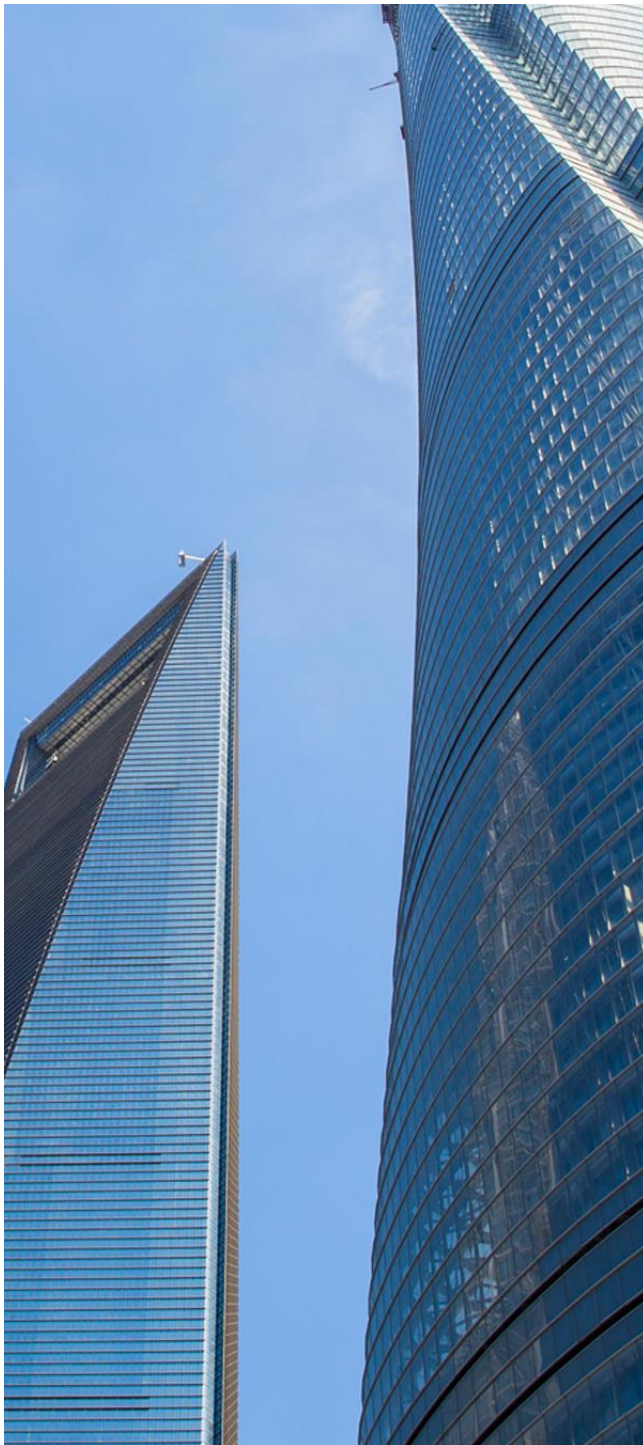


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# China's Foreign Investment Law

Corporate legal flash

March 2019



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## Summary

On March 15, 2019, the Second Session of the Thirteenth National People's Congress passed the Foreign Investment Law of the People's Republic of China (the "Foreign Investment Law"), which will come into effect on January 1, 2020.

When it does, the current "Three Foreign Investment Laws" (i.e., the Law on Wholly Foreign-owned Enterprises, the Law on Sino-foreign Equity Joint Ventures and the Law on Sino-foreign Cooperative Joint Ventures) will be simultaneously abolished.



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## China's Foreign Investment Law

On January 19, 2015, the Ministry of Commerce (“MOFCOM”) published the Foreign Investment Law of the People’s Republic of China (Draft for Comment), which had 170 articles. Four years later, on March 8, 2019, a largely reduced draft, with only 41 articles, was tabled for discussion at the Second Session of the 13th National People’s Congress. On March 15, 2019, the Foreign Investment Law was passed with 42 articles, which will take effect from January 1, 2020, at which time the current “Three Foreign Investment Laws” will be abolished.

The Foreign Investment Law was enacted to serve as a fundamental law on foreign investment in China, covering promotion, protection and management of investment in this area. This legal flash summarizes the highlights of foreign investment management.

### Definition and scope of foreign investment

Foreign investment includes investment activities that foreign individuals, enterprises and other organizations directly or indirectly carry out within the territory of China, including:

- establishing foreign-invested enterprises (“FIEs”), independently or jointly with other investors;
- acquiring shares, equities, assets and any other similar interests of a domestic enterprise;
- investing in new projects, independently or jointly with other investors; and
- carrying out other investments stipulated under laws, administrative regulations and provisions of the State Council.

Under the Foreign Investment Law, the forms of foreign investment extend from greenfield investment to include mergers and acquisitions, investment in new projects, and others. However, it does not clarify whether Chinese individuals can qualify as other investors to set up FIEs with foreign investors and whether the current regulations governing mergers and acquisitions will remain in effect.

The minimum percentage (i.e., 25%) of foreign investment to qualify as an FIE has been removed, and the Foreign Investment Law introduces the concept of indirect foreign investment, which is yet to be defined.



The Foreign Investment Law does not specify the applicability to investments from Hong Kong, Macao and Taiwan. However, on March 15, 2019, Premier Li Keqiang stated in a press conference that those investments can refer to the Foreign Investment Law, and previous arrangements and current practices that have worked well for a long time will continue to be followed. We expect that supplementary regulations will be issued to clarify this matter.

