After years of deliberation, the PRC National People’s Congress issued the PRC Foreign Investment Law ("FI Law") on 15 March 2019. The law will enter into effect on 1 January 2020 and will – among others – apply to all foreign investment enterprises ("FIEs") within the territory of the PRC.

Once entering into effect, the FI Law will be the comprehensive law governing foreign investment activities in the PRC. Forthwith, the PRC Wholly Foreign-Owned Enterprise Law ("WFOE Law"), the PRC Sino-Foreign Equity Joint Venture Enterprise Law ("EJV Law") and the PRC Sino-Foreign Cooperative Joint Venture Enterprise Law ("CJV Law") will be abolished.

The issuance of the FI Law corroborates the trend of unifying the legislation for domestic and foreign investments in China.

Once in effect, the FI Law will adjust the corporate legal framework governing FIEs in many aspects, some of which will materially impact on the operation of the existing FIEs and some of which will impact the strategy applied by foreign investors to enter the PRC market.

For existing FIEs the FI Law provides a five years transition period (counted as of 1 January 2020 and hence lapsing on 31 December 2024) to adjust their corporate governance to the new system of the FI Law.

Since the FI Law is a very simple and short piece of legislation, many aspects of the actual application will be subject to (yet to be published) specific implementing measures.

This publication is hence designed to summarise the key points of the FI Law. At the same time, one shall closely monitor the issuance of the specific implementing measures of the FI Law.

1. **Definition of “Foreign Investment”**

Prior to the FI Law, no PRC law actually defined what shall be considered “foreign investment”. The FI Law defines “foreign investment” as investment activities carried out (in-)directly by foreign natural persons, foreign enterprises and other foreign organisations in China, including the following investment models:

- Foreign investors, independently or jointly with other investors, set up FIEs in China

- Foreign investors obtain shares, equity, property shares or other similar rights and interests in Chinese domestic enterprises

- Foreign investors, independently or jointly with other investors, invest in new projects in China
Investment through other means stipulated in laws, administrative regulations or provisions of the State Council

Thus far, the WFOE Law, EJV Law and CJV Law mainly focus on foreign investments in the form of direct corporate investments. Additionally, certain other foreign investment schemes were governed by other (non-law-ranking) legislation, such as e.g. the “Provisions on Foreign Investors’ Merger with and Acquisition of Domestic Enterprises”.

Compared with the existing legislation, the FI Law applies a seemingly much more comprehensive definition of what constitutes “foreign investment”. In part, such definition appears to be open to a substantial degree of interpretation as to what does and what does not qualify as “foreign investment”.

Terms such as “foreign investors obtain other similar rights of Chinese domestic enterprises” or “investment through other means” (likely intentionally) lend themselves to wide interpretation. They could e.g. be used to reign in investment forms that are designed to circumvent the many still existing restrictions for foreign investment in China (e.g. in internet, telecoms and other restricted industry sectors). Hence, any such circumventive structures that thus far seemed to fly somewhat under the radar of governmental scrutiny (such as e.g. variable interest entity structures (“VIEs”)) may want to re-assess if the corporate set-up may require modification under the new FI Law in order to minimise compliance risks.

2. Pre-entry National Treatment Plus Negative List Mode

According to the FI Law “pre-entry national treatment” means that at market-access level, the conditions offered to foreign investors and their investments in China shall not be less favorable than the conditions granted to Chinese investors.

In addition to such general provision of the FI Law, the so-called “Negative List for Market Access” applies. Such list is a table of prohibitions and licensing requirements that applies to both domestic and foreign companies in China. The latest version of the Negative List for Market Access was released by the National Development and Reform Commission (“NDRC”) on 25 December 2018 and categorises industries as either “prohibited” or “restricted”. Sectors that are not explicitly mentioned in the negative list are considered “permitted” industries, meaning that they do not have special requirements for investment. For companies looking to enter a “restricted” industry sector, the negative list stipulates the relevant procedures, standards and approvals that need to be attained before access to that market is granted.
Foreign investors are not allowed to invest in fields prohibited in the negative list for foreign investment.

