



**FANGDA PARTNERS**  
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# Recent Trends in the New Foreign Investment Law and JV Partner Issues

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**1. Foreign Investment Law : Recent Trends**

**2. Establishing and Operating a JV in China: JV Partner Issues**

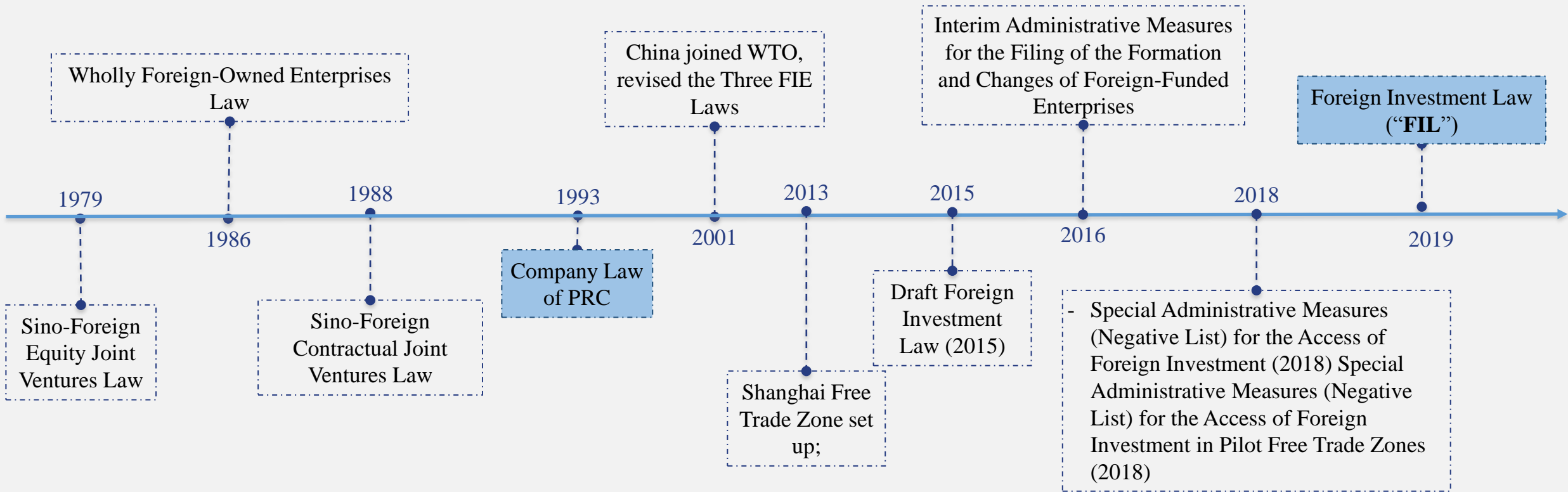
**3. Investment Agreement with the Management Committee of the Economic Development Zone**

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# Foreign Investment Law: Recent Trends

