

China Adopts New Foreign Investment Law

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The National People's Congress of China adopted the new Foreign Investment Law on March 15, 2019, with a view toward unifying and streamlining the foreign investment framework into China. The Foreign Investment Laws will go into effect on January 1, 2020.

Overview of the Foreign Investment Law

The Foreign Investment Law has been widely promoted as a framework that will emphasize equal national treatment of foreign investment, putting foreign investors on equal footing with domestic investors in the Chinese market and giving them equal protections.

From a high-level perspective, the Foreign Investment Law embodies China's resolve to continue to modernize its laws to reflect the changing global economy. At the same time, the Foreign Investment Law, as currently passed, is more high-level than the draft Foreign Investment Law proposed in 2015, which contained more specific provisions but still left questions regarding its viability in implementation.

As the State Council continues to promulgate further rules to implement the broad guidance under the Foreign Investment Law, the specific implementation rules will demonstrate China's determination to provide an ever-more open and transparent environment for foreign investment. In particular, the highlights of the Foreign Investment Law are as follows

Definition of foreign investment. The Foreign Investment Law will replace the PRC Law on Sino-foreign Equity Joint Ventures, the PRC Law on Wholly Foreign-owned Enterprise and the PRC Law on Sino-foreign Cooperative Joint Ventures. Article 2 of the Foreign Investment Law defines the types of foreign investment into China that will be regulated by the Foreign Investment Law.

Specifically, the covered foreign investment activities will include:

- establishment of a foreign invested enterprise (FIE) in China, independently or jointly with any other investor
- acquisition of shares, equities, property or any other similar rights and interests of an enterprise in China
- investment in a new project in China, independently or jointly with any other investor
- investment in any other way as may be stipulated by laws, administrative regulations or provisions of the State Council

Establishment of "pre-establishment national treatment and negative list" management system. The Foreign Investment Law establishes a nationwide "pre-establishment national treatment and negative list" management system. The system is intended to create an environment where all foreign investment will be treated the same as domestic investments, other than foreign investments

into industries that are listed in the “Market Access by Foreign Investors special Administrative Measures (Negative List).”

The Negative List 2018 is a list of industries into which foreign investment is either prohibited or restricted, and contains restrictions or prohibitions on foreign investment in 34 sectors. The Negative List had already been published and in use nationwide since mid-2018, and is not a new concept proposed under the Foreign Investment Law. Aside from steering clear of industries on the Negative List, foreign investors will also need to ensure that their investments do not trigger concerns under the National Security Review laws which have already been in effect for almost eight years.

Registration rather than approvals. At the same time, the Foreign Investment Law also formally does away with the prior systems that required approval by the Ministry of Commerce and registration with the Administration of Industry and Commerce before a foreign investment would be permitted into China.

Other than for investments under the restricted industries in the Negative List, foreign investors are now only required to register their investments with the relevant agencies. This simplified system of foreign investment registration rather than approval has evolved over the past couple of years, and therefore is not a new proposal under the Foreign Investment Law. Foreign investors will also be required to disclose certain of their information on a periodic basis to the Ministry of Commerce and State Administration of Market Regulation.

Corporate governance to follow PRC Company Law. Because the Foreign Investment Law is intended to unify the approach for all types of foreign investment into China, all foreign invested enterprises will be required to follow the corporate governance rules under the PRC Company Law once the Foreign Investment Law comes into effect. However, for foreign invested enterprises formed prior to the adoption of the Foreign Investment Law, the Foreign Investment Law allows for a five-year transition period to bring the corporate governance of such foreign invested enterprises in line with the PRC Company Law.

Principles to encourage foreign investment in China. The Foreign Investment Law also contains principles designed to encourage foreign investors into China. Foreign investors will now have equal access to national policies supporting the development of certain industries, be allowed to comment during the legislative process, participate in standards-making and participate in government procurement processes.

