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CLIENT ALERT

NPC Approves China's New Foreign Investment Law

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On Friday, 15 March 2019, the National People's Congress (the "***NPC***"), the highest legislative body of the People's Republic of China (the "***PRC***"), approved the Foreign Investment Law (the "***FIL***"). Widely viewed as an olive branch to help facilitate a resolution of China's trade war with the United States, the drafting and promulgation of the FIL proceeded very rapidly. The NPC Standing Committee circulated a first draft for public comments on 26 December 2018 and produced a revised draft on 29 January 2019. President Xi Jinping then immediately signed this revised draft, which the NPC officially promulgated on 15 March 2019. The FIL is set to come into effect on 1 January 2020.

The FIL is meant to promote increased foreign investment into China, mainly by enhancing protections for foreign investors' rights and interests, in particular by addressing concerns raised by the United States and other countries such as forced technology transfer, weak intellectual property protection, and limited overall market access.

The FIL differs significantly from China's previous attempt to reform its foreign investment regime, the Draft Foreign Investment Law, which the Ministry of Commerce circulated for public comments on 19 January 2015 (the "***2015 Draft***"). Relative to the 2015 Draft, the FIL is much more high-level, having only 41 articles in total and lacking significant detail regarding implementation. Though much of the FIL merely restates existing Chinese law and practices, it does make a number of important changes:

- **Repeal of the Three FIE Laws**. The FIL replaces China's three existing laws on foreign investment enterprises ("***FIE***") (the Sino-Foreign Equity Joint Venture Enterprises Law; the Sino-Foreign Cooperative Joint Venture Enterprises Law; and the Wholly Foreign-Owned Enterprises Law) (the "***FIE Laws***").

  Any FIE established after the FIL comes into force shall, just like a domestic Chinese company, comply with the provisions of the PRC Company Law in terms of its organization, corporate governance, and structure and bylaws. FIEs established before this date are subject to a five-year transition period ("***Transition Period***").

  One major implication of the repeal of the FIE Laws is that all existing equity joint ventures ("***EJV***") and cooperative joint ventures ("***CJV***") will have to replace their board of directors as their highest decision-maker with a "shareholder assembly". This will involve amending joint venture contracts and articles of association and filing the same with the local Administration of Industry and Commerce.

- **Protection of Trade Secrets and Intellectual Property**. The FIL contained a number of last-minute amendments meant to protect trade secrets and intellectual property. In particular, one provision stipulates that government agencies and their officers must keep confidential all foreign investors and FIE trade secrets of which they become aware during the performance of their duties. Divulging or communicating such information could result in administrative liability or, in serious cases, criminal liability.

  The FIL prohibits forced technology transfers. As well, it further states that China will sanction all intellectual property infringements strictly in accordance with the prevailing laws.

  Though this language is, to some extent, effectively a restatement of existing law and practice, it is significant as it signals the seriousness of the Chinese government to help end trade tensions by addressing a major concern raised by the United States and other countries.

- **Reciprocal Treatment**. Though the FIL is clearly meant to liberalize China's foreign investment regime, foreign investors will not necessarily view all of its provisions positively. In particular, the FIL states that China may retaliate against countries that discriminate against inbound Chinese investment.

  This language is drafted broadly so as to allow Chinese regulators considerable latitude in exercising their discretion to retaliate against foreign investments from jurisdictions that discriminate against Chinese investment. Some may argue that such language is simply a statement of an already existing practice on the part of Chinese authorities and will not effect any meaningful change for foreign investors.

In addition to the above, the FIL also makes other stipulations, such as expanding the scope of China's national security review of foreign investments. However, it is also noticeably silent on certain issues, in particular that of the variable interest entity ("**VIE**").

The VIE structure involves using nominee shareholders, debt, or other measures to allow an investor to retain a controlling interest in an investment without having the majority of its equity or even any equity at all. It has been widely used by foreign investors to invest in restricted or prohibited industry sectors and also as a means for Chinese domestic companies to achieve an offshore financing or listing.

The 2015 Draft introduced the concept of "effective control", i.e., that the determination of whether an investor is domestic or foreign would depend upon its actual controller rather than its location of incorporation or domicile. As such, the 2015 Draft, if implemented, would have rendered illegal foreign VIE investments into restricted and prohibited sectors.

Interestingly, the FIL does not address VIEs. Nevertheless, when enumerating possible forms of foreign investments, Article 2 of the FIL includes "other forms of investment stipulated in laws, administrative regulations or by the State Council." This effectively ensures that there is still an opportunity for future regulation of the VIE structure.

We will continue to monitor this new law as it begins to roll out and implementing rules are issued. Readers are encouraged to contact Winston & Strawn's China team with any questions regarding the new FIL.
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