

Haiwen Comments on the Foreign Investment Law

On March 15, 2019, the Second Session of the Thirteenth National People's Congress of the People's Republic of China reviewed and adopted the Foreign Investment Law of the People's Republic of China (the "Foreign Investment Law"), which will come into effect on January 1, 2020. From the circulation of the Foreign Country Investment Law of the People's Republic of China (Exposure Draft) by the Ministry of Commerce on January 19, 2015 (the "Foreign Investment Law Draft (2015)") to the promulgation of the Foreign Investment Law, the legislative process took more than four years, and the structure and content of the Foreign Investment Law underwent major changes. This article intends to analyze the significance of the adoption of the Foreign Investment Law through the presentation of legislative evolution in the field of foreign investment, and on that basis, comment on the Foreign Investment Law.

1、The "Predecessors" of the Foreign Investment Law

The Third Plenary Session of the Eleventh Central Committee of the Communist Party of China held in December 1978 announced the beginning of China's internal economic reform and opening up to the outside world. In response to it, the Second Session of the Fifth National People's Congress of China on July 1, 1979 adopted the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Fourth Session of the Sixth National People's Congress of China on April 12, 1986 adopted the Law of the People's Republic of China on Wholly Foreign-owned Enterprises and the First Session of the Seventh National People's Congress of China on April 13, 1988 adopted the Law of the People's Republic of China on Sino-foreign Co-operative Enterprises (collectively referred to as the "Three Laws on the Foreign-invested Enterprises"). The successive introduction of the Three Laws on the Foreign-invested Enterprises marked the new stage of China's opening up in accordance with law, and established a regulatory system represented by case-by-case approval in the field of foreign investment.

Around 2001, in order to promote China's accession to the WTO, the Three Laws on the Foreign-invested Enterprises were amended to meet the requirements of the WTO rules. Although the amendment and the subsequent legislation and reform in the administrative field did not change the regulatory system of the case-by-case approval in the field of foreign investment, the approval system and procedures for foreign investment were gradually standardized, and the provisions with a strong flavor of the planned economy such as requiring foreign-invested enterprises to make onshore procurement on a priority basis, or to report its operation and construction schemes to the competent authorities, etc. were deleted. Such changes met the needs of China's adaption to the WTO rules after its accession to the WTO, and further accelerated the pace of China's opening up.

As the reform and opening up is transforming from the market-driven mode to the

innovation-driven mode, the above-mentioned regulatory system with the feature of emphasizing regulation and neglecting service in the field of foreign investment was unable to satisfy the booming development of various industries in China and the demands of foreign investors for an innovative regulatory system. In January 2015, the Ministry of Commerce published the Foreign Investment Law Draft (2015) to solicit opinions from the public. The draft showed the framework of a basic law to uniformly and systematically regulate the field of foreign investment, and proposed the new regulatory system of pre-establishment national treatment and negative list in the field of foreign investment, aiming to create a stable, transparent and predictable legal environment for foreign investors to invest in China. However, due to the excessively cumbersome provisions thereof and its coverage of many debatable issues such as VIE arrangement and detailed rules of national security review system etc., it sparked fierce discussions in the market after the announcement but failed to be formally promulgated.

In April 2015, the State Council approved the establishment of certain free trade zones to explore the negative list regulatory system for foreign investment. Since 2016, the Three Laws on Foreign-invested Enterprises were further revised. In conjunction with the issuance and revision of the Provisional Measures on Administration of Filing for Establishment and Change of Foreign Investment Enterprises by the Ministry of Commerce, the reform of the regulatory system for foreign-invested enterprises was implemented, and the regulatory system combining the general filing and the limited approval with respect to foreign investment captured by the negative list was established with the intention to gradually transfer into the new regulatory system of the pre-establishment national treatment and negative list in the field of foreign investment.

Based on the above explorations, on December 26, 2018, the National People's Congress of China published the Foreign Investment Law (Draft) on its official website (the "Foreign Investment Law (Draft)"), soliciting opinions from the public. Compared with the Foreign Investment Law Draft (2015), the Foreign Investment Law (Draft) was much shorter in the sense that the number of provisions was reduced from 170 to 39 and the provisions thereof were more of general guiding principles rather than detailed implementing rules. Controversial issues such as the VIE arrangement as well as details of national security review system were deleted from this draft. It clarified the regulatory system of pre-establishment national treatment and negative list for foreign investment, and focused on the promotion and protection of foreign investment. It also stipulated guiding principles for foreign investment regulatory systems, including the investment information report system, the review system for concentration of undertakings and the national security review system, etc. From December 2018 to mid-March 2019, the Foreign Investment Law (Draft) was submitted to the Standing Committee of the National People's Congress of China and the National People's Congress of China for review several times. The Foreign Investment Law officially promulgated generally follows the framework of Foreign Investment Law (Draft) but is further revised and improved.

