China's New Foreign Investment Law – With A Special Note On Swiss-Chinese Investment

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ABSTRACT

The new Foreign Investment Law ("FIL") will come into force in China on 1 January 2020. Simultaneously, the current „three foreign investment laws", namely the EJV Law, CJV Law and WFOE Law, will be repealed. The new legal regime subscribes to the spirit of national treatment of foreign-invested entities ("FIE"), although adopting specific rules for FIE's in itself prevents real national treatment of such entities. This thesis discusses achievements as well as open questions with regard to the FIL. Important topics include the FIL's new foreign investment security review system, the new working mechanism for complaints of foreign investors as well as the nature of "policy commitments" issued by government authorities towards foreign investors. In addition, the paper discusses the FIL's effect on corporate government structures of existing FIEs and on the legal situation of "variable interest entities" operating in China.

KEYWORDS: Chinese Foreign Investment Law, Foreign Direct Investment, Negative List, Catalogue, National Treatment, Security Review System, Working Mechanism For Complaints, Policy Commitments, Variable Interest Entities

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I. Introduction

In the last two decades, China has become a huge player in the area of foreign direct investment ("FDI"). Its annual inward FDI flow grew from 41 billion USD in 2000 to 136 billion USD in 2017, which now makes China the second largest recipient of annual inward FDI flow after the United States.[2] During the same time period, China's annual outward FDI flow grew from under 1 billion USD to 125 billion USD, making it the third largest foreign investor after the United States and Japan in 2017 (it was even listed second behind the United States in 2016).[3] While in 2000, China's outward FDI flows only amounted to 6% of its inward FDI, this number changed to 91% in 2017.[4] These numbers confirm what is often referred to as the "miraculous" growth of China's economy in the last few decades as well as its changing dynamics, transforming the country from a mere recipient of FDI to one of the principal investors in the global FDI market. With China taking its place as a global economic superpower, many foreign (especially western) countries and investors have become more and more critical of China's treatment of inwards FDI, its reliance on its status as a "developing country" and the continuing use of protective measures.[5] Although the Chinese government continues to voice its commitment to improve conditions for inwards flowing FDI, the EU, the United States and other governments have grown more and more impatient. In case of the United States, the dissatisfaction eventually led up to the current "China-United States Trade War". Before this background, one major event in the continuous evolution of China's economic and legal landscape is the National People's Congress' ("NPC") adoption of the new Chinese Foreign Investment Law ("FIL"), which will enter into force on 1 January 2020.

This paper discusses the content of the FIL and its contribution to China's legal framework regarding FDI. To that extent, Chapter II will first present a historical overview of China's entry into the global FDI market since the reform and opening-up policy implemented in the late 1970s. Chapter III will add a special note on the evolution of the bilateral relationship regarding FDI between Switzerland and China. Chapter IV will discuss China's legal

[2] All date are based on the statistics of the United Nations Conference on Trade and Development (UNCTAD STAT), available at https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=96740 (last accessed 14 December 2019).
[3] UNCTAD STAT (fn. 2).
[4] UNCTAD STAT (fn. 2); compare the numbers at Karl P. Sauvant/Michael D. Nolan, China's Outward Foreign Direct Investment and International Investment Law, Journal of International Economic Law 1 (2015), 1 f.
[5] See for example European Union Chamber of Commerce in China, European Business in China, Position Paper 2018/2019, available at https://europeanchamber.com.cn/en/publications-position-paper (last accessed 14 December 2019), Executive Summary p. f, Executive Position Paper p. 9 ff.

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framework on FDI. This includes a comment on the current framework consisting of the "three foreign investment laws" as well as an introduction on the creation of the new FIL. Chapter V will then take a closer look at the content of the FIL and present its achievements as well as some of the unresolved or even "problematic" issues that require further discussion.

II. Historical overview of FDI in China

After the two Opium Wars in the 19th century, the "unequal treaties" subsequently entered into with Western powers and the collapse of the Chinese empire in 1911, China's view on foreign trade and investment changed.[6] Following the Chinese civil war of the late 1920s until the late 1940s, which ended with the victory of the Communist Party under the leadership of Mao Zedong in 1949, the new People's Republic of China ("PRC") implemented a centrally planned socialist economy that was closed to investments from advanced industrial economies.[7] What followed were years of political and social turbulence with devastating effects on the Chinese economy until the death of Mao Zedong in 1976. Subsequently, the "reform and opening-up policy" or "open door policy" implemented under Deng Xiaoping in the late 1970s permitted the development of a private sector economy and slowly re-opened China's economy to the world, hoping for a stimulating effect of new foreign investment.[8] These reforms proved to be successful, seeing that China's gross domestic product grew with an average rate of over nine percent from the late 1980s until the early 2000s.[9] In the 1990s, China also shifted from its tradition of rejecting any form of international law protecting foreign investment and began concluding Bilateral Investment Treaties ("BIT") with a number of foreign governments.[10] This policy shift was also confirmed by China's accession to the

[6] Giuseppe Matteo Vaccaro-Incisa, The Evolution of China's Policy and Treaty Practice in International Investment Law: An Outline, 4 Bocconi Legal Papers 89 (2014), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2635199 (last accessed 14 December 2019), 89.

[7] Samuel Farrell Ziegler, China's Variable Interest Entity Problem: How Americans Have Illegally Invested Billions in China and How to Fix It, 85 The George Washington Law Review 539 (2016), 544; Roger Polack, Inbound FDI Liberalization with Chinese Characteristics: Contextualizing China's 2015 Draft Foreign Investment Law and its National Security Review, Georgetown University Law Center, available at http://203.187.160.132:9011/www.gwlr.org/c3pr90ntc0td/wp-content/uploads/2016/03/84-Geo.-Was.-L.-Rev.-539.pdf (last accessed 14 December 2019), 2.

[8] Omar R. Gutierrez, An Analysis of the People's Republic of China's Foreign Investment Law and Foreign Direct Investment in Shanghai's Free Trade Zones, 9 Bocconi Legal Papers 15 (2017), 19; Li Wanqiang, Chinese Foreign Investment Laws: A Review from the Perspective of Policy-Oriented Jurisprudence, 19 Asia Pac. L. Rev. 35 (2011), 38.

[9] Samuel Farrell Ziegler (fn. 7), 541.

[10] Laura B. McCaskill, China's Proposed New Foreign Investment Law: A New Era for Foreign Investment in China, 3 June 2015, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2824426 (last accessed 14 December 2019), 13.

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World Trade Organisation in 2001.[11]

Although China was and is gradually opening up, its treatment of foreign investment remains the subject of criticism. One of the main areas of concern is the unfair transfer of technology. In a survey conducted by the European Chamber of Commerce in 2017, 19% of the questioned foreign investors in China felt compelled to transfer technology in order to maintain market access.[12] Other common concerns are barriers to market access, preferential access of Chinese companies to subsidies and licences as well as overall preferential treatment of Chinese State Owned Enterprises ("SOE").[13] In addition, there are concerns about lengthy and non-transparent administrative procedures, difficulties in enforcing laws or contractual agreements and poor coordination between different Chinese government agencies.[14] Another issue is the preferential treatment of Chinese companies in government procurement. This is likely to become even more important in the context of China's Belt and Road Initiative ("BRI"). According to a report published by the Centre for Strategic and International Studies in January 2018, 89% of projects related to the BRI were so far awarded to Chinese enterprises, a number that raises serious questions on the equal treatment of foreign and domestic enterprises in the procurement system.[15] Many foreign governments argue that Chinese outbound FDI is not subject to the same disadvantages, resulting in an unfair lack of reciprocity.[16] Many – if not all – of these issues have contributed to the "trade war" or trade negotiations between the United States and China.

