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The New Foreign Investment Law in China

How Does It Affect Your China Investment?

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The new Foreign Investment Law (the "**Law**") along with the Implementing Regulations for the Foreign Investment Law (the "**Implementing Regulations**") (collectively the "**FIL**") have recently come into force on 1 January 2020.

As stated in Article 1 of the Law, the purpose of the FIL is to further open up the market, encourage foreign investment, enhance protection of foreign investors and regulate the administration of foreign investment. Overall, the implementation of the FIL is good news to foreign investors wishing to enter the China market. However, the FIL sets out only the general principles and its brevity suggests that the actual implementation practice will depend on further laws and regulations to be issued.

Below are some key changes that we wish to highlight and consider to be particularly important to new and existing foreign investors: -

I. KEY CHANGES

1. Revamp of Foreign Investment Framework

Upon the commencement of the FIL, the laws governing the three forms of Foreign Invested Enterprises ("**FIEs**"), namely Equity Joint Ventures ("**EJV**"), Cooperative Joint Ventures ("**CJV**") and Wholly Foreign-Owned Enterprises ("**WFOE**"), have been repealed. The FIL provides for a five-year transitional period until 31 December 2024 for existing FIEs to arrange for the appropriate changes to their organizational forms and structure for compliance with the new law. These changes naturally have more impact on EJVs and CJVs than WFOEs which do not involve Chinese investors.

The FIL offers greater latitude for foreign investors as they are now subject to the corporate laws which govern domestic entities, i.e. the Company Law or where applicable, the Partnership Law. Certain restrictive provisions under the previous FIE laws have been removed. For example, there is no limitation on the foreign investor's shareholding ratio as previously required for EJVs and shareholders are free to decide on the proportion for distributions of profits/dividends.

2. Equal National Treatment of Foreign Investment

Under the FIL, FIEs are entitled to national treatment in various areas, including:

(i) In terms of market access, foreign investors and their investments are entitled to no less favorable treatment than domestic investors outside the "negative list" (which provides a list of prohibited or restricted industries for foreign investment);

(ii) State policies supporting development of domestic companies apply equally to FIEs;

(iii) Equal participation of FIEs with domestic companies in the formulation of compulsory standards;

(iv) Participation of FIEs in government procurement activities through fair competition; and

(v) Products manufactured and services provided by FIEs within China shall enjoy equal treatment in government procurement.

With the promise of equal national treatment, the FIL offers a level playing field for foreign investors.

3. Enhanced Flexibility and Protection of Foreign Investors

Prior to the implementation of the FIL, FIEs may only contribute capital by way of cash and specific property rights. The FIL now permits foreign investors to contribute capital with equity rights, which, in other words, means that share swaps is possible in M&A transactions. FIEs are now expressly subject to the same rules as domestic companies in the context of corporate finance. As such, we expect to see a significant increase in the number of public offerings of FIEs in the coming years.

The Implementing Regulations explicitly provide that administrative authorities shall not force foreign investors or FIEs to transfer technologies and violators will be subject to penalties. Further, infringers of intellectual property rights will be held strictly liable according to the law. The FIL also restricts expropriation against foreign investment and provides assurance to foreign investors on remittance of lawful income outside China. Such provisions appear to be an attempt to address some of the most common concerns among foreign investors and to thereby attract foreign investments.

II. WHAT EXISTING FIES SHOULD BE AWARE OF?

As WFOEs are generally regarded as limited liability companies with a status substantially identical to those incorporated under the Company Law, the effect of the FIL on WFOEs is limited. One key change is that they are no longer limited to the organization form of limited liability companies and can also take the form of a joint-stock company under the Company Law. WFOEs should thus seek professional advice for re-establishing an organizational form most suitable for their business.

Joint ventures will likely face more challenges as it will involve renegotiations between the foreign and Chinese investors over corporate governance issues. Since the implementation of the FIL, a joint venture entity can now be incorporated as limited liability company or joint stock company. While we anticipate transition procedures to be put in place in the near future, we would advise foreign parties in an EJV or CJV to begin discussions over the status of the joint venture in light of the FIL as they are required to be compliant with the FIL within the five-year transitional period.

III. WHAT NEW FOREIGN INVESTORS SHOULD BE AWARE OF?

In terms of market access, while the concept of "negative list" have been maintained and even codified into the law, this may mean that discretionary reviews of foreign investment transactions are reduced. The recent trend also shows that the "negative list" of regulated industries are also gradually shrinking, which is good news to foreign investors. Under the FIL, a local government at and above the county level may develop foreign investment promotion and facilitation policies within its statutory authority under the law. Thus, foreign investors are suggested to check whether any local incentives offered are compliant with the law and to keep abreast of the legislative updates and seek professional advice before investment.

IV. CONCLUSION

The FIL is undoubtedly a right step by the Chinese government to improve the business environment for foreign investors and encourage foreign investments. Given the relaxed rules and enhanced protection, foreign investors who have been interested but reluctant in entering the China market should therefore reconsider their strategies in light of the FIL. However, as mentioned above, the actual implementation and effect of the FIL will depend on further regulations, guidelines and interpretations to be issued. These may significantly change various requirements for foreign investments and thus will be crucial to both existing and new investors for maintaining presence in the China market. We will keep monitoring further developments and keep you updated.