CONFEDERATION OF DANISH INDUSTRY IN CHINA

CHINA'S NEW FOREIGN INVESTMENT LAW 2020

In Spring 2019, China passed a new Foreign Investment Law (FIL), thereby granting foreign-invested enterprises and local companies equal treatment in the market. **The Foreign Investment Law will come into effect on 1st January 2020 and will replace the current foreign investment regime referred to as the "Three Laws on Foreign Capital"**.

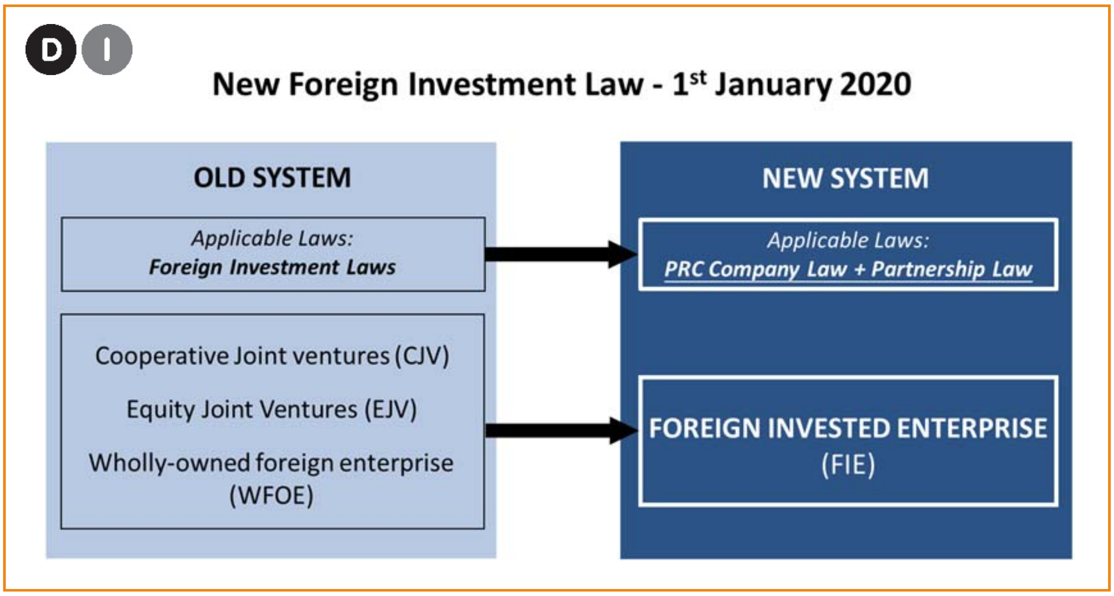
The new FIL is a major piece of Chinese legislation that symbolizes the shift from the old foreign investment system to reflect the modern market access centered around the Negative List system. The FIL, that should be considered as a framework guiding future foreign investment legislation, addresses some of the biggest challenges facing foreign investors: intellectual property rights, forced technology transfers and equal treatment in government procurement between local and foreign enterprises.

The New Foreign Investment Law in Practice

What is going to change?

The three existing laws on foreign investment, including the law on Sino-foreign cooperative Joint ventures (CJV), Law on wholly foreign-owned enterprises (WFOE/WOFE) and Law on Sino-foreign equity joint-ventures (EJV) will be **replaced by the new Law on Foreign Investment**.

This means that the distinction between WOFE, EJV and CJV will no longer exist, and the current foreign investment structures will uniformly be referred to as 'foreign-invested enterprise' (FIE).



Why a new Foreign Investment Law?

The current legislative framework for foreign investment was established in the early stage of China's economic awakening and no longer serve the needs of China's economy. Approaching 2020, China needs a new legislative framework to establish its commitment to a more open, transparent and fair business environment for foreign investment.

CHINA'S NEW FOREIGN INVESTMENT LAW

- KEY POINTS -

WHO IS CONCERNED?

A foreign investment is '[an] *investment activity directly or indirectly carried out by foreign natural persons, enterprises or other organizations*."

Here are some examples:

1. A foreign investor **establishes a foreign-funded enterprise** within the territory of China, **independently or jointly** with any other investor;
2. A foreign investor acquires **shares, equities, property shares** or any other similar rights and interests of an enterprise within the territory of China;
3. A foreign investor makes **investment to initiate a new project** within the territory of China, **independently or jointly** with any other investor; and
4. A foreign investor makes investment in any other way stipulated by laws, administrative regulations or provisions of the State Council.

A **Foreign Investment Enterprise (FIE)** is considered as an enterprise established under Chinese Law in PRC and with all or part of its investment from a foreign investor.

WHAT IS THE FIL GOING TO CHANGE?

