China’s New Draft Foreign Trade Investment Law

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The National People’s Congress Standing Committee (NPCSC) released a draft proposal of the new PRC Foreign Investment Law on December 26, 2018, which will be available for public comment until February 24, 2019. This new draft law will serve as a replacement to the prior draft, which the Ministry of Commerce (MOFCOM) proposed in 2015, and is significantly shorter (the prior draft included 170 articles, while this present draft only has 39). In addition, if implemented, it will repeal three existing sets of laws: the Sino-Foreign Equity Joint Venture Enterprise Law, the Wholly Foreign-Owned Enterprise Law, and the Sino-Foreign Cooperative Joint Venture Enterprise Law. The intention of the draft law is to resolve many areas of confusion that existed amongst these prior laws. However, many of its provisions are still vague and leave a large number of questions unanswered regarding implementation and enforcement.

According to MOFCOM spokesperson Gao Feng, the new draft law seeks to achieve three objectives. The first is to establish a new statutory scheme for foreign investment, known as “pre-establishment national treatment plus negative list.” The second objective is to place more emphasis on promotion and protection of foreign investment, as well as provide clearer guidance to implementing institutions in order to achieve these aims. The third objective is to limit the scope of regulation to foreign investors and their investment practices, as opposed to the structure, operation, and management of such foreign enterprises. Further, the draft law’s provisions may have an impact on the current trade war between the United States and China, as MOFCOM has stated that both countries have been in trade talks via phone call and intend to arrange a face-to-face meeting in the near future.

Scope and Objectives

In its General Provisions, the draft law establishes the scope and objectives of the law. Its purpose is aimed at promoting foreign investment and protecting the legitimate rights and interests of foreign investors, all in order to improve the development of the social market economy (art. 1). The scope of the law covers foreign investment within China, foreign investment being defined as “investment activities carried out directly or indirectly by foreign natural persons, foreign enterprises and other foreign organizations (‘foreign investors’) in China” (art. 2). This definition, along with the Article 2 clause that states “foreign-invested enterprises refers to enterprises registered and established in China in accordance with the Chinese laws, which are wholly or partly invested by foreign investors,” can be interpreted to now include variable interest entities (VIEs), where in the past they were excluded from Chinese foreign investment law.

Article 2 further specifies that the type of conduct that can be regulated under the draft law includes: “1) foreign investors, independently or jointly with other investors, invest[ing] in new projects, set[ting] up foreign-invested enterprises or increase investment in China; 2) foreign investors obtain[ing] shares, equities, property shares or other similar rights and interests of Chinese domestic enterprises through mergers and acquisitions; and 3) foreign investors invest[ing] in China through other means stipulated in laws, administrative regulations or other provisions of the State Council.” In addition, the draft law establishes a mechanism of pre-entry national treatment plus negative list which shall be implemented by the competent commerce or investment department under the State Council, and explains that a “negative list” consists of measures stipulated by the State regarding foreign investment access to specific areas (arts. 4 and 7).

Investment Promotion

For the purposes of promoting foreign investment, the draft law equally applies policies that support enterprise development to foreign-invested enterprises, permits foreign-invested enterprises to make suggestions regarding foreign investment to relevant lawmaking authorities, and introduces a foreign investment service system that provides advice and services regarding laws, investment project information, etc. (arts. 9-11). In addition, the draft law introduces multilateral and bilateral mechanisms for investment cooperation and promotion with other countries, international organizations, etc., as well as pilot policies and measures in specific regions to promote foreign investment, and preferential measures to encourage foreign investors to invest in specific industries, fields and regions (arts. 12-14). Foreign-invested enterprises are required to receive equal treatment regarding standardization work and government procurement, and they may raise funds through public issuance of stocks, corporate bonds, etc. (arts. 15-17).

Investment Protection

The draft law elaborates on several other issues that serve the purpose of enhancing protection for foreign-invested enterprises. For example, (1) expropriation will not be imposed on foreign investment enterprises unless it is necessary for public interest needs and reasonable compensation is provided; (2) capital contributions, profits, capital gains, intellectual property royalties (IPRs), and indemnity or compensation may freely be transferred overseas in either RMB or foreign currency; and (3) IPRs and the legitimate rights and interests of IPR holders are protected (arts. 20-22). The draft law also limits the powers of governments at all levels and
their relevant departments regarding regulation of foreign-investment enterprises, specifically prohibiting them from illegally impairing or reducing the legitimate rights and interests of foreign-invested enterprises and illegally setting market access and exit conditions (art. 23). Governments are also bound by the policies made to foreign investors and foreign-invested enterprises, and if any changes to the national policy need to be made, they shall be made in strict accordance with statutory powers and procedures, and any foreign-investors or foreign-invested enterprises that suffer losses must be compensated (art. 24).