III. Note on foreign investment between Switzerland and the PRC

With what for diplomatic traditions of Switzerland was an unusually quick and bold act, it placed itself amongst the first group of western countries that formally recognized the PRC in January 1950 (the others being the United Kingdom, Denmark, Norway and Sweden).[17]

[11] Laura B. McCaskill (fn. 10), 13.
[12] European Union Chamber of Commerce in China (fn. 5) 4.
[13] European Union Chamber of Commerce in China (fn. 5), 5.
[14] European Union Chamber of Commerce in China (fn. 5), 5.
[15] Jonathan E. Hillman, China's Belt and Road Initiative: Five Years Later, Center for Strategic and International Studies, 25 January 2018, accessible at https://www.csis.org/analysis/chinas-belt-and-road-initiative-five-years-later-0 (last accessed 14 December 2019).
[16] European Union Chamber of Commerce in China (fn. 5), 5.
[17] Konrad Specker, Aspekte der Beziehungen zwischen der Schweiz und China – eine historische Perspektive / Switzerland and China – a Historical Perspective, Swiss-Chinese Chamber of Commerce, 20th Anniversary Edition-Bulletin 2/00 p. 30 ff., available at https://www.sinoptic.ch/textes/articles/2000/2000_02_Specker.Konrad.pdf (last accessed 14 December 2019), 41.

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This set the stage for a close economic relationship for the coming decades. After the initiation of the reform and opening up policy in 1978 and the adoption of the Chinese-Foreign Equity Joint Venture Law in 1979, the Swiss company "Schindler Aufzüge" with its Chinese counterpart established "China Schindler Elevator Co." in Beijing – the very first industrial Chinese-foreign joint venture within the PRC.[18]

The two countries later concluded a BIT that entered into force in 2010.[19] The BIT includes a most-favoured national clause and provides for national treatment of the other country's investors.[20] Regarding investment dispute resolution, it grants investors of each country the right to either file suit before the national courts of where the investment takes place or to initiate arbitral proceedings before the International Centre for Settlement of Investment Disputes ("ICSID") or before an ad-hoc tribunal.[21] It is interesting to note that at the beginning of the reform and opening up-policy, China did not accept foreign or transnational dispute settlement for investment disputes. Therefore, early BITs such as the ones concluded between China and Sweden or China and Germany in the early 1980s did not contain any provisions on investor-state dispute resolution.[22] Different than classical "fork-in-the-road clauses" found in some BITs, the Switzerland-China BIT allows an investor to initiate arbitral proceedings even after filing suit with a court, provided that the investor has recalled the suit.[23] However, the BIT also provides that China may require a Swiss investor (there is no reciprocity for this provision) to exhaust all local administrative remedies before initiating arbitration, with a time-bar for the local remedies of three months.[24]

Swiss direct investments in China have significantly increased since 2004 and reached its peaks in 2011 (5.3 billion CHF/USD) and 2014 (3.4 billion CHF/USD).[25] Nevertheless, only 1.8% of total Swiss outbound FDI was located in China in 2017.[26] In the same year, however,

[18] Konrad Specker (fn. 17), 50; see also the website of Schindler at https://www.schindler.com/com/internet/en/about-schindler/schindler-history.html (last accessed 14 December 2019).
[19] Abkommen zwischen dem Schweizerischen Bundesrat und der Regierung der Volksrepublik China über die Förderung und den gegenseitigen Schutz von Investitionen ("Switzerland-China BIT"), adopted on 27 January 2009 (entry into force on 13 April 2010).
[20] Art. 4.2. and 4.3 Switzerland-China BIT.
[21] Art. 11.2 Switzerland-China BIT.
[22] Yongmin Bian, A Revisit to China's Foreign Investment Law: With Special Reference to Foreign Investment Protection, 8 J. E. Asia & Int'l L. 447 (2015), 467.
[23] Art. 11.4 Switzerland-China BIT.
[24] Protokoll zu Art. 11.2 (a) Switzerland-China BIT.
[25] Felix Rosenberger, Volksrepublik China, Länderinformation, Staatssekretariat für Wirtschaft SECO, January 2009, available at https://www.seco.admin.ch/seco/de/home/Aussenwirtschaftspolitik_Wirtschaftliche_Zusammenarbeit/Wirtschaftsbeziehungen/laenderinformationen/asien---ozeanien.html (last accessed 14 December 2019), 5.
[26] Felix Rosenberger (fn. 25), 5.

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Chinese ChemChina's acquisition of the Swiss pharmaceutical company Syngenta for 43 billion CHF/UDS accounted for roughly half of all Chinese M&A in the world in that year.[27]

While there is a trend in the EU and the United States towards stricter national security screenings with regard to Chinese investments, this has so far not been true for Switzerland. Like other smaller European countries such as Iceland, Ireland or Sweden, Switzerland does not have a foreign investment control mechanism.[28] The Swiss Federal Council, the highest executive body of the Swiss government, has just recently reiterated this position and deems additional control mechanisms as detrimental to Switzerland's open policy towards foreign investment.[29] As such, it can be expected that Switzerland will continue its welcoming attitude towards Chinese FDI in coming years.

IV. China's legal framework on foreign investment

A. Current legal framework

1. Legal system

China has a civil law system (though its legal system is also significantly influenced by common law).[30] However, with the laws historically being implemented patchwork-wise rather than as a systematic unity, navigating the different laws can be difficult.[31] And although the NPC is the highest state authority in China, the adoption of regulations and specific implementation rules is often delegated to different national or local government bodies, adding to the challenge of finding the relevant legal sources in a particular case.[32] Finally, it is important to note that so far, China's economic legal system is a dichotomous system, with

[27] Neue Zürcher Zeitung, Warum sich chinesische Investoren aus Europa und den USA zurückziehen, 14 January 2019, available at https://www.nzz.ch/wirtschaft/warum-sich-chinesische-investoren-aus-europa-und-den-usa-zurueckziehen-ld.1451197 (last accessed 14. December 2019).

[28] Neue Zürcher Zeitung, Der Bundesrat will keine «Lex China», 13 February 2019, available at https://www.nzz.ch/wirtschaft/der-bundesrat-will-keine-lex-china-ld.1459544 (last accessed 14. December 2019).

[29] Bundesrat, Grenzüberschreitende Investitionen und Investitionskontrollen, 13 February 2019, available at https://www.seco.admin.ch/seco/de/home/Aussenwirtschaftspolitik_Wirtschaftliche_Zusammenarbeit/Wirtschaftsbeziehungen/Internationale_Investitionen/Auslandsinvestitionen/Investitionskontrollen.html (last accessed 14. December 2019).

[30] Emanuel Schiwow, Foreign investment vehicles in China – overview of the legal framework, in: Gesellschafts- und Kapitalmarktrecht (GesKR) 2006 S. 331, 331.

[31] Emanuel Schiwow (fn. 30), 331.

[32] Emanuel Schiwow (fn. 30), 331.

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domestic economic affairs and foreign-related economic affairs being regulated separately.[33] These two separate systems are merging gradually, with the FIL being an additional step to that regard.

2. Three foreign investment laws

Much of the early 20th century economic activity in China was conducted in an environment lacking an elaborate legal framework, as prior to the open door policy there was little to no development in areas such as business organisation law, contract law, property law and foreign investment law.[34] However, after the start of the opening up, three major laws (together often referred to as the "three foreign investment laws") were created and together with their subsequent amendments ever since constituted the legal framework for foreign investment in China. These three laws are the 1979 Law of China-Foreign Equity Joint Ventures ("EJV Law"), the 1986 Law of Wholly Foreign-Owned Enterprises ("WFOE Law") and the 1988 Law on China-Foreign Contractual Joint Ventures ("CJV Law"). Interestingly, much of the development of the foreign investment legal framework occurred before China adopted its General Principle of Civil Law in 1986 and its Company Law in 1993. China's reason for allowing foreign investment was first and foremost to develop the technological capabilities of its economy. This is, for example, illustrated by art. 5 EJV Law, which states that "[t]he technology and the equipment that serve as a foreign joint venturer's investment must be advanced technology and equipment that actually suit our country's needs."

