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China Publishes New Draft of Foreign Investment Law

On December 26, 2018, the National People's Congress ("**NPC**") of China published the draft F**oreign Investment Law** ("**New Draft**"), seeking for public opinions. This draft is considered as an updated version based on a draft made by China's Ministry of Commerce which was published four years ago ("**MOFCOM Draft**")[1].

Notably, comparing to the MOFCOM Draft, the scale of the New Draft shrinks significantly from 170 articles to 39 articles, with certain aspects removed from the scope of the law and various detailed implementation rules replaced by more generic articles.

Among other changes, we would like to highlight the following new developments in the New Draft:

1. New Definition of Foreign Investment

Pursuant to the New Draft, the "foreign investment" refers to the investment activities of foreign investors in new projects, establishment of foreign-invested enterprises, or increase of investment in mainland China, or acquisition of stock shares, stock equity, property shares or other similar rights and interests in mainland Chinese enterprises through mergers or acquisitions. In the meantime, the New Draft also authorizes the State Council to further indicate other forms of foreign investment.

Comparing to the MOFCOM Draft, which implies that contractual control over the Chinese enterprises by foreign investor would also constitute "foreign investment", the New Draft has taken a more conservative attitude towards this controversial issue. This may reflect the ambivalence of the Chinese legislators over the widely used "VIE" structure, which features the contractual control of the onshore companies by offshore special purpose vehicles ("**SPVs**"). This kind of contractual control structure has been applied so that the Chinese companies may receive foreign funding (mainly by getting their controlling offshore SPVs listed at foreign stock markets) while still keeping their legal status as domestic companies, so as to maintain the legal qualifications for the operation in the foreign investment restricted/prohibited areas.

Having said so, taking into account the recent challenge from the Chinese government on the VIE structure in specific area (i.e. pre-school education services[2]), it is not clear what will be the final resolution of the Chinese government on this issue.

2. Promotion and Protection of Foreign Investment

The New Draft highlights equal treatments of foreign investors operating in China and bans mandatory technology transfers requested by administrative authorities or their officials. It also indicates that local governments are required to keep their promises to the foreign investors and honour the investment agreements with the foreign investors according to the laws.

[1] See our commentary on the MOFCOM Draft at https://www.garrigues.com/en_GB/new/draft-foreign-investment-law-chinas-reform-regime-foreign-investment-0

[2] On November 15, 2018, *Opinions Regarding the Deepening the Reform and Standardizing the Development of Pre-school Education* jointly released by the Communist Party of China Central Committee and the State Council prohibits the control of kindergartens or non-profit kindergartens invested by the State assets or collective assets through VIE structure.

3. Foreign Investment Administrative Systems

The New Draft affirms that the State implements the management scheme of pre-establishment national treatment plus negative list. Since the relevant detailed rules of those administrative systems have already been covered by administrative regulations previously published by the State Council, the New Draft does not go into further details.

4. Five-Year Transition Period

Same as MOFCOM Draft, the New Draft also aims to transform the current administration system of foreign investment and to replace the three existing laws on joint ventures and wholly foreign-owned enterprises. The joint ventures and wholly foreign-owned enterprises established so far based on the three existing laws will be given a five-year transition period to perform necessary changes on their corporate forms in order to be compliance with the laws applicable at that time (which will be mainly the Company Law of the PRC).

Comparing to the MOFCOM Draft which provided a three-year transition period, the New Draft has provided two additional years for the foreign invested companies to make adaptations to the then applicable laws.

By emphasizing the principles of protecting foreign investments while keeping silent on the controversial topics, the new draft of Foreign Investment Law sends out the positive messages that China intends to pacify the foreign investors by making assurances and addressing some of their major concerns. As it may take a few more years for the Foreign Investment Law to be formally enacted, it is advisable for the investors to keep track on the future development of this new law.

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Follow us

3205 West Gate Mall 1038 Nanjing Xi Lu
200041 Shanghai
T +86 21 5228 1122
F +86 21 6272 6125
shanghai@garrigues.com

China World Trade Center 1 Jian Guo Men Wai Avenue
(Tower 1 – Office 1815) - 100004 Beijing
T +86 10 8572 0000
F +86 10 8572 0020
beijing@garrigues.com

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