



China's New Foreign Investment Law

[CHINA REGULATION WATCH](#)¹

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On March 15, 2019, the National People's Congress (the "NPC") of the People's Republic of China (the "PRC" or "China") passed the Foreign Investment Law (the "New FIL").² Before the New FIL's passage, China's government had previously published two draft versions of the Foreign Investment Law for public comment. China's Ministry of Commerce ("MOFCOM") published the first draft on January 19, 2015 (the "2015 Draft FIL"), the provisions of which we summarized in a prior [China Regulation Watch](#).³ The NPC published the second draft on December 26, 2018 (the "2018 Draft FIL").⁴ The legislators' signification reduced the amount of content in the New FIL (and the 2018 Draft FIL) when compared with the 2015 Draft FIL (from 11 chapters and 170 articles to 6 chapters and 42 articles). Key content in the New FIL include definitions for "foreign investors" and "foreign investments," along with regimes for foreign investment management, promotion and protection. Based on available public information, the legislative process for the Foreign Investment Law was on hold for more than three years between the two drafts of the law. This raises questions about whether the 2018 Draft FIL's release was motivated by the ongoing China and U.S. trade tensions, with the hope that some provisions of the New FIL might be viewed favorably by U.S. trade negotiators.

The New FIL will become effective on January 1, 2020.⁵ Once the New FIL comes into effect it will replace the existing foreign investment laws, including the Sino-Foreign Equity Joint Venture Enterprise Law (中外合资经营企业法), the Sino-Foreign Cooperative Joint Venture Law (中外合作经营企业法), the Wholly Foreign Invested Enterprise Law (外资企业法) and the various implementation rules and ancillary regulations associated with these laws (the "Existing FIE Laws"). In a departure from Existing FIE Laws, the organization and business operations of foreign invested companies will be regulated under the Company Law of the People's Republic of China (中华人民共和国公司法) as amended in 2018 (the "Company Law"). As a result, wholly foreign-owned enterprises and foreign invested joint ventures will no longer be subject to a separate legal regime from domestic invested companies. As the New FIL aims to establish a new basic foreign investment legal framework, we expect additional implementation rules and ancillary regulations to be released in the near future.

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² See the full New FIL, and an informal English translation on [China Law Translate](#).

³ See the full 2015 Draft FIL on [MOFCOM website](#).

⁴ See the full 2018 Draft FIL, and an informal English translation on [China Law Translate](#).

⁵ See the full New FIL, and an informal English translation on [China Law Translate](#).

1. Definition of Foreign Investment; Abandoning VIE Normalization

Although Existing FIE Laws do not clearly define “foreign investments” or “foreign investors,” a company has generally been classified as either foreign invested or domestic invested based upon the citizenship or organizational jurisdiction of the company’s registered equity holders. The New FIL generally retains and codifies this traditional approach.⁶ Pursuant to Article 2 of the New FIL, “Foreign Investment” means any investment activity directly or indirectly conducted by foreign natural persons, foreign enterprises or other foreign organizations (the “foreign investors”) within the PRC, including (i) the establishment of a foreign-funded enterprise by a foreign investor either alone or in conjunction with other investors; (ii) the acquisition of shares, equity, property shares or any other similar rights and interests by a foreign investor in an entity; (iii) investment in any new business project by a foreign investor either alone or in conjunction with other investors, and (iv) investment by a foreign investor within the territory of the PRC in any other way as stipulated under the laws, administrative regulations or provisions of the State Council.