2、Comments on the Foreign Investment Law

Based on the presentation of legislative evolution in the field of foreign investment, we will have a glimpse of the present Foreign Investment Law from the following three perspectives: the implementation of the regulatory system of pre-establishment national treatment and negative list for foreign investment, the promotion and protection of foreign investment, and the connections between the Foreign Investment Law and the existing laws and systems.

- The Implementation of the Regulatory System of Pre-Establishment National Treatment and Negative List for Foreign Investment

Paragraphs 1 and 2 of Article 4 of the Foreign Investment Law provide that: “the State adopts the regulatory system of pre-establishment national treatment and negative list for foreign investment. For the purpose of the preceding paragraph, the pre-establishment national treatment refers to granting to foreign investors and their investments, at the stage of investment access, the treatment no less favorable than that granted to domestic investors and their investments; the negative list refers to special administrative measures for access of foreign investment in specific fields as stipulated by the State. The State shall grant national treatment to foreign investments outside the negative list.”

More special implications may be seen if above provisions are reviewed together with the “one counter, one form” reform of foreign-invested enterprises’ filing at the commerce authorities and registration with market supervision and regulatory authorities. Beginning in June 2018, the reform aims to improve the information exchange and data sharing between the commerce authorities and market supervision and regulatory authorities, optimize the application procedures for foreign-invested enterprises, and reduce the processing time and costs of enterprises. Under this background, the Provisional Measures on Administration of Filing for Establishment and Change of Foreign Investment Enterprises (2018 Amendment), which was issued on June 30, 2018, clarifies that while establishing a new foreign-invested enterprise or converting a domestic enterprise into a foreign-invested enterprise through mergers and acquisitions, the relevant entity shall apply for registration with the market supervision and regulatory authority and report the filing information of the establishment of the foreign-invested enterprise to the commerce authority online. When the commerce authority obtains the filing information from the market supervision and regulatory authority, it should start the filing procedures and inform the investors at the same time. However, the above-mentioned foreign-invested enterprise still needs to go through the change procedures via the comprehensive regulatory system of the commerce authorities separately when handling subsequent changes. The reason may be that the scope of changes stipulated in the Provisional Measures on Administration of Filing for Establishment and Change of Foreign Investment Enterprises (2018 Amendment) is broader than the scope of changes to be registered with the market supervision and regulatory authorities. Under the regulatory system of pre-establishment national treatment and negative list as stipulated in the Foreign Investment Law, certain matters still remain to be observed, such as whether the foreign-invested enterprises outside the negative list still need to submit the filing information to commerce authorities online or even through a separate channel when they go through establishment registration and change registration

at the market supervision and regulatory authorities, or whether the filing system of commerce authorities may be changed so the re-submission of any information that can be obtained by interdepartmental information sharing is no longer required .

Regarding the foreign investment fields captured by the negative list, the implementation measures of the special administrative measures for access of foreign investment remain to be observed. For example, for industries with explicit requirements for equity ratio, organizational form or senior management position allocation, it remains to be observed in supporting rules and regulatory practices whether the national treatment (i.e. domestic-invested and foreign-invested enterprises are equally treated) can be granted upon the fulfillment of the above requirements, or the case-by-case approval regulatory system continues to apply.

- Promotion and Protection of Foreign Investment

The promotion and protection of foreign investment is a major feature of the Foreign Investment Law compared to the Three Laws on the Foreign-invested Enterprises. This section will observe the implementation measures of the Foreign Investment Law in terms of the promotion and protection of foreign investment from four aspects: legislation in the field of foreign investment, standard setting and government procurement participation rights; technical cooperation principles; local policies, expropriation, requisition and local governments' commitments; and complaint mechanism for foreign-invested enterprises in the field of foreign investment.

- Legislation in the Field of Foreign Investment, Standard Setting and Government Procurement Participation Rights

Paragraph 1 of Article 10 of the Foreign Investment Law provides that: "opinions and suggestions of foreign-invested enterprises shall be solicited by appropriate means when enacting laws, regulations and rules relating to foreign investment."