# Evolution of China's Foreign Investment Legal System

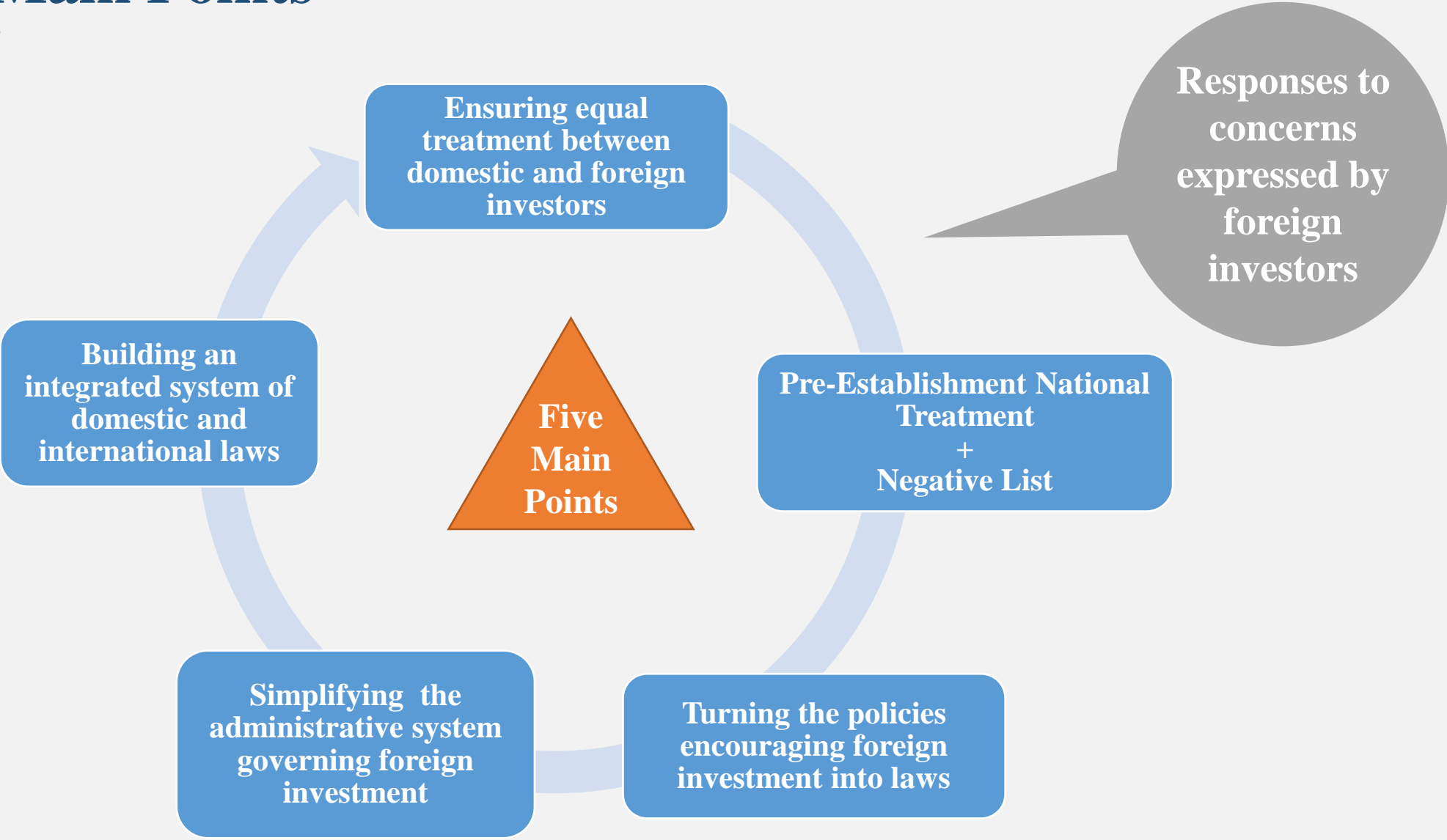


# FIL: Background

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- ◆ US – China Trade War: "Omnibus Report on Significant Trade Deficits" & Section 301 violations of the U.S. 1974 Trade Act
- ◆ More manufacturers relocating from China to Southeast Asia
- ◆ Industrial transformation and upgrades: Made in China 2025
- ◆ Ease of doing business: China jumps from 46th to 31th place (released on 31 October)
- ◆ Successful experiences in the establishment of Free Trade Zones