Foreign investors intending to invest in the fields of the “restricted” category shall satisfy the conditions stipulated in the negative list, e.g. foreign investment shall not exceed a certain percentage of shareholding ratio.

The negative list is to date supplemented by the “Special Administrative Measures on Access to Foreign Investment” (“FI Measures”). Before the FI Law enters into effect, foreign investors considering to establish a company in China shall first check the FI Measures to see if investment by foreign shareholders is permitted in the intended industry sector and under what ownership structure (e.g. WFOE, JV, etc.), before moving on to the negative list to see if any further licensing or certification requirements apply.

At least until the end of 2019, the investment itself is then implemented based on laws and regulations for specific types of FIEs (i.e. JV, WFOE). These FIE specific laws and regulations will then be abolished by 31 December 2019.

3. Corporate Governance of FIEs

Corporate governance structures of FIEs are currently governed by specific laws such as the WFOE Law and the JV Laws. Where such specific laws lack provisions, the PRC Company Law applies.

Once the FI Law enters into effect on 1 January 2020, the specific corporate governance rules of the WFOE and JV Laws will be abolished and henceforth only the PRC Company Law (and for partnerships the PRC Partnership Law) will apply.

While for WFOEs the resultant changes will be in most cases more limited (because the corporate governance structure under the WFOE Law generally corroborates with the PRC Company Law), the changes for Joint Ventures will be more profound. While thus far EJVs had no formalised Shareholders’ Meeting this will henceforth become the highest organ. The Board of Directors (or Executive Director) will then become a subordinate organ to the Shareholders’ Meeting.

Also, the EJV Law requires that certain decisions require unanimous consent of all members of the Board of Directors (irrespective of the majority/minority ratio of the shareholders). Under the PRC Company Law (provided the articles of associations of the company do not provide otherwise), a majority of two-thirds of the votes is sufficient to resolve any matter subject to approval by the Shareholders’ Meeting.
Another major change will concern equity transfer transactions of EJVs. According to the EJV Law, where an EJV shareholder intends to transfer any equity interest in the EJV to a third party, all other EJV shareholders must agree. In practice, this often led to substantial disputes and deadlocks. Under the PRC Company Law, a proposed transfer of equity by a shareholder to a third party is subject to consent of more than half of the votes of the other shareholders (unless otherwise stipulated in the articles of associations of such company). Where more than half of the other shareholders do not consent to the transfer, such non-consenting shareholders must acquire the equity interest to be transferred and failure to do so shall be deemed as consent to the transfer to the third party.

One may presume that for many EJVs the new FI Law will trigger re-negotiations of existing agreements. All FIEs existing before 1 January 2020 will have time until 31 December 2024 to implement the necessary changes. Also, it is expected that specific implementing measures will be issued by the PRC State Council to provide guidance on how to proceed with such changes.

**4. Total Amount Investment / Foreign Debt Threshold of FIEs**

The “total amount of investment” is a concept only applies in such form to FIEs. It refers to the sum of funds for operating the enterprise, i.e. the sum total of registered capital funds and working capital necessary for reaching the operation needs of the FIE.

The registered capital of a FIE refers to the total amount of capital registered with the enterprise registration authorities, i.e. all the capital subscribed by the shareholder(s).

FIEs have thus far been required to observe the following “debt-equity ratio” between total investment and registered capital:

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<th>Total Investment (TI)</th>
<th>Minimum Registered Capital</th>
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<tr>
<td>≤ USD 3 million</td>
<td>70% of the TI</td>
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<tr>
<td>USD 3 – 10 million</td>
<td>50% of the TI (if the TI is &lt; USD 4.2 million, at least USD 2.1 million)</td>
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<tr>
<td>USD 10 – 30 million</td>
<td>40% of the TI (if the TI is &lt; USD 12.5 million, at least USD 5 million)</td>
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<tr>
<td>&gt; USD 30 million</td>
<td>33.3% of the TI (if the TI is &lt; USD 36 million, at least USD 12 million)</td>
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The total amount of investment sets the threshold for foreign debt that can be assumed by a FIE. This means FIEs are permitted to take out foreign exchange debt (e.g. foreign exchange loans (including shareholder loans)) up to a maximum amount of the difference between their total amount of investment and the registered capital.

