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M E M O R A N D U M

TO: Addison-Clifton, LLC Clients

FROM: Addison-Clifton, LLC Asia Market Services

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SUBJECT: China's New Foreign Investment Law and Negative Lists

On Friday, March 15, 2019, the National People's Congress of China adopted the Foreign Investment Law (the "Law") by a 2,929 to 8 vote, with 8 abstentions and 3 delegates not voting. Effective January 1, 2020, the Law will replace China's fragmented foreign investment regulatory regime. There are three separate foreign investment laws that are currently in effect which were enacted in the early years of China's economic reform: Chinese-Foreign Equity Joint Ventures Law, Wholly Foreign-Owned Enterprises Law and Chinese-Foreign Contractual Joint Ventures Law. The Law includes 6 chapters with a total of 42 articles. It is an abridged version of the 170-article draft the Ministry of Commerce ("MOFCOM") released in 2015. The China State Council has the authority to promulgate implementing rules by the Law's effective date.

Key Definitions. Chapter I provides a few definitions and guiding principles *vis-à-vis* foreign investment. It defines "foreign investors" as any "natural person, enterprise, or other organization of a foreign country" and "foreign-invested enterprises" ("FIEs") as any enterprise that is established under China law that is wholly- or partially-invested by foreign investors. The Law further defines "foreign investment" as any foreign investor's direct or indirect investment in mainland China, including: (1) establishing FIEs, either individually or jointly, with other investors; (2) acquiring shares, equity, property shares, other similar rights and interests in China domestic enterprises; (3) investing in new projects, either individually or jointly, with other investors; or (4) making investments through other means provided by laws, administrative regulations or the State Council.

Article 4 creates a "pre-establishment national treatment plus negative list" as the basic statutory scheme. Conceptually, China will treat foreign investment no less favorably than domestic investment during the "investment access stage" (defined as

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the “establishment, acquisition, expansion, and such other stages of an enterprise”), unless the negative list provides otherwise. Article 4 also specifies that, when a treaty to which China is a party provides for more favorable treatment of foreign investment at the access stage, China is not obligated to - but simply “may” - follow such provisions.

Promoting Foreign Investment. Chapter II sets out a list of policy measures for promoting foreign investment. Under this chapter, China will treat foreign and domestic investments equally with respect to the application of business development policies, formulation of standards and application of compulsory standards and government procurement. In addition, the government will: (1) consult FIEs when formulating rules on foreign investment; (2) promptly make public legal documents or judicial rulings related to foreign investment; (3) provide counseling and services on a range of topics to foreign investors and FIEs; and (4) publish foreign investment guidelines for their convenience. FIEs are also allowed to raise capital by issuing securities or through other means.

Protecting Foreign Investment. Chapter III lists a few protective measures for foreign investment. Article 20 provides that, in general, investments by foreign investors are not subject to governmental expropriation. Under “special circumstances” and “for the public interest,” the China Government may expropriate or requisition its investments, but must “promptly” provide “fair and reasonable compensation.”

Article 22 prohibits forced technology transfer by administrative measures.

Article 23 bars government employees from “disclosing or unlawfully providing to others” trade secrets they learn at work. Article 24 essentially bars local governments from interfering with national foreign investment laws and policies. Article 25 requires local governments to fulfill their policy commitments to, and contracts with, foreign investors and FIEs. If national or public interest require changing the commitments or contractual terms, they must compensate foreign investors and FIEs for any loss that is sustained as a result of the change. Article 26 allows FIEs and their investors to file complaints against administrative agencies and their employees through an “FIE complaint working mechanism.” This article specifies that the working mechanism does not replace other remedies that are available under the existing law.

