**Notes to the Foreign Investment Law of the**

**People's Republic of China (Draft for Comment)**

(January 19, 2015)

The Law on Sino-foreign Equity Joint Ventures, the Law on Wholly Foreign-owned Enterprises, and the Law on Sino-foreign Cooperative Joint Ventures (hereinafter referred to as the "Three Foreign Investment Laws") formulated in the early years of China's reform and opening up provide a legal base for China's foreign investment utilization and have made significant contributions to the great historical process of China's reform and opening up. The legal system for foreign investment dominated by the Three Foreign Investment Laws has played a pivotal role in China's active and effective use of foreign investment and promotion of national economic development. Over the years, China has stably ranked second in the world and first in developing countries in terms of foreign investment absorption. From introduction of capital, technology, management experience, and export channels in the early days to introduction of modern services, new operation philosophy, and high-end talent nowadays, foreign-invested enterprises have become an important force to promote the economic and social development of China.

 At present, China is entering a critical stage in building a moderately prosperous society in all respects and a hard and important stage in its reform. Opening up is also challenged by new situations and new tasks. The prevailing Three Foreign Investment Laws can hardly adapt to the needs of comprehensively deepening reforms and further opening up. Firstly, the "case-by-case examination and approval system" management mode established by the Three Foreign Investment Laws has been unable to meet the needs for the construction of a new open economic system, and is not conducive to the activation of the market or transformation of governmental functions; secondly, the provisions of the Three Foreign Investment Laws on enterprise organization forms and operating activities are repeated provisions of, and even conflict with, the Company Law and other relevant laws; and thirdly, important systems on foreign mergers and acquisitions and national security review are required to be included in fundamental laws governing foreign investment and are subject to further improvements.

The following were raised at the Third Plenary Session of the 18th Central Committee of the Communist Party of China (hereinafter referred to as the "CPC"): "constructing a new open economic system", "unitizing laws and regulations on domestic and foreign investments and keeping foreign investment policies stable, transparent, and foreseeable", "reforming the foreign investment examination and approval system", and "exploring the application of the management mode of pre-access national treatment plus negative list to foreign investment"; the Fourth Plenary Session of the 18th CPC Central Committee required "adapting to the deepening opening up, improving foreign-related laws and regulations, and promoting the construction of a new open economic system". All of these give us a direction to amend the Three Foreign Investment Laws. The Ministry of Commerce has amended the Law on Sino-foreign Equity Joint Ventures, the Law on Wholly Foreign-owned Enterprises, and the Law on Sino-foreign Cooperative Joint Ventures to work out the Foreign Investment Law of the People's Republic of China (Draft for Comment) (hereinafter referred to as the "Draft for Comment") in accordance with the Legislation Program of the Standing Committee of the 12th National People's Congress and the 2014 Legislation Plan of the State Council in order to implement the spirit of the Third and Fourth Plenary Sessions of the 18th CPC Central Committee.

I. Guiding Ideology and Basic Principles

The drafting of the Draft for Comment, guided by the spirit of the 18th CPC National Congress and the Third and Fourth Plenary Sessions of the 18th CPC Central Committee, is to meet the requirements for building a new open economic system, adhere to market, legalization, and internationalization oriented reforms, innovate the foreign investment administration system, and develop a basic law governing foreign investment in line with the stage of economic development and basic national conditions of China and in compliance with the development requirements of prevailing international rules so as to create a more stable, transparent, and foreseeable legal environment for foreign investment.

We believe that the Foreign Investment Law shall be positioned to deepen institutional reform, further open up to the outside world, promote foreign investment, and standardize foreign capital administration. To achieve the above goals, we adhere to the following principles in drafting the Draft for Comment:

**Firstly, define the basic legal positioning.** The Foreign Investment Law is positioned as a basic law unifying the administration and promotion of foreign investment, and no longer regards organization forms of enterprises as the object of standardization.

**Secondly, innovate the management mode of foreign investment** by cancelling the existing case-by-case examination and approval system for foreign investment, adopting the management mode of pre-access national treatment plus negative list, significantly reducing the restrictive measures for foreign investment, relaxing foreign investment access, and enhancing information reporting.

