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I. Introduction

On March 15, 2019 the Standing Committee of the National People's Congress published the Foreign Investment Law (FIL). The FIL will be effective on January 1, 2020.

Prior to the FIL, China has published several laws and regulations to attract foreign investment in China, i.e. Sino-Foreign Equity Joint Venture Enterprise Law, Sino-Foreign Contractual Joint Ventures Enterprise Law, Wholly Foreign-Owned Enterprise Law (Three Laws) and respective implementation rules.

The issuance of the FIL this march is an important legislative step of China, which will replace the Three Laws and has significant practical implications for all existing and future Foreign-Invested Enterprises (FIE), in all industries and sectors. The highlights are as follows:

II. Highlights

1. Replacement and Unification of the Three Laws

The Three Laws stipulate three methods of investment for foreign investors, different investment methods subject to different rules. According to article 42 of FIL, the Three Laws will be repealed once the FIL becomes effective on January 1, 2020. That is to say, the FIL will replace and unify the Three Laws and their implementing rules.

However, the FIL with only 42 articles is extremely lean. Only the basics are regulated by this law. Other parts, such as corporate governance, will directly fall within the scope of the Company Law and the Partnership Enterprise Law of China and other laws. In this regard, the new FIL will treat FIEs just like Chinese companies.

Such a general law, of course, by often using vague expressions creates a higher risk of legal uncertainty. Today, it is often not very clear what the law will be enforcing. Therefore, the true content of FIL depends on the implementing rules which are expected to be published in addition to FIL.

2. Extension of the Scope of Foreign Investment

According to article 2 of the FIL, the term “Foreign investment” covers investment activities within China directly or indirectly conducted by foreign natural persons, enterprises, and other organizations (hereinafter referred to as “foreign investors”), including the following circumstances:

- (1) Establishment of a foreign invested enterprise (FIE) in China, independently or jointly with any other investor;
- (2) Acquisition of shares, equities, property or any other similar rights and interests of an enterprise in China;
- (3) Investment in a new project in China, independently or jointly with any other investor;
- (4) Investments in any other way as may be stipulated by laws, administrative regulations or provisions of the State Council.

Based on the above information, we can conclude that the FIL includes both direct investment and indirect investment in its regulation. However, paragraphs (1) establishment of a new enterprise, (2) acquisition, and (3) new construction project of this provision only explicitly list the methods of direct investments. Therefore, it remains unclear how the FIL regulates indirect investments.

3. Creation of New Market Access Management System

Compared to the Three Laws and relevant regulations, one remarkable breakthrough is that the FIL establishes a nationwide "pre-establishment national treatment and negative list" management system.

Article 4 of the FIL stipulates that the government adopts the management system of pre-establishment national treatment and negative list for foreign investment. Since 2017, the State Council has published several Special Administrative Measures for Foreign Investment Access (Negative List). The Negative List lists up industries where foreign investment is either prohibited or restricted and contains restrictions or prohibitions on foreign investment in many sectors, e.g. the restriction of equity ratio of foreign investment in financial industry, the prohibition of foreign investment in news agency and so on.

In the new market access management system established by FIL, aside from staying clear of industries on the Negative List, foreign investors will also need to ensure that their investments do not trigger concerns under the so-called National Security Review System.

4. Equal Treatment to foreign investment

In principle, the FIL provides equal rights for foreign investors to access national policies supporting the development of certain industries; to comment during the legislative process; to participate in standards-making and to participate in government procurement processes.

According to article 14 of the FIL, foreign investors and FIEs may enjoy preferential treatments. FIEs have equal rights to participate in the setting of standards and equal rights to participate in government procurement activities through fair competition.

5. Protection of Lawful Rights

The FIL includes specific provisions designed to address certain issues that foreign investors may previously have encountered when investing in China. In particular, the FIL provides specific protections such as:

- (1) No expropriation of foreign-owned assets other than in special circumstances;
- (2) Free transfer of Renminbi or foreign currency into and out of China, for returns of capital, profits, capital gains, royalty payments, and other lawfully obtained compensation;
- (3) The local governments shall honour lawfully made contractual and other commitments;
- (4) Protection of foreign investors' intellectual property rights in China.

III. Opportunities and Challenges

As we can see, the FIL set up several principles to attract foreign investments in China, which will bring a lot of opportunities to foreign investors such as:

1. Easily Enter in China Market

As mentioned above, the Chinese government will adopt the "pre-establishment national treatment and negative list" management system. With the market access regime, the time of setting up a new FIE is said to be shortened dramatically. In addition, if the opening of the markets continues as promised, the content of the negative list is likely to decrease in the future. Hence, it is expected that investing in China will be easier in the future, however, as for now, it is hard to value such effect of the new FIL.