# FIL: Main Points



# FIL: Propaganda or substantial improvements?

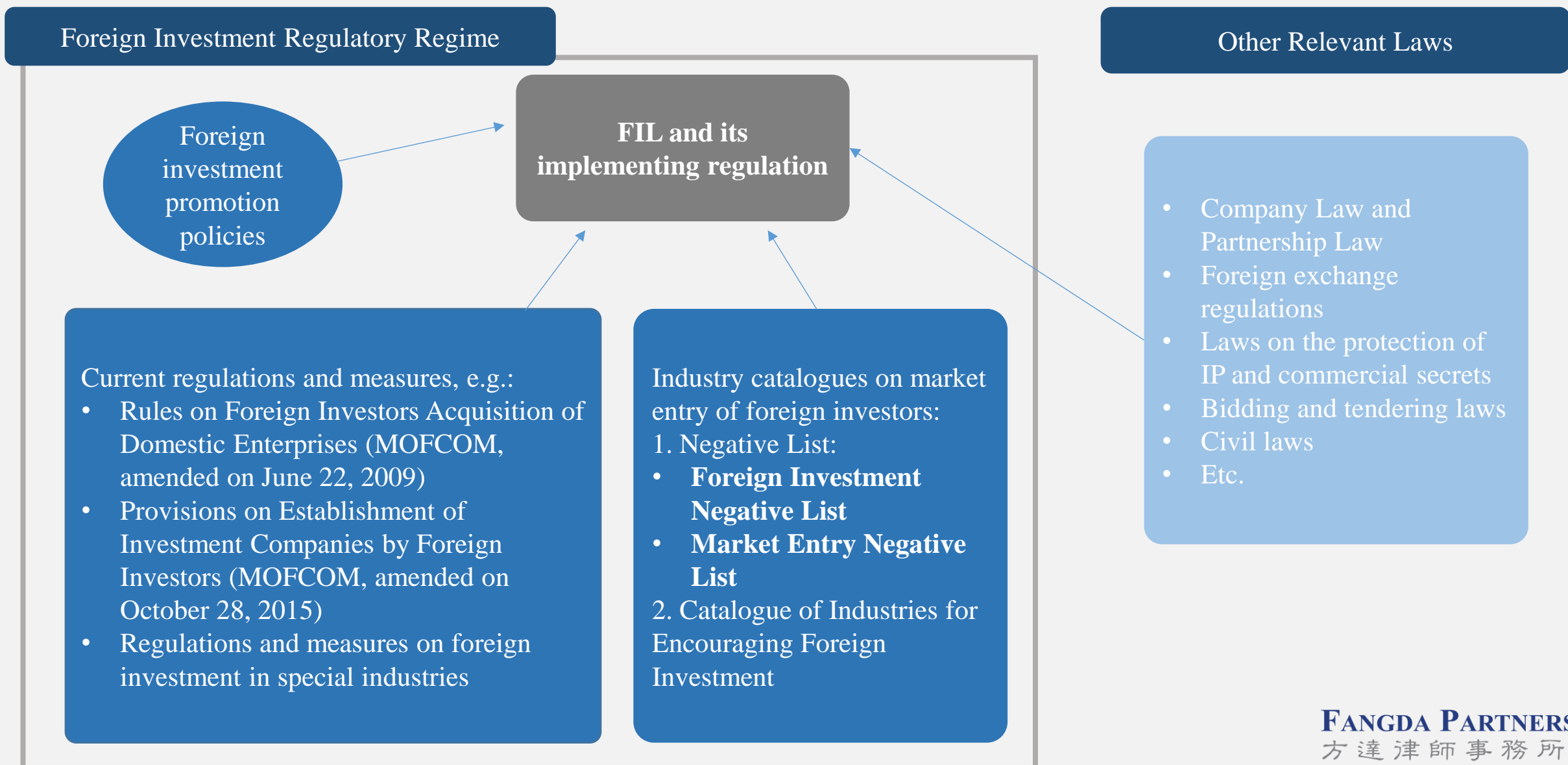
Criticism	Reponses
<p><b>Heavy regulatory burdens</b></p> <ul style="list-style-type: none"> <li>• Market entry</li> <li>• Licenses</li> </ul>	<p>Art 3: Opening-up policy and investment encouragement  <b>Art 4: National treatment + negative list</b>            Art 24: Protecting FIEs from unreasonable administrative infringement  <b>Art 30: Equal treatment in licensing</b></p>
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# FIL: Propaganda or substantial improvements?

