

**ABSTRACT**

On March 15th, 2019, the Foreign Investment Law of PRC (the “Foreign Investment Law”) was ratified by the National People’s Congress (“NPC”) and will come into force on January 1st, 2020. The Foreign Investment Law will replace the Law of PRC on Sino-Foreign Equity Joint Ventures, the Law of PRC on Wholly Foreign-Owned Enterprises and the Law of PRC on Sino-Foreign Cooperative Joint Ventures, and become the fundamental law to regulate foreign investment in China. It will have an important impact on the practices of existing foreign-invested enterprises and the future foreign investment in China. This Newsletter analyses the main aspects of the Foreign Investment Law from the legal and practical perspectives.

***March 15th, 2019
ratification of a new
basic law to
regulate foreign
investment
in China***



FOREIGN INVESTMENT LAW – NEW BASIC LAW TO REGULATE FOREIGN INVESTMENT IN CHINA

After four years' preparation, public consultation and expert deliberation, on March 15th, 2019, the Foreign Investment Law of PRC (the "Foreign Investment Law") has been finally ratified by the National People's Congress ("NPC") and will come into force on January 1st, 2020.

The Foreign Investment Law will replace the existing laws regulating foreign investment in China and become the new legal foundation in this regard. We analyze and summarize the Foreign Investment Law on the following aspects:

I - Scope of Application of Foreign investment Law

The Foreign Investment Law defines "foreign investment" as "*investment activity directly or indirectly conducted by foreign natural persons, enterprises or other organizations in the territory of China*", and classifies it into 4 categories of investment:

1. *"a foreign investor establishes a foreign-funded enterprise within the territory of China, independently or jointly with any other investor;*
2. *a foreign investor acquires shares, equities, property shares or any other similar rights and interests of an enterprise within the territory of China;*
3. *a foreign investor makes investment to initiate a new project within the territory of China, independently or jointly with any other investor; and*
4. *a foreign investor makes investment in any other way stipulated by laws, administrative regulations or provisions of the State Council."*

This definition does not contain the way of foreign investment of actually controlling or holding rights and interests of a domestic enterprise by contracts or trusts, i.e. the famous VIE structure (which has been used by plenty of huge transactions and giant enterprises like Alibaba, JD, Tencent etc.) and the concept of "actual control" in the 2015 Draft appears no more in this definition. That is to say, VIE structure is not put under the range of regulation of the Foreign Investment Law, especially the regulation of Negative List (please refer to Section II herein); and the feasibility of VIE structure is not expressly prohibited or restricted by the Foreign Investment Law.

Notwithstanding, due to the fallback provision, the (4) category of investment in the definition, it remains to be seen whether any administrative regulations or provisions will be legislated for the administration upon foreign investment by VIE structure. This definition also excludes investment from Hong Kong, Macau and Taiwan. Whether the Foreign Investment Law will apply to investment from Hong Kong, Macau and Taiwan *mutatis mutandis* still is an open question.

Meanwhile, the Foreign Investment Law defines enterprises that are incorporated under the Chinese laws within the territory of China and are wholly or partly invested by foreign investors as "foreign-funded enterprises". The original classified names of "wholly foreign-owned enterprises", "Sino-foreign equity joint venture" and "Sino-foreign cooperative joint venture" will be abandoned.

II – Negative List and Administrative Formalities

Practically and procedurally, to implant an investment in China, the most important aspects foreign investors need to know are the Negative List and administrative formalities.

1. Negative List

The Foreign Investment Law clearly stipulates that the State will implement the administration system of negative list and pre-establishment national treatment for foreign investment. "Negative List" refers to special administrative measures for the access of foreign investment in specific fields as stipulated by the State. "Pre-establishment national treatment" refers to the treatment given to foreign investors and their investments during the investment access stage, which is not lower than that given to their domestic counterparts.