3. Foreign invested entities

While China's economy did start to open up to foreign investment with the promulgation of the three foreign investment laws, there was always a clear differentiation between foreign and domestic enterprises in the Chinese legal system.[35] Foreign investors, including investors from Hong Kong, Taiwan and Macau, are to the present not allowed to operate in the same business structures as domestic business entities.[36] Whereas Chinese domestic enterprises are

[33] Emanuel Schiwow (fn. 30), 331.
[34] Samuel Farrell Ziegler (fn. 7), 544.
[35] Anyuan Yuan, China's Entry into the WTO: Impact on China's Regulating Regime of Foreign Direct Investment, 35 Int'l L. 195 (2001), 206.
[36] Meichen Liu, The New Chinese Foreign Investment Law and Its Implication on Foreign Investors, 38 Nw. J. Int'l L. & Bus. 285 (2018), 288.

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established in accordance with Chinese Company Law, foreign-invested enterprises ("FIE") are required to operate as either an Equity Joint Venture ("EJV"), a Contractual/Cooperative[37] Joint Venture ("CJV") or a Wholly Foreign Owned Enterprise ("WFOE").[38] Although these entities usually also take the form of a company with limited liability ("LLC") under Chinese Company Law, the foreign investment laws provide additional requirements that must be adhered to:[39] EJVs and CJVs require foreign investors to partner up with Chinese counterparts. Art. 4 EJV Law specifies that an EJV must take the form of a limited liability company with the foreign party contributing at least 25% of the registered capital. The CJV, on the other hand, allows investors more flexibility in areas such as the business form of the enterprise (parties are free to choose whether they want to create a legal person or not), arrangement of management and share of profits.[40] Practice has shown that foreign investors have preferred EJVs over CJVs, especially because of reasons of predictability of the cooperation.[41] Finally, the WFOE Law allows foreign investors to operate as independent corporate structures with limited liability without a Chinese partner.[42] In this corporate form, foreign investors can reduce the risk of IP infringements, though at the cost of not being able to make use of the Chinese *guanxi*, the relationship network crucial to many successful business transactions.[43] WFOEs are at present by far the most preferred business structure for foreign investors.[44]

4. Catalogue

The Chinese government maintains a firm control on the market access of FIEs. Market access was formerly regulated in the Catalogue for the Guidance of Foreign Investment Industries ("Catalogue"), first issued in 1995 and later revised numerous times. The Catalogue was accompanied by the explanatory Provisions on Guiding the Orientation of Foreign Investment. The Catalogue set out whether foreign investment in a particular industry was

[37] Anyuan Yuan (fn. 35), 203.
[38] Meichen Liu (fn. 36), 288.
[39] Emanuel Schiwow (fn. 30), 333; see for example art. 18 Detailed Rules for the Implementation of the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (2014 Revision), effective on 1 March 2014: "The form of organization of a foreign-invested enterprise shall be a limited liability company. Other liability forms may be adopted by approval. [..]"
[40] Art. 2 and 21 CJV Law; Yongmin Bian, A Revisit to China's Foreign Investment Law: With Special Reference to Foreign Investment Protection, 8 J. E. Asia & Int'l L. 447 (2015), 449 f.; Anyuan Yuan (fn. 35), 204.
[41] Omar R. Gutierrez (fn. 8), 26 f.
[42] Art. 2 WFOE Law.
[43] Roger Polack (fn. 7), 7.
[44] Omar R. Gutierrez (fn. 8), 27; Roger Polack (fn. 7), 11.

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"prohibited", "restricted" or "encouraged".[45] Industries not listed in the Catalogue were simply considered "permitted".[46] Encouraged industries were traditionally those with the most sought-after technologies and were promoted by means such as tax breaks (at one point, Chinese businesses paid 35% corporate income tax while foreign owned businesses paid no income tax at all)[47], free or cheap renting of land, exemption from paying social welfare or faster approval processes.[48] Examples of such industries included power supply or certain types of agriculture.[49] Restricted industries would typically be industries that are protected for Chinese SOEs or industries with no modern technologies.[50] They included industries such as banking, food processing or mining.[51] For restricted industries, the Catalogue specified the requirements necessary to allow foreign investment. Often, the Catalogue would demand that in order to get market access, foreign investors must enter into a Chinese-Foreign joint venture and would provide rules on the distribution of shares.[52] In prohibited industries, no foreign investment was allowed at all. Examples included media, internet and other telecommunications or military projects.[53]

No matter the qualification of the industry by the Catalogue, every foreign investment was formerly subject to a lengthy and bureaucratic review and approval process involving several government authorities. Most importantly, such review included an anti-trust as well as a national security review. In addition and depending on the specific case, there could be further reviews such as approval of enterprise registration, project approval, regulatory approval or the approval to invest in publicly traded Chinese companies.[54] Once a project was approved, the FIE's business activities were strictly limited to the business scope listed on their business license.[55] This review and approval process was widely criticised by foreign investors as inefficient, non-transparent, arbitrary and heavily favouring national entities (especially state-owned enterprises) over foreign investors. Altogether, the procedures and requirements for FDI constituted a considerable obstacle to market access.

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45 Samuel Farrell Ziegler (fn. 7), 545 f.; Roger Polack (fn. 7), 9 f.
46 Meichen Liu (fn. 36), 288.
47 Steve Dickinson, New China Foreign Investment Law: Not Good News, 23 April 2019, available at https://www.chinalawblog.com/2019/04/new-china-foreign-investment-law-not-good-news.html (last accessed 14 December 2019).
48 Steve Dickinson, News (fn. 47); Roger Polack (fn. 7), 12 f.
49 Samuel Farrell Ziegler (fn. 7), 545 f.; Roger Polack (fn. 7), 9 f.
50 Roger Polack (fn. 7), 14.
51 Samuel Farrell Ziegler (fn. 7), 545 f.; Roger Polack (fn. 7), 9 f.
52 Emanuel Schiwow (fn. 30), 332; Samuel Farrell Ziegler (fn. 7), 545 f.; Roger Polack (fn. 7), 9 f.
53 Samuel Farrell Ziegler (fn. 7), 545 f.; Roger Polack (fn. 7), 9 f.
54 Samuel Farrell Ziegler (fn. 7), 545.
55 Meichen Liu (fn. 36), 288.

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5. Variable interest entities

Some foreign investors – together with Chinese domestic enterprises operating in restricted or prohibited industries and in need of capital – found a way to circumvent the restrictions of the Catalogue. This scheme involves setting up so-called variable interest entities ("VIE") in China.[56] Under such a scheme, a Chinese domestic company operating in a prohibited or restricted industry is contractually linked to a foreign shell company partially or wholly owned by foreign investors. These structures can by relatively complex and normally involve at least three entities: an offshore holding company listed at a foreign stock market, a WFOE located in China as well as a Chinese domestic business entity (the VIE) operating in the prohibited or restricted industry.[57] VIE structures involve considerable risks, as the VIEs are at all times susceptible to government crackdowns and the contracts between the different business entities – their primary purpose being the circumvention of foreign investment restrictions – are unlikely to be enforced by Chinese courts.[58]

One famous example of the vulnerability of VIE structures is how Jack Ma came to own Alipay. Alipay way first controlled by a WFOE, which in turn was controlled by an offshore company owned and controlled by Yahoo! and some other foreign investors, besides being partially owned by Jack Ma. After Chinese regulators decided that Alipay cannot be operated by a WFOE, the investors established a VIE structure where the investors contractually exerted control over Alipay through a VIE owned by Jack Ma. When the VIE was denied the necessary licenses to operate Alipay, Jack Ma as the sole owner of the VIE transferred Alipay to himself without the consent of Yahoo! and the other foreign investors. Lacking any chance of seeing their contracts with the VIE enforced in China, the foreign investors had no other choice but to settle for compensation.[59] Albeit such risks, VIE business structures remain popular in China, given the huge potential for profit in the Chinese market. Another prominent example of a VIE structure is Alibaba, which operates in the "prohibited" Chinese e-commerce industry. The holding of the VIE is Alibaba Group Holding Limited, incorporated under the laws of the

[56] Maximilian J. Chapman, China's Variable Interest Entities In Context: Past, Present And Future, UNSWLJ Student Series No. 16-05 (2016), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2720097 (last accessed 14 December 2019), 3 f.
[57] Giulio Santoni, Foreign Capital in Chinese Telecommunication Companies: From the Variable Interest Entity Model to the Draft of the New Chinese Foreign Investment Law, 4 The Italian Law Journal 589 (2018), 597, 599; Meichen Liu (fn. 36), 289 f.; Maximilian J. Chapman (fn. 56), 5 f.
[58] Samuel Farrell Ziegler (fn. 7), 541, 547 ff.; Meichen Liu (fn. 36), 291.
[59] Giulio Santoni (fn. 57), 603 f.

