

The new Chinese Foreign Investment Law

Introduction

The National People's Congress of PRC promulgated the new *Foreign Investment Law* (FIL) on 15.03.2019. The FIL will come into effect on 01.01.2020 and will replace three of the special laws currently applicable to foreign investment.

The new law had been eagerly awaited. The background is the simmering dispute between China and its international partners over the mutual granting of market access (reciprocity). In 2015, China had already submitted a detailed draft for the foreign investment law. By comparison, the new version of the law is now much slimmer.

Legal basis	Wholly Foreign Owned Enterprise	Equity Joint Venture	Contractual Joint Venture
Until now	Law on Wholly Foreign-Owned Enterprises, Company Law	Sino-Foreign Equity-JV Law, Company Law	Sino-Foreign Cooperative JV Law
In future	Company Law or Partnership Enterprise Law, depending on legal form		

The law hardly specifies concrete legal consequences. Key topics discussed around the draft in 2015 remain open. In particular, it remains unclear whether the current rules for M&A and re-investment remain valid after the FIL taking effect. For this reason, foreign companies should wait and see how the law will be specified by further implementation regulations, and also consider the five-year deadline of the transitional period. 'What To Dos' are already foreseeable and what issues you should pay attention to as a company operating in China, we have summarized for you below:

Essential contents of the FIL and conclusions

1. Needs for adjustment, especially for equity joint ventures

In the future, the organizational structure and internal rules for all foreign-invested companies will be governed exclusively by the company law, which also applies to Chinese companies. This means that all companies whose organizational structure does not comply with the requirements of the company law must amend their internal documents, such as the Articles of Association of the company.

WFOEs founded in recent years are usually already organized in accordance with the company law and are unlikely to be affected. Older WFOEs, whose organizational structure is still based on old, already surpassed regulations, will be required by the FIL to reorganize their structures.

Significantly affected are Equity Joint Ventures. The key differences are as follows:

	Company Law	Sino-Foreign Equity-JV Law
Highest Organ	Shareholders' meeting	Board of Directors (Number of members and powers to be determined by the parties)
Minimum quorum at meeting of the highest organ	Two thirds of the votes	At least two-thirds of the directors
Votes on special matters	Two-thirds majority on special matters	Unanimity on special matters
Share Transfer	Approval of half of the other shareholders or deviating rules in Articles of Association	Unanimous approval of the other shareholders

Companies that are currently negotiating a joint venture with a Chinese partner should develop a strategy to handle the changes of the law. Since the FIL will not enter into force until 2020, all joint ventures to be established in 2019 must still comply with the joint venture law. However, the parties may already agree on a timetable as to when the transition should take place within the transitional period until 2024 and how this should be done.

2. Negative list for foreign investment remains

The FIL confirms that the existing negative list system stays. The admissibility of each foreign investment project therefore should be checked firstly against the negative list (national list or specific list in free trade zones depending on the location).

Systematics of the negative list for foreign investments				
legal framework	National Negative List 2018 and Negative List for Free Trade Zones		Investment Steering Catalog 2017	Art. VI of the Clarification of the Negative List 2018
Category	Forbidden	Restricted	Encouraged	Permitted

Areas of Industry (Examples)	-Agriculture -Fishery -Mining -Postal industry -Internet news	-Printing -Water Transport -General Aviation Services -Telecommunication	-High-tech manufacturing -High-tech development	All areas not listed in the Negative List
consequences	Foreign investment not possible	Foreign investment possible, but are restricted and need to be approved	Foreign investments are welcome. Thus, special treatment may be granted	Foreign investments are possible under the same conditions as for Chinese companies No need for approval

In addition, for all investments - both Chinese and foreign - the "Negative List for Market Access" applies from the end of 2018. This list includes, by industry, business operation guidelines. These include, for example, special approvals and licenses, e.g. for the production and distribution of certain products or content requirements, such as minimum capital requirements for investments in specific areas.

3. Stricter control of foreign companies?

Over the next few months and years, one issue to be observed closely is whether the FIL and its implementation regulations to be issued will bring stricter control over foreign-invested companies in China.

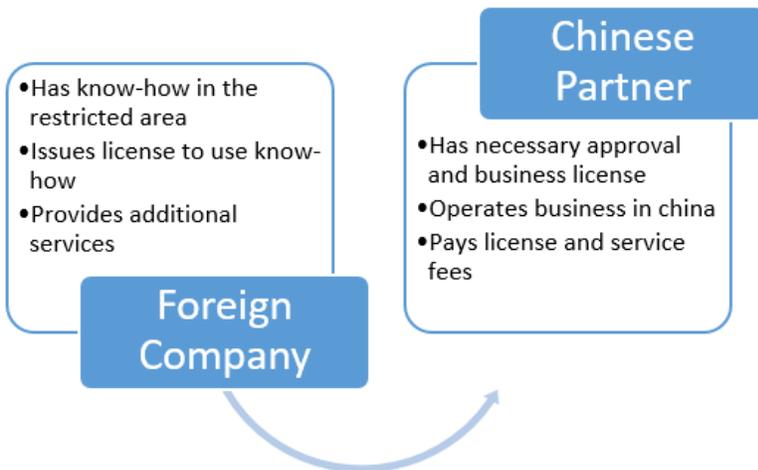
In general, a trend has emerged that China is creating great possibilities for capturing more data on business activities, e.g. by digitizing registration process and sharing information within the enterprise credit system (similar to the Social Credit System for individuals, you can review the current status of your business at <https://www.creditchina.gov.cn/>).

Correspondingly, the FIL introduces a foreign investment reporting system without giving any details, referring to the information collected during the enterprise registration process and/or contained in the enterprise credit system. It remains to be unclear that whether this covers only information that is already being collected, or whether other new mechanisms will be created.

Another unclear issue is the "security checks for foreign investment related to the national security", the so-called National Security Review. A whole chapter was devoted to this topic in the 2015 draft, while there are exactly two sentences in the final FIL. Thus, the implementing regulations are to be wait and see, in particular how this Review works with the existing regulations on security checks for M&A.

4. Risk for licensing models which circumvent market access restrictions?

Another area that foreign investors may be of interests is the so-called "Variable Interest Entity" (VIE). These are used to gain market access in areas that are not actually accessible to foreign investment (see the negative list for foreign investment above).



Also the "indirect investment" by foreign companies and "investment by foreign companies in other forms" are covered in the FIL - without specifying in detail.

It is therefore quite possible that Chinese authorities could use the FIL against models designed to circumvent the restrictions on access to the negative list, or at least check whether the foreign company obtains a legal status similar to that of a shareholder, for example through the license agreements.

5. More equal treatment for foreign companies?

Finally, the FIL contains some descriptive articles intended to reflect the growing equality of treatment between foreign and Chinese companies. Here it will be necessary to observe how the implementation is done in practice.

Examples of these provisions include the propagated protection of intellectual property and trade secrets of foreign companies (Articles 22, 23) or the equal treatment of foreign companies in the context of standardization projects or participation in public tenders (Articles 15, 16).

Assessment

The new FIL confirms that the same rules governing organizational structure apply to both foreign and Chinese companies (see point 1). On the other hand, however, the differentiation between foreign and Chinese investments remains. Actual equal treatment would only be achieved with further reduction or abolition of the negative list.