Criticism	Reponses
<p><b>Compelled tech transfers (through JV agreements)</b></p>	<p><b>Art.22 : No forced technology transfers by administrative means</b></p>
<p><b>Inadequate IPR protection</b></p> <ul style="list-style-type: none"> <li>• A clear, unified system of penalties to deter intellectual property (IP) theft including through cyber means has not been well established</li> </ul>	<p><b>Art 22: IPR protection</b>  <b>Art 23: Trade secret protection</b></p>
<p><b>Discriminatory/Unfair treatment</b></p> <ul style="list-style-type: none"> <li>• Foreign investors receive less favorable treatment than domestic Chinese companies</li> <li>• FIEs can rarely participate in drafting and review of relevant laws and regulations</li> <li>• Not all technical standards development committees are open to foreign-invested enterprises (FIEs) on an equal basis</li> </ul>	<p><b>Art 15: Equal participation in setting standards</b>  <b>Art 16: Participate in government procurement activities through fair competition</b>  <b>Art 31: Equal application of Company Law, Partnership Law, etc.</b></p>



# FIL : Foreign Investment Regulatory Regime



# FIL: Latest Developments

Since the FIL, several regulations and rules relevant to FIL were released

## Foreign Investment Regulation

- *Implementing Regulation of the Foreign Investment Law (Draft for Public Consultation)* (Ministry of Justice, November 1, 2019; “**Draft FIL Implementing Regulation**” )
- *Opinion on Further Improving Foreign Investment Utilization*(the State Council, November 7, 2019; “**Order [2019] No. 23**”)

## Relevant Laws & Regulations

- *Notification of SAFE on Further Improvements to Facilitate Cross-Border Trade and Investment* ( SAFE, October 23, 2019 ; “**SAFE Order [2019] No. 28**” )
- *Anti-Unfair Competition Law of PRC* (NPC Standing Committee, amended on April 23, 2019)
- *Trademark Law of PRC* (NPC Standing Committee, amended on April 23, 2019)
- *Administrative Regulations on Import and Export of Technology* (the State Council, amended on March 2, 2019)
- Etc.

# FIL: Latest Developments

## Draft FIL Implementing Regulation

### Highlights - What is New?

- ◆ Corporate structure transformation of existing Sino-foreign JVs must be completed by June 30, 2025, which means a 6-month grace period would be granted to the existing Sino-foreign JVs (Art. 42 and 43)

### Highlights - What is re-affirmed?

- ◆ Chinese natural person can be the JV partner in an FIE (Art. 3)
- ◆ Equal treatment of FIE products in government procurement: discrimination on investor's nationality should be deemed as illegal (Art. 17 and 18)
- ◆ **Currency, amount and frequency** of foreign exchange remittance may not be **illegally** restricted (Art. 23)
- ◆ FIEs and foreign trade associations are entitled to participate in the legislation drafting progress; FIEs are encouraged to participate in standard setting process equally and undertake relevant works (Art. 15)
- ◆ Protection of IPR and commercial secrets of FIEs (Art. 24 to 26)
- ◆ Detailed requirements on owing local governments to their commitments on preferential policies (Art. 28 and 29)
- ◆ Details on complaint mechanism for FIEs (Art. 30 to 32)

**Note: the concerned national security review mechanism is not provided in Draft FIL Implementing Regulation**

# FIL: Latest Developments

## Opinion on Further Improvement of Works of Utilization of Foreign Investment (the State Council, November 7, 2019; “Order [2019] No. 23”)

### Highlights – What is new?

- ◆ Industry policy: **Further opening** in finance and automotive sectors
- ◆ Foreign exchange administration: **promoting FIE investment in domestic equity markets** (see next slide)
- ◆ Relaxing limitations on foreigner work permit applications
- ◆ Simplifying land grant procedures for foreign invested projects

### Highlights – What is re-affirmed?

- ◆ Improving predictability in enforcement procedures
  - Response to the frequent complaints about the lack of transparency and predictability in new measures/rules as well as the discretion in work safety and environment protection enforcement that impedes normal operations
- ◆ Further reducing the foreign investment negative list
- ◆ Encouraging foreign investors to participate in standard setting for **medical devices, pharmaceuticals, food and information products**
- ◆ Enforcing FIL