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Cayman Islands.[60] The holding opened on the New York Stock Exchange in 2014 with what is to date the largest IPO in history.[61]

6. Negative list

Starting in 2013 in the Shanghai Pilot Free Trade Zone and later extending its scope to other special free trade zones ("FTZ"), the Catalogue and its corresponding review and approval mechanism were gradually replaced by the Special Administrative Measures for the Access to Foreign Investment, known as the "Negative List".[62] Under the Negative List regime, a simple record filing system replaced the former lengthy approval procedures. This means that FIEs benefit from national treatment regarding market access and their investments are subject to the same regulatory framework as investments from Chinese enterprises, unless the particular industry is listed as prohibited or restricted under the Negative List.[63] In 2018, the Ministry of Commerce ("MOFCOM") and the National Development and Reform Commission ("NDRC") jointly issued a Negative List that applied on a national level and replaced the Catalogue, containing 48 restrictive measures for 22 industry sectors.[64] The latest version of the Negative List was issued by MOFCOM and NDRC in 2019, reducing the restrictive measures to 40.[65] At the same time, the free trade zones still have their own negative lists, which are again less restrictive than the national Negative List.[66]

B. Creation of the FIL

In 2015, China started to revise the legal framework for foreign investment with MOFCOM publishing a draft of a new Foreign Investment Law ("Draft FIL") and soliciting public opinion on the draft. This draft was rather comprehensive and contained 170 provisions.

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[60] Giulio Santoni (fn. 57), 602.
[61] Meichen Liu (fn. 36), 290.
[62] Practical Law China, MOFCOM finalises FIE record-filing measures, 13 October 2016, accessible at https://1.next.westlaw.com/w-003-9184?transitionType=Default&contextData=(sc.Default)&__lrTS=20190430032625353&firstPage=true&fromAnonymous=true&bhcp=1 (last accessed 14 December 2019).
[63] Meichen Liu (fn. 36), 287.
[64] Special Administrative Measures (Negative List) for the Access of Foreign Investment (2018), effective on 28 July 2018; Dorcas Wong, How to Read China's 2018 Negative List, 7 July 2018, available at https://www.china-briefing.com/news/how-to-read-chinas-2018-negative-list/ (last accessed 14 December 2019).
[65] Special Administrative Measures (Negative List) for the Access of Foreign Investment (2019), effective on 30 July 2019.
[66] Dorcas Wong (fn. 64).

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In comparison, the FIL adopted by the NPC on 15 March 2019 only consists of 42 provisions and is much vaguer than the MOFCOM draft. For example, contrary to the Draft FIL, the FIL does not contain any provisions on the procedure for obtaining a permit to operate in a restricted industry (art. 27 ff. Draft FIL), on the procedure and any applicable foreign control thresholds with regard to the national security review (art. 48 ff. Draft FIL) or on the issue of VIEs (art. 14.6 in connection with art. 18 Draft FIL). One reason for the broad character of the FIL is likely that the NPC wanted to adopt the law rather sooner than later due to the pressure resulting from the US-China trade war to reform China's legal framework on foreign investment.[67] Because time was of the essence, the NPC did not take the time necessary to put together a more detailed foreign investment law. A more comprehensive law would have required a much stronger involvement of different ministries (e.g., MOFCOM, NDRC, Ministry of Foreign Affairs, State Administration of Foreign Exchange), which in turn would have required a time-consuming decision finding process regarding the specific powers and procedures of all relevant ministries.

As a consequence of the broad nature of the FIL, more specific issues are to be dealt with in a body of implementation rules accompanying the FIL. Such implementation rules should be issued by the State Council or the relevant ministries. The implementation rules should enter into force at the same time as the FIL, i.e. in January 2020. However, as of now the scope and content of those implementation rules are still obscure, as no drafts of the implementation rules are publicly available yet.

V. Analysis of the FIL

A. Overview

The FIL is divided into six chapters: Chapter I on General Provisions, Chapter II on Investment Promotion, Chapter III on Investment Protection, Chapter IV on Investment Administration, Chapter V on Legal Liability and Chapter VI on Supplemental Provisions.

In the general provisions (Chapter I), the FIL sets out its goal of "further expanding the country's opening up, vigorously boosting foreign investment, protecting the lawful rights and interests of foreign investors, regulating the administration of foreign investment, propelling

[67] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.

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the formation of a new pattern of extensively opening up, and promoting the sound development of the socialist market economy" (art. 1 FIL). In addition, it defines several terms relevant to the FIL. As such, "foreign investment" is defined as "investing activities within China directly or indirectly conducted by foreign natural persons, enterprises, and other organizations" including when such an investor jointly or alone "forms foreign-invested enterprises within China", "acquires any shares, equities, portion of property, or other similar interests in an enterprise within China" or "invests in any new construction project within China" (art. 2 FIL). Under this definition, foreign investment includes greenfield investment as well as mergers and acquisitions. Pursuant to art. 2.4 FIL, foreign investment can also include any other investment so designated under laws, regulations or provisions of the State Council (this might become relevant, for example, for VIEs). A "foreign-invested enterprise" is defined as "an enterprise formed and registered within China under the laws of China in which all or part of investment is made by a foreign investor" (art. 2.4 FIL). Art. 4 FIL establishes an "administrative system of pre-establishment national treatment plus negative list". This essentially means that market access continues to be governed by the means of the Negative List and if market access is not restricted or prohibited, the foreign investors and their investments are to receive national treatment.

Chapter II on investment promotion contains several provisions on transparency. As such, "regulatory documents and adjudicative instruments […] relating to foreign investment shall be published in a timely manner" (art. 10 FIL) and the state is to set up and improve a "foreign investment service system" that will provide foreign investors with information on relevant laws, regulations, policies and measures. Moreover, Chapter II provides for multi- and bilateral cooperative mechanisms for investment promotion (art. 12 FIL) and reiterates the possibility of setting up "special economic zones" as well as "pilot policies" to promote foreign investment in particular regions (art. 13 FIL). In addition, art. 16 FIL underlines equal treatment of foreign-invested enterprises in government procurement.

In Chapter III on investment protection, the FIL protects foreign investment from expropriation, though expropriation or requisition is possible "under certain special circumstances" (art. 20 FIL). It provides that "[t]he state protects the intellectual property rights of foreign investors and foreign-invested enterprises" and "strictly holds […] infringers legally liable according to the law" (art. 22 FIL). Also, it strictly forbids administrative agencies to force any transfer of technology by administrative means (art. 22 FIL). Local governments are bound not only to comply with contracts, but also with "policy commitments" legally made to foreign investors (art. 25 FIL). Furthermore, the law provides for a new

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"working mechanism for complaints" in case foreign-invested enterprises or their investors deem an administrative act by a government agency unlawful (art. 26 FIL).

In Chapter IV on investment administration, the FIL sets the legal basis for issuing the Negative List. Market access for foreign investment and equal treatment with domestic investment is the general rule. Foreign investors must adhere to specific investment conditions set out in the Negative List if the particular industry is listed as restricted. And market access is denied to foreign investors if the Negative List declares a particular industry as prohibited (art. 28 FIL). The law also provides for the establishment of a new "foreign investment information reporting system", under which every foreign investor or foreign-invested enterprise must submit certain investment information (art. 34 FIL). It is not clear yet, however, how this reporting system will intersect with the record filing system of newly established foreign-invested enterprises. Importantly, the law also provides for a "foreign investment security review system", under which foreign investment that may impact national security must pass a security review (art. 35 FIL).