2. Strengthening of Protection of Intellectual Property Rights

According to past practices, it happened to some foreign investors that they were forced to transfer their IP rights to Chinese party. However, the FIL clearly forbids such transfer forced by administrative means. Article 22 of FIL stipulates that the State encourages technical cooperation on the basis of free will and business rules in the process of foreign investment. The conditions for technical cooperation shall be determined under the principle of fairness by all investment parties upon equal negotiation.

In addition, intellectual property royalties are allowed to be freely remitted into or out of China in Renminbi or any other foreign currency.

Other than that, trade secrets also fall into the scope of protection. The FIL regulates that administrative organs and their functionaries have the obligation to treat trade secrets of FIEs, which they have learned about in the course of performing their duties, confidentially and they are prohibited from disclosing or illegally providing such secrets to third parties.

3. Flexibility on Corporate Governance

The Three Laws contain certain strict requirements in relation to corporate governance. For example, according to Sino-foreign Equity Joint Ventures Law, the chairperson and deputy chairperson shall be selected by the equity joint venture partners through consultation or shall be elected by the board of directors. Where the chairperson is appointed from one party to an equity joint venture, the deputy chairperson shall be appointed from another party.

Now with the phasing out of the Three Laws as of January 1, 2020, international investors will have more flexibility to negotiate and determine the corporate governance structure and key contract terms for their investments in China.

Besides the opportunities, the FIL will pose big challenges for foreign investors such as:

4. Included Control Range

Article 2 of Foreign Investment Law stipulates, for the purpose of this Law, "foreign investment" means the investment activities carried out directly or indirectly by foreign natural persons, foreign enterprises or other foreign organizations in China. As noted earlier, article 2(4) mentions, "Investments in any other way as may be stipulated by laws, administrative regulations or provisions of the State Council." This is a catch-all clause, covering any other type of investment in China. Hence, the scope of foreign investment will most likely be expanded, which of course means that the scope of supervision will be extended too, possibly to enterprises invested by foreign-invested enterprises and enterprises invested by its subsidiaries.

It is generally believed that this catch-all wording is intended to open up room to impose control to Variable Interest Entities (VIE) or Investments made by foreign investors in restricted industries over past decades by the implementing rules. It remains to be seen how far the FIL and its implementing rules will reach out to such VIE investments.

5. Inclusion of Information Report Regime

In order to replace the examination and approval system, the FIL provides for an information report system to control the foreign investment.

The registration system for establishing foreign invested enterprises has been evolving over the past several years, and under Article 34 of FIL, China now wants to establish a system that mainly reports information on establishments and modifications of FIEs. But because Article 34 or other provisions of the FIL do not provide any guidance on what information will be collected under the foreign investment information reporting system, it is not yet clear how the registration process and the reporting system will intersect.

The FIL only provides that foreign investors and foreign invested enterprises will be required to report their investment information through the enterprise registration system at the Ministry of Commerce and the enterprise credit information publicity system established by the State Administration of Market Regulation. It is unclear, how the foreign investment information reporting system differs from or connects with existing systems.

6. Inclusion of Safety Review Regime

Article 35 of FIL stipulates that the State establishes a security review system for foreign investment under which the security review shall be conducted for foreign investment affecting or likely affecting the state security.

The FIL only keeps one generic clause to the effect that China will adopt the national security review for foreign investments which have or may have a bearing on China's national security and that decisions of the national security review are to be final. Apart from this generic requirement, the FIL does not contain any details about the national security review process. It is anticipated that the Chinese authorities will pass separate implementing rules to provide details for the national security review. Until then, it remains to be seen, what risks lay behind the term "national security "for foreign investors in China, since the term is obviously widely construed.

7. FIL is rather General and Vague

A first impression reveals the new FIL's wording is very general and vague. At the given time it is highly unpredictable if rights like the participation in public

procurement or the newly introduced interdiction of forced IP transfer will actually create a more equal and transparent surrounding for foreign investors, or if such stipulations in the end remain a dead letter. The real influence and the actual value of the new law can only be evaluated, once implementing rules have been published and authorities have shown their efforts to enforce the law in a way that actually creates an investor friendly environment.

IV. Future Action Plan

The FIL will become effective from January 1, 2020. The FIL allows 5 years of transition for the FIEs which have been formed under the “Three Laws” before January 1, 2020. During the 5-year period FIEs may maintain their original type of entity. Given the significant changes especially in regard to major flexibilities allowed under the new regime, international investors should start to consider the strategies for optimizing their FIE strategies in China.

In brief, compared with China’s current foreign investment regime, the FIL contains a number of important provisions with a view to offering a better protection to international investors and building a more transparent and investor-friendly business environment. This obviously demonstrates a major step in addressing the concerns raised by international business community and building a level playing field for foreign investments.

However, it is noted that the FIL also has a number of significant grey areas to be clarified as we have analysed above. For example, key issues such as how the VIE structure will be regulated, what the detailed national security review requirements will be and how the investment sanction reciprocity will work are all to be clarified. We expect that Chinese governmental authorities will issue further rules or regulations and we will keep close watch on regulatory developments in this regard and provide updates where appropriate.

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