### **Management of foreign investment**

#### **> Access management and information reporting system**

The Foreign Investment Law establishes a national access management system consisting of national treatment plus a negative list. Foreign investors are prohibited from investing in the prohibited category. In the restricted category, foreign investments must meet the conditions established in the negative list. Foreign investment outside the negative list will be treated in the same way as domestic investment.

Under previous administrative regulations issued by MOFCOM and the National Development and Reform Commission (the “DNRC”), the negative list management system has been in place since 2016, and it was last updated in 2018.

Currently, foreign investment:

- in the prohibited category is forbidden;
- in the restricted category is subject to approval by MOFCOM and its local counterparts; and
- outside the negative list is subject to record filing with MOFCOM and its local counterparts.

Once the Foreign Investment Law becomes effective, the “Three Foreign Investment Laws” will be abolished simultaneously, which will result in the disappearance of the legal grounds for the above approval and record-filing procedures. Although the Foreign Investment Law has introduced an information reporting system, detailed rules are yet to be established.

We expect that detailed management measures will be issued to regulate specific foreign investment.



- Management of foreign investment projects

Approval and record filing of foreign investment projects will still be carried out under existing regulations. Currently, the in-charge authority is the NDRC and its local counterparts.

- National security review system

Under the Foreign Investment Law, a foreign investment security review system will be established to review the foreign investment that affects (or could affect) national security. The decision made in this review system will be final.

- Governance structure of FIEs and transition period

The Foreign Investment Law nullifies the governance structure established under the “Three Foreign Investment Laws” and provides a five-year transition period for FIEs to adapt.

Given the previous legal framework and the number of enterprises, Sino-foreign equity joint ventures (“JVs”) will be most affected. In the next section, we summarize the most important changes to the governance structure of JVs.

### **Changes to the governance structure of JVs**

Previously, the governance structure of JVs was established under the Law on Sino-foreign Equity Joint Ventures and the implementing regulations (the “JV Laws”). Under the JV Laws, the highest authority was the board of directors, under which a management office was established to be in charge of the day-to-day management and operation of JVs.

However, the Foreign Investment Law requires the governance structure of JVs to be in line with the Company Law. Under the Company Law, the highest authority will be the board of shareholders, under which a board of directors or executive director will be established and accountable to the board of shareholders. The board of directors or the executive director can appoint the manager to be in charge of the day-to-day management and operation of the JVs.

The table below summarizes the major differences between the two laws concerning the highest authority and the profit distribution in a limited liability company.



	JV Laws	Company Law
<b>Highest authority</b>	Board of directors	Board of shareholders
<b>Members</b>	≥ 3 directors, appointed by the shareholders with reference to the percentage of their respective capital contribution	All shareholders, but ≤ 50 shareholders
<b>Quorum</b>	2/3 and above	No
<b>Deliberation rules</b>	<p>4 issues require unanimous approval of the directors attending the meeting:</p> <ul style="list-style-type: none"><li>- amendment to articles of association (the “AoA”)</li><li>- suspension or dissolution</li><li>- increase or decrease of the registered capital</li><li>- merger or division</li></ul> <p>Others are subject to rules provided under the AoA.</p>	<p>4 issues require the affirmative vote of shareholders representing at least 2/3 of voting rights:</p> <ul style="list-style-type: none"><li>- amendment to AoA</li><li>- dissolution or change of company form</li><li>- increase or decrease of the registered capital</li><li>- merger or division</li></ul> <p>Others are subject to rules provided under the AoA.</p> <p>Voting rights may or may not be in proportion to the capital contribution.</p> <p>Resolution of the shareholders meeting can be passed in writing, provided all shareholders have signed it.</p>
<b>Profit distribution</b>	Profits must be shared in proportion to respective contributions to the registered capital.	Profits can be distributed based on the actual contribution of registered capital; however, the shareholders can decide otherwise.

With the abolishment of the JV Laws, the concept of joint venture contract (the “JVC”) no longer exists. Whether it will be maintained or changed into other forms of agreement (e.g., shareholders agreement) is yet to be clarified.

Although a five-year transition is provided, allowing existing JVs to maintain their current governance structures, with the abolishment of the JV Laws, whether clauses that conflict with the Company Law will still be effective during this period is still in question.



Once the Foreign Investment Law is implemented, we recommend that existing JVs amend their JVCs or AoA as soon as possible, as the State Administration for Market Regulation (the “SAMR”) and its counterparts may refuse to proceed with any corporate changes before these documents have been amended.

Main amendments include but not limited to:

- changing the highest authority from the board of directors to the board of shareholders;
- introducing clauses related to the powers and deliberation rules for the board of shareholders; and
- revising the establishment, quorum, powers and deliberation rules for the board of directors.

This transformation may lead to a new round of negotiations between JV shareholders, and we expect that the State Council will issue the specific implementing measures separately to provide guidance on this transformation.

### **Conclusion**

The Foreign Investment Law aims to establish principles that will create a more equal environment for foreign investors. However, the vague provisions and lack of detailed rules create uncertainties for implementation. The Foreign Investment Law is also silent on whether the regulations and rules based on the Three Foreign Investment Laws will continue to be effective, especially those that NDRC, MOFOM and SAMR have issued regulating specific management procedures. We expect that detailed implementation regulations will be issued to unify and clarify the regulatory matters relating to foreign investment.



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