Chapter V on legal liability deals with the consequences of illegal foreign investment in industries prohibited or restricted by the Negative List (art. 36 FIL) as well as of non-compliance with the information reporting system (art. 37 FIL). It also states that any administrative officials abusing power, practicing favouritism, making falsifications for personal gain or divulging trade secrets shall be subject to disciplinary action and held criminally liable (art. 39 FIL).

In its supplementary provisions, the FIL stipulates the possibility of retaliation in case other countries or regions adopt "prohibitive, restrictive or other similar discriminatory measures" relating to foreign investment against the PRC (art. 40 FIL). With the entry into force of the FIL on 1 January 2020, the current three foreign investment laws will be repealed (art. 42 FIL). Henceforth, foreign-invested enterprises will no longer be distinguished as EJVs, CJVs and WFOEs, but will be uniformly designated as FIEs and established in accordance with Chinese Company Law. Already established foreign-invested enterprises will continue to exist in their current form for a maximum of five years after the coming into force of the FIL (art. 42 FIL). During this transition period, all current FIEs must adapt their corporate governance structure to conform to Chinese Company Law or Chinese Partnership Enterprise Law.

Under the new legal framework, many parties currently operating under a JV will have to adjust their corporate governance structure. Most importantly, JV partners will need to establish a shareholder meeting, which will become the enterprise's highest authority when

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the JV is transferred into an LLC.[68] Also, Chinese Company Law has provisions regarding the number of board members, term of office of a board member, required quorum for a board meeting and appointment of directors that differ from the requirements under the JV laws.[69] As a consequence, parties to a joint venture must soon start revising their JV contracts and articles of association, negotiating or re-negotiating such issues as shareholder powers and their voting method as well as the board of directors' regulating duties, responsibilities, election and voting method and applicable quorums.[70]

B. Achievements

1. Commitment to national treatment

Besides the simple fact that one law on foreign investment is easier to navigate than three foreign investment laws, one of the main achievements of the FIL is the commitment to national treatment of foreign investment that is not prohibited or restricted by the Negative List. This should result in a more equal footing and healthier competition between Chinese and foreign-invested business entities. A major aspect of the national treatment is that FIEs will start operating under the same business structures as Chinese entities, as most entities will be subject to Chinese Company Law. One of the benefits of this will be speed: In the past, setting up a new WFOE or JV in China could take up to several months, depending on the jurisdiction.[71] This is considerably longer than the average time required by foreign investors to set up a company in for example the United States or most European countries. Under Chinese Company Law, it is expected that forming a FIE can take as little as a week and will become less costly.[72] Also, it is possible that under the FIL's promulgation of national treatment, foreign investors will be allowed to buy shares of private Chinese companies, whereas this is currently not possible without changing the Chinese company into a JV.[73]

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[68] Kaiding Wang/Jian Zeng et al., Into A New Era: Changes and Challenges in the Foreign Investment Legal Regime of China, 18 March 2019, available at https://www.chinalawinsight.com/2019/03/articles/foreign-investment/into-a-new-era-changes-and-challenges-in-the-foreign-investment-legal-regime-of-china/ (last accessed 14 December 2019), section II N. 12 and 13.
[69] Kaiding Wang/Jian Zeng et al. (fn. 68), section II N. 14.
[70] Kaiding Wang/Jian Zeng et al. (fn. 68), section II N. 14.
[71] Steve Dickinson, China's New Foreign Investment Law Benefits: Like Putting Lipstick on a Pig, 25 April 2019, available at https://www.chinalawblog.com/2019/04/chinas-new-foreign-investment-law-benefits-like-putting-lipstick-on-a-pig.html (last accessed 14 December 2019).
[72] Steve Dickinson, Lipstick (fn. 71).
[73] Steve Dickinson, Lipstick (fn. 71).

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It is important to note, however, that "national treatment" has its limits. By continuing to employ the concept of "foreign-invested enterprises", the FIL continues the bifurcated system established under the three foreign investment laws distinguishing between FIEs and domestic enterprises. The FIL does not go so far as to abolish the notion of FIE altogether, which would be necessary under a full commitment to national treatment of foreign business entities operating within China.[74] In addition, following a narrow interpretation of the wording of art. 4 FIL, establishing the principle of "pre-establishment national treatment plus negative list to foreign investment" does not preclude discrimination against FIEs *after* their establishment.[75]

Finally, one also must bear in mind that a more equal treatment of FIEs can also have undesired effects. National treatment can potentially eliminate preferential treatments and protections that FIEs have enjoyed over Chinese domestic enterprises in the past. Moreover, it is conceivable that after the entry into force of the FIL, more FIEs will have to accept Chinese Communist Party ("CCP") party branches within their company, accept CCP controlled worker unions, or are required to store their data on Chinese cloud servers accessible to the Chinese government.[76]

2. Commitment to negative list regime and record filing system

Another achievement of the FIL is the legal commitment to the Negative List regime.[77] Although negative lists already exist on the level of regulations, the FIL constitutes the first law formally adopted by the NPC codifying the Negative List regime as national law. As a matter of law, market access for foreign investment will now constitute the rule and restrictions or prohibitions the exception. Naturally, how much market access is actually granted is to be seen with the promulgation of further revisions of the national Negative List.

Hand in hand with the Negative List comes the formal abolishment of the review and approval mechanism where, for example, joint venture contracts and articles of association required prior approval by government authorities before a JV could start operations.[78] As long as a specific industry is not listed as restricted or prohibited, the review and approval

[74] American Chamber of Commerce in China/American Chamber of Commerce in Shanghai/U.S. Chamber of Commerce, Joint Submission on draft Foreign Investment Law (December 2018 Version), January 2019 Version, 2.
[75] American Chamber of Commerce in China/American Chamber of Commerce in Shanghai/U.S. Chamber of Commerce (fn. 74), 5.
[76] Steve Dickinson, News (fn. 47).
[77] The same was true for the Draft FIL, see Laura B. McCaskill (fn. 10), 39.
[78] Kaiding Wang/Jian Zeng et al. (fn. 68), section II N. 6.

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mechanism is replaced by the much simpler and faster record filing system, where there is no review of the founding documents prior to the company establishment.[79] As is the case for the Negative List regime, the record filing system also already exists under the current legal framework. Nevertheless, the record filing system has never before been codified as the ordinary procedure in a national law issued by the NPC.

3. Enhancing rights of foreign investors

The FIL also stipulates and enhances the protection of numerous rights of foreign investors: The expropriation of foreign-owned assets is generally prohibited, though it remains allowed under "special circumstances" (art. 20 FIL). Foreign investors are guaranteed the free transfer of Renminbi and foreign currencies out of and into China (art. 21 FIL). Foreign investors' intellectual property is protected (art. 22 FIL). Local governments are obliged to honour contracts and policy commitments (art. 25 FIL). Naturally, the nature of many provisions is relatively broad and as always, the devil lies in the details. What protections foreign investments will eventually receive will not so much depend on the FIL, but on the upcoming implementation rules and regulations giving life to the FIL's guidelines. Nevertheless, the protections stipulated in the FIL show a commitment to the strengthening of foreign investor's rights and are to be welcomed.

C. Unresolved or "problematic" issues

1. Broad nature and declaratory value of many provisions

As mentioned, one of the characteristics of the FIL is that many of its provisions are either overly broad (see for example the possibility of expropriating foreign investment under "certain special circumstances" stipulated in art. 20 FIL) or of mere declaratory nature. Many of the new features introduced by the FIL require further development by the implementation rules. Such features include the working mechanism for complaints, the national security review or the binding nature of "policy commitments", all of which will be addressed further below.

Apart from new features, the FIL also mentions different protections that are already

[79] Kaiding Wang/Jian Zeng et al. (fn. 68), section II N. 6.