The "Negative List" mainly refers to the following 2 lists:

- Special Administrative Measures (Negative List) for the Access of Foreign Investment (2018 version) ("Negative List for Foreign Investment") which became effective on July 28th, 2018, applies for all the foreign investment activities out of the pilot free trade zones; and
- Special Administrative Measures (Negative List) for the Access of Foreign Investment in Pilot Free Trade-Zones (2018 version) ("Negative List for Foreign Investment in FTZ") which became effective on July 30th, 2018, applies for all the foreign investment activities in the pilot free trade zones.



Foreign investors shall not invest in any field forbidden by the Negative List, shall conform to the investment conditions stipulated under the Negative List for any field restricted by the Negative List, and the fields not included in the Negative List shall be administrated under the principle that domestic investment and foreign investment shall be treated uniformly.

The Negative List for Foreign Investment (2018 version) contains 48 forbidden or restrictive measures covering 34 industries. The Negative List for Foreign Investment in FTZ (2018 version) contains 45 forbidden or restrictive measures covering 32 industries. At present the 2019 version of Negative Lists are in process of formulation and are expected to contain less forbidden or restrictive measures and cover fewer industries.

2. Administrative Formalities

The Foreign Investment Law stipulates and streamlines the following administrative formalities that foreign investors shall follow depending on the nature of the investment:

- **Fixed assets investment project verification and record-filing** with development and reform department (conventionally called “NDRC”) according to the Catalog of Investment Projects Subject to Government Verification (2016 version), in case fixed assets investment, such as construction of factories, is involved;
- **Licensing as industrial market access** by competent authorities according mainly to the Market Access Negative List (2018 version) which applies to both foreign-funded enterprises and Chinese domestic enterprises, in case special operational license is needed for the industry concerned;
- **Enterprises registration** with market supervision and administration department (conventionally called “AIC”), applying to all kinds of investments with legal vehicle;
- **Examination for concentration of undertakings** by the Ministry of Commerce according to the Anti-Monopoly Law of PRC for foreign investors acquiring Chinese domestic companies, in case the thresholds prescribed by law are reached;
- **National security review** on foreign investment, in case the investment may affect or have the possibility to affect the national security; and
- **Foreign Investment information reporting** to the commercial department through the enterprises

registration system and the enterprises credit information publicity system, applying to all kinds of investments.

It is worth noting that the Foreign Investment Law does not mention the formality of approval and record-filing with commercial department for establishment and modification of foreign-funded enterprises, which is stipulated in the Interim Measures for the Recordation Administration of Incorporation and Modification of Foreign-Funded Enterprises (2018 Amendment). Whether this formality is revoked or not needs further observation on promulgation, amendment or revocation of those associated regulations.

III - Multiple Measures to Promote Foreign Investment

“Equality” is a keyword of the Foreign Investment Law and is the highlighted policy to promote foreign investment. Specifically, the Foreign Investment Law provides in particular the following promotion measures for foreign investment:

1. Equal application of supporting policies

National policies on supporting the development of enterprises shall equally apply to foreign-funded enterprises.

2. Equal participation in standards formulation

The State guarantees that foreign-funded enterprises can equally participate in the formulation of various standards. This provision confirms the right of foreign-funded enterprises to participate in the standards formulation that has been provided in the Guiding Opinions on Foreign-funded Enterprises Participating in the Standardization Work of China promulgated on November 6th, 2017, which stipulated that foreign-funded enterprises may participate in the drafting and translation of national standards, and may bring forward opinions and advices in process of initiation of standardization, seeking for comments and implementation of standards.

3. Equal participation in government procurement

The State guarantees that foreign-funded enterprises can participate in government procurement activities through fair competition. Products produced by foreign-funded enterprises within the territory of China shall be treated equally in government procurement. Unfavorable treatment of foreign-funded enterprises in the context of government procurement has always been criticized by the EU and the USA in the past. Whether and how this new legislation may bring new chances to foreign-funded enterprises is still to be observed.



4. Right to issuing securities

The Foreign Investment Law reconfirms the right of foreign-funded enterprises to conduct financing by public offering of shares, corporate bonds and other securities or by other means.