Regulating Foreign Investment. Chapter IV includes provisions regarding regulating foreign investment. Article 28 bans foreign investors from investing in prohibited industries on the negative list. Foreign investors must comply with the specified requirements when investing in restricted industries on the negative list. When a license is required to enter a certain industry, the foreign investor must apply for one, and the China Government must treat the application the same as one by a domestic enterprise, except where laws or regulations provide otherwise (Article 30). Article 34 requires foreign investors or FIEs to file information reports, and violations are punishable with a fine of up to RMB 500,000. Article 35 mandates national security review of foreign investment that “affects or may affect national security” and provides that national security review decisions are final (presumably not subject to administrative reconsideration or judicial review).

Legal Responsibilities. Chapter V governs legal responsibilities of foreign investors. Under Article 35, if a foreign investor invests in a prohibited industry, it will be ordered to cease investment activities and restore the *status quo* (e.g., dispose its shares or assets and forfeit any illegal proceeds). If a foreign investor who invests in a restricted industry violates the conditions that are specified on the negative list, the foreign investor will be ordered to make corrections to satisfy the conditions by a specific date. If the foreign investor fails to comply, the investor will then be deemed to have invested in a prohibited industry subject to the applicable penalties. Any violation of laws or regulations by a foreign investor or an FIE will be recorded in the enterprise credit information system governed by the Provisional Regulations on the Disclosure of Enterprise Information and other rules (Article 38).

Under Chapter VI, the Law authorizes China to take reciprocal measures against jurisdictions that discriminate against China investment (Article 40). The Law also makes it clear that where other laws or regulations have contrary provisions for the management of investments by foreign investors in financial industries or making investments in financial markets, those specific provisions prevail (Article 41). Upon its effective date, the Law will repeal China's three current foreign investment laws. FIEs will then have five years to comply with China's general corporation and partnership laws.

Negative Lists for Foreign Investment. On June 28, 2018, China's National Development and Reform Commission ("NDRC") and MOFCOM jointly released the Special Administrative Measures on Access to Foreign Investment (Negative List) (2018 Version) (the "2018 Nationwide Negative List") which took effect on July 28, 2018. The 2018 Nationwide Negative List contains 48 restricted and prohibited sectors for foreign investment, which is reduced from 63 sectors identified in the 2017 negative list. Under the "negative list" regime implemented since 2016, foreign investment in sectors outside the negative list is regulated in essentially the same manner as investment by domestic investors and does not require prior approval from MOFCOM.

Most of the revisions in the 2018 Nationwide Negative List reflect recently-announced measures that are aimed at relaxing certain foreign investment restrictions. These measures, with respect to the specified sectors, remove: (1) the prohibition on foreign ownership; (2) the requirement for Sino-foreign joint venture; (3) the requirement for China majority ownership; and (4) foreign ownership cap, and other operational restrictions. Affected sectors range from financial services, transportation, professional services, infrastructure, energy and resources to agriculture. The particularly notable changes include increasing the foreign ownership limit up to 51% for certain financial services businesses, with the cap to be abolished by 2021, and foreign ownership limits in various automobile sub-sectors to be abolished between 2018-2022.

On June 30, 2018, the NDRC and MOFCOM jointly released the Special Administrative Measures on Access to Foreign Investment in Free Trade Zones (Negative List) (2018 Version) (the "2018 FTZ Negative List") which went into effect on July 30, 2018. The 2018 FTZ Negative List applies to the 12 Pilot Free Trade Zones

from Shanghai to Hainan and impacts 45 restricted and prohibited sectors. This revised list opens up certain sectors that are either restricted or prohibited under the 2018 Nationwide Negative List. In addition to these two Foreign Investment Negative Lists, it is worth noting that on December 21, 2018, the NDRC and MOFCOM jointly promulgated the Negative List for Market Entry (the “Market Entry Negative List”) which identifies those businesses that are generally prohibited from investment by any investor (whether Chinese or foreign) and those regulated businesses that are subject to licensing requirements. All foreign investors must also comply with this Market Entry Negative List, which includes the banning of investment in police training schools, movie imports, post office business and internet news.

If you have any questions regarding the Law or the negative lists, please do not hesitate to let us know.