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codified in other bodies of law. This leads to the question whether such protections are intended to be enhanced by means of the FIL or if they constitute mere references, which would be unnecessary as it only adds redundancies to the law. One such example is the protection of FIE's intellectual property, as provided for in art. 22 FIL. Forced transfer of foreign intellectual property has long been an issue in China. Whereas in the 1990s, foreign investors entering into Sino-foreign joint ventures were often formally required to transfer their technology to the joint venture, today's "forced" technology transfers occur in more subtle ways. For example, a foreign investor may encounter difficulties of selling products manufactured in foreign operated factories as opposed to the same products manufactured in factories operated by a Chinese company. This factually forces the investor to have its products manufactured by a Chinese partner and to license to that partner its production IP.[80] As such practices are of concern to many foreign investors, a strengthening of IP protection is welcome and necessary. However, as art. 22 FIL lacks any new protection mechanisms, it will likely not strengthen the IP protection framework already implemented in the Chinese Patent Law, Trademark Law and Copyright Law.[81] As such, the provision serves no purpose save a political purpose. For the sake of a concise legal landscape, it could have been omitted altogether.

The same holds true for the provisions on legal liability for administrative agency employees in art. 39 FIL. Liability for breach of administrative duties as well as for criminal offences is each regulated in other bodies of law. The FIL does not go so far as to establish a special liability in the area of foreign investment. Rather, it appears that the liability provisions' sole purpose is to serve as a reminder of existing legal liabilities. Again, the reason for such a provision seems to be of political nature, aimed at addressing concerns of foreign investors over corruption within the state agencies, but without adding anything specific to the existing legal regime.

Another noteworthy element of uncertainty under the FIL is the governing law of FIEs. Under the current legal regime, art. 126 Contract Law provides that EJVs as well as CJVs operating within the territory of the PRC must be governed by PRC law. The FIL does not contain any provision on the law governing FIEs after the transition period, when EJVs and

[80] Steve Dickinson, China's New Foreign Investment Law and Forced Technology Transfer: Same As it Ever Was, 21 March 2019, available at https://www.chinalawblog.com/2019/03/chinas-new-foreign-investment-law-and-forced-technology-transfer-same-as-it-ever-was.html (last accessed 14 December 2019).

[81] Steve Dickinson, Technology Transfer (fn.80).

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CJVs seize to exist. As a result, it is unclear whether parties to an FIE are now given the liberty to choose the governing law for their investment agreements.[82] In the same vein, while EJV Law and the CJV Law only permit foreign investors to enter into joint ventures with Chinese companies or other economic organisations but not with Chinese natural persons, art. 2 FIL merely states that foreign natural persons, enterprises and other organisations can enter into foreign-invested enterprises within China alone or jointly with "any other investor". The broad language of the provision does not indicate whether such joint enterprises are also allowed with Chinese natural persons.[83] Other examples of uncertainty include the applicability of the FIL to investors from Taiwan, Hong Kong and Macau (art. 2 FIL), the applicability of the FIL when foreigners hold an insignificantly low amount of equity of a Chinese company (art. 2 and 28 FIL), the requirement that foreign investors and foreign-invested enterprises do not cause damage to the "public interest" (art. 6 FIL) and the exact nature of the "foreign investor service system" (art. 11 FIL).

2. Foreign investment security review system

Art. 35 FIL establishes a new foreign investment security review system:

> *Art. 35 FIL*
>
> *"The state establishes a foreign investment security review system to conduct a security review of foreign investment that impacts or may impact the national security. A decision legally made upon a security review shall be final."*

The security review system in China is often compared with the National Security Review (NSR) in the United States. Both systems were initiated by the executive government as opposed to the law-making body.[84] In addition, both systems are conducted by an inter-governmental body. In the United States, the review is conducted by the Committee on Foreign Investment in the United States ("CFIUS"), which is jointly chaired by the Department of Commerce and the Treasury Department.[85] In China, the review is led by the State Council

[82] American Chamber of Commerce in China/American Chamber of Commerce in Shanghai/U.S. Chamber of Commerce (fn. 74), 17; Kaiding Wang/Jian Zeng et al. (fn. 78), section II N. 4.
[83] Kaiding Wang/Jian Zeng et al. (fn. 68), section II N. 10.
[84] Kai Schlender, Die Staatssicherheitsprüfung der VR China, in: Recht der Internationalen Wirtschaft (RIW) 2018 S. 38, 38.
[85] Roger Polack (fn. 7), 30; Xingxing Li, National Security Review in Foreign Investments: A Comparative and

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and effectively conducted by NDRC and MOFCOM, jointly with other departments relevant to a specific review.[86]

In the United States, Congress provided a legislative legal basis for the NSR by adopting the "Foreign Investment and National Security Act" (FINSA) in 2007. Similar to the situation in the United States before 2007, the Chinese national security review mechanism was so far governed by executive orders. Those orders are the "Notice of the General Office of the State Council on the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors" ("Notice No. 6") issued by the General Office of the State Council in 2011, and the "Regulations of the Ministry of Commerce on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors" published as Announcement No. 53 by MOFCOM in 2011 ("Announcement No. 53"). With the entry into force of the FIL, the NPC as lawmaking body establishes a formal legal basis for the security review system.

The scope of the review mechanism stipulated in the FIL appears to be broader than under the existing regime: Arts. 1 and 2 Notice No. 6 currently define the scope of the security review and limit it to M&A transactions in specifically denominated sectors. Under the FIL, however, the scope of the security review encompasses all "foreign investment" as defined in Art. 2 FIL, if the investment "impacts or may impact the national security". Thereby, the FIL allows for security reviews in all areas of FDI, including greenfield investment. In comparison, CFIUS can only review M&A but not greenfield investment.[87] With the Chinese security review including greenfield investment, its scope is extended considerably and surpasses that of many other jurisdictions.[88]

In the spirit of its broad nature, the FIL does not provide for a specific review procedure.[89] It is possible that the security review mechanism will rely on current structures, but it is also possible that it will be restructured entirely.[90] The FIL is also silent on the question of which administrative body or bodies will conduct the review.[91] In addition, the absence of a clear definition of the term "national security" raises the concern that the security review system

Critical Assessment on China and U.S. Laws and Practices, 13 Berkeley Bus. L.J. 255 (2016), 260.

[86] Art. III.2 Notice of the General Office of the State Council on the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors.

[87] Roger Polack (fn. 7), 30; Xingxing Li (fn. 85), 260.

[88] American Chamber of Commerce in China/American Chamber of Commerce in Shanghai/U.S. Chamber of Commerce (fn. 74), 2 f.

[89] This was also true for the Draft FIL, see Laura B. McCaskill (fn. 10), 44.

[90] Kai Schlender (fn. 84), 44.

[91] See art. 49 Draft FIL.

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will serve as a tool to prohibit foreign investment not only because of concerns of national security in a strict sense, but also because of economic or political reasons.[92] Already after the publication of the Draft FIL, the European Union Chamber of Commerce in China released a statement that "[t]he European Chamber is very concerned about the […] overly broad and vague definitions of what constitutes 'national security'."[93] The even broader nature of the FIL's provisions on the security review in comparison to MOFCOM's Draft FIL will likely not have dispelled such concerns.

The unpredictability of the new security review system is accentuated by the fact that under art. 35 FIL – different than is the case for CFIUS reviews under US law[94] – investors are precluded from any form of appeal against the verdict of the security review.[95] As the procedure of the security review is not yet known, there remains a possibility that the review system itself will include a form of internal appeal. Nevertheless, it is regretful that lawmakers chose not to provide for a possibility of appeal outside the review system. Reading the provision as it stands, it is likely that the foreign investment security review system will be one of the most controversial issues under the new regime of the FIL. With its extensive scope, it has the potential of offsetting much of the progress otherwise achieved by strengthening national treatment of FIEs and rights of foreign investors.[96]

3. National treatment and SOEs

Chinese SOEs traditionally receive preferential treatment within the Chinese economy. Preferential treatment includes benefits such as government subsidies, special policy treatment, preferential treatment in obtaining licences or quotas and guaranteed government procurement contracts.[97] With this special treatment, the government aims at strengthening its SOE's market positions and creating national champions with strong competitive positions in the domestic as well as in the international market.[98] The FIL provides for national treatment for

[92] Roger Polack (fn. 7), 1, 28.
[93] European Union Chamber of Commerce in China, available at https://www.europeanchamber.com.cn/en/national-news/2284/foreign_business_is_deeply_concerned_by_the_overly_broad_and_vague_definitions_of_the_draft_prc_national_security_law (last accessed 14 December 2019).
[94] Omar R. Gutierrez (fn. 8), 32.
[95] American Chamber of Commerce in China/American Chamber of Commerce in Shanghai/U.S. Chamber of Commerce (fn. 74), 3; see also already art. 73 Draft FIL.
[96] Roger Polack (fn. 7), 29.
[97] Anyuan Yuan (fn. 35), 216.
[98] Yongmin Bian (fn. 40), 456.

