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Highlights on the new Foreign Investment Law in China

On 15 March 2019 the National People's Congress of the People's Republic of China passed the **Foreign Investment Law** (FIL), which will come into effect on 1 January 2020. The new legislation aims to facilitate foreign investment into China, protect the legitimate rights and interests of foreign investors and standardise the management of foreign investment in China. The FIL will introduce a unified legislative regime and repeal the three existing statutes that have governed the foreign investment regime since they were enacted over three decades ago.[1] The FIL is expected to bring significant changes to the foreign investment regime and may have a material impact on any existing or planned foreign investment in China.

Concept of "Foreign Investment"

Under the FIL, foreign investment is broadly defined to refer to any investment activity *directly* or *indirectly* conducted by a foreign natural person, enterprise or other organisation. Foreign invested entity (FIE) refers to domestic enterprise (i.e. PRC-registered) in which part or whole of an investment comes from such foreign investor. The definition of foreign investment includes any acquisition of shares or interest and greenfield investment by such foreign investor. The FIL does not specify any particular threshold for the level of foreign investment.

National treatment plus negative list

Under the FIL, foreign investment will receive "national treatment" (i.e. no less favourable treatment than domestic investors) at the pre-establishment stage, unless the sector falls within a "negative list" of prohibited or restricted sectors as approved by the State Council from time to time. There are two implications:

[1] The existing foreign investment-related statutes to be repealed are: (i) the Sino-foreign Equity Joint Ventures Law; (ii) the Sino-foreign Cooperative Joint Ventures Law; and (iii) the Wholly Foreign-owned Enterprises Law.

- If the sector falls outside the negative list, the foreign investment transaction will receive equal treatment as a domestic transaction. Since October 2016, MOFCOM has established a streamlined system of filing requirements for such foreign investment transactions (such that no approval is required).[2] The extent to which the FIL simplifies the existing filing regime will depend on the implementing rules that are expected to be issued in the future.
- If the sector falls within the negative list, the treatment will depend on whether the sector is prohibited or restricted under the negative list. It will be important to pay attention to the implementing rules and refer to the latest negative list to understand how the scope and procedures of the relevant restrictions may change.

Protection of foreign investment

The FIL provides statutory protection to foreign investment in a number of respects:

- *Non-expropriation*: the FIL expressly prohibits the State from expropriating foreign investment except in exceptional circumstances. Where the State expropriates foreign investment to satisfy public interest needs, foreign investors shall receive fair and reasonable compensation in a timely manner.
- *Cross-border fund flow*: foreign investors may freely transfer in and out of China contributions, profits, capital gains, income from asset disposal and royalties and other lawfully obtained income.
- *Intellectual property*: the State shall protect intellectual property rights of foreign investors and FIEs. The State shall not force any transfer of technology via use of administrative means.
- *Policy*: government departments are required to formulate “normative” documents in compliance with the FIL, and prohibited from impairing legitimate interests of FIEs, imposing additional obligations, market entry or exit conditions on FIEs and interfering with FIEs’ normal production and economic activities.
- *Complaint*: the State shall establish a complaint mechanism for FIEs and resolve in a timely manner issues reported by FIEs and foreign investors.

More equality and flexibility for FIEs

A significant change from a corporate law perspective is that, under the FIL, the organisational structure and corporate governance of newly established FIEs (after 1 January 2020) will be subject to, amongst others, the Company Law and Partnership Enterprise Law, in the same way as domestic entities. They will no longer be established as Wholly-owned Foreign Enterprises, Contractual Joint Ventures or Equity Joint Ventures, as they are under the three existing statutes to be repealed on 1 January 2020.

For existing FIEs, the FIL provides for a grace period: they are able to retain their original organisational forms and other arrangements until the end of 2024, after which they are required to amend their constitutional documents to comply with the new legal requirements. To take an example, a sino-foreign

[2] Interim Measures for Administration of Filing of Establishment and Changes of Foreign-invested Enterprises

joint venture will need to provide for shareholders' meetings to be its highest authority in line with the Company Law, whereas currently under the existing FIE laws, the board enjoys the highest authority. Another example is that, unlike the law on Equity Joint Ventures, the Company Law offers FIEs flexibility of distributing profits to shareholders in a manner that is not in proportion to equity interest. There is also a possibility that investors may wish to take advantage of the newly available flexibilities to re-negotiate the governance terms of FIE.

Variable Interest Entity structure

Foreign investors wishing to invest in certain restricted or prohibited sectors in China have commonly used the variable interest entity (VIE) structure to exercise contractual control over the relevant Chinese business and reap economic benefits similar to equity investment. However, there is uncertainty over the legal status of VIE structure, which has posed various legal difficulties, for example, where transactions involving parties with VIE structures are subject to a merger control filing requirement.

The final version of the FIL has deleted wording from an earlier draft on the definition of "de facto control" through contract or trusts and no longer addresses the VIE structure explicitly. The FIL may potentially be broad enough to capture VIE structures in future as the definition of foreign investment includes a catch-all clause covering "*any other form of investment in accordance with law, administrative regulations and provisions of the State Council*".

National security review

In addition to the negative list system, the FIL also provides that the State shall establish a security review system to review any foreign investment that affects (or may affect) national security. It remains to be seen how the existing regime may change, depending on the implementing rules to be issued.

Conclusion

The FIL sends an important message that China welcomes foreign investment. In general, the changes are positive where they confer additional protection for foreign investment and offer an increased degree of equality and flexibility for FIEs. However, the extent to which the Chinese government is willing to further open up its markets for foreign investment will ultimately depend on how the negative list is revised.