**Thirdly, improve the foreign investment administration system** by summarizing over 30 years' foreign investment administration practices, incorporating foreign investment mergers and acquisitions, national security review, and other important systems into the Foreign Investment Law, and making further improvements.

**Fourthly, effectively transform governmental functions** by transforming from prior examination and approval to the provision of public services and strengthening of interim and ex post regulation, and strengthening investment promotion and protection, supervision and inspection, and other systems while substantially cancelling administrative examination and approval.

II. Main Content

The Draft for Comment consists of 170 articles, which are divided into 11 chapters, namely General Provisions, Foreign Investors and Foreign Investment, Access Administration, National Security Review, Information Reporting, Investment Promotion, Investment Protection, Complaint Coordination and Handling, Supervision and Inspection, Legal Liability, and Supplementary Provisions. The main content is set out as follows:

**(I) Definitions of foreign investors and foreign investment**

For foreign investors, while defining foreign investors according to the standard of the registered place, the Draft for Comment also introduces the standard of "actual control". On the one hand, domestic enterprises controlled by foreign investors are deemed foreign investors; on the other hand, for foreign investors controlled by Chinese investors, their investments within the territory of China may be deemed those of Chinese investors.

The Draft for Comment specifies that foreign investment includes not only investment in green land but also mergers and acquisitions, medium and long-term financing, acquisition of the concessions to explore or exploit natural resources or to construct or operate infrastructure, acquisition of immovable property rights and control over any domestic enterprise or holding of the interests in any domestic enterprise by way of contract or trust.

**(II) Access administration system**

The Draft for Comment has abolished the case-by-case examination and approval system established by the Three Foreign Investment Laws and designed the foreign investment access administration system in line with the management mode of pre-access national treatment plus negative list. The competent authorities of foreign investment only implement access permission for investment within the fields specified in the Catalogue of Special Administrative Measures and the objects of review are no longer contracts and articles of association, but foreign investors and their investment behaviors. Under the management mode of negative list, a majority of foreign investment access matters will no longer be subject to examination and approval. The Draft for Comment also provides that foreign investors must perform the reporting obligation when investing within the territory of China, whether within the fields specified in the Catalogue of Special Administrative Measures or not.

**(III) National security review system**

In order to prevent foreign investment from causing or possibly causing harm to national security, the Draft for Comment provides for a national security review system for foreign investment in a designated chapter. Aimed at such defects as the low level of the existing national security review system and imperfect systems, the Draft for Comment, based on the Circular on Establishing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors of the General Office of the State Council and by fully learning the practices of the relevant countries, further improves the review factors and review procedures of national security review, defines such content as the measures to be taken to eliminate national security hazards, and specifies that no administrative reconsideration and administrative litigation may be instituted against national security review decisions.

**(IV) Information reporting system**

In order to timely, accurately, and comprehensively grasp information on foreign investment and operating conditions of foreign-invested enterprises, the Draft for Comment provides for an information reporting system for foreign investment. Foreign investors or foreign-invested enterprises must perform the obligation to report information on their investing and operating behaviors, regardless of whether such behaviors fall within the fields specified in the Catalogue of Special Administrative Measures or not, to the competent authorities of foreign investment. Information reported must be authentic, accurate, and complete without any false records, misleading statements, or material omissions. The Draft for Comment distinguishes between three categories of information reporting (reporting on foreign investment matters, reporting on changes in foreign investment matters, and periodic reporting) and specifies the corresponding content to be reported and report timing.

**(V) Investment promotion system**

At present, strengthening governmental functions in foreign investment facilitation is a new trend in foreign investment legislation and policies of countries all over the world. In order to establish a perfect investment promotion mechanism, improve the professional level of investment facilitation, and promote and enhance the quality and level of foreign investment utilization, the Draft for Comment standardizes the investment facilitation from such aspects as investment promotion policies, investment promotion organizations, and special economic zones.

**(VI) Investment protection system**

In order to protect the legitimate rights and interests of foreign investors and their investment, the Draft for Comment comprehensively strengthens the protection systems for foreign investors and their investment from such aspects as expropriation, requisition, national compensation, transfer, transparency, and intellectual property protection.