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FIEs that are not prevented from accessing the Chinese market by means of the Negative List. One concern under the FIL is how to reconcile national treatment of FIEs with the preferential treatment granted to Chinese SOEs.

For example, Art. 16 FIL expressly stipulates the principle of national treatment of FIEs in government procurement. It remains unclear if this provision is only aimed at creating equality between FIEs and Chinese private enterprises, or if it goes so far as to put FIEs on an equal footing with Chinese SOEs. Looking at the special status and privileges of SOEs in China's economy, an equal footing of foreign-invested entities seems highly unlikely. The answer will perhaps be found in the implementation rules. There, different options are possible: One possibility is that "national treatment" under the FIL excludes any comparison with SOEs altogether. Another possibility is that the implementation rules will undertake a classification of industries, implementing equal treatment with all Chinese entities including SOEs in some industries and maintaining the privileged treatment of SOEs in others. A rule establishing equal treatment between FIEs and SOEs in all industries would likely remain a dead letter.[99]

4. Working mechanism for complaints

Art. 26 FIL establishes a new working mechanism for complaints of foreign-invested enterprises:

> *Art. 26 FIL*
>
> *"The state establishes a working mechanism for complaints of foreign-invested enterprises to address concerns of foreign-invested enterprises and their investors in a timely manner and coordinate and improve the relevant policies and measures. Where a foreign-invested enterprise or its investor deems that an administrative action taken by an administrative agency or its employee infringes upon its lawful rights and interests, it may, through the working mechanism for complaints of foreign-invested enterprises, apply for coordination to resolve the issue. (...)"*

Different than ordinary administrative reviews, court litigation or arbitration, the complaint mechanism stipulated in art. 26 FIL is so far unheard of in Chinese law. Not

[99] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.

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referring to any existing mechanisms must be understood as a deliberate choice by Chinese lawmakers. It can therefore be assumed that the complaint mechanism constitutes something completely new. However, other than creating the legal basis for the mechanism, the law omits to provide any further context of the specific purpose and characteristics of this mechanism or of differences to already existing review mechanisms.

One possible reading of the provision is that it serves mainly to enhance transparency in administrative dispute resolution. It might be the case, for example, that a foreign-invested enterprise feels that it is being unfairly treated but does not know to whom to address its complaints (local or central government, which branches of government), that its complaints are not being heard or that it is continuously redirected from one government branch to another. In such circumstances, the complaint mechanism could take note of the complaint, direct the enterprise to the competent government branch and ensure adequate reaction from that government branch.[100] Under such a reading of the provisions, the complaint mechanism would constitute investment *facilitation* as opposed to *litigation*. What speaks against this interpretation is that in the FIL, lawmakers included the provisions into Chapter II on investment protection rather than in Chapter III on investment promotion.

Another possible reading of the provision is that Chinese lawmakers intended to create a voluntary dispute prevention mechanism that would precede other dispute resolution procedures. As such, the mechanism could be regarded as a form of alternative dispute resolution that would likely consist of government-led mediation. In fact, a reading of the Draft FIL suggests that the complaint mechanism is indeed intended to be an independent dispute resolution process, as art. 118 Draft FIL stipulated that investment disputes may be resolved "through negotiation, mediation, *lodging complaint*, applying for reconsideration, arbitration or litigation in accordance with relevant laws or regulations" (emphasis added). Similarly, art. 119 Draft FIL stated that the State will establish a complaint mechanism "for coordination *and handling* of foreign investor complaints" (emphasis added).[101] However, in case lawmakers did indeed intend to implement an additional dispute prevention mechanism, the consequences on dispute resolution clauses in many of China's BITs are unclear. Many BITs contain so-called "fork-in-the-road clauses" where the investor is given the choice between domestic litigation and arbitration. Potentially, making use of the complaint

[100] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.
[101] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.

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mechanism could preclude a foreign investor from initiating arbitration proceedings against the PRC. Therefore, initiating an investment complaint under the new complaint mechanism should only occur after carefully checking with the authorities of the consequences of such an act.[102]

5. "Policy commitments"

Art. 25 FIL addresses policy commitments issued by local governments:

> *Art. 25 FIL*
>
> *"The local people's governments at all levels and their relevant departments shall fulfil their policy commitments legally made to foreign investors and foreign-invested enterprises and various contracts legally concluded."*

Art. 25 FIL refers to "policy commitments" made by local governments to foreign investors and declares these commitments legally binding. Especially in the context of foreign investment, government commitments will often play an important role in forming an investor's expectations during the initial phase of establishing whether an investment is feasible and profitable. At the same time, local governments are competing for foreign investment. With the goal of securing foreign investment in their particular region, local authorities may feel inclined to voice certain promises, e.g. swiftly issuing necessary permits or facilitating the lease of land. The foreign investor will rely on such promises. The difficulty, however, is to know when a certain promise issued by a government official constitutes a legally binding policy commitment in accordance with the FIL. In art. 25, the FIL notably refers to "commitments" and not to contracts. Art. 18 FIL shows that "commitments" are further differentiated from "policies" and "measures" that a local government may develop to promote and facilitate foreign investment. It seems that policy commitments are established as a new form of creating rights and duties between investors and government agencies, although the details on their formation and validity remain unclear.

The requirements of formation and validity are of course necessary in order to differentiate legally enforceable policy commitments from mere "chat". Such difficulties of differentiation can occur in many circumstances: As is common in Chinese business culture,

[102] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.

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business "promises" may often be made in the context of informal meetings, many of which will at some point involve toasts and drinks. If this context, it is important to know for example whether the fact that a government agent was under the influence has any effect on the validity of his or her policy commitments. The same is true for commitments that are issued in exchange of favours, be it monetary or in other forms, that might reach the level of corruption. Also, it is not clear whether policy commitments are valid if they touch upon issues that do not lie within the formal responsibilities of the issuing government agent. Finally, it is uncertain if mere words suffice to create policy commitments or if there are additional requirements as to their form, such as for example that they must be issued in writing.[103]

In practice, much will also depend on the enforcement procedure for policy commitments. For example, seeking for enforcement of policy commitments at the local level would be virtually impossible due to the entanglement of the competent authority with the authority that issued the policy commitment in the first place. However, enforcement at the national level would have its own difficulties. The burden of proof will likely lie on the foreign investor, who might be confronted with the fact that local governments will not be very cooperative in any investigation conducted by national authorities.[104] It remains to be seen if and how the implementation rules to the FIL will further develop the issue of government policy commitments.

6. Variable interest entities

The VIE corporate structure described above[105] has been used in China since the 1990s in order to circumvent restrictions on foreign investment. The model is known to investors and the Chinese government alike. Therefore, the absence of any specific regulations on VIEs has so far been in line with the Chinese government's policy interests.[106] Keeping VIEs in a legal grey area allows the government to turn a blind eye on VIEs deemed beneficial. At the same time, it allows the government to selectively enforce investment regulations in case a VIE loses the government's favour.[107]

[103] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.
[104] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.
[105] See above III.I.A.5.
[106] Laura B. McCaskill (fn. 10), 10.
[107] Laura B. McCaskill (fn. 10), 10.

