment.

Major contents of record-filing administration mechanism of FIE

The Decision specified explicitly that the approval administration mechanism on the relevant establishment and alternation matters under the three Foreign-invested Enterprise Laws and the *Investment Protection of Taiwanese Compatriots of PRC* would be replaced by the record-filing administration mechanism and the relevant provisions have been amended accordingly.

Based on the Decision, the Provisional Measures has set out specific regulations on the implementation measures for the record-filing administration mechanism of FIE and the details are as follows:

a Applicable scope of the record-filing administration mechanism of FIE

The establishment and alteration of FIE (including, Wholly Foreign-owned Enterprises, Sino-Foreign Equity Joint Ventures, Sino-Foreign Cooperative Joint Ventures and Foreign-invested Joint Stock Company), if not related to items on the Negative List, will be applicable to the Provisional Measures.

Investment Companies and Venture Capital Investment Enterprises invested by foreign investors shall be deemed as foreign investors and their investment in China which is outside the "Negative List" will be applicable to the Provisional Measures.

Investment by investors from Hong Kong, Macau and Taiwan which is outside the "Negative List" will be applicable to the Provisional Measures. However, if the investors from Hong Kong and Macau invest in the Mainland via *Closer Economic Partnership Arrangement* (**CEPA**), they shall follow the relevant regulations in the *Administrative Measures for the Record-filing of Investments by Hong Kong and Macau Service Providers in the Mainland (Trial Version/Implementation)*.

The Provisional Measures will be applicable to the establishment and alteration of FIE. The scope of alteration includes change of basic information of FIE and its investors, change of shares (stocks) and cooperative equity as well as merger, spin-off and termination, etc.

b Procedures and timeline of FIE's record-filing administration

As for the establishment of FIE, the record-filing formalities can be performed before the incorporation (which is prior to the receipt of Business License and after getting the pre-approval of the enterprise name) or within 30 days after issuance of the Business License. The record-filing is not a precondition for the business registration of the FIE.

As for the alteration of FIE, the record-filing formalities can be performed within 30 days after the relevant alteration matter occurs. The time of the occurrence of the alteration matter refers to the time when the highest authority of a FIE makes the resolution or decision on the alteration, unless there are laws and regulations which provide for the alteration matter of the FIE to take effect at another time.

FIE shall perform the record-filing formalities by filing and submitting the relevant record-filing forms online as well as uploading the required documents via the information system for comprehensive administration of foreign investment (the "record-filing system").

The record-filing institutions shall formally review the completeness and accuracy of the filed information and determine whether the matters declared are within the scope of record-filing or not. For those which are within the applicable scope, the record-filing institutions shall complete the record-filing within three working days and inform the FIE of the record-filing result online. FIE can choose whether or not to collect the receipt of the record-filing.

c Record-filing institutions

Record-filing institutions refer to the competent department of commerce under the State Council, the competent department of commerce of all the provinces, autonomous regions, municipalities directly under the Central Government, municipalities separately listed in the State Plan, Xinjiang Production and Construction Corps and sub-provincial cities as well as the relevant institutions of Pilot Free Trade Zones and National Economic and Technological Development Zones.

d The scope of Negative List

On the same day with the enforcement of Provisional Measures, the National Development and Reform Commission (**NDRC**) and the MOC jointly released the Public Notice [2016] No. 22, which clarifies that the scope of "special administrative measures regarding FIE's permission to China" shall refer to the items of "Restricted Investment", "Prohibited Investment" and the "Encouraged Investment" as prescribed in Industry Catalogue Guide for Foreign Investment (2015 Revised Version) (**2015 Catalogue**).

Establishment and alteration matters of FIE that are related to merger and acquisition (**M&A**) are subject to currently in-force regulations. Based on the Public Notice [2016] No. 22, the MOC has further clarified in the interpretation of Provisional Measures that the existing approval measures shall still be implemented in relation to shareholding and senior executive requirements under "Restriction Investments" and the "Encouraged Investments" items regardless of payment amount or investment mode. M&A of a domestic non-FIE by a foreign investor shall refer to Regulations on the Merger and Acquisition of Domestic Enterprises by Foreign Investors (MOC Order [2009] No. 6).

Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors is applicable to the cases related to listed companies.

The record-filing administration mechanism shall be implemented on the investment in other fields or other investment modes taken by foreign investors. Stricter supervision to be imposed on foreign investment after implementation of the record-filing administration mechanism

After implementation of the record-filing administration mechanism, administration and supervision of foreign investment will be mainly at the post-setup stage. Chapter Three and Chapter Four of the Provisional Measures have set out the specific requirements for supervision and administration respectively as well as the legal liabilities of FIE for violation of the Provisional Measures.

It is worth noting that the record-filing institution will collaborate with the relevant administrative departments of public security, state-owned assets, customs, taxation, industry and commerce, securities, foreign exchange, etc. to strengthen the information sharing by means of regular random inspection, inspection upon informer reporting and so on in order to carry out the post-setup administration and supervision of foreign investment.

Meanwhile, the MOC will also set up a credit file system for foreign investment (**CFS**) to record and track the credit information of FIE and their investors as well as share the information with the relevant administrative departments.

Takeaway

Applying the "Negative List" administration mechanism to foreign investment will simplify the administrative procedures of the establishment and alteration of FIE and eventually improve the efficiency.

This transformation will certainly set a higher requirement for the compliance level of FIE from the regulatory perspective as their performance of the record-filings will be put into the credit files.

Therefore, FIE's should fully comply with the record-filing requirements to avoid being named in the public announcement of the CFS for non-compliance activities upon inspection by the record-filing institution and the other relevant departments which would affect their credit rating. They would also be subject to administrative penalties as well as a potential negative impact on their operations in China. Even worse, their foreign investors may be required to dispose of their shares in the FIE within a certain prescribed period.

The administration on FIE was adjusted from pre-inspection to interim and post-supervision along with the administration on comprehensive information and credit record. It brings a more stringent compliant requirement for FIEs.

Despite that the Provisional Measures has already come into effect, how it will connect with other prevailing FIE regulations (e.g. M&A regulations, reinvestment regulations, etc.) would need to be further explored and improved by FIEs through live experience. It is highly suggested that FIE should actively communicate with the in-charge authorities and seek advice from legal or regulatory consultants if they are considering new investment or altering their existing business in China during the transitional period.

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