Paragraph 1 of Article 15 provides that: "the State protects the right of foreign-invested enterprises to legally and equally participate in the setting of standards, and reinforces the information disclosure and social supervision for setting standards."

Article 16 provides that: "the State protects foreign-invested enterprises' participation in government procurement activities through fair competition. Products produced and services provided by foreign-invested enterprises within the territory of China shall be equally treated in government procurement according to law."

In the process of legislation participation, standards setting and government procurement, foreign-invested enterprises are generally in a weak position compared with domestic enterprises and private enterprises are generally in a weak position compared with state-owned enterprises. It is explicitly written in the Foreign Investment Law that opinions of foreign-invested enterprises shall be solicited in the legislation process relating to foreign

investment, that foreign-invested enterprises may equally participate in standards setting in accordance with laws, that the products produced and services provided by foreign-invested enterprises in China shall be treated equally, and that foreign-invested enterprises may participate in the government procurement activities through fair competition and in accordance with the law. The above indicate the confidence and determination of the Chinese government to improve the transparency of legislation in the field of foreign investment, to advance the promotion and protection of foreign investment, and to grant national treatment to foreign-invested enterprises.

- Technical Cooperation Principle

Article 22 of the Foreign Investment Law provides that: “the State protects the intellectual property of foreign investors and foreign-invested enterprises, as well as the legitimate rights and interests of intellectual property owners and relevant parties; any infringement upon intellectual property will be held liable according to law. The State encourages technical cooperation on the basis of free will and business rules in the process of foreign investment. Technical cooperation conditions may be determined under the principle of fairness by all investment parties upon equal negotiation and no administrative authority or officials thereof may force the transfer of any technology by administrative means.”

One of the highlights of the Foreign Investment Law is the explicit inclusion of “no administrative authority or officials thereof may force the transfer of any technology by administrative means.” One of the goals of China's opening up is to introduce advanced foreign technology while one of the leverages of foreign investors is their advanced technology. Arrangements with respect to technology transfer, license and restrictions thereof are usually heavily negotiated in the process of foreign investment. “No administrative authority or officials thereof may force the transfer of any technology by administrative means” is the formal commitment made by China to address the concerns of foreign investors, as well as a strong response to the accusation of compulsory technology transfer made by some foreign countries.

- Local Policies, Expropriation, Requisition and Local Governments’ Commitments

Article 18 of the Foreign Investment Law provides that: “a local people's government at or above the county level may, according to laws, administrative regulations and local rules, adopt foreign investment promotion and facilitation policies and measures within its statutory authorization.”

Article 20 provides that: “the State shall not expropriate the investment of foreign investors. Under special circumstances, the State may, for the need of the public interest, expropriate or requisite the investment of foreign investors according to law. In such case, statutory procedures shall be followed, and fair and reasonable compensation shall be made in a timely manner.”

Article 25 provides that: “local people's governments at all levels and relevant departments

thereof shall honor policy commitments lawfully made to foreign investors and foreign-invested enterprises and perform all contracts entered into according to law. If any policy commitment or contract needs to be changed for the sake of national interests or public interests, the statutory authorization and procedures shall be followed, and the foreign investor or foreign-invested enterprise concerned shall be compensated for losses incurred thereby according to law.”

The level of economic development varies across China, and the demand for foreign investment and service capabilities thereto are also different. The explicit inclusion of “adopt foreign investment promotion and facilitation policies and measures within its statutory authorization” not only gives local governments the policy flexibility in attracting foreign investment, but also restricts the local governments’ unauthorized behavior to attract investment.” In the future, local governments should change the ways to attract foreign investment from relying on land, tax incentives, and local subsidies to focusing on providing local policies tailored to local conditions and improving their service quality.

Willingly or unwillingly trading or cooperation with governments at all levels and relevant departments is a common situation encountered in the process of foreign investment. Compared to the Three Laws on Foreign-invested Enterprises, the Foreign Investment Law emphasizes that “fair and reasonable” compensation should be given for expropriation and requisition, and that any change of policy commitment or contract needed for the sake of “national interests or public interests” should be carried out according to law and any loss caused thereof should be compensated. Such provisions limit the causes for governments at all levels and relevant departments to change their policy commitments and contracts, and expressly provide the protection to the rights of foreign investors to obtain compensation under the aforementioned circumstances. It should be noted that the Foreign Investment Law emphasizes that the policy commitments and contracts that governments at all levels and relevant departments should honor have to be made according to law. In the future, when trading or cooperating with governments and relevant departments, foreign investors and foreign-invested enterprises should make judgments on the scope of statutory authorization of governments and relevant departments, so as to avoid the situations where the commitments given by or contracts entered into with governments or relevant departments cannot be implemented or enforced because their acts are ultra vires.