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Antitrust

European Commission fines Nike for restricting cross-border sales of licensed merchandising products

On 25 March 2019 the European Commission issued a **press release** setting out the findings of its antitrust investigation into Nike's non-exclusive licensing and distribution practices and agreements. The **investigation**, which was opened in June 2017, concerned Nike's practices and operations as a licensor to other traders of its 'licensed merchandise'[3], including to football clubs and federations such as FC Barcelona, Manchester United and Juventus.

The EC's decision found that Nike's agreements breached EU competition rules for an approximate 13-year period by imposing direct and indirect prohibitive measures on sales outside the defined European Economic Area (EEA) territory (i.e. by inserting clauses explicitly prohibiting these sales and threatening licensees with termination if they sold out-of-territory) and, in doing so, artificially increased the price of merchandise for certain football teams under its licenses. Speaking about the decision, Commissioner Margrethe Vestager said Nike's prohibitive practices had led to "*less choice and higher prices*" for consumers of branded football products. Vestager also commented that the Commission's decision ensured that *"retailers and consumers can take full advantage of one of the main benefits of the Single Market: the ability to shop around Europe for a larger variety of products and for the best deals*".

It is noteworthy that the EC recognised that Nike's cooperation "*beyond its legal obligation to do so*" throughout the investigation both aided the EC and extended the scope of the case. As such, Nike's fine was reduced by 40 per cent. The fine took into account the value of sales relating to the infringement as well as the gravity and duration of the infringement and was set at €12,555,000 (approximately £10,732,516).

[3] Nike's core business is design and sale of athletic footwear and apparel, including for football clubs and federations, which generally feature Nike's registered trademarks such as its name or "Swoosh" logo. For 'licensed merchandise' not featuring Nike trademarks, Nike acts as a licensor, granting licenses to third parties who become entitled to manufacture and distribute these products.

Regulatory

NAO report recommends that regulators better outline and measure their objectives to ensure consumers are protected

On 20 March 2019 the National Audit Office (NAO) published its **report** examining the four key regulators – the Water Service Regulation Authority (Ofwat), the Office of Gas and Electricity Markets (Ofgem), the Office of Communications (Ofcom) and the Financial Conduct Authority (FCA) – in response to concerns as to whether consumers in the relevant regulated industries are receiving adequate protection.

In the report, the NAO found that the most common problem consumers face across the relevant regulated industries concerns dealing with debt associated with paying bills and credit repayments. The report suggests that, in markets experiencing real-term price increases of 28 per cent in gas, 37 per cent in electricity and 6 per cent in water since 2007, this highlights a weakness of consumer protection in an economy where wages are not rising at the same pace.

The NAO recommends that a consistent and more meaningful approach should be adopted by the regulators to measure their performance, to ensure that they understand what works well for consumers and what does not, and to help them to plan interventions. The report also comments that regulators should aim to be more specific in defining overall consumer-orientated outcomes, including sector-wide targets and other success measures. These aims, the NAO recommends, must go beyond the generalised and high-level, and set out specific practical steps to ensure they are dealing with the range of "serious difficulties" consumers face.

The NAO highlights the importance of measuring regulators' influence and impact on consumers. Regulators need to "*do more to show the concrete results they are aiming to achieve for consumer*s". It also recommends regulators work more collaboratively with government to resolve potential conflicts or trade-offs between regulatory objectives or groups of consumers. The NAO also identified service issues across all sectors which needed to be addressed by regulators.

In response to the report, the Chief Executive of the FCA, Andrew Bailey, has said that the FCA will consider the NAO's recommendations when evaluating their work to protect consumers. Similarly, Ofwat and Ofgem commented that the report provided a "clear independent steer" to improve their regulatory approaches.

CMA response to the Digital Competition Expert Panel recommendations

On 21 March 2019 the Competition and Markets Authority (CMA) issued a **response** to the final **report** and recommendations published by the government on 13 March 2019 considering competition in the digital economy (Furman Report).

The Furman Report (the subject of a previous **client briefing**) recommended:

- the creation of a new digital markets unit with specific powers to set a code of conduct for companies with “strategic market status”, to implement personal data mobility and systems with open standards, and to secure access to non-personal anonymised data;
- adapting the merger control rules to include an obligation on strategic digital companies to inform the CMA of all intended acquisitions;
- introducing an additional ‘balance of harms’ standard for merger control assessment, which takes into account the scale as well as the likelihood of harm and which can be utilised in cases involving potential competition and/or harm to innovation; and
- changing the standard of appeal for antitrust cases and reviewing the current appeal procedures in order to strengthen the CMA’s competition enforcement tools.

In its response, the CMA agrees with the Furman Report’s recommendations relating to creating the digital markets unit and its associated functions. Its response notes that the new regulatory functions will need to be established in statute so that the CMA can respond more dynamically to competition concerns.

While welcoming the Furman Report’s recommendation that strategic digital companies must notify the CMA of all intended acquisitions, the CMA considers that the current UK legislative framework for merger control is “fit for purpose” and it raises concerns about potential unintended consequences from introducing the ‘balance of harms’ test.

Similarly, while agreeing with the Furman Report’s recommendations to change the standard of appeal for antitrust cases as well as to review the current appeal procedures, the CMA also warns that the recommendation to introduce more independent CMA decision-making structures for enforcement cases may prevent it from reacting swiftly in fast-moving digital markets.

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