**(VII) System for complaint coordination and handling**

The Draft for Comment provides for a system for complaint coordination and handling, strengthening the functions of coordination and handling authorities of foreign investment complaints in coordinating and handling disputes between foreign investors and foreign-invested enterprises and administrative organs, and resolving foreign investment disputes in a timely and effective manner.

 **(VIII) Supervision and inspection system**

Strengthening interim and ex post regulation while expanding market access and reducing administrative examination and approval is the "top priority" for the transformation of governmental functions of the new government. The Draft for Comment comprehensively provides for the supervision and inspection system from such aspects as launch of supervision and inspection, ways of inspection, content to be inspected, and inspection results. At the same time, the Draft for Comment enhances the self-discipline consciousness of foreign investors and foreign-invested enterprises by establishing a credit archive system for foreign investors.

**(IX) Legal liability system**

The Draft for Comment provides for a legal liability system, defining the administrative liability or criminal liability which shall be undertaken for investment in prohibited fields, investment in restricted fields without permission or in violation of permission conditions, violation of the information reporting obligation, violation of the provisions on national security review, and circumvention of compulsory legal provisions.

III. Notes to Several Issues

**(I) Arrangements during the transitional period**

After the entry into force of the Foreign Investment Law, the Three Foreign Investment Laws will be abolished. As the Foreign Investment Law no longer standardizes the organization form and organizational structure of foreign-invested enterprises, the Draft for Comment specifies that foreign-invested enterprises existing in accordance with the law before the entry into force of the Law shall, within three years and in accordance with the Company Law and other laws and regulations, adjust the organization form and organizational structure of enterprises.

**(II) Treatment given to Hong Kong, Macao and Taiwan investors and overseas Chinese**

Since the reform and opening up, investment by Hong Kong, Macao and Taiwan compatriots and overseas Chinese has played an indispensable role in promoting the vigorous development of China's economy. The Draft for Comment specifies that the Law applies mutatis mutandis to investment by Hong Kong, Macao and Taiwan investors and overseas Chinese; special treatment for their investment is suggested to be separately determined by the State Council.

**(III) Handling of protocol control**

The issues on the control over domestic enterprises obtained by foreign-invested enterprises by signing a series of protocols have attracted extensive attention. The Draft for Comment clearly defines protocol control as a form of foreign investment. After the entry into force of the Law, the Law shall apply to investment by protocol control. For investment by protocol control existing before the entry into force of the Law, if such investment still falls within prohibited or restricted foreign investment after the entry into force of the Law, there are opinions as below in the theory cycle and practice cycle on how to deal with such investment:

1. where a foreign-invested enterprise that implements protocol control declares to the competent authority of foreign investment under the State Council its actual control by Chinese investors, it may continue to retain the structure of protocol control and the relevant subjects may continue to carry out business activities;

2. a foreign-invested enterprise that implements protocol control shall apply to the competent authority of foreign investment under the State Council for determining its actual control by Chinese investors; after the competent authority of foreign investment under the State Council determines its actual control by Chinese investors, it may continue to retain the structure of protocol control and the relevant subjects may continue to carry out business activities;

3. a foreign-invested enterprise that implements protocol control shall apply for access permission to the competent authority of foreign investment under the State Council, which will, in concert with relevant departments, make a decision after comprehensively considering the actual controller of the foreign-invested enterprise and other factors.

We will further study this issue based on intensively listening to public comments and make recommendations for handling thereof.

**(IV) Relationships between foreign investment access permission, business registration, and industry licensing**

The Draft for Comment provides that where a foreign investor invests in a field specified in the Catalogue of Special Administrative Measures, if the investment is involved in a field for which an application for pre-licensing is required, the foreign investor shall submit its industry license when applying for foreign investment access permission; if no application for pre-licensing is required, the competent authority of foreign investment shall solicit the opinions of the competent authority of the relevant industry in the course of review; the foreign investor shall handle business registration after obtaining foreign investment access permission. At present, China is advancing administrative examination and approval and registration system reforms. We will further improve the design of systems related to foreign investment access permission according to the reform process so as to well deal with the relationships between foreign investment access permission, business registration, and industrial licensing.