The Foreign Investment Law Implementation Regulations come into force: but why all the last minute changes?

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Hogan Lovells

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1. Introduction and Overview

On December 31, 2019, the State Council of the People's Republic of China (the "**PRC**" or "**China**") promulgated the *PRC Foreign Investment Law Implementation Regulations* (the "**Implementation Regulations**", full text in Chinese, in-house English translation available[1] upon request), which came into effect the very next day, and now sit alongside the *PRC Foreign Investment Law* (the "**FIL**"). Around the same time, the Ministry of Commerce ("**MOFCOM**") and the State Administration for Market Regulation ("**SAMR**") issued a set of new rules and circulars (collectively the "**Ancillary Rules**"), some of which are touched upon below, in an apparent effort to reconcile the thousands of old rules governing and regulating foreign investment and foreign-invested enterprises ("**FIEs**") in China with the FIL and the Implementation Regulations. Even before the FIL had come into force, the Supreme People's Court had already weighed in and promulgated its first set of judicial interpretations on the FIL, entitled *the Supreme People's Court Interpretations on Several Issues concerning the Application of the Foreign Investment Law* (the "**SPC FIL Interpretations**"), addressing issues as to the validity of investment contracts in relation to foreign investment.

A draft of the Implementation Regulations (the "**Draft**") was released at the beginning of November 2019 to seek public opinions. We have discussed the key provisions of the Draft at length in our earlier Client Note *"The Foreign Investment Law gets wings: draