

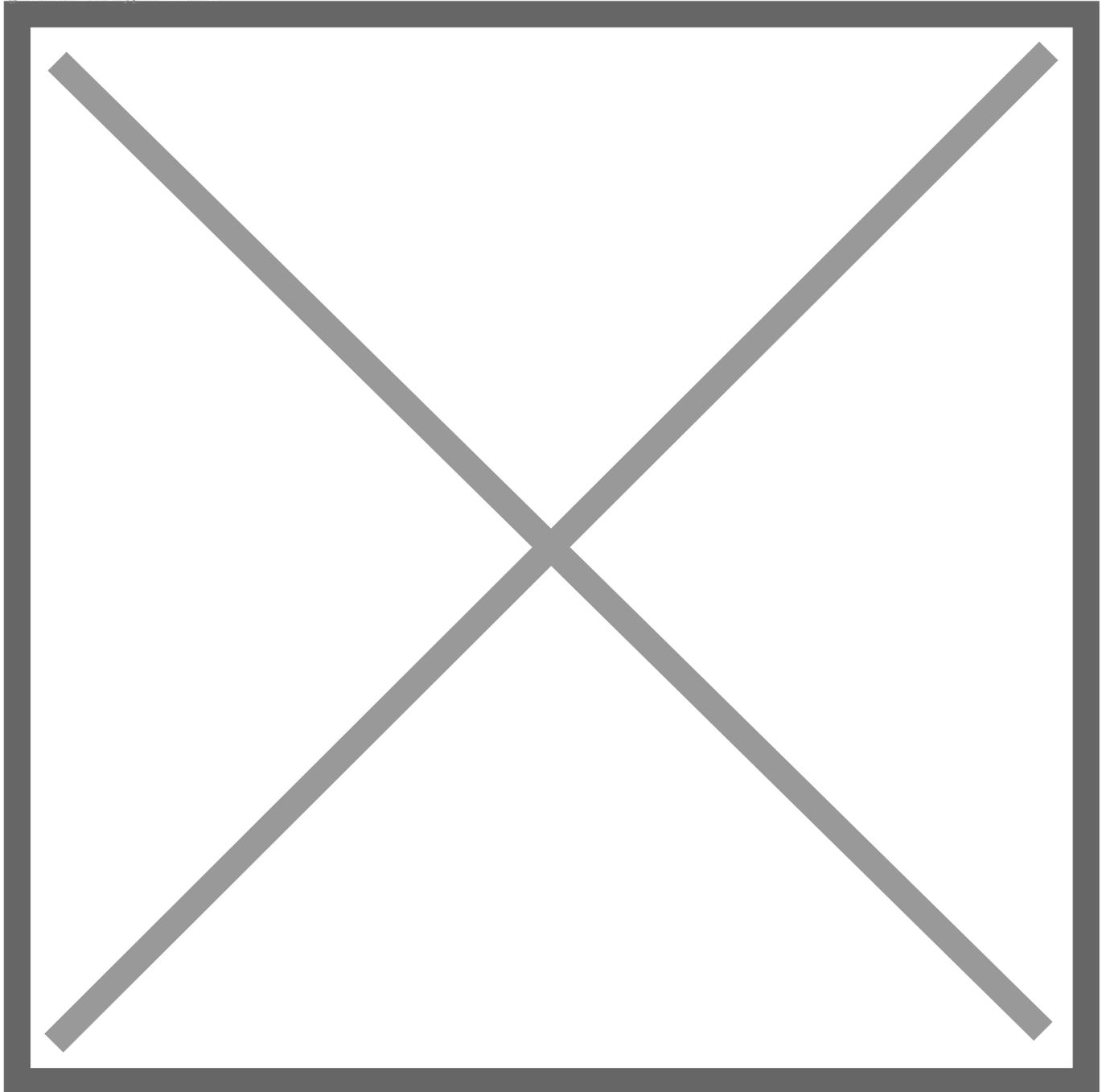
# The Foreign Investment Law | March 2019

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On 15th March, the National People's Congress passed the Chinese Foreign Investment Law. The law will come into effect on 1st January 2020.

