China Legal Update

New PRC Foreign Investment Law and Its Implementing Regulations

Presented by
Dr. Ulrike Glueck, Managing Partner CMS, China

29 April 2020
PART ONE

Introduction
Introduction

Content of Presentation

- Past Regulations
- New Foreign Investment Law
- Implementing Regulations to the Foreign Investment Law
- Details of Changes
- Main Impact on Companies
- New Developments due to Impact of COVID-19
Introduction

Background

For Decades

Foreign investment into China and foreign invested enterprises (FIEs) in China subject to separate set of regulations

Completely separate regulations for establishment and corporate changes in FIEs, e.g.
- PRC Law on Sino-foreign Equity Joint Ventures and Implementing Regulations
- PRC Law on Sino-foreign Cooperative Joint Ventures and Implementing Regulations
- PRC Law on Wholly Foreign-owned Enterprises and Implementing Regulations

Market access for foreign investors governed by Guideline Catalogue

All types of foreign investment subject to approval
Introduction

Background

Opening up Step by Step

Since October 2016: shifting from approval system to so-called Negative List approach

Negative List approach:
- Only projects in industrial sectors listed in Negative Lists remain subject to approval
- All projects in industrial sectors not included in Negative Lists only subject to recordal

Different Negative Lists for free trade zones (FTZs) and areas outside of FTZs

Next update of Negative Lists to be expected shortly

Negative Lists are regularly updated and shortened with each update
Introduction

Background

New Foreign Investment Law (FIL)

- **2015**: first draft with 170 articles
- **2019**: second draft with 39 articles
- **2019.3.15**: FIL was promulgated with 42 articles

A very long story in making

- **2020.1.1**: FIL took effect
PART TWO
Replacement of existing FIE laws

National treatment of foreign investments which do not fall into Negative Lists

Negative List administration system confirmed

Promotion and protection of foreign investment, including
- Local governments allowed to offer local incentives and obliged to perform them
- FIEs allowed to participate in standardization work
- Fair participation in government procurement
- Protection of intellectual property and trade secrets; no forced technology transfer

Establishment of foreign investment information reporting system

Establishment of foreign investment national security review system
FIL – a Great Leap Forward or just a Small Step Sideways?

PLUS

- FIL is an improvement compared to old FIE laws
- Special laws for FIEs abolished

MINUS

- FIL only contains general principles
- Stipulations are relatively general, short and vague
- Details need to be provided in implementing rules and ancillary regulations

In 2019 increasing calls of foreign investors and foreign governments for national treatment of FIEs and open market access

FIL reads like an answer to complaints of Trump administration; all key words are included
New Foreign Investment Regime

Details

✿ Flesh to the Bones

Implementing Regulations of FIL: effective since 1 January 2020; 49 articles

Various other supporting regulations on foreign investment; all effective since 1 January 2020; inter alia:

- Interpretations of the PRC Supreme People’s Court on Several Issues Concerning the Application of the FIL
- Measures for the Reporting of Foreign Investment Information
- Announcement on Matters Concerning the Reporting of Information on Foreign Investment
- Circular on Effective Work on Registration of Foreign – invested Enterprises for the Implementation of the FIL
- Notice on the Reform of Multi-Report Integration of Annual Reports
New Foreign Investment Regime

Details

Foreign Investment with Participation of Chinese Individuals

- Chinese individuals allowed to directly establish joint venture companies together with foreign investors
- New policies already confirmed by local regulations, e.g. in Shanghai, Jiangsu, Anhui and Zhejiang
- Foreign entities controlled by Chinese entities still deemed as foreign investors

- Article 35 of initial draft for comments of the FIL Implementing Rules was not implemented in the actual FIL Implementing Rules: A round-trip invested entity would have been exempted from the Negative List regulations under the FIL and, thus, de facto be treated as a domestic company, if its investor is an offshore entity which is wholly-owned by Chinese individuals, entities or other organizations, and such investment was reviewed by a state-level authority and approved by the State Council
New Foreign Investment Regime

Details

Negative Lists and National Treatment

Negative Lists

- **Special Administrative Measures for Access of Foreign Investment**
  - Started to be implemented since October 2016
  - Current version from 2019
- Foreign investors shall not invest in any sectors in which foreign investment is forbidden by the Negative List. Foreign investors shall meet the investment conditions stipulated under the Negative Lists for any restricted sector

