

Legal Commentary

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漢坤律師事務所
HAN KUN LAW OFFICES

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Interpreting the Foreign Investment Law: In a Nutshell

Authors: Jun LI | Jundong GUO | Haowen XU

On March 15, 2019, the *Foreign Investment Law of the People's Republic of China* was adopted at the Second Session of the Thirteenth National People's Congress. The law will become effective on January 1, 2020.

I. Before the Foreign Investment Law

What is past is prologue—adoption of the Foreign Investment Law is based on 40 years of China's opening-up. The well-known “three enterprise laws” and related foreign investment administrative systems took shape during China's opening-up and have been constantly updated and adjusted to adapt to the new challenges of the times. In recent years, however, such patchwork regulatory adjustments and partial system innovations have increasingly fallen short. The 2015 issuance of a consultation draft foreign investment law drew spirited debate; while views differed on specific provisions, everyone looked forward to the introduction of a unified basic law on foreign investment.

Fewer than three months elapsed from the initial deliberation of the draft Foreign Investment Law at the seventh meeting of the Thirteenth NPC Standing Committee on December 26, 2018 until its adoption by the National People's Congress on March 15, 2019. This speed reflects China's strong determination to introduce a basic foreign investment law.

II. Arrival of the Foreign Investment Law

The Foreign Investment Law is divided into 6 chapters and 42 articles. As the basic law for the new foreign investment legal system, the Foreign Investment Law establishes fundamental rules for the promotion, protection and access management of foreign investment. This article summarizes the main content of the Foreign Investment Law.

For a more detailed analysis of certain hot topics related to the Foreign Investment Law, you may refer to *Interpreting the Foreign Investment Law: Uncharted Waters*.

1. Consistency Between Domestic and Foreign Investment

The biggest highlight of the Foreign Investment Law lies in clarifying the principle of “consistency between domestic and foreign investment”, which is not only embodied at the foreign investment

access stage, but also continues to apply at the post-investment operating stage.

At the foreign investment access stage, the law specifies that foreign investment is subject to a pre-access national treatment plus negative list system. National treatment is provided to foreign investment outside the negative list and is administered in accordance with the principle of consistency between domestic and foreign investment. The negative list management system is not entirely new in China. Since 2013, when the Shanghai Free Trade Zone began piloting negative list and filing management systems, the negative list system has been implemented throughout China, underlined by revisions to the three enterprise laws and promulgation of related ministerial rules. The Foreign Investment Law, which has a higher level of superiority, establishes this system as the basic system for China's opening-up.

More specifically, the Foreign Investment Law expressly provides that the treatment of foreign investors and their investments at the investment access stage are not to be less favorable than those of domestic investors and their investments. In general, the investment access stage includes greenfield and M&A investment activities by foreign investors, such as initial set-up, acquisition and expansion. National treatment at this stage indicates that various investment activities of foreign investors should no longer be subject to special restrictions which target foreign direct investment, and foreign investors will enjoy the same rights and autonomy as domestic investors. The investment process will also be more convenient and flexible. On the other hand, national treatment is always accompanied by a negative list. The negative list refers to the special management measures for the access of foreign investment in specific industries, which is to be updated from time to time. In this sense, the greatest significance of the negative list is not in the specific areas open to investment and the extent of opening, but rather that it indicates China has entirely evolved from the previous "positive list" management model and clearly established that "all is permissible unless legally prohibited", which is more in line with the practices of market economies, greatly improving the transparency and predictability of foreign investment access.

In line with national treatment at the access stage, the Foreign Investment Law also establishes the principle of "consistency between domestic and foreign investment" at the post-investment operating stage. According to the Foreign Investment Law, all national policies supporting the development of enterprises will equally apply to foreign-invested enterprises. Unless otherwise stipulated by laws and administrative regulations, governmental authorities at all levels must not impair the legitimate rights and interests of or impose any additional obligations on foreign-invested enterprises, set any conditions for market access and exit, or intervene in any normal production and operating activities of foreign-invested enterprises. This indicates that the consistency principle will be applied to foreign-invested enterprise operations to the maximum extent. Limiting exceptions to only where permitted by "laws and administrative regulations" can also ensure to the greatest extent that implementation of this principle will not be interfered with by any particular governmental departments or local governments.

2. Consolidation of the Three Enterprise Laws

The three enterprise laws implemented during the decades of China's opening-up will be officially

repealed as of the effectiveness of the Foreign Investment Law on January 1, 2020. Foreign-invested enterprises will no longer be divided into wholly foreign-owned enterprises, Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, and will instead be equally subject to the provisions of the *Company Law of the People's Republic of China*, the *Law of the People's Republic of China on Partnership Enterprises*, and other laws. Domestic and foreign-invested enterprises will be established and operated in accordance with unified rules. Arrangements for internal governance structures, rules of order, voting procedures, equity transfers and profit distribution will be fully compatible with those of domestic enterprises. Domestic and foreign-invested enterprises will no longer be divided into different working systems due to differences in their capital territoriality, and parties to foreign-invested enterprises may design and implement various arrangements and practices more flexibly.

For a more detailed analysis of how foreign-invested enterprises should adjust their governance structures during the transition period, you may refer to *Interpreting the Foreign Investment Law: Uncharted Waters*.

At the same time, the application of foreign enterprise-related laws has in the past caused confusion due to differences between these special and general laws, and between the provisions of new and old laws. Unifying the rules for foreign and domestic enterprises will act to dispel much of this confusion and cause the rules to be clearer and more explicit.

3. Investment Promotion and Protection

The Foreign Investment Law emphasizes the promotion and protection of investment in special chapters covering these aspects. Among these chapters, the protection of intellectual property rights, the prohibition of compulsory technology transfers, and the equal participation of foreign-invested enterprises in government procurement and equal participation in standard setting may be considered a positive response to recent public demands.

III. Outlook

The Foreign Investment Law establishes the framework and rules of the basic system for a new era of opening-up and marks the beginning of this new system. Realization of the many principles and requirements of the Foreign Investment Law depends on subsequent implementing regulations, more detailed rules and local regulations. In particular, to fully implement the principle of “consistency between domestic and foreign investment”, it will be necessary for legislatures at all levels to examine existing laws, regulations and normative documents. At the access stage, legislatures at all levels need to further liberalize various substantive restrictions and requirements for foreign investment at the access stage (including greenfield investment and M&A), and to give foreign investors greater autonomy to enable them to design investment and transaction arrangements as flexibly as domestic investors. At the operating stage, it will be necessary to remove all additional requirements and limitations on foreign-invested enterprises, except in the case of special requirements set out in laws and administrative regulations, while also particularly focusing on the scope and content of such special requirements to avoid the creation of new restrictions on foreign investment.

It is conceivable that implementation of the Foreign Investment Law and the repeal of the three enterprise laws will lead to large-scale adjustments and a cleanup of various regulations based on decades-old regulatory approaches. The restructuring of the regulatory system brought by the Foreign Investment Law will be a larger task than the “clean-up” of regulations caused by the reform of the registered capital system and implementation of the negative list system. In this regard, our legal practitioners are both excited and curious: in one sense, a more relaxed regulatory environment provides space for innovative investment and transaction arrangements, the structures and terms of which can be more in line with market practices. In another sense, however, it is also necessary for legal practitioners to quickly master the new foreign investment regulatory system, to reflect upon how to reasonably utilize the new rules of the game so that investors and foreign-invested enterprises can eventually enjoy the benefits of further reform and opening-up.

Important Announcement

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If you have any questions regarding this publication, please contact:

Jun Li

Tel: +86-21-6080 0981

Email: jun.li@hankunlaw.com