- The Complaint Mechanism for Foreign-Invested Enterprises

Article 26 of the Foreign Investment Law provides that: “the State shall establish a complaint mechanism for foreign-invested enterprises to timely resolve problems encountered by foreign-invested enterprises or their investors, to coordinate and to promote the implementation of relevant policies and measures. If a foreign-invested enterprise or any of its investors claims that the administrative action of an administrative authority or officials thereof infringes its legitimate rights and interests, it may apply for mediation and resolution through the complaint mechanism for foreign-invested enterprises. If a foreign-invested enterprise or any of its investors claims that the

administrative action of an administrative authority or any official thereof infringes its legal rights and interests, besides applying for mediation and resolution through the complaint mechanism for foreign-invested enterprises as prescribed in the preceding paragraph, it may also apply for an administrative reconsideration or file an administrative lawsuit.”

This mechanism is an assurance of promotion and protection of foreign investments. Although foreign investors and foreign-invested enterprises are not excluded from the current framework of administrative and judicial procedures, an independent complaint mechanism specifically serving foreign-invested enterprises will contribute to the implementation of the promotion and protection of foreign investments, given the overloaded capacity of the current framework of administrative and judicial procedures. Different from the Foreign Investment Law Draft, the officially promulgated Foreign Investment Law defines the “complaint mechanism for foreign-invested enterprises” as a mediation and resolution mechanism, and connects it to the administrative reconsideration and administrative lawsuit, making clear that the complaint mechanism for foreign-invested enterprises is not a preparatory procedure of administrative reconsideration or administrative lawsuit in the field of foreign investment.

- Connections between the Foreign Investment Law and Current Laws and Legal Systems
- Connection with International Treaties and Agreements

Paragraph 4 of Article 4 of the Foreign Investment Law provides that: “if any of the international treaties or agreements to which the People's Republic of China is a contracting party provides treatments more favorable (than in this Law) with respect to the access of foreign investors, such treatments may apply.”

This provision harmonizes the national treatment granted to foreign investors under the Foreign Investment Law with the possible “super-national” treatment that may be granted to foreign investors from certain nations or regions under international treaties or agreements, resolves the potential conflicts between domestic legislation and international treaties and agreements, and reserves flexibilities for the opening up and diplomatic policies of China as well.

- Connection with Laws including the Company Law and the Partnership Enterprise Law

Article 31 of the Foreign Investment Law provides that: “the provisions of the Company Law of the People's Republic of China, the Partnership Enterprise Law of the People's Republic of China and other applicable laws shall apply to the organizational form and structure and operating rules of foreign-invested enterprises.”

Paragraph 2 of Article 42 provides that: “foreign-invested enterprises, established in accordance with the Law of the People's Republic of China on Sino-foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises or

the Law of the People's Republic of China on Sino-foreign Co-operative Enterprises before the effectiveness of this Law, may retain the original organizational forms for five years after the effectiveness of this Law. The specific implementing measures shall be issued by the State Council."

Instead of differentiating regulation according to the organizational forms of enterprises established under the Three Laws on the Foreign-invested Enterprises, the Foreign Investment Law directs issues of "organizational form and structure" to the Company Law of the People's Republic of China (the "Company Law"), the Partnership Enterprise Law of the People's Republic of China (the "Partnership Enterprise Law") and other applicable laws, and thus on one hand, effects the national treatment to foreign investors, while on the other hand, avoids conflicts with laws such as the Company Law and the Partnership Enterprise Law as well as their further amendments.