Equal treatment

- State shall give national treatment to foreign investments which do not fall into the Negative Lists
- FIEs shall receive equal treatment as domestic companies
New Foreign Investment Regime

Promotion of Foreign Investment

- Policies on supporting the development of enterprises
- Equal Treatment
- Comments and suggestions of FIEs shall be sought
- When formulating foreign investment-related administrative regulations
- Establish a sound service system for foreign investment
- Keep improving service for foreign investment
- Establish multilateral and bilateral cooperation mechanisms
- Enhance international communications and cooperation for promotion of foreign investment
- Special economic zones
- Implement opening-up policy measures to a greater extent
- Catalogue of Encouraged Industries for Foreign Investment
- Enjoy preferential treatment in government finance, taxation, finance, land use, etc.
## Promotion of Foreign Investment

### Standardization work
- Equal participation in setting standards in accordance with the law
- Mandatory standards developed by State shall apply equally to FIEs and domestic enterprises

### Government Procurement
- No government or relevant department may obstruct or restrict any FIE from freely accessing government procurement
- FIEs can inquire and question relevant procurers and procurement agencies about any government procurement activity, and lodge complaints
- Strengthen the supervision and inspection of government procurement activities
- Needs to be seen in combination with China’s planned accession to UN Convention on Government Procurement
New Foreign Investment Regime

Promotion of Foreign Investment

<table>
<thead>
<tr>
<th>Intellectual Property Rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Punishment of intellectual property infringements</td>
</tr>
<tr>
<td>• Technology cooperation on the basis of free will and business rules</td>
</tr>
<tr>
<td>• No forced technology transfer</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Trade Secrets – Obligations of Authorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Keep confidential any trade secret of foreign investors or FIEs</td>
</tr>
<tr>
<td>• Limit the provision of materials or information involving trade secrets</td>
</tr>
<tr>
<td>• Establish internal management system and take effective measures to protect trade secrets</td>
</tr>
</tbody>
</table>
New Foreign Investment Regime

Details

Promotion of Foreign Investment

Policy Commitments by Local Authorities

• Strictly keep their policy commitments made to foreign investors and FIEs
• Perform all contracts entered into in accordance with the law

Transparency of Normative Documents

• Normative documents relating to foreign investment shall be published in accordance with the law in due time
• Unpublished foreign investment related normative documents shall not be used as basis for implementing administrative management on foreign investment
# New Foreign Investment Regime

## Protection of Foreign Investment

### Expropriation
- Must follow statutory procedures
- To be carried out in a non-discriminatory manner
- Compensation shall be timely made based on fair and reasonable market value of expropriated investment

### Complaint Mechanism
- Joint conference system involving different ministries concerning complaints filed by FIEs shall be set up
- Department or agency to accept complaints filed by FIEs or their investors within the local area shall be designated
- Foreign investors and FIEs may apply for administrative review or administrative litigation

### Legal Liabilities of Government and Officials
- In case of unequal treatment, imposing higher technical standards, failing to fulfill policy commitments, forced technology transfer, unequal treatment in government procurement, etc.
- **Scope:** not stated in FIL Implementing Regulations; details currently unclear
New Foreign Investment Regime

Management of Foreign Investment

- Negative List
- Merger Control Filing
- Information Reporting System of Foreign Investment
- MSA registration, Licenses, DRC Approval/Recordal
- Security Review System
New Foreign Investment Regime

Details

Information Reporting System

- Applies to all projects
- Basically shift from former recordal requirement to mere reporting obligation, if project does not fall into Negative Lists

Practical impact

- Content wise no big change from recordal procedure
- Slightly less red tape; registration with MSA and reporting can now, generally, all be done in one online application

IN THE PAST

recordal certificate required by various other authorities and institutions, e.g. SAFE and banks – may lead to problems on a case by case basis;

NOW

however: now other authorities should have access to relevant information through a shared online system
New Foreign Investment Regime

