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Draft Foreign Investment Law on Deliberation

I. Introduction

On January 29, 2019 the Standing Committee of the National People's Congress deliberated the draft *Foreign Investment Law* (“Draft”) in Beijing. The draft on December 26, 2018, was published to solicited public opinions. The Deadline for comments and opinions is on February 24, 2019.

Once adopted, the Draft will replace three existing laws, namely the *Sino-foreign Equity Joint Ventures Law, Contractual Joint Ventures Law, and Wholly Foreign-owned Enterprises Law*, and unify *Special Management Measures for the Market Entry of Foreign Investment* (“Negative List”) to govern multiple types of foreign investment. Firstly, it clearly gives a definition of “Foreign Investment”; secondly, regarding the implementation of pre-entry national treatment and negative list management system, the Draft clarifies that the negative list management system will implement the unification of domestic and foreign standards; thirdly, the Draft sets out investment protection mechanism; finally but also importantly, the Draft sets up supervisory rules on foreign investment.

II. Contents

The main contents of the Draft read as follows:

1. Definition of Foreign Investment

The concept of Foreign Investment, occurred in several Chinese laws and regulations, such as *Company Law, Foreign Trade Law, three FIE Laws*. However, no existing laws or regulations give a clear definition on that. The Draft for the first time explained "Foreign Investment”, according to article 2, which refers to the investment activities carried out directly or indirectly by foreign investors within the territory of China, including foreign natural persons, foreign enterprises and other foreign organizations, no matter: (1) in an independent way or jointly with other investors; (2) by setting up new enterprises or purchasing shares, equities, property shares or other similar rights and interests of Chinese domestic enterprises through mergers and acquisitions.

The definition of foreign investment enterprises includes all kinds of enterprises invested by foreign investors, including direct investment and indirect investment. That means, multiple types of foreign investment could enter into China legally. However, it is unclear whether Macau, Hongkong and Taiwan investment would belong to foreign investment.

2. Equally treatment to Domestic and Foreign Investment

(1) Offering National Treatment to Foreign Investment

National treatment is a principle in international law. Used in many treaty regimes involving trade and intellectual property, it requires equal treatment of foreigners and locals. Under national treatment, a state granting particular rights, benefits or privileges to its own citizens must also grant those advantages to the citizens of other states while they are in that country.

The Draft offers national treatment to foreign investors except for investment in industries specified under the Negative List. It abolishes the management mode "case-by-case" examination and approval system established by three Foreign Investment Laws, tries to embrace foreign investors and Chinese investors into one system with regard to the establishment of entities..

(2) Supporting Policies and Mandatory Standards Equally Apply

Besides the pre-entry phase, the Draft also regulates equal treatment with regard to operating phase to foreign investors. Article 9 of the Draft provides, the State's policies supporting enterprise development are equally applicable to foreign-invested enterprises, unless otherwise provided for by laws and administrative regulations. For example, China published tax preferential policies to support micromini enterprises and high-tech enterprises, such policies will also apply to foreign-invested enterprises.

Other than preferential policies, the Draft also imposes obligations on foreign investors. Article 15 of the Draft stipulates, foreign-invested enterprises participate in standardization work equally. Information disclosure and social supervision shall be strengthened. The mandatory standards formulated by the

State shall be equally applicable to foreign-invested enterprises, e.g. national standards, industrial standards, local standards.

(3) Fair Competition in Government Procurement Activities

Because of administrative and legal interventions, foreign-invested enterprises have been blocked in government procurement during the past years. According to Article 10 of the *Government Procurement Law of the People's Republic of China*, the government shall procure domestic goods, construction and services. This has prohibited fair competition and foreign investors from becoming significant suppliers in Chinese government procurements. But things might change if the Draft is adopted. Article 16 of the Draft says, the State guarantees that foreign-invested enterprises participate in government procurement activities fairly. Products produced by foreign-invested enterprises in China shall be treated equally according to law in government procurement activities.

It is expected the *Government Procurement Law* will be amended once the Draft becomes effective. But it is hard to predict whether the current restrict environment will be changed just because of a new law. Practice is another story in China considering the Chinese cultural environment.

3. Investment Protection

(1) No Expropriation

Article 20 of the Draft reads, the State does not impose expropriation on foreign investment. However, it also mentions, under special circumstances, if it requires imposing expropriation on foreign investment due to the needs of public interest, expropriation shall be imposed according to legal procedures, and the foreign-invested enterprises concerned shall receive fair and reasonable compensation.

There is no clear definition and scope of public interest, so expropriation and inadequate compensation remain a realistic risk for foreign investment.

(2) Foreign Exchange

Article 21 of the Draft stipulates, a foreign investor's capital contribution, profits, capital gains, intellectual property rights (IPR) royalties, and indemnity or compensation received in China according to law may be freely transmitted to overseas. But considering China's strict control in foreign exchange, it will be difficult to predict any change of the current foreign exchange practice.

(3) No Interference and Additional Obligations from Government

The Draft claims that China protects the IPRs of foreign investors and foreign-invested enterprises, the legitimate rights and interests of IPR holders and the related rights holders, and encourages technical cooperation carried out based on voluntary principles and business rules. Foreign investors should have the right to determine the cooperation with all market operators. The Draft emphasizes that all administrative organs shall not use administrative means to force foreign investors to transfer their technology.

The meaning of administrative means is not further explained. In practice, foreign investors, when making contribution by technology, have to transfer their technology to the to-be-established foreign-invested enterprises. In case foreign investors prefer to hold the technology at hand, licensing might be a better choice instead of technology contribution.

In order to regulate the local government's arbitrarily increase of obligations, Article 23 of the Draft clearly reaffirms that legitimate rights and interests of foreign-invested enterprises shall not be impaired and access conditions shall not be increased illegally. No illegal interference in or affection of the normal production and operation activities of foreign-invested enterprises is allowed.

(4) Complaint

To further support the foreign investment entering in China, article 25 of the Draft sets up complaint mechanism to solve the problems promptly raised by foreign investors.

It is expected that detailed complaint regulations could be published to implement such mechanism. For example, increase administrative reconsideration, administrative litigation and other remedies. Based on two decades of experiences in administrative reconsideration and administrative litigation proceedings, not much can be expected from a new complaint mechanism.

4. Control Regime

(1) Information Report System

In replace of the examination and approval system, the Draft provides information report system to control the foreign investment. Article 31 of the Draft stipulates, the State establishes a foreign investment information reporting system, and the content and scope of the information report shall be determined according to the principles of necessity and strict control. Foreign investors or foreign-invested enterprises shall submit investment information to the competent commerce authorities through the enterprise registration system and the enterprise credit information disclosure system, including the registered capital, total investment amount, information of foreign investors, etc., which will be disclosed to public by the government.

(2) Security Supervision System

Besides the information report system, the Draft also introduces security supervision system. Article 32 and 33 of the Draft provides, unless otherwise stipulated by law, relevant competent authorities shall conduct supervision and inspection of foreign-invested enterprises according to the principle of treating Chinese domestic investment and foreign investment equally. The State establishes a foreign investment security review system to conduct security reviews of foreign investment that affects or may affect the national security.

But it is unclear how often and on what information should be conducted by the authorities. What's more, there is no clear explanation what project and industries will affect the nation's security. That will give the Chinese authorities great discretion and interference on foreign investors.

III. Tendency

The Draft tries to unify the existing foreign investment regimes in China and set up equal treatment to foreign investment. But obviously, with regard to the prohibited and restricted industries, especially the prohibited industries, China will continue to be strict in controlling foreign investors.

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