# FIL: Latest Developments

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**Notification of SAFE on Further Improvement on Facilitating Cross Border Trade and Investment (SAFE, October 23, 2019; “SAFE Order [2019] No. 28”)**

## **Highlights**

- ◆ **Equity investment with contributed capital of an FIE become feasible**
- ◆ Various other simplifications

**Implementation: simplified foreign exchange accounts and updated forex guidance**

# FIL: Latest Developments

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## Regulatory updates on protection of IPR and Commercial Secrets

### Highlights: IPR Protection

- ◆ Crack down on “malicious trademark registration”
- ◆ Punitive damages in cases of “malicious infringement”
- ◆ Removal of provisions imposing unilateral obligations on foreign technology licensor
- ◆ **Note: certain judicial interpretation issued in the past still restrict IP licensor’s rights to limit licensee’s use and improvements of its IP.**

### Highlights: commercial secrets protection

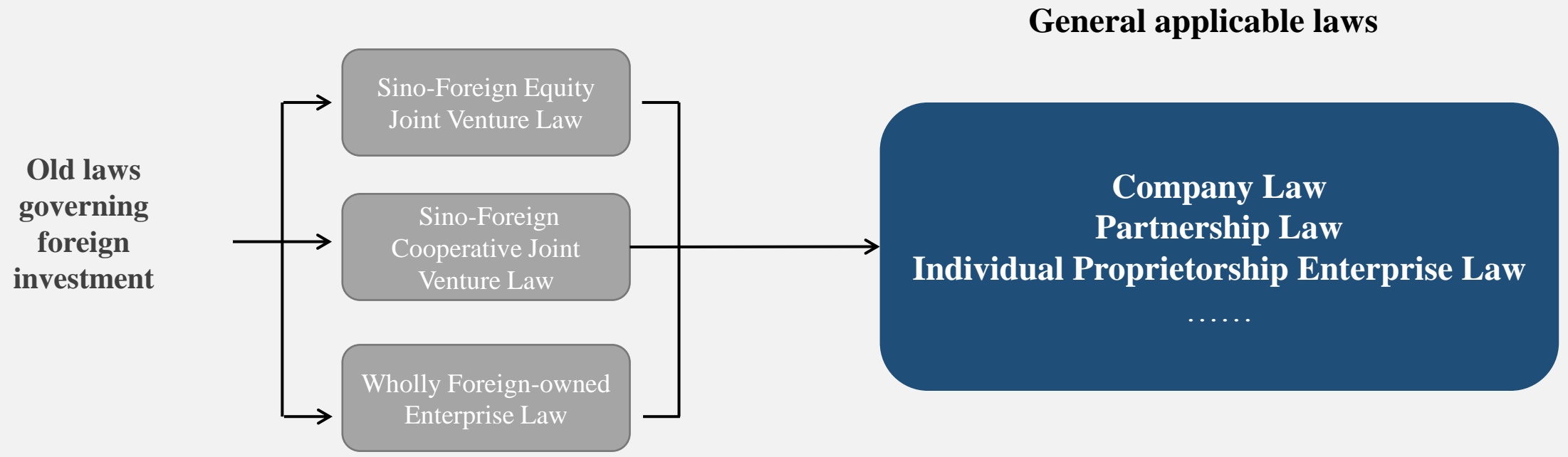
- ◆ Broader definition of commercial secrets
- ◆ Punitive damages in cases of “malicious infringement”

# FIL: Latest Developments

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- **Judicial interpretations of the FIL, Regulations, Administrative Measures, and supplemental policies are expected to be released**
  
- **Outdated regulations and measures in relation to foreign investment administration, e.g.:**
  - Provisions for the Alteration of Investors' Equities in Foreign-funded Enterprises (MOFCOM and former SAIC, May 28, 1997)

