

Brave New World (2): Now for the PRC Foreign Investment Law Implementing Regulations

The *PRC Foreign Investment Law* (《中华人民共和国外商投资法》, “**FIL**”) and its *Implementing Regulations* (《中华人民共和国外商投资法实施条例》, “**Implementing Regulations**”), took effect on January 1st, 2020. This means a single set of unified guiding documents has replaced the previous foreign investment regime, which mainly consisted of *PRC Foreign Invested Enterprise Law* (《中华人民共和国外资企业法》), *PRC Sino-Foreign Equity Joint Venture Law* (《中华人民共和国中外合资企业法》) and *PRC Sino-Foreign Cooperative Joint Venture Law* (《中华人民共和国中外合作经营企业法》) (see our earlier update on the [FIL on August 12, 2019, “Alert on FIL”](#)).

The Implementing Regulations restate general principles to promote foreign investment in China by enhancing protections for foreign investors and addressing concerns concerning unequal market access, weak intellectual property protection and forced technology transfers, and provide more details and clarity on the FIL.

Foreign Investment Regime

As we mentioned in our Alert on the FIL, “National Treatment” is the keyword of the reform to foreign investment legislation. As of January 1st, 2020, a “pre-entry national treatment and negative list” approach has replaced the previous “negative list and filing” approach in the PRC foreign investment regime, creating a more level playing field and promising a more stable, fair, consistent and predictable foreign investment environment.

According to Articles 34 to 37, currently foreign investment may be regulated in four respects:

1. MOFCOM and its local counterparts – responsible for approving establishment, change of registration of foreign-invested enterprises (FIEs) subject to the negative list, and for managing foreign investment information reporting¹;
2. National Development and Reform Commission and its local counterparts – responsible for approving foreign investment projects;
3. Regulatory authorities of each special industry – responsible for review and approving

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specific industry licenses;

4. State Administration for Market Regulation (SAMR) – responsible for registration, including registration of, establishment and subsequent changes to FIEs.

Apart from these regulations, reviews and approvals for antitrust and national security may also be required where a proposed foreign investment amounts to a concentration of undertakings or there is any national security concern.

Details and Clarity on FIL

- Definition of Foreign Investment

Before the promulgation of the FIL, Chinese individuals were not eligible to set up a new FIE with foreign investors. Article 2 of the FIL defines foreign investment as investment activities, directly or indirectly, conducted by foreign individuals, companies, or other organizations in China. However, the FIL is silent on the eligibility of Chinese shareholder/partner to become party to a foreign investment. This lack of clarity is addressed in Article 3 of the Implementing Regulations which states that Chinese individuals are eligible to set up a new FIE or invest a new project with foreign investors.

We discussed the variable interest entity (“**VIE**”) structure in our Alert on the FIL, a contractual arrangement used by Chinese companies in foreign restricted or prohibited industries to foreign investment that seek to be financed or listed outside China and which have been tolerated by the Chinese government for many years. The FIL neither clearly defines “indirect investment” nor addresses the question of whether the VIE structure will be governed by the foreign investment regime. The Implementing Regulations, rather than adopt the “control” approach in the 2015 Draft FIL, take the same silent position as the FIL. Therefore, it is still not clear whether the VIE structure is covered by the catch-all category of “investment in other forms as stipulated in laws, administrative regulations or permitted by the State Council” as set out in Article 2 of the FIL.

Also, the Implementing Regulations leave us the question about how we treat round-trip investments. Article 35 of the Draft Implementing Regulations is a safe harbor provision for round-trip investments. According to Article 35, round-trip investments made by offshore companies wholly invested by Chinese investors (including Chinese individuals, entities and other organizations), upon approval of the State Council, may be exempted from being subject to restrictions under the negative list. The Implementing Regulations however have removed this safe harbor provision. Therefore, registration and regulatory requirements under Circular 37 on round-trip investments should continue to be applicable as before.

- Protection of Intellectual Property Rights

Article 22 and Article 23 of the FIL emphasize the protection of intellectual property rights of foreign investors and FIEs. Article 22 bars government officials from using administrative measures to force technology transfers. Article 23 prohibits administrative or other officers from disclosing foreign investors’ and FIEs’ trade secrets. As we

observed in our Alert of FIL, the definition and legal consequences arising from “forced technology transfers” are left unclear in the FIL. Article 24 and Article 43 of the Implementing Regulations seem to be an attempt to address such lack of clarity. Article 24 lists four means of administrative interference – administrative licensing, administrative inspection, administrative punishment, administrative enforcement, and Article 43 generally mentions that person(s)-in-charge and other directly accountable person(s) responsible for the “forced technology transfer” should be punished.

- **More Assurance of Enforceability of Government Commitments and Contracts**

Article 25 of the FIL requires governments to honor policy commitments made to, and contracts lawfully entered into with, foreign investors and/or FIEs. Article 27 and Article 28 of the Implementing Regulations provide us with more detail about such requirements under the FIL. Article 27 of the Implementing Regulations defines “policy commitments” as written commitments made by governments at all levels within their authority, including supporting policies, preferential treatment and facilitating measures. And Article 28 of the Implementing Regulations specifies that administrative division adjustments, re-election of government, organizational or functional adjustments or replacement of relevant responsible personnel should not be defenses for breach of contract between the government and foreign investors and/or FIEs. In addition, legal consequences for breach of contract by government and relevant officers are generally mentioned in Article 41 of the Implementing Regulations.

Conclusion

The FIL and its Implementing Regulations have been effective for 3 months. In practice, we are still in a transitional period from the previous “separated” administrated foreign investment regime to the new unified one. For example, registration and reporting practices still vary from locale to locale subject to different guidelines of local regulatory authorities. Although the Implementing Regulations give more clarity and provide more detail in respect of the FIL, the language is still vague in some respects and some pending issues in FIL are still left unresolved in the Implementing Regulations. We understand the government is trying to reform the foreign investment regime so as to systematically arrive at a solution for all pending and controversial issues. While the Chinese government is working to improve its foreign investment regime, we will need to await the issuance of follow-up implementing documents as well as corresponding revisions to laws in other areas to ascertain how the rights and interests of foreign investors will be protected in practice.

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¹ Following promulgation of the Implementing Regulations, the Ministry of Commerce (MOFCOM) and State Administration for Market Regulation (SAMR) jointly issued the *Foreign Investor Information Reporting Measures* on December 30th, 2019, and on the following day, MOFCOM issued the Notice Regarding Foreign Investor Information Reporting Related Matters to clarify details of foreign investment information reporting matters.