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A less lenient approach to VIE structures was taken in MOFCOM's Draft FIL. There, the definition of foreign investment for the first time specifically included VIE structures, as it introduced the element of *de facto* control (art. 14.6 in connection with art. 18 Draft FIL). With such a definition, the Draft FIL expressly extended the application scope of the new law to VIEs, and rendered the use of *new* VIEs to bypass restrictions to foreign investment illegal.[108] For *currently operating* VIEs, MOFCOM did not propose a definite solution, left art. 158 Draft FIL blank and invited the public for comments. Different options included that such existing structures would be generally legalised, submitted to a notification requirement or to a case-by-case approval procedure that would likely have resulted in the prohibition of many of the existing VIEs.[109] Different than the Draft FIL, the FIL does not expressly list foreign factual control of a Chinese enterprise as a form of foreign investment and is silent on the issue of VIEs. The FIL does, however, leave the door open to such an approach. In its definition of foreign investment in art. 2.4. FIL, it includes as foreign investment "any other manner as specified by a law or administrative regulation or the State Council". It is to be seen if the implementation rules will provide further guidance on whether or in what circumstances the government intends to treat VIEs as foreign investment under this provision of the FIL.[110] A suitable solution would be to legitimize all VIEs, perhaps with the exception of a negative list of very limited scope.[111]

7. More favourable treatment under international treaties

Art. 4 FIL allows for international treaties to provide for more favourable treatment of foreign investors:

> *Art. 4 FIL*
>
> *"(...) Where any international treaty or agreement concluded or acceded to by the People's Republic of China provides for any more favourable treatment in respect of access of foreign investors, the relevant provisions of*

[108] Laura B. McCaskill (fn. 10), 48.
[109] Laura B. McCaskill (fn. 10), 51.
[110] Z. Alex Zhang, Vivian Tsoi, China Adopts New Foreign Investment Law, White&Case Client Alert, March 2019, available at https://www.whitecase.com/publications/alert/china-adopts-new-foreign-investment-law (last accessed 14 December 2019), 2 f.; Kaiding Wang/Jian Zeng et al. (fn. 68), section II N. 3.
[111] In the same vein American Chamber of Commerce in China/American Chamber of Commerce in Shanghai/U.S. Chamber of Commerce (fn. 74), 5.

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the treaty or agreement may apply."

Art. 4 FIL stipulates that the more favourable treatment of investors under international treaties is applicable "in respect of access of foreign investors". Under this wording, different interpretations are possible. Under a narrow interpretation, this provision only applies to questions of market access. However, market access is so far exclusively regulated by domestic Chinese law, i.e. formerly the Catalogue and now the Negative List, and has not been the subject of any international treaty China has entered into with its international partners. As a result, this provision would have no practical effect under the current situation.

If future BITs or other treaties will include provisions on market access in China, this will lead to new questions that are not resolved by the FIL. First of all, the relationship between domestic law and international treaties in the area of administrative law is not clear in Chinese law. In Chinese administrative law, there is no notion of "self-executing" treaties that would be binding to local governments and courts. And even if the FIL would serve as a legal basis to render market access provisions in international treaties self-executing, there is the questions of who would interpret those provisions to determine if they are indeed more favourable than the Negative List or other domestic law. It is unlikely that local courts would take upon the responsibility and be granted the power to interpret treaties concluded between the Chinese central government and foreign states.[112] In China, local courts traditionally do not interpret and enforce international treaties. Although there are some exceptions in commercial matters, such as for example the interpretation of the CISG, on which parts of Chinese contract law are based.[113]

If the provision is interpreted in a broader sense, this could lead to the application of terms of international treaties containing rules not only on *if*, but also on *how* foreign investors may access Chinese markets. This would not necessarily be limited to BITs, but could also include issues such as social and political rights that are highly sensitive in China. For example, China is a signatory state to the UN International Covenant on Civil and Political Rights, but has not ratified it. This convention grants the freedom of association. A foreign investor could argue under art. 4 FIL that its market access is improved if it can associate with other foreign investors to have more bargaining power when facing local government authorities. Similar arguments could be made with the Convention on the Elimination of all Forms of

[112] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.
[113] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.

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Discrimination Against Women (CEDAW), which has been ratified by China. Evidently, such an interpretation is not likely to be in line with Chinese lawmakers' intentions and, if so argued, will have little success in a Chinese court.[114]

8. Reciprocity in case of discriminatory measures by foreign countries

Art. 40 FIL establishes the reciprocity principle in case of discriminatory measures against Chinese investments enacted by foreign states or regions:

> *Art. 40 FIL*
>
> *"Where any country or region adopts any prohibitive, restrictive or other similar discriminatory measures against the People's Republic of China in terms of investment, the People's Republic of China may adopt corresponding measures against the aforesaid country or region according to the actual circumstances."*

The standard required by this provision in order to trigger the reciprocity principle is that a measure must be "discriminatory". The FIL does not contain any further guidance on when this is the case, thereby creating uncertainty. For example, if a foreign state denies market access to a Chinese investor because of national security concerns, it is not clear whether this already constitutes a discriminatory measure under the FIL.

Also the nature of the "corresponding measures" China could implement against the discriminating state is not clear. Specifically, the FIL does not mention further criteria such as necessity, proportionality and subsidiarity of the measures. China as a sovereign state is not limited in adopting any measures it deems appropriate, as long as this remains within the boundaries of international law. Nevertheless, there is a concern that the broad character of art. 40 FIL will allow the provision to be instrumentalised as a legal basis for retaliatory purposes.[115]

[114] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.
[115] This statement is based on conversations with several seasoned Chinese lawyers as well as foreign lawyers operating within China that occurred during July and August 2019.

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VI. Conclusion

In the context of China's economic opening up that has gradually developed in the last four decades, the adoption of the FIL constitutes the latest step of bringing China's legal framework on FDI closer to international standards. Amongst the achievements of the new law is the commitment to national treatment of FIEs, which is best illustrated by the fact that FIEs will from now on operate under the same corporate governance structures as domestic companies. One important benefit of this will be the speed with which a foreign investor can set up a company in China and start operating. In addition, the FIL contains a strong commitment to the Negative List regime and to further reductions of the scope of restricted or prohibited industries. Also, instead of the three current foreign investment laws, the FIL will provide a single entry point into Chinese foreign investment law, creating an easier to navigate legal landscape for FDI.

However, a close reading of the law shows that due to the vague nature of many of its provisions, the FIL itself only does little for foreign investors. The unequal treatment between FIEs and SOEs remains unresolved and the future of VIEs remains unclear. In addition, many of the key elements of the FIL are mere concepts, with little information on their actual functioning in practice. Such is the case for the working mechanism for complaints, the security review system, the legally binding nature of policy commitments and the more favourable treatment under international treaties. The actual effects of these elements will not derive from the FIL, but will be decided by the State Council and its ministries when adopting the implementation rules. Whether the implementation rules can address all the unresolved aspects of the FIL is questionable. This would require a very extensive set of rules, which might be difficult to set up in time to enact the rules together with the FIL on 1 January 2020.

In order to adopt a set of implementation rules in a timely manner, it is likely that the State Council will want to avoid delegating too many rule-making responsibilities to ministries, as this would entail the risk of power struggles between different ministries. Rather, the State Council will likely want to coordinate the process of establishing the rules itself. This in turn would lead to a broader set of rules, as the State Council will not decide on specific procedures within the different ministries. It is also possible that the State Council will itself first adopt a set of implementation rules, which will at a later stage be complemented by more specific rules issued by the relevant ministries. Another possibility is that part of the law-making responsibilities will be taken on by the Supreme People's Court by the means of judicial interpretations. In any event, amidst all this speculation it seems probable that many of the

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current questions on the FIL will remain unanswered also after 1 January 2020.

As a whole, the FIL must be seen as a quickly drafted body of law with the primary political purpose of reducing tensions in the ongoing trade dispute with the US and other pressures from the outside. The vague character of the Law accurately reflects the CCP’s struggle to advance China’s market economy while at the same time maintaining firm market control. From a legal perspective, a slower legal drafting process leading to a more thorough and detailed legal framework for FDI would have been preferable. Nevertheless, even though the FIL will not revolutionize the conditions of FDI in China, it is certainly an important step in China’s gradual path towards a more open market economy.

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