Once the FIE specific laws are abolished by end of 2019, the concept of the “total investment amount” will lose its legal basis. One may presume (though this is subject to future confirmation by the PRC legislators) that as of 1 January 2020, the general provisions for determination of foreign debt thresholds already now applicable to domestic companies will then also become applicable to FIEs.

5. Choice of Law for FIE Shareholder Agreements

From a general PRC legal perspective, parties to a “foreign-related” contract may choose the law that governs the contract between them, unless PRC laws require otherwise. Such “foreign-related” characteristics are in particular established if at least one party to a contract is not a PRC domestic enterprise.

However, since PRC laws provide explicitly that Joint Venture Contracts must be governed by PRC laws, thus far there was no choice of law for such contracts available under PRC laws.

It remains to be seen how the expected implementing rules for the FI Law will address this matter and if potentially shareholders of FIEs would be free to have their shareholder agreements governed by foreign laws if they so choose.

6. Prohibition of Forced Technology Transfer

Foreign investors have long feared the forced technology transfers often connected to their investment activities in the PRC. In that context, the FI Law stipulates that technical cooperation matters shall be negotiated and determined by the parties concerned based on the principles of voluntariness, equality and fairness. It goes on to say that forced transfers using administrative measures by the administrative organs and their staff members are prohibited. How much impact such clause will have in practice in the future remains to be seen, but at least this provision grants a certain leverage to argue against such forced transfers where they would be encountered in the future.
7. Profit Distribution

Under the EJV Law, dividends shall be allotted to the shareholders in proportion to their registered capital ratio. With the abolishment of such law as of the end of 2019, the general provisions of the PRC Company Law will apply also concerning dividend distribution. According thereto, the shareholders can agree on the profit distribution plan as they deem fit and are not bound by the registered capital ratio if they wish to deviate therefrom.

The FI Law also provides that dividends may be transferred out of China in RMB or foreign exchange in accordance with law. Hence, the foreign exchange control restrictions will still have to be adhered to.

8. Governmental Reporting and Supervision Systems for FIEs

Prior to October 2016, all FIE projects required at least approval by the Ministry of Commerce (MOFCOM) (or its subordinate authorities) and registration by the State Administration of Industry and Commerce (SAIC) (or its subordinate authorities).

With the introduction of the negative list, many FIEs no longer required MOFCOM approval but only SAIC registration. Still they had to record their FIE projects though the MOFCOM online platforms.

The FI Law now provides that a unified “foreign investment information reporting system” shall be established, taking into account also the existing administrative management regimes for FIEs, e.g. NDRC investment projects approval/recordal, operating license management, anti-monopoly review, etc..

Finally, the FI Law affirms that a security review system shall apply to review foreign investment projects that (may) affect national security.

The detailed implementation for such information reporting regime and security review remain to be published by legislators in the future.
9. Outlook

The promulgation of the FI Law is a significant legal development for FIEs in China. Compared with a much more detailed draft of the FI Law circulated in 2015 (which contained over 170 articles), the finally promulgated version now only contains a mere 42 articles.

This alone exemplifies that the FI Law on its own is a very high-level outline of certain core principles but that the actual implementation of such law will largely depend on yet unknown implementing regulations, interpretations and guidelines.

Hence at this early stage of the FI Law, the main takeaway for foreign investors is to know that currently little action is necessary other than to monitor how the future implementing regulations, interpretations and guidelines will impact their investments in China.