The 2015 Draft FIL introduced a new classification method for foreign or domestic companies based on “actual control” whereby a company under the actual control of foreign investors would have been classified as a foreign invested company while a company whose equity holder is a foreign entity but is under the actual control of Chinese investors would have been classified as a domestic company.⁷ The 2015 Draft FIL would have also imposed heavy penalties for using contractual control mechanisms, such as a variable interest entity structure (the “VIE Structure”), to evade the foreign investment restrictions.⁸ Under the “actual control” standard, a company that is controlled by non-PRC citizens or non-PRC entities would not have been allowed to operate a business in a restricted or prohibited industry through the utilization of a VIE Structure. In contrast, the New FIL (and the 2018 Draft FIL) removed all references to “actual control” and penalties associated with using the VIE Structure to evade foreign investment restrictions. This change is consistent with our prior conclusion, that there was no feasible way to adopt the “actual control” standard given the use of the VIE Structure for many Chinese businesses listed on the New York Stock Exchange, Nasdaq and other foreign stock exchanges. Although the definition of “foreign investment” in the New FIL suggests that other laws, administrative regulations and provisions issued by the State Council may further change the classification standards for foreign invested and domestic invested companies, given the significant potential negative effects that the “actual control” standard would have had on many of China’s leading internet companies, it is unlikely that the State Council will adopt this “actual control” standard in the future.

2. Foreign Investment Management System

The New FIL indicates that the general management system for foreign investment will be through pre-entry national treatment with a negative list.

⁶ See Article 2 of the New FIL.

⁷ See Article 12 and Article 18 of the 2015 Draft FIL.

⁸ See Article 149 of the 2015 Draft FIL.



(1) Foreign Investment Negative List

The New FIL further clarifies that the “negative list” is composed of the special administrative measures (negative list) for foreign investment (the “Foreign Investment Negative List”). The National Development and Reform Commission (the “NDRC”) and MOFCOM released the 2018 Edition of the Foreign Investment Negative List⁹ on June 28, 2018, replacing the prior Industry Catalogue for the Guidance of Foreign Investments (Revised in 2017) (外商投资指导目录 (2017年修订)) (the “Industry Catalogue”). Unlike the Industry Catalogue, which classified all industries as encouraged, permitted, restricted or prohibited with respect to foreign investment, the Foreign Investment Negative List only includes two categories – restricted or prohibited. As a result, the Foreign Investment Negative List is significantly shorter than the Industry Catalogue, but there does not appear to be a substantial difference from the previous “industry catalogue” system.

Pursuant to Article 28, a foreign investor may not invest in any prohibited industries, and any foreign investment in any restricted industries must meet the conditions stipulated in the Foreign Investment Negative List. If the foreign investment is in an industry not listed as restricted or prohibited under the Foreign Investment Negative List, then foreign investment will be subject to the same restrictions as a domestic investment. Under the 2018 Edition of the Foreign Investment Negative List, foreign investors are permitted to invest in internet access operation establishments, such as internet cafés. Nonetheless, many internet and high-tech related industries, including the operation and publishing of online games, are still classified as either restricted or prohibited.

(2) Market Access Negative List

In addition to the restrictions imposed in the Foreign Investment Negative List, foreign investment is subject to the policy of “pre-entry national treatment,” which provides that a foreign investment made at the market pre-entry stage will face the same treatment as if it was a domestic investment.¹⁰ On December 25, 2018, the NDRC and MOFCOM jointly released the market access negative list (2018 Version) (the “Market Access Negative List”),¹¹ and a NDRC officer recently explained that the Market Access Negative List is a part of the pre-entry national treatment policy.¹² Unlike the Foreign Investment Negative List, the Market Access Negative List applies to both foreign and domestic investment. Pursuant to Article 28 of the New FIL, foreign investment in an industry other than those classified as restricted or prohibited on the Foreign Investment Negative List will be subject to the same management system as domestic investment, as such the Market Access Negative List is a part of the aforementioned management system.

The Market Access Negative List has two categories: prohibited and permissible. Neither a domestic investor nor foreign investor may invest into industries categorized as prohibited. For

⁹ See the full of the 2018 Edition of the Foreign Investment Negative List, and an informal English translation on [China Law Translate](#).

¹⁰ See Article 4 of the New FIL.

¹¹ See the full Market Access Negative List on [NDRC website](#).