Below is a brief introduction of the Law for an easier understanding for EU SMEs.

## **I. Contents**

The new Foreign Investment Law includes 6 chapters, general provisions, investment promotion, investment protection, investment management, legal liability and supplementary provisions, for a total of 42 clauses.

The law reiterates the principle of adopting the management system of “pre-establishment national treatment and negative list” for foreign investment first formed and piloted in Shanghai FTZ since 2015.

Many general provisions were set out in regards of the Investment Promotion. Under this chapter, China will equally apply the State’s various policies in support of enterprise development to both domestically invested enterprises and foreign-invested enterprises (the “FIEs”). Moreover, it will establish a sound foreign investment service system; allow fair competition for foreign-invested enterprises in the Chinese market; specifically equal participation in the setting of standardization government procurement, and financing by means of the public offering of shares; corporate bonds or other securities; allow local governments to develop foreign investment promotion and facilitation policies and measures within their authority.

In regards of the Investment Protection, the following aspects are covered: the general principle of non-expropriation; the free remittance of legitimate funds in and out of China; the implementation of intellectual property rights (“IPR”) protection with non-mandatory requirements for foreign investors on technology transfer; confidentiality obligations from administrative authorities; compliance with national laws and regulations in local legislation activities; changing in the result of policy commitments made and in various contracts signed by local governmental authorities to foreign investors; establishment of a complaint mechanism.

Besides the mention on the negative list for foreign investment access, the chapter regarding the Investment Administration provides the applicable laws related to the organization form and structure; the review of business operator concentration, the foreign investment information reporting system, and the review of the national security review.

## **II. Issues to be noted**

The issuance and implementation of the Foreign Investment Law mark the establishment of a new framework of foreign investment administration system in China. The first draft of the law was released for comments in early 2015, and the Chinese central government has worked on it for several years. After the first review made in December 2018, the legislation authority speeded up the reviewing process that took less than 3 months. The final version is quite general, though it covers many important issues of interest for foreign investors such as IPR protection, free remittance of funds, government procurement, standardization, financing, expropriation and requisition, commitment by local governmental authorities etc. It has been said that this law was approved in this session of the National People’s Congress as an olive branch to the US in the trade. Being true or not, there are many issues about the provisions of the Foreign Investment Law pending further clarification for its future implementation. Below we list a few which should be paid attention to by

EU SME investors.

## 1. Investor identity

The Chinese Constitution states that foreign enterprises, other foreign economic organizations and individual foreigners, are allowed to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and other economic organizations in accordance with China laws.

In reality, some Chinese individuals are allowed to be shareholders of newly established FIEs in some areas, which is a breakthrough to the above provision of the Chinese Constitution. The Foreign Investment Law does not give clear provision if this practice is legally allowed as a general principle; therefore, there is still something that needs to be clarified.

According to the Foreign Investment Law, foreign investors refer to foreign natural persons, enterprises or other organizations. It is not clear if foreign non-economic organizations as part of foreign organizations can be considered as foreign investors.

## 2. Foreign investment

In regards of the foreign investment, there are still some questions that need to be answered for a better implementation of the law. To name a few: how to understand indirect investment provided in the law? Will the negative list apply to investment indirectly made by any foreign investors, or will it apply only to indirect investment controlled by foreign investors? What will be the criteria considered as being the controlling one? What does "investment in newly built projects" as a mode of foreign investment in the law refer to? How will the foreign investment administration system like information reporting and national security review apply to this mode of foreign investment?