Details

🌟 Information Reporting System

Scope to be Reported

- Foreign investors directly establishing FIE or partnership within China
- Foreign-invested holding companies, venture capital enterprises and partnerships with investment as primary business establishing enterprises within China
- Foreign investors engaging in production and operation activities within China
- Foreign investors establishing resident representative offices within China
Examples of Reporting

Initial Reports
- Establishment
- Acquisition of equity interests of domestic enterprises

Change Reports
- E.g. capital increases, share transfers, etc.
- Registration with Market Supervision Authority (MSA)
- Reporting only to Authority of Commerce (within 20 days of change, e.g. change of ultimate controller, information changes in tax relief for imported equipment)

De-registration Reports

Annual Reports (Customs, Tax, MSA, SAFE and MOT)
New Foreign Investment Regime

Main Impact on Companies

Old FIE laws cease to be effective
- Since 1 January 2020, FIE Laws have been abolished and the FIL now is the main legal basis for foreign investment in the PRC.

Organization Form of FIEs to be Adjusted
- Since 1 January 2020, organization form, institutional framework and standard of conduct of FIEs subject to the PRC Company Law, the PRC Partnership Enterprise Law, and other laws.
- Consequences: organization form, institutional framework and standard of conduct of the existing FIEs, which are not consistent with the PRC Company Law or the PRC Partnership Law, shall be changed.
- Major impact on Sino-foreign Equity Joint Ventures (“EJVs”) and Sino-foreign Cooperative Joint Ventures (“CJVs”).

Grace period of 5 years
- Existing FIEs have a grace period of five years, i.e. until 31 December 2024, during which they may retain their original organizational form before they must adapt to the new legal requirements.
## New Foreign Investment Regime

### Details

#### Main Impact on Companies

**Example: EJVs**

<table>
<thead>
<tr>
<th>Matters</th>
<th>Before: according to <em>PRC Sino-foreign Equity Joint Venture Law</em></th>
<th>After: according to <em>PRC Company Law</em></th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest Authority</td>
<td>Board of Directors</td>
<td>Shareholders’ Meeting</td>
</tr>
<tr>
<td>Quorum</td>
<td>At least two thirds of directors</td>
<td>None (unless otherwise stipulated in Articles of Association)</td>
</tr>
<tr>
<td>Voting on significant matters*</td>
<td>Unanimous approval by all directors</td>
<td>Approval by shareholders holding at least two thirds of voting rights</td>
</tr>
<tr>
<td>Legal Representative</td>
<td>Chairman of Board of Directors</td>
<td>Chairman of Board of Directors, Executive Director or General Manager</td>
</tr>
</tbody>
</table>

*Significant matters include amendment of Articles of Association, increase or reduction of registered capital, merger, demerger, change of company form, dissolution.*
New Foreign Investment Regime

Details

Corporate Governance of EJVs Before FIL

Parties appoint Directors and Supervisor(s)

- Party A
- Supervisory Board or Supervisor(s)
- Board of Directors
- General Manager/Management Office
- Party B

appointment supervision
New Foreign Investment Regime

Details

Corporate Governance of EJVs after FIL

- Shareholders’ Meeting
- Board of Directors or Executive Director
- Supervisory Board or Supervisor(s)
- General Manager/Management Office

appointment
 supervision
### New Foreign Investment Regime

#### Main Impact on Companies

**Example: EJVs**

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</thead>
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<tr>
<td><strong>Distribution of Profits</strong></td>
<td>In proportion to contribution to the registered capital</td>
<td>In proportion to paid-in contribution to the registered capital, unless otherwise agreed by shareholders</td>
</tr>
<tr>
<td></td>
<td>(mandatory; different arrangement only possible for CJVs)</td>
<td></td>
</tr>
<tr>
<td><strong>Transfer of equity interests to a third party which is not a current shareholder</strong></td>
<td>Unanimous approval by all other shareholders</td>
<td>Approval by more than 50% of other shareholders, unless otherwise stipulated in Articles of Association</td>
</tr>
<tr>
<td><strong>Total Amount of Investment</strong></td>
<td>Currently, in practice, concept of the total amount of investment of a FIE (which is a theoretical amount only which does not need to be actually paid in by shareholders, but which has relevance for financing capacity of a FIE via loans from abroad) still applies and needs to be stipulated in the Articles of Association. <strong>Note however:</strong> total amount of investment will no longer be registered by MSA</td>
<td></td>
</tr>
</tbody>
</table>