In addition, foreign-invested enterprises are now given more options to safeguard their own interests. The draft law will establish a complaint mechanism, coordinate and improve policy measures to handle such complaints, and promptly resolve problems reported by foreign-invested enterprises (art. 25). The draft law also allows foreign investors and foreign-invested enterprises to establish chambers of commerce and associations in accordance with law, as well as carry out activities and make regulations and articles of association (art. 26).

Investment Administration

In general, foreign investors must comply with relevant governing rules, local and national, when carrying out foreign investment. Generally, they may not invest in fields or sectors prohibited on the negative list for foreign investment; however, if they do, they must satisfy the conditions stipulated on the negative list to permit investment. Review, approval, and record-filing of foreign-investment projects; application for and review of special licenses; and registration, taxation, accounting and foreign exchange matters of a foreign-invested enterprise all must be handled according to the relevant laws, regulations and procedures (arts. 29-30). The draft law also establishes two systems for monitoring the conduct of foreign investors and foreign-invested enterprises. It first establishes an information reporting system, where foreign investors and foreign-invested enterprises are required to submit investment information to competent authorities via the enterprise registration and credit information disclosure systems (art. 31). It then establishes a security review system that conducts security reviews of foreign investment that “affects or may affect the national security,” and provides that decisions from such security review system shall be final (art. 33).

Legal Liability

Finally, the draft law includes several other provisions that describe the scope of conduct to which foreign investors and foreign-invested enterprises must adhere in order to avoid legal liability, as well as other measures that seek to ensure the draft law is implemented fairly. Foreign investors and foreign-invested enterprises that invest in fields or sectors that are prohibited by the market access negative list will be ordered to stop such activity, dispose of any shares or assets or any other necessary measures within a specified time limit, return to the status that they were in before the occurrence of the prohibited investment, and relinquish any legal gains (art. 35). The draft law also prohibits Chinese staff members of the governmental departments that implement and enforce this law from abusing their powers, neglecting their duties, or engaging in malpractice for personal gain in the course of carrying out these provisions, and imposes criminal liability and punishment for violations (art. 34). In addition, foreign investors or foreign-invested enterprises that had been established under the three repealed foreign investment laws have been given five years after the law's implementation to adjust to the standards and requirements of the new draft law (art. 39).

Future Impacts of the Draft Law

One of the most noteworthy changes that this new draft law would bring is extending the scope of the definition of “foreign investment” to also include VIEs. Before the draft law, one of the main advantages of establishing a VIE in China was that VIEs were not subject to foreign investment law regulations, and thus they did not have to comply with the registration and establishment procedures. Under this new law, those who seek to establish a VIE in China will have to complete these steps, which now include but are not limited to “pre-entry national treatment” and the “negative list.” More importantly, this could have adverse effects on VIEs that have already been established in China with the understanding that they would be subject to significantly less regulation. This law would give such VIEs five years to adjust to the new laws or be shut down.

It is presently unclear how soon or even whether this new draft law will be implemented. Interestingly, when the NPCSC met at its 7th session on December 29, 2018 and announced the agenda and date of the 2019 NPC session (March 5, 2019), the draft law was noticeably lacking from the agenda. In light of this, there are two possibilities that may occur. The first is that the draft law may still be included in the March session. However, because the draft law's comment period will have just ended on February 24, the NPCSC will have had very little time, barely more than a week, to thoroughly review the comments and take them into consideration in their decisions. It is also possible that the draft law may not be discussed until the NPCSC's next meeting the following year. However, postponing the foreign investment law for an additional year may be an inconvenient decision in light of the current talks between China and the United States regarding the trade war.

Furthermore, the draft law still maintains a large amount of ambiguity as to exactly how it will be implemented and enforced in practice. The majority of its rules lay out general standards of what the draft law is intended to ultimately accomplish, rather than specific rules instructing foreign investors and law enforcement officials on how they may carry out their roles and responsibilities. For example, the rules say that foreign investors and foreign-invested enterprises will be compensated in the event of expropriation, which will only occur as a result of public interest needs, but there is no explanation of what such needs may look like, leaving much room for interpretation. The rules also state that any changes that are made will be made in accordance with statutory powers and procedures, and that foreign investors and foreign-invested enterprises will be compensated in the event of
such changes. However, this rule leaves open a wide range of possibilities as to what this law could evolve into with no clear insight as to where its boundaries lie. Finally, beyond prohibiting officials from abusing their powers or engaging in illegality, there is very limited guidance as to exactly how they will ultimately carry out their regulation and oversight duties. These are only a few of the ambiguities that can be found within the provisions of the draft law. With this said, if the draft law is implemented, it is likely that MOFCOM and other authorities will issue subsequent regulations and measures further clarifying these matters. Ultimately, it remains to be seen exactly what kind of effect this draft law, if implemented, will have on foreign investors and foreign-invested enterprises in practice within China.