# Impact of the FIE: Sino-foreign joint venture example





## Impact of the FIE: Sino-foreign joint venture example

### More flexibility in corporate structure for Company Limited:

Issue	Under EJV law	Under FIL
<b>The highest authority</b>	Board of directors	Shareholder's meeting
<b>Quorum of meetings of the highest authority</b>	At least two-thirds of all directors	No statutory requirement
<b>Voting mechanism for key issues</b>	<p>The following matters require <b>unanimous approval</b> of all directors</p> <ol style="list-style-type: none"> <li>1. amendment of its articles of association;</li> <li>2. suspension of its business or dissolution;</li> <li>3. increase or decrease of its registered capital;</li> <li>4. merger or division</li> </ol>	<p>The following matters require adoption by shareholders representing more than two-thirds of the voting rights in the shareholder's meeting:</p> <ol style="list-style-type: none"> <li>1. amendment of its articles of association;</li> <li>2. increase or decrease of its registered capital;</li> <li>3. merger, division, dissolution or change of its form of organization</li> </ol>
<b>Board of directors</b>	<ul style="list-style-type: none"> <li>• The seats of directors shall be determined on pro rata basis of capital contribution of the JV Parties</li> <li>• Directors shall be appointed by the JV Parties, in which the Chairman and the Vice Chairman shall be appointed by the different JV Parties</li> <li>• Meeting procedure is provided in detail in the EJV law</li> </ul>	<ul style="list-style-type: none"> <li>• A Company Limited may have a executive director instead of a board of directors</li> <li>• Directors shall be elected by shareholder's meeting</li> <li>• The Chairman may either be elected or appointed</li> <li>• Meeting procedures may be agreed by shareholders</li> </ul>

## Impact of the FIE: Sino-foreign joint venture example

Issue	Under EJV law	Under FIL
<b>Legal representative</b>	Chairman of the board	Either chairman of the board/executive director or the general manager
<b>Management</b>	The general manager (or plant manager) and vice general manager (or vice plant manager) shall be appointed by the JV Parties	The general manager and other manager(s) shall be engaged by the board of directors/executive director.
<b>External equity transfer</b>	Unanimous consent of all JV Parties is required	Shareholders may agree
<b>Distribution of dividends</b>	In proportion to each investor's contributions to the registered capital	In proportion to each investor's paid-in capital, unless otherwise agreed among the shareholders



# Establishing and Operating a JV in China: JV Partner Issues

## Establishing and Operating a JV in China – Taking Control of the JV

### Issues

- Chinese partner controls operation of the JV and controls seals of the company
- Foreign investor not allowed to access financial data of the JV, conduct audits or even enter the JV premises
- Lack of transparency in the operation and profit distribution
- Cannot exit or liquidate

### What to do?

- Foreign investors should seek control or influence in the joint venture, e.g., assume roles as legal representatives, directors, managers or CFOs (liability for legal representatives and directors not a serious issue)
- Take possession of the company seal, business license, etc. if possible
- Establish a WFOE instead of a JV if no legal or commercial obstacles

# Establishing and Operating a JV in China –Merger Control Filing

## Issues

- Merger control filing obligation for newly established JV (especially a JV functioning as project company or SPV) is sometimes neglected
- The foreign party may need to balance taking control of the JV and merger filing risks

## What to do?

- Conduct preliminary merger filing assessment for JV establishment at early stage (including each party's previous non-compliance with merger control filing obligations)
- Carefully design the transaction documents (e.g., veto rights)
- Pay attention to important JVC clauses (e.g., non-competition clause)

## Establishing and Operating a JV in China – Consolidation

### Issues

- Prior to FIL: 50:50 JV with foreign investor controlled board was able to consolidate the JV in its financial statement
- After the FIL: 50:50 JV with shareholders' meeting as the highest authority means foreign investor can lose control of the JV and cannot consolidate