Note however: total amount of investment will no longer be registered by MSA.
New Foreign Investment Regime

Details

📍 Overall Assessment of Changes

**Good**
- Separate legal regime for FIEs abolished
- Important principles confirmed:
  - Equal treatment
  - Participation in government procurement
  - Protection of IP and no forced technology transfer

**Still Scope for Further Improvement**
- Negative List approach not abolished – still no full and unrestricted market access for foreign investors
- Many stipulations still general and vague
- Only part of special regulations for foreign investment abolished, e.g. Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors still exist – leads to uncertainties
- Replacement of recordal by reporting system basically mainly name change
Foreign Investment
New Developments due to Impact of COVID-19

Central and local governments eager to stabilize foreign investment

Various regulations promise supporting policies, e.g.

- Circular on Further Expanding Reform and Opening up to Stabilize Foreign Investment during COVID-19 Epidemic of MOFCOM of 1 April 2020

- Several Measures on Implementing the Opinions of the State Council on Further Improving the Use of Foreign Capital of Shanghai Government of 8 April 2020
Foreign Investment
New Developments due to Impact of COVID-19

Main Content

- MOFCOM will fully support FIEs in resumption of normal production and operation
- MOFCOM will speed up revision of Negative Lists and Catalogue of Encouraged Industries for Foreign Investment – number of items in Negative Lists will be reduced; sectors in which foreign investment is encouraged will be expanded, e.g. advanced manufacturing industries, energy saving and high-tech technologies, environmental protection, telecommunication
- Foreign investment in central, western and north-eastern regions are encouraged
- National Economic and Development Zones to play a driving role in stabilizing foreign investment and foreign trade
- MOFCOM will delegate decision powers further down to Authorities of Commerce at lower levels
- Service information platforms for foreign investment to be created or improved, e.g. www.fdi.gov.cn
- In Shanghai: qualified FIEs to be allowed to facilitate certain payments from capital account without having to provide supporting documents in advance
Foreign Investment
New Developments due to Impact of COVID-19

Important

- Some outdated regulations on foreign investment will be revised or abolished
- FIEs shall enjoy the same preferential policies issued due to COVID-19 as domestic enterprises

Assessment

- Above regulations mainly serve as comprehensive summary of various policies issued in the past 3 months
- Are directed to government entities and provide for working plans
- Announced plans still to be implemented
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CMS, China

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<tr>
<td>Commercial</td>
<td>Machinery, Equipments and Manufacturing</td>
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<td>Banking &amp; Finance</td>
<td>Technology, Media &amp; Communications</td>
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<td>Competition</td>
<td>Lifesciences and Healthcare</td>
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<td>Consumer Products</td>
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<td>Chemical</td>
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<td>Infrastructure &amp; Projects</td>
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<td>Tax &amp; Customs</td>
<td>Hotels &amp; Leisure</td>
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<td>Energy &amp; Climate</td>
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Leading Firm for Corporate and M&A in China: Foreign Firms 2020

Recommended Firm for Corporate and M&A, China-based (International Firms) 2019

Notable Firm in M&A – Foreign 2019

China Business Law Awards – M&A (Inbound and domestic) 2020

China Business Law Awards – Tax 2020

Leading Firm for TMT in China: Foreign Firms 2020

Labour & Employment Firm of the Year (nominated) 2019

Leading Firm for Intellectual Property in China: Foreign Firms 2020
CMS Global

Staff > 8,000
Lawyers > 4,800
Partners > 1,100

Operating in 70 cities
Across 43 countries

19 PRACTICE AND SECTOR GROUPS WORKING ACROSS OFFICES

EUR 1.36bn turnover for 2018

49 NEW PARTNERS IN 2019, TAKING THE TOTAL TO OVER 1,100

Ranked 5th largest law firm (by headcount) in the 2018 Am Law Global 100

- #1 CEE, DACH, Germany (Mergermarket)
- #1 Germany, UK (Thomson Reuters)
- Top rankings in 2018 M&A League Tables (by deal count)
- #1 Europe, Germany, UK (Bloomberg)
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