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## CHINA REVAMPS LAWS ON FOREIGN INVESTMENTS

To Our Clients and Friends:

On March 15, 2019, the National People's Congress of China passed the Foreign Investment Law (the "**Foreign Investment Law**") which, upon taking effect on January 1, 2020, will replace some of the basic laws and regulations relating to foreign investments in China (the "**Existing Laws**"). This new law represents a major overhaul of China's foreign investment regulatory regime developed over the last four decades.

### *Current Regime*

The Existing Laws consist primarily of three pieces of legislation: the Sino-Foreign Joint Venture Law (the "**Equity JV Law**"), the Foreign Enterprise Law (the "**WFOE Law**") and the Sino-Foreign Co-operative Joint Venture Law (the "**Co-operative JV Law**"). Each of these laws allows foreign investors to invest in a particular type of legal entity in China. Under the WFOE Law, for example, a foreign investor can incorporate a wholly foreign owned enterprise (a "**WFOE**"). Similarly, under the Equity JV Law and the Co-operative JV Law, foreign investors can set up equity or co-operative joint ventures with Chinese partners (the "**Joint Ventures**"). The WFOEs and the Joint Ventures are collectively referred to as foreign invested enterprises (the "**FIEs**"). Apart from these laws, China has (and periodically updates) a foreign investment catalogue (the "**Foreign Investment Catalogue**") which divides foreign investments into those that are *encouraged* and those that are on a negative list (the "**Negative List**"). The Negative List contains two sub-categories: the *prohibited* (i.e., no foreign investment is allowed) and the *restricted* (i.e., foreign investment is allowed subject to satisfaction of certain conditions). Those sectors that are not on the encouraged list or the Negative List are treated as *permitted*.

The overriding feature of China's regulation of foreign investments is that the FIEs are treated very differently from companies that are not owned by foreign investors (the "**Domestic Companies**"). While China is not unique in this regard, it is the degree of such difference that sets China apart from many other countries. For instance, the FIEs not only have to satisfy the requirements under the Foreign Investment Catalogue, they also must be registered as different legal entities and subject to different governance procedures compared with the Domestic Companies. Furthermore, the FIEs are often required to obtain more approvals and enjoy less benefits than the Domestic Companies.

Over the last several years, partly as a result of complaints and pressure from foreign governments and businesses, China has taken steps to grant more equal treatment to the FIEs. While the incorporation documents for all FIEs had to be reviewed and approved by China's Ministry of Commerce ("**MOFCOM**"), such requirement is now only applicable to investments in sectors on the Negative

List. The Foreign Investment Law can be seen as another step towards creating a more level playing field in China for both the FIEs and the Domestic Companies.

## ***Major Provisions***

The major provisions of the Foreign Investment Law include the following:

### National Treatment

The Foreign Investment Law specifically provides that the market entry management system for foreign investments in China consists of national treatment plus complying with the Negative List. In other words, unless otherwise required under the Negative List, the FIEs should be treated in the same way as the Domestic Companies. This is the first time such national treatment principle is expressly and unequivocally provided in a national law in China.

The law also includes some specific requirements for national treatment, including that government policies in supporting business development be applied equally to the FIEs and that equal treatment be accorded to the FIEs in respect of government procurements.

Moreover, after the Foreign Investment Law becomes effective, the FIEs will undergo the same incorporation process required under the PRC Company Law (instead of the Existing Laws) as the Domestic Companies. The FIEs will also be governed in the same way as the Domestic Companies.

### Protection of Foreign Investments

In addition to national treatment, the Foreign Investment Law also contains some general principles which apparently are aimed at allaying concerns over lack of protection of foreign investments in China, including:

- there will be no expropriation of foreign investments, unless in special circumstances required for public interest and conducted through a legal process with fair and reasonable compensation made in a timely fashion;
- the intellectual property rights of the foreign investors and FIEs will be protected and infringements of such rights will be prosecuted strictly according to law;
- while voluntary technological cooperation between Chinese and foreign investors is encouraged, the terms of such cooperation should be discussed by the investing parties themselves based on principles of fairness and equality, and government authorities or officials may not force transfer of technology through administrative means;
- government authorities and officials must keep confidential commercial secrets obtained from the foreign investors and FIEs while performing normal government functions;

- government authorities may not decrease the lawful rights of the FIEs, increase their obligations, impose market entry or exit conditions or interfere with their normal business activities, unless otherwise required by law;
- local government authorities must honor and perform promises to and contracts with the foreign investors and FIEs made pursuant to law; and
- a mechanism will be established to collect and address complaints from the FIEs.

## Requirements under Other Laws

The Foreign Investment Law also refers to a number of other laws and regulations relating to foreign investments in China, such as the PRC Anti-Monopoly Law and regulations relating to national security review. These laws and regulations will continue to be applicable after the Foreign Investment Law comes into effect.

## *Unanswered Questions*

The Foreign Investment Law is generally viewed as an improvement over the Existing Laws, but it also leaves some important questions unanswered. One glaring example is that MOFCOM issued a prior draft of the Foreign Investment Law in 2015 for public comments (the “**2015 Draft**”), which, among other things, dealt with issues relating to variable interest entities (the “**VIEs**”) (please click [here](#) for our comments on the 2015 Draft). However, the VIE related provisions have all been dropped from the promulgated Foreign Investment Law. As the VIE structure has been widely used in investments in certain sectors in China for many years, the fact that the Chinese government is still unwilling or unready to tackle this issue is a disappointment to many foreign investors.

Furthermore, the Foreign Investment Law is a rather short piece of legislation which contains primarily broad language on general principles. The extent to which it will actually improve the environment for foreign investments in China will depend on what specific rules and policies will be adopted to implement the law. For instance, the current Negative List was issued in June 2018. Many foreign investors are hoping that, with the passage of the Foreign Investment Law, the Negative List will be updated again to further liberalize restrictions on foreign investments in certain sectors. Similarly, the Foreign Investment Law provides that foreign investors can freely remit out of China their earnings, royalties, capital gains and proceeds from disposal of assets. However, given China’s tight foreign exchange controls, foreign investors often encounter obstacles and delays in actually making such remittance. One encouraging development was that three days after the Foreign Investment Law was passed, China’s forex authority issued a circular revising and simplifying rules on cross border financing activities by multinational companies.

The Foreign Investment Law is intended to promote and protect foreign investments by making the FIEs less “foreign” in China. This is a challenge as well as a welcome step in a country which traditionally has believed strongly that there is a big difference between what is domestic and what is foreign. It remains to be seen whether the purported benefits for foreign investors under the Foreign Investment Law will be fully realized in real life.

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