- ### Granting foreign investors equal treatment

The new FIL introduces a management scheme of pre-establishment national treatment plus negative list. In other words, the Chinese state will afford **national treatment to foreign investment outside the negative list**. This means that from 1st January 2020, foreign investors will be granted the same market access as Chinese local investors, while being subjected to the Negative List.

The Negative List has been regulating market access for foreign investors in Mainland China since 2018 (2013 for Shanghai). It restricts investments in certain strategical industries and fields such as Media, Education, Finance, Logistics, Research, etc.

- **Lower market threshold … but stronger oversight**

The new FIL introduces the establishment of a foreign investment information **reporting system**.

Foreign investors and foreign invested enterprises will be required to submit investment information through the *Enterprise Registration System* and the *Enterprise Credit Information Publicity System*.

The FIL does not specify which type of information will be required under the **foreign investment reporting system**. Future legislation will clarify how this reporting system differs and will intersect with existing systems.

- **Protective measures for foreign investors in China**

The new FIL includes measures aiming at protecting the rights of foreign investors.

The Law includes:

- ✓ No expropriation of foreign-owned assets (except in special circumstances such as for the public interest)
- ✓ Free transfer into and out of China of capital contributions, profits, capital gains, income from asset disposal, intellectual property right royalties, liquidation income, etc. in Chinese RMB or foreign currency.
- ✓ Requirements for local governments to honor contractual commitments
- ✓ Lawful protection of trade secrets, intellectual property, technological cooperation based on voluntariness and business rules.

The FIL states that no organization nor individuals may unlawfully impose restrictions on the currency, amount and frequency of such remittance made in both directions. The reality is that **banks might still receive window guidance from the State Administration of Foreign Exchange**. Depending on the current foreign exchange policy environment, those restrictions might not be applicable.

- **Stronger IP protection**

The new FIL addresses foreign investors' concerns on the protection of intellectual property and forced technology transfers.

The new law provides that a foreign investor's intellectual property must be protected and that administrative organs and their employees cannot force a foreign investor to transfer technology into China. Besides, the FIL specifies that government agencies are to maintain the confidentiality of the trade secrets of foreign investors.

What is the impact on foreign businesses?

The current FIE laws will no longer be applicable from the 1st January 2020, and from this date onwards, the **PRC Company Law or the Partnership Law will regulate and govern the organizational structures, bodies, and rules governing the FIEs' activities.**

<u>The new FIL will mostly have an **impact on Joint Ventures**.</u>

Since WFOEs are in the form of a limited liability company with its shareholders meeting as the supreme governance body (cf. Company Law), the changes will mostly affect JVs such as equity joint ventures and cooperative joint ventures. The existing laws governing FIEs were drafted in a time when the tendency was to protect the perceived weaker Chinese party. Under the new legislation, foreign investors will have more or less the same bargaining power. For example, this will include entrenched minority protections for Chinese investors in key areas like changes in the Articles of Association (AOA), capital increase or decrease, termination and dissolution, merger and demerger and mortgages of assets or change of corporate form.

> China's New Foreign Investment Law will likely have a major impact on Joint Ventures by imposing major administrative and management burdens on them.

What's the next step?

- Foreign investors who are planning to set up **new operations in China** will have to set up their business in accordance with the laws applicable to domestic investors such as the Company Law and the Partnership Enterprise Law, and other applicable laws.
- The biggest impact for **foreign-invested companies** will be to adjust their corporate structures to **be compliant with the PRC Company Law** or the **Partnership Law.**

<u>**5 YEAR DEADLINE**</u>

All FIEs will have to change their structure within **5 years** to comply with the new FIL, starting 1st January 2020. If the FIE fails to make the switch within the 5-year transitional period, it will have another **grace period of 6 months**. If the FIE fails to make the change after the grace period, the government will no longer be able to accept its applications made for other corporate changes and may notify the non-compliance through the Enterprise Information Publicity System.

Concluding remarks

The FIL can be considered as the most important change in the Chinese foreign investment regime since the early 1990s. It brings in lower market thresholds for foreign investors and implements a tighter oversight over commercial activities in China. In a sense, it is in line with the current legislative trend in China and the government's efforts to create a healthier market. However, the new FIL raises more questions than it provides answers. There is a lack of guidance about the implementation of the new legislation as well as little information on how the new system will work in practice and will intersect with other reporting systems.

The new FIL comes in a time when China's economic growth has been the weakest since 1990 and the effects of trade tensions with the United States start to be tangible. Boosting FDI inflows seems to be China's new strategy to create jobs and support the challenging domestic economic situation.

Further guidelines on how to make the changes are expected to be released in early 2020. Foreign investors are encouraged to ***stay updated on further regulations*** *that will impact their operations in China.*

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