

## Draft Implementation Regulations on the New Foreign Investment Law (for public comments) Certain clarifications on the upcoming legal framework of foreign investments in the People's Republic of China

Long expected after the enactment by the National People's Congress of the People's Republic of China of the new Foreign Investment Law (the "FIL") on March 15, 2019 (due to come into effect on January 1, 2020 as a replacement of the current laws and regulations governing the foreign invested enterprise (the "FIE")), the Draft Implementation Regulations on the Foreign Investment Law (the "Draft Regulations") were released by the Ministry of Justice of the People's Republic of China on November 1, 2019 for public comments before promulgation. It aims to further regulate and clarify the general principles set forth in the FIL, which are basically concerned with national treatment, non-discrimination, investment facilitation and protection of investment. While providing for much needed details inducing certain commentators to find it "surprisingly accommodating to concerns"<sup>1</sup> of foreign investors, it still leaves many issues unaddressed that will need to be regulated at a later stage. Especially, the changes to be implemented by the existing FIEs during the transition period in order to reflect the provisions of the FIL are left to be determined by the Administration for Market Regulation (the "AMR") with seemingly no strict obligation nor right for a foreign investor to force amendment to existing joint-venture agreements.

### ❖ Pre-establishment national treatment and non-discrimination

The core principles of the FIL, which are detailed by the Draft Regulations, are that of "Pre-establishment National Treatment" and "Non-Discrimination", whereby all foreign investors shall be subject to discrimination-free national treatment on equal basis with domestic investors for all their investments in the PRC unless such investments

fall within the scope of the "Negative List" which prohibits or restricts investments in certain limited sensitive sectors (conditions as to shareholding ratio, governance, etc.).

The currently effective Negative List was last published on June 30, 2019 (*Please refer to the current version of the list [here](#)*). It is expected to be further simplified and replaced by a shorter list by June 2020 in the wake of the FIL's effectiveness.

Subject to the Negative List, measures as to guarantee foreign investors' non-discriminatory national treatment include the following:

- » Free establishment, either individually or jointly with other investors (including Chinese nationals), without necessity to establish a foreign-invested enterprise (the Draft Regulation aims to facilitate non-equity investment in the PRC);
- » FIE governed by the PRC Company Law as domestic companies;
- » Equal access to public procurement (no local government being entitled to impose on the foreign investors stricter conditions);
- » Right to apply for and obtain permits and licenses as required to specific sector/activity on the same conditions and procedure as those applicable to domestic investors;
- » Entitlement to government funding arrangements, land supply, tax incentives, etc. equally with domestic investors;
- » Right to request judicial examination, as part of a lawsuit, on local regulations/policies applied to foreign investor ;
- » Prohibition on public authorities to require from foreign investors to apply higher technical standards than domestic ones or to

<sup>1</sup> Comment by Mr. Joerg Wuttke, president of the European Chamber of Commerce in China

transfer technology as a condition to investment;

- » Prohibition on public authorities to apply to foreign investors non-published regulations or policies;
- » Prohibition on public authorities to formulate or implement any discriminative policies or restrictive measures to foreign investors.

#### ❖ Protection of foreign investment

“Pre-establishment National Treatment” and “Non-Discrimination” principles are further strengthened by a set of rules aiming to protect the foreign investors’ rights and interests while taking account of their foreign nature.

Especially:

- » Duty on local authorities to publish and ensure equal access to legal information (including procurement) by the foreign investors;
- » Duty on local authorities to ensure confidentiality of material or information involving trade secrets of foreign investors;
- » Entitlement by foreign investors and their employees to free conversion and remittance from the PRC to the overseas of their contributions to investment, profits, dividends, incomes, royalties, salaries, etc. without any restriction on currency, amount, or frequency of remittance but subject to applicable laws (NB: given the general context worldwide, it is however unlikely that exchange control is softened);
- » Entitlement by foreign investors to legal certainty (public authorities are forbidden to terminate or vary contracts with or commitments to foreign investors except in the national interests or social public interests);
- » Establishment by the PRC State of a multiple-layers settlement mechanism and a punitive penalty mechanism with respect to IP infringement.

However, those protection measures are broadly of a vague and general nature, with no sanction being provided in the Draft Regulations in case of violation or non-implementation by public authorities which would aptly secure their enforcement.

#### ❖ Promotion of foreign investment

In addition to protective measures, the Draft Regulations also aim to promote the foreign investments by:

- » Maintaining the right of local authorities to implement foreign preferential treatment in specific industries, fields or regions, subject however to national approval;
- » Allowing the foreign investors to seek financing within or outside the PRC through public offering of stocks and corporate bonds, public or non-public offering of other financing instruments, obtaining loans from financial institutions or by other means, subject however to national laws and regulations.

Notwithstanding these welcoming principles, it seems more likely that the PRC government actually wishes to restrict all local incentives which are not granted in accordance with national laws and regulations in an effort to control the flows of investment countrywide. Moreover, it is yet uncertain whether it is the intent of the PRC government to actually allow for more flexibility by the foreign investors to seek foreign financing (either as banking or as shareholders’ loans), and especially whether the ratio total investment Vs/ registered capital will be withdrawn. Further comments and regulations by the relevant authorities (especially the AMR and the exchange control authority) will be highly anticipated.

#### ❖ Transition Periods for Existing FIEs

As required by the FIL, the existing FIEs should modify their corporate governance structure to make it compliant with the new law (*Please refer to LPA-CGR SmartNews China CHINA’S NEW FOREIGN INVESTMENT LAW, DECLARATION OF PRINCIPLES OR REAL LEGAL REVOLUTION?*).

With a view to allow for a seamless transition, the Draft Regulations provides for a three-phase process:

**Phase I – 5-year transition period** from January 1, 2025 to December 31, 2024: all existing FIEs are encouraged to effectuate the required modification and the relevant registration;

**Phase II – 6-month grace period** from January 1, 2025 to June 30, 2025: all existing FIEs who have not registered the said modification are requested to effectuate the required modification and the relevant registration;

**Phase III – Non registration** from July 1, 2025: all FIEs who have failed to effectuate the required modification and the relevant registration during Phase II will be barred from doing so.

During this transitional period, the authorities may in practice require existing FIEs to update their articles of association in order to be in line with the Company Law.

It is unclear however to what extent should the parties to an equity joint-venture have the right (or obligation) to vary their contractual arrangements regarding governance, profit distribution and such that were agreed to implement the mandatory provisions of the then applicable rules and regulations governing the equity joint-ventures, as the Draft Regulations expressly provide that contractually agreed provisions of the parties to existing equity/cooperative joint-venture involving a

FIE will continue to be effective after the implementation of the FIL for the duration provided in the relevant contract. In light of the foregoing, the announced guidelines to be promulgated by the AMR will be highly anticipated.

#### ❖ Conclusive comments

In spite of certain unclarity and practical uncertainties which remain to be identified and addressed, the Draft Regulation provides an encouraging background for the development of foreign investments and the improvement of PRC business environment (both in terms of promotion and protection) for foreign investors, which is all the more remarkable by contrast to the observable trend within European countries and the USA to strengthen their control of foreign investments.

Our team will continue to follow up any evolution on the Draft Regulations and/or other draft laws and regulations in connection with the FIL.

Our dedicated team remains at your entire disposal for any additional information you may need.



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