## 3. Mandatory application of governing law

According to the Chinese Contract Law, Chinese laws should be the ones to be applied to joint venture contracts. This provision was first provided in the implementation regulations of the laws governing Sino-foreign joint ventures, and it was then accepted by the Chinese Contract Law. Since contractual provisions may be interpreted differently under different legal system and thus affect the parties' rights and obligation, foreign investors, including EU SME investors, are advised to pay attention to whether the mandatory application of Chinese law as governing law may be changed in the future.

## 4. Organization form and structure of FIEs

With the implementation of the Foreign Investment Law, the laws on wholly foreign owned enterprises, equity joint ventures, and cooperative joint ventures will be abolished, and the Chinese Company Law and the Chinese Partnership Enterprises Law will apply uniformly to both FIEs and domestically invested enterprises, in terms of organization form, structure and operating rules.

Difference exists between the Chinese Company Law and the original three laws in the aspects of highest authority organ in the enterprise, decision making mechanism, profit distribution, distribution of residual property, and equity transfer etc. Before the end of the 5-year transitional

period, the already existing Sino-foreign joint ventures will need to revise their joint venture contracts and articles of association to comply with the Chinese Company Law. Some may trigger the negotiation between shareholders on corporate governance to reflect their current interest allocation under the Foreign Investment Law.

It is still not clear whether is possible for foreign investors who will set up FIEs with legal personality before 1st January 2020 to draft the contracts/agreements and articles of associations in accordance with the Chinese Company Law instead of the still effective laws on wholly foreign owned enterprises and joint ventures. In this way, the foreign investors may avoid the problem/complication of revising the chartered documents later when the Foreign Investment Law comes into effect, but the confirmation of relevant authority is needed for this.

#### 5. Effectiveness of affiliated regulations

Besides the current three laws on FIEs, there are many affiliated rules and regulations issued by various governmental authorities which are still effective. Which regulations will remain effective and which will be abolished or changed? The governmental authorities need to make clear decisions on that, and the outcome will surely affect FIEs.

#### 6. Investment from Hong Kong, Macau and Taiwan

This issue is not mentioned in the Foreign Investment Law. After the closure of the session, the Prime Minister Li Keqiang expressed publicly that administration on investment from Hong Kong, Macau, and Taiwan can refer to administration on foreign investment as provided in this law. Still, specific written provisions are required to justify this decision from legal perspective.

#### 7. VIE structure

Compared to the draft that was issued in 2015 and that was available for public inspection and comments, the approved final version of the Foreign Investment Law has removed/deleted all clauses about actual controllers and VIE (Variable Interest Entity) structure. It means the legality of the VIE structure and its supervision issue remain in the grey area. But the fallback provision about foreign investment i.e. "the foreign investment in other way stipulated under laws, administrative regulations or provisions of the State Council" gives the space for the governmental authorities to decide how to deal with this issue in the future.

#### 8. National Security Review

National security review is officially provided in the Foreign Investment Law to apply to foreign investment across the country, both green land investment and investment through M&A. No detailed provisions are made about the scope of review, the competent authority, documents required, timeline and procedure, factors affecting the review result, and violation consequence etc. Foreign investors including EU SME investors should keep a close eye on this as, according to the Foreign Investment Law, the review result is final and binding, which means that no administrative reconsideration or litigation is allowed.

As a basic law governing foreign investment in China, the general provisions above leave uncertainties as well as space for lobbying before detailed affiliated rules are finalized and issued. The EU SME Centre will keep a close eye on it and we will update EU SMEs in the future of any development.

In the end, we would like to remind EU SME investors that the principle of reciprocity is provided in the “Supplementary Provisions” in the current Law, which gives Chinese government flexible space in the future implementation. Foreign investors’ interest may be affected if their home country takes any measures towards Chinese investors which is seen as discriminatory from the Chinese government.

EU SMEs can find the Foreign Investment Law at

[http://www.chinalaw.gov.cn/Department/content/2019-03/18/592\\_230773.html](http://www.chinalaw.gov.cn/Department/content/2019-03/18/592_230773.html).