勤理

China’s New Foreign Investment Law (Draft)

On January 19, 2015, the Ministry of Commerce (MOFCOM) published a draft version of the Foreign Investment Law (FIL) to solicit public comments, together with an explanatory note on the FIL. The FIL represents the determination of the Chinese government to further liberalize foreign investment in the country in line with prevailing best practices worldwide. It is suggested that foreign investors who have invested or propose to invest in China to understand the trend that how China might interact with foreign investment in the near future.

Affected Legislation

Once the FIL has been enforced, China’s current three primary foreign investment laws, i.e., *WOFE Law*, *EJV Law* and *CJV Law* and relevant implementation rules will be superseded.

It is very likely that the *Tentative Provisions on Merger/Acquisition of Domestic Enterprises by Foreign Investors (Circular 10)* will be amended in accordance with FIL.

The foreign exchange control polices will certainly be adjusted to support the reform of foreign investment regime.

Definition of Foreign Investment

Foreign Investor	1) Foreigners, enterprises incorporated in accordance of laws of other countries or regions (foreign enterprises), foreign authorities, international organizations; and 2) Domestic enterprises **controlled** by entities listed in 1).
Foreign Investment	Investment activities directly or indirectly conducted by foreign investors, including green field investment, merger and acquisition, long-term financing, obtaining of franchise rights of exploring or developing natural resources/ constructing or operating infrastructures, obtaining of rights to real estate, controlling over domestic enterprises through **VIE structure** and transfer of de facto control of a domestic enterprise to foreign investor(s).

***NOTE*:** If a foreign enterprise is de facto controlled by a Chinese investor, such enterprise may, when applying for entry clearance for its investment within the restricted industries, submit written application for deeming its investment as the investment made by the Chinese investor.

Fundamental Changes

- National treatment: “negative list” approach is adopted, which only provides Prohibited Industries and Restricted Industries for the foreign investment. The foreign investor will be subject to the identical rules as domestic investors, unless its investment falls in the negative list or meets certain review thresholds;
- Limited entry clearance replacing foreign investment approvals: only foreign investment covered by the negative list will be required to apply for entry clearance;
- The corporate governance of foreign invested enterprises (FIEs) will be uniform with the domestic enterprise in accordance with PRC Company Law and will not be subject to the approval of MOFCOM any more;
- Information report to replace pre-approval: foreign investment not covered by the negative list will only be subject to the information report; Share transfer, capital increase and other changes of the foreign investment that used to require prior approvals can now simply be reported within 30 days;
- National security review regime: FIL integrates the national security review regime, which will be further applied to the foreign investments falling in the negative list that are considered as sensitive;
- Clarification on the relations amongst foreign investor entry clearance, business registration and industry permit;
- The concept of “control” and “de facto controller” are introduced;
- Legal liabilities: criminal liabilities are introduced against the violations of information report rules.

Impact on Existing FIEs

- Existing WOFEs will be treated as foreign investors;
- Risks to be deemed as non-compliance, if a foreign investor or an FIE engages in Prohibited Industries or in Restricted Industries without entry clearance, via nominee shareholder, trust, multilevel reinvestment, leasing, VIE structure or overseas transactions;
- Existing FIEs will need to adjust the corporate governance in accordance with PRC Company Law within the transitional period, e.g. establishment of shareholders’ meeting for EJV and adjustment of the enterprise type for CJV;
- How to deal with long-term financing, obtaining of franchise rights of exploring or developing natural resources/ constructing or operating infrastructures, obtaining of rights to immovable property within the transitional period is currently unclear;
- The changes subsequent to the enforcement of the FIL will be subject to the entry clearance and information report rules.

Impact on VIE structure

The FIL does not shut the door to the VIE structure. Instead, the FIL provides that (1) a VIE structure de facto controlled by Chinese investors is allowed and will not be subject to foreign investment restrictions; and (2) a VIE structure set up by foreign investor in the industries not covered by the negative list is permitted; while keeps silent on how to deal with those existing VIEs upon which the foreign investors circumvented the foreign investment restrictions. The potential impacts of FIL on the VIE structures would be as follows:

- The necessity to establish new VIE structures are reduced, as VIE would become an infeasible way to avoid foreign investment restrictions;
- The VIE structures used in Red Chip structure might draw the special attention of HK Exchanges, if such VIE structures are essentially not necessary;
- Pre-existing VIE structures might be challenged , if they are established for the purpose of circumventing the foreign investment restrictions.

Recommended Steps

The enforcement of the FIL will fundamentally change the current foreign investment regulatory regime in China. Affected foreign investors should consider the following steps:

- Review the corporate governance of the existing EJVs/CJVs to identify items that need/could to be adjusted for their best interests;
- Prepare for the strategy of the transition, as well as the strategy to negotiate with the Chinese partners;
- For those foreign investment relying on the VIE structures in sensitive industries, the foreign investors may need to look for new solutions;
- Design the investment structure to protect their interests, if foreign investor look for compliance via granting de facto controlling right to Chinese partners;
- Seek legal consulting and advices for better preparation of dealing with the new law.

Contact

For more information, please contact:

Nora Fu
Partner
+86 21 6141 1258
nfu@qinlilawfirm.com

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