Measures to protect lawful rights of the foreign investors and FIEs. The Foreign Investment Law now includes specific provisions designed to address certain issues that foreign investors may previously have had regarding investment into China. In particular, the Foreign Investment Law provides specific protections such as:

- no expropriation of foreign-owned assets other than in special circumstances
- free transfer of renminbi or foreign currency into and out of China, for returns of capital, profits, capital gains, royalty payments, and other lawfully obtained compensation
- requirements that the local governments honor contractual and other commitments lawfully made
- lawful protection of foreign investors’ intellectual property rights in China

Challenges to Foreign Investment Legal Practice

While the broad provisions of the Foreign Investment Law do create a general framework that will place foreign investors and foreign invested enterprises on equal footing with domestic investors and domestic companies, there is legal territory that remains to be clarified under the Foreign Investment Law.

Definition of Foreign Investment. As noted earlier, the fourth type of “foreign investment” is a catch-all covering any other type of investment into China. It is generally believed that this catch-all is intended to leave room for the implementing rules to address the controls that may be placed over the *variable interest entity* (VIE) investments made by foreign investors in restricted industries over past

decades. It remains to be seen how far the Foreign Investment Law and its implementing rules will go toward regulating such VIE investments.

Information Reporting Obligations. The registration system for forming foreign invested enterprises has been evolving over the past several years, and under Article 34 of the Foreign Investment Law, China will establish a foreign investment information reporting system. But because Article 34 or the other provisions of the Foreign Investment Law do not provide any guidance as to the information that will be required under a foreign investment information reporting system, it is not yet clear how the registration process and the reporting system will intersect.

The Foreign Investment Law only provides that foreign investors and foreign invested enterprises will be required to report their investment information through the enterprise registration system established by the Ministry of Commerce and the enterprise credit information publicity system established by the State Administration of Market Regulation. It is unclear how the foreign investment information reporting system differs from or connects with existing systems.

Modification of corporate governance structures for existing foreign invested enterprises. The requirement for existing foreign invested enterprises to modify their corporate governance structures to come into line with the PRC Company Law will be the trickiest aspect of the Foreign Investment Law to implement.

Most Sino-foreign equity joint ventures or contractual joint ventures were established under the PRC Law on Sino-foreign Equity Joint Ventures or the PRC Law on Sino-foreign Cooperative Joint Ventures (the “Chinese Joint Venture Laws,” which provide a specific corporate governance framework between a foreign investor and a Chinese party).

For example, under the Chinese Joint Venture Laws, the board of directors is the highest decision-making authority, not the shareholders. Certain issues were subject to unanimous approval of the board so that the minority shareholder would always be protected, and additional unanimous approval rights were always subject to heavy negotiations between the parties. However, as these foreign invested enterprises move towards a corporate governance structure under the PRC Company Law, the shareholders are the highest decision-making authority, and the law only provides that certain matters would be subject to two-thirds approval of the shareholders.

This mismatch between the original terms of a joint venture formed prior to the Foreign Investment Law and the corporate governance provisions under the PRC Company Law will need to be reconciled, and will surely become the subject of much negotiation between the foreign parties and their Chinese counterparts over the next five years.

Protections of foreign investors in China. There has been much emphasis placed on the provisions protecting the intellectual property rights of foreign investors under the Foreign Investment Law. The Foreign Investment Law now provides that a foreign investor’s intellectual property must be protected and government agencies cannot “force” a foreign investor to commit to a technology transfer into China. However, the actual force of these provisions will need to be tested in court and in commercial negotiations between foreign investors and Chinese parties in the coming years.

Conclusion

Overall, the Foreign Investment Law as passed is much broader and more general than the 2015 draft, and therefore creates less cause for concern than the more detailed provisions of the 2015 draft.

A number of issues remain to be addressed as the implementing rules are published following the Foreign Investment Law. This process will give the relevant agencies the time to consider and propose appropriate measures to implement the policy behind the Foreign Investment Law, empowering China to continue to foster and develop the more open and transparent foreign investment environment it intends.

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