¹² See [chinanew.com](#).



the industries categorized as permissible, both a domestic investor and foreign investor will need to obtain the required approvals, licenses or certificates from the applicable PRC government authorities before undertaking any business in the relevant industry. If an investment is made into an industry other than those categorized as prohibited or permissible, then the investment generally doesn't require market access permissions from government authorities.

3. Foreign Investment Promotion and Protection Mechanisms

The New FIL includes promotion and protection mechanisms to encourage foreign investment. The table below describes select mechanisms set forth in the New FIL and indicates whether or not a similar provision was included in the 2015 Draft FIL.

Item	New FIL	2015 Draft FIL
Equal Treatment - Government Policies	Government policies which support and promote the development of domestic invested companies shall also apply equally to foreign invested companies. (Article 9)	Not mentioned.
Equal Treatment - Industry Standardization	Foreign invested companies shall have equal participation opportunities in industry standardization work as domestic invested companies, and all national industry standardization policies shall apply equally to both foreign invested and domestic invested companies. (Article 15)	Not mentioned
Equal Treatment - Government Procurement Activities	Foreign invested companies shall have equal participation opportunities in government procurement activities as domestic invested companies. (Article 16)	Not mentioned
Regulations and Judicial Judgement	Foreign invested companies shall be consulted for comments and suggestions with respect to the formulation of foreign investment related laws, regulations and rules. Regulatory documents and judicial judgments related to foreign investment shall be published in a timely manner. (Article 10)	Similar to Article 115 of the 2015 Draft FIL.
Financing	Foreign invested companies shall be permitted to receive financing through public offerings, corporate bonds and other securities sold in China. (Article 17)	Not mentioned
Foreign Exchange Transfer	Capital contributions, revenue, capital gains, intellectual property license fees, and other legally obtained compensation or reimbursement for a	Similar to Article 114 of the 2015 Draft FIL.



Item	New FIL	2015 Draft FIL
	foreign investor may be freely transferred outside of China. (Article 21)	
No Forced Technology Transfers	Forced technology transfer through administrative measures is prohibited. (Article 22)	Not mentioned
Protection of Trade Secrets	Officers or other government administrative personnel shall not disclose any confidential information of a foreign invested company obtained in connection with the performance of his/her duties. (Article 23)	Not mentioned.
Local Government Obligations	Local governments and their relevant departments shall (i) strictly abide by the promises made to foreign investors and foreign invested companies with respect to their local policies, and (ii) perform under all contracts entered into with foreign investors and foreign invested companies. (Article 25)	Not mentioned

4. Additional Rules & Regulations to be Implemented

Many provisions of the New FIL are very broad and may present implementation or enforcement challenges. Accordingly, we expect additional rules and regulations to be released in the future in connection with the implementation of the New FIL. Some of the required additional rules and ancillary regulations were referenced in the text of the New FIL, including the following:

- Article 11 requires China's government to establish a foreign investor service system which will provide information support.

- Article 17 permits foreign invested companies to receive funds through public offering and corporate bonds.

- Article 34, requires China's government to establish an information report system for foreign invested companies. This system was described in greater detail in the 2015 Draft FIL,¹³ but those provisions were removed from the New FIL and the 2018 Draft FIL.

- Article 35, requires China's government to establish a national security censorship system which will conduct review of foreign investment influencing or potentially influencing

¹³ See Chapter 4 of 2015 Draft FIL.



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Chinese national security. This system was also described in greater detail in the 2015 Draft FIL,¹⁴ but those provisions were also removed from the New FIL and the 2018 Draft FIL.

The removal detailed implementation clauses with respect to the information report system and the national security censorship system makes the New FIL appear friendlier to foreign investors. It is, however, unlikely that China intends to abandon these requirements as the concept were still retained in the New FIL. While foreign investors may be encouraged by some of the more attractive investment policies positions set forth in the New FIL, foreign investors should still be wary with respect to the future implementation of the rules and ancillary regulations and their actual effects on foreign investment.

¹⁴ See Chapter 4 of 2015 Draft FIL.