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Foreign Investment Law in China 2020

At the beginning of this year 2020, the new investment law for China, the Foreign Investment Law (FIL 2020), came into force. The background for the current development is the increasing competitive situation between China and other economic powers in the world - China is aware that it can only offer an attractive framework for foreign investment with a rule of law and reliable order. The Foreign Investment Law 2020 follows China's path towards economic openness, which was initiated with its WTO membership. Bilateral trade agreements with the USA and other countries also support this development, while the trade agreement with the European Union is still being negotiated.

Reason for the new investment law

The new investment law is therefore based on further investment freedom for foreign companies in China. This is understood against the historical background, where a few decades ago foreign investment was only possible in the form of joint ventures - with considerable restrictions, such as majority ownership by a Chinese partner, technology transfer, further obligations to invest and others. Investments and the establishment of companies were only permitted with government approval based on a business plan that set equity requirements and provided for minimum investments. The approval procedures were sometimes extensive and often required up to six months of processing time or longer. The procedures in the authorities were also partly non-transparent and not always in conformity with the state requirements.
Private-sector as well as state-owned forms of enterprise were available, but overlapped with the requirements of investment law.
Another difficulty for investment in China for many companies was the critical situation regarding intellectual property, especially the lack of protection in the case of infringements of patents, copyright, trademarks and other property rights.
Another obstacle to investment was seen in the limited possibilities to acquire and use business real estate.
An important role is played by the investment catalogue, which is based not least on China’s five-year economic development plans. In it, the possible investments are classified as permitted, desired and prohibited. In each case, the investor needed a permit; for the permitted

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investments, the catalogue was already considered a general permit without the need to obtain an individual permit. The innovations in Chinese development were often tested in special economic zones, such as Shenzhen or Shanghai Pudong.

The new investment law

With the new investment law, the investment steps have now been streamlined. In principle, companies with foreign participation are now on an equal level with Chinese companies, with exceptions only in certain areas. The negative list has been reduced to less than 40 areas. Foreign companies are to have the same access to tenders as Chinese companies. The Investment Law prohibits the expropriation of investments without compensation. However, if a foreign company operates in a prohibited area without special permission, the Chinese state can confiscate the shareholding and the current profits from this engagement.

The Foreign Investment Law now also explicitly addresses authorities and their administrative procedures. It explicitly emphasises that local authorities are bound by the law and that, once made, official decisions and commitments may not be withdrawn by a successor in office without legal grounds. The law also clarifies that public officials may not disclose business secrets entrusted to them in the course of their official duties, but must continue to keep them confidential and secret.

Company law

Another major change is the streamlining of company law: the previous forms as Equity Joint Venture (EJV), Cooperative Joint Venture (CJV) and Wholly Foreign Enterprise (WFOE) have been abolished. Instead, there is only the normal legal form of the corporation, i.e. as a Limited, or the form of the partnership as a partnership. This eliminates the previous overlapping of regulations. The regulations on the WFOE are in principle unchanged and correspond to the law as it stood in 2018.

Joint ventures must be converted to the new structure within five years. This includes, among other things, that the board of directors no longer has control over the company, but that the shareholders are the highest body (board of shareholders).

The procedure for setting up a company has also been streamlined. The company no longer needs a business license, so the obligation to submit and approve the business plan is also eliminated. Approval by local business authorities is no longer required. The previous requirements for equity ratios in relation to the total investment and the ratio of the cash contribution are also no longer mandatory. With this simplified procedure, China is building on the experience gained from the tests in the special economic zones, where simplified procedures for business permits and simplified and accelerated registration procedures already existed in various cases.

Intellectual property

With regard to the protection of intellectual property, the focus is on the fact that the frequently required obligations to transfer technology in the case of investments have been dropped. The

Investment Law once again emphasizes that the protection of intellectual property through technical protection rights (patents, utility models, design protection), through copyright and trademark law should be guaranteed in any case and should correspond to international standards. However, the FIL has not formulated any substantial changes in terms of content, but wants to introduce more effective sanctions in the case of infringements, in particular punitive damages - the previous standards for damages, with almost only the usual license fees, were set too low. It also provides for improved legal protection in court. In this context, too, the Investment Act once again emphasizes the protection of trade secrets also vis-à-vis public authorities.

Real estate

In the case of real estate, the acquisition of property by foreigners is still restricted. As a rule, production areas continue to be leased for use. However, if property was allowed to be acquired, it is protected against expropriation and may not be expropriated without compensation.

Overall picture on investment law

In conclusion, the FIL formulates progress for foreign investment. The main ones are equality with Chinese companies, simplification of company law, access to Chinese tenders, shortening of the negative list from the investment catalogue, in principle more legal certainty and the abandonment of the compulsion to transfer technology.
However, the investment law is also criticized, especially because negative lists for investments still exist.
The text of the law is not very specific, it does not grant companies any concrete basis for claims and does not formulate clear rules for the implementation of claims. The law is more of a political declaration.
The companies concerned do not see any significant improvement in the area of IP protection.
It is seen as a political risk that the law once again expresses the principle of reciprocity: this means not only a positive effect through the possibility of access for foreign companies in China, but also, conversely, permissible countermeasures by China in the case of discrimination against Chinese companies abroad.

Reduction of the negative list for investments in 2019

Still in 2019 and thus to the introduction of the FIL, China had cut the negative list by some items:

Mining

Removal of the restriction that oil and gas exploration and development is limited to equity joint ventures and cooperative joint ventures. A WFOE is now allowed to engage in such businesses.
Removal of the ban on foreign investors from investing in the exploration and mining of molybdenum, tin, antimony and fluorite.

Production

Abolish the ban on foreign investors from investing in the production of Xuan paper and ink pens.

Production and supply of electricity, heating, gas and water.

Abolition of the restriction that the construction and operation of gas, heating and water supply and drainage networks for a city with a population of more than 500,000 must be controlled by the Chinese Party. Foreign investors are now allowed to hold majority stakes in such enterprises.

Transport, warehousing and postal services

Removal of the restriction that domestic shipping agencies must be controlled by the Chinese Party. Foreign investors may now hold majority stakes in such businesses.

Information transmission, software and information technology services.

Abolish the restriction on foreign investment in domestic multi-party communications, store-and-forward and call centre businesses.

Water management, environment and management of public facilities

Abolish the prohibition on foreign investors investing in the development of wildlife and plant resources originating and protected in China.

Culture, sports and entertainment

Abolish the restriction that the construction and operation of cinemas must be controlled by the Chinese Party. Foreign investors are now allowed to hold majority stakes in such enterprises.
Abolish the restriction that performance agencies must be controlled by the Chinese Party. Foreign investors may now hold the majority stake.

Free trade zones

Agriculture, forestry, livestock and fisheries

Abolish the rule that foreign investors are prohibited from investing in fisheries in China's territorial and inland waters.

Production

Abolition of the restriction that printing publications must be controlled by the Chinese party. Foreign investors are now allowed to hold majority stakes in such companies.

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