Despite of this provision, the Company Law of PRC requires a company limited by shares to have half or more of its initiators having domiciles within the territory of China. This clause of Company Law of PRC impedes foreign-funded enterprises, especially wholly foreign-owned enterprises, from establishing companies limited by shares, and thus impedes them from financing by issuing securities. Attention should be paid to the promulgation and amendment of supporting regulations and rules on this aspect.

5. Local preferential policies for foreign investment

The Foreign Investment Law reiterates that local governments at county level or above may formulate local policies to promote and facilitate foreign investment within their respective statutory authorities.

Nonetheless, such local policies must accord with the statutory authorities of the local governments; otherwise the rights and interests obtained by the foreign investors or foreign-funded enterprises from local policies made by local government beyond its authority may lose legal protection (please refer to Section IV.4 hereof).

6. Company framework subject to the Company Law and the Partnership Enterprise Law

The organization form and institutional framework of foreign-funded enterprises shall be subject to the Company Law of PRC and the Partnership Enterprise Law of PRC.

The Foreign Investment Law eliminates the discrepancies in terms of company framework between the Company Law of PRC and the Law of PRC on Sino-Foreign Equity Joint Ventures, the Law of PRC on Wholly Foreign-Owned Enterprises and the Law of PRC on Sino-Foreign Cooperative Joint Ventures, as well as the consequential uncertainties in the implementation of the foregoing laws.

III - Multiple Measures to Protect Foreign Investment

The Foreign Investment Law stipulates emphatically multiple measures to protect foreign investment, which include in particular the following:

1. No expropriation unless special circumstances

The State is not to expropriate any investment made by foreign investors. Under special circumstances, the State may expropriate or requisition the investment made by foreign investors for public interests pursuant to statutory procedures and with fair and reasonable compensation given in a timely manner.

2. Free transfer of fund inward and outward

The foreign investors are entitled to freely transfer inward and outward its contributions, profits, capital gains, income from assets disposal, royalties or intellectual property rights, lawfully acquired compensation or indemnity, income from liquidation and so on in RMB or in foreign currency.

Comparing with the current policies of foreign exchange, the Foreign Investment Law underlines the free transfer of fund "inward", not only "outward"; as well as the free transfer of contributions, not only foreign exchange of current account. Therefore, related foreign exchange regulations and rules are expected to be issued in the near future in order to realize the free transfer as provided in the Foreign Investment Law.

3. No forcible transfer of technology

The Foreign Investment Law requires protection of the intellectual property rights of foreign investors and foreign-funded enterprises, and expressly forbids administrative organ or its staff member from forcing any transfer of technology by administrative means in the process of foreign investment.

Currently whether the technology of foreign investors could be contributed in the form of licensing or has to be contributed in the form of transfer is a prevalent question to consult with the foreign investment approval or filing authorities and enterprises registration authorities. The answers of this question from the authorities usually differ from place to place. It seems likely that foreign investment in technology by the means of licensing may become generally acceptable to the authorities in the future.

4. Local governments shall keep promises

The Foreign Investment Law requests local governments to keep their policy commitments made to the foreign investors and foreign-funded enterprises according to the law and perform all contracts entered into with the foreign investors and foreign-funded enterprises according to the law. If any policy commitment or contract needs to be changed due to national interests or public interests, the statutory authority and procedures shall be strictly followed, and the foreign investors or foreign-funded enterprises concerned shall be compensated for losses incurred thereby. Notwithstanding this provision, it is worth mentioning that only those policy commitments and contracts "in accordance with the law" are compensable; those policy commitments made by and contracts entered into with local governments beyond their statutory authority are not protected by this provision and thus are not compensable.

NEWSLETTER

THE FOREIGN INVESTMENT LAW OF PRC

Comments

The Foreign Investment Law is the basic and significant law for foreign investment in China. It focuses on “national treatment” and “equality” granted to the foreign investors and foreign-funded enterprises, and gives expression to the purpose of promotion of foreign investment and the prospect of creating more open, free and convenient investment environment. Following the promulgation of the Foreign Investment Law, it could be expected that a lot of related supporting laws, regulations and rules in various fields will be newly issued or amended so as to clarify the specific policies in detail and in practice, on which our eyes should be kept constantly.

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