### What to do?

- Cannot delegate all powers of the shareholders' meeting to board of directors (Company law expressly requires 2/3 shareholding vote for increase or decrease of registered capital, amendment of AOA, merger, division, liquidation of the company; article 37 of the company law listed powers of the shareholders' meeting, these powers usually can not be delegated to the board either)
- PRC law allows AOA to provide that shareholding voting powers do not need to correspond to the shareholding ratio, e.g., in a 50:50 JV, foreign investor is allowed to have 70% of the voting power

# Establishing and Operating a JV in China – Advance Payment for the JV

## Issues

- Foreign shareholder advances payment to suppliers of the JV and seek reimbursement from the JV e.g. global procurement for all group companies, payment was made by the headquarter
- Foreign shareholder advance payment for visiting expert to local JV and seek reimbursement from the local JV
- Under certain circumstances, JV is not able to reimbursement the foreign investor for the payment

## What to do?

- Reimbursement under PRC laws are generally allowed if the underlying transactions are true and legitimate
- Pay attention to other specific requirement under PRC law, e.g. the period between the date on which the foreign shareholder advanced payment on behalf of the JV and the date on which the JV makes the reimbursement to the shareholder cannot exceed 12 months
- Keep all supporting documents
- If possible, do not advance payment on behalf of the JV

## Establishing and Operating a JV in China – SOE Specifics

### Issues

- Procedures governing transactions involving state-owned property will apply if an Chinese SOE JV partner is selling or transferring its equity interests in the JV
- If the Chinese SOE JV partner is not a minor shareholder, mandatory SOE bidding and supplier management rules may apply to the JV, which complicates cooperation with certain suppliers
- The JV must establish a CCP party branch

### What to do?

- Clarify with the Chinese SOE JV partner what rules apply to SOEs and seek solutions or compromise in advance
- Establishing a CCP branch in the JV is generally acceptable if there is no material adverse effect on the JV's business operations and commercial decisions





# Investment Agreement Signed with the Economic Development Zone

# Purpose of the Agreement

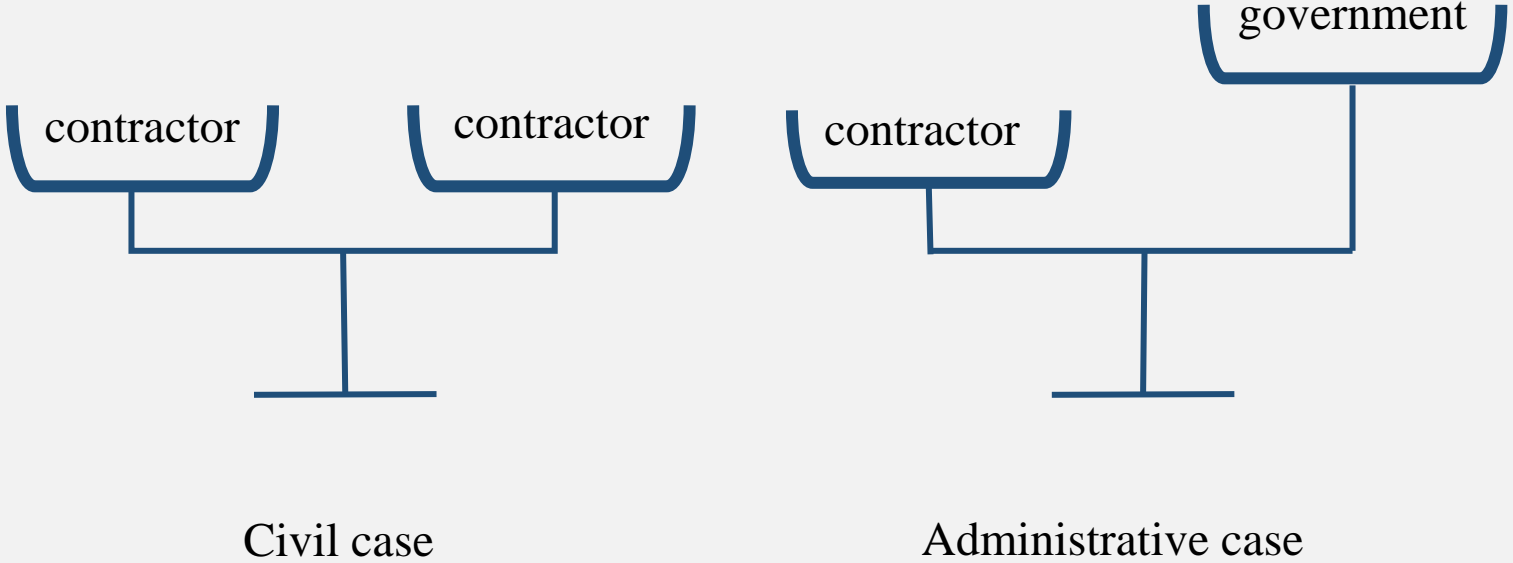
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- Confirm preferential treatment



# Nature of the agreement

- Private contract or administrative agreement?
  - ✓ Sue in administrative courts
  - ✓ The administrative entity is prerogative under certain circumstances
  - ✓ Arbitration might not be available

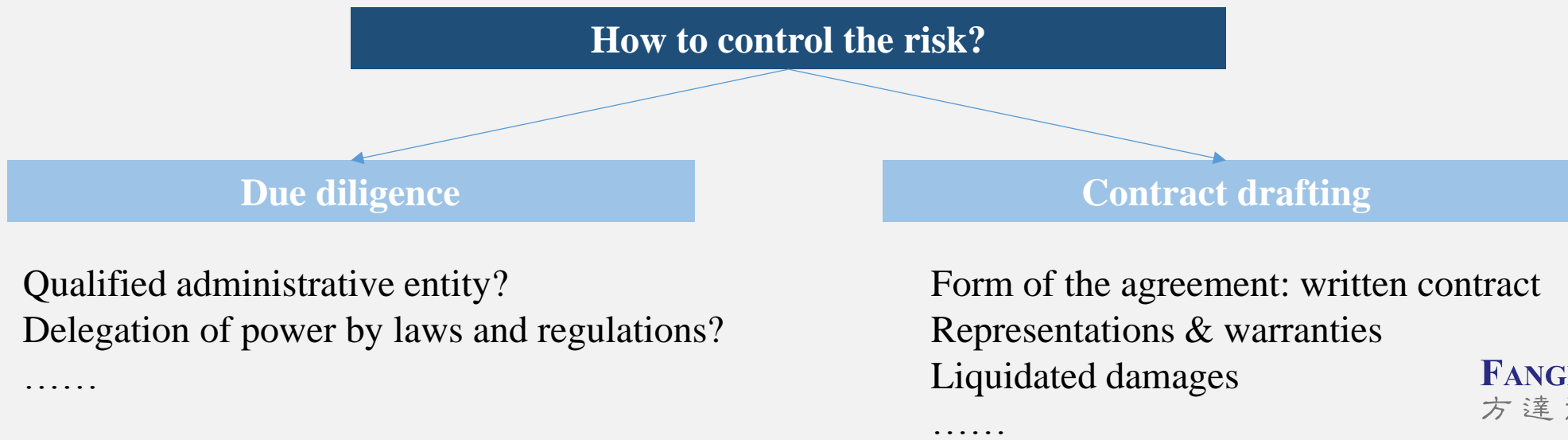


- ✓ One contractor is an administrative body
- ✓ Exercise of administrative power
- ✓ Underlying purpose of the agreement is for public benefit

# Legal risk of the agreement

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- Validity of the agreement: under contract law and administrative law
- Unequal bargaining power: administrative entity has the right to repudiate the contract for the benefit of the public
- Policies and regulations may change from time to time
- Inadequate remedy for breach of agreement



# Why Stay in China?

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- ◆ Large market with vast numbers of potential customers
- ◆ Well-established supply chain and a wide range of optional local suppliers at different levels
- ◆ Skilled workers
- ◆ Compete for public procurement: product localization required

# Q&A