The Foreign Investment Law provides a five-year grace period for foreign-invested enterprises established under the Three Laws on the Foreign-invested Enterprises to adjust the organizational forms, etc. The earlier established foreign-invested enterprise should be reminded to adjust its organizational form per its specific situation in accordance to the Company Law or the Partnership Enterprise Law. For example, a Sino-foreign equity joint venture with the board of directors as its supreme governing body should establish the shareholders' meeting, the board of directors and the board of supervisors according to the Company Law. We notice that compared to the Foreign Investment Law Draft, the expression that "the specific implementing measures shall be issued by the State Council" with respect to the adjustments in the five-year grace period is added to the officially promulgated Foreign Investment Law. We look forward to the following being further elaborated in the implementing measures to be issued by the State Council: (i) the specific approaches to adjust organizational form and structure and operating rules for the foreign-invested enterprises established under the Three Laws on the Foreign-invested Enterprises to be in conformity to the Company Law, the Partnership Enterprise Law and other applicable laws, such as, how to deal with those foreign-invested enterprises established under the Three Laws on the Foreign-invested Enterprises that have special rules regarding its internal corporate governance, equity transfer, profit distribution and withholding of relevant reserves, etc., and (ii) the measures applicable to foreign-invested enterprises that fail to complete the adjustment after the expiration of the five-year grace period.

- Connection with the Anti-monopoly Law

Article 33 of the Foreign Investment Law provides that: "where a foreign investor acquires a domestic enterprise in China or participates in the concentration of undertakings by other means, it shall be subject to the review of concentration of undertakings according to the provisions of the Anti-monopoly Law of the People's Republic of China."

The above provision makes clear that the review of concentration of undertakings also applies to the field of foreign investments, while the scope or procedures of such review shall be subject to the more specialized Anti-monopoly Law of the People's Republic of

China.

- Connection with the Current Information Report System

Article 34 of the Foreign Investment Law provides that: “the State shall establish a foreign investment information report system. Foreign investors or foreign-invested enterprises shall submit investment information to the commerce authority through the enterprise registration system and the enterprise credit information publicity system. The content and scope of foreign investment information report shall be determined based on the principle of necessity; no separate submission shall be required with respect to any investment information that can be obtained by interdepartmental information sharing.”

The above provision makes clear the channel and scope of the information report. The channel of “the enterprise registration system and the enterprise credit information publicity system” seems to be the extension of the “one counter, one form” for the foreign-invested enterprise’ commerce filing and market supervision and regulatory registration. The principles of “necessity” and “exclusion of shared information” may effectively lighten the burden of foreign investors and foreign-invested enterprises regarding such reporting obligation.

- Connection with the Review of National Security

Article 35 of the Foreign Investment Law provides that: “the State shall establish a security review system for foreign investment, under which the security review shall be conducted with respect to foreign investments that affect or may affect national security. The decision on security review legally rendered shall be the final decision.”

Instead of attempting to establish a detailed national security review system for foreign investment with a chapter of 27 provisions in the Foreign Investment Law Draft (2015), the officially promulgated Foreign Investment Law only includes a general rule with respect to the “security review system for foreign investment.” Before the implementing measures regarding the specific scope and procedures of the review are enacted, the current security review system for foreign investment, established by the Notice of the General Office of State Council on Establishment of Security Review System Pertaining to Mergers and Acquisitions of Domestic Enterprises by Foreign Investors and the Trial Measures on National Security Review for Foreign Investments in Pilot Free Trade Zones, shall remain to apply in this field. Considering the types of foreign investments provided in Article 2 of the Foreign Investment Law and the structure of the aforementioned provision, it can be reasonably inferred that the national security review system for foreign investment in the future may be similar to the mode in the pilot free trade zones and cover all types of foreign investment, rather than be limited to mergers and acquisitions of domestic enterprises by foreign investors. Such mode of review may better meet the needs for the protection of national security in complicated circumstances that may change from time to time as well.

It is worth noting whether “the decision on security review legally rendered shall be the final decision” has the same effect as “no administrative reconsideration and administrative litigation may be filed against any decision on the national security review rendered in accordance with the present Chapter” under the Foreign Investment Law Draft (2015). Despite the fact that the national security review is a relatively special administrative function of the government and may involve large amount of confidential information concerning national strategy, the exemption of such decision from administrative reconsideration and administrative litigation entirely may result in the national security review being a “black hole” in the field of foreign investment if the approach of the Foreign Investment Law Draft (2015) is to be followed. It will be an important issue in the future establishment of national security review system for foreign investment as to how to connect the national security review decision with administrative reconsideration and administrative litigation under certain conditions.

3、 Conclusion

Compared to the drafts in the process of legislation, the officially promulgated Foreign Investment Law is more comprehensive and general. It explicitly specifies the regulatory system of pre-establishment national treatment and negative list in the field of foreign investment, clarifies the principles and rules of promotion and protection of foreign investments, and connects with the current laws and legal systems successfully. However, the generality of the provisions of Foreign Investment Law also makes its implementing effect remain to be observed in the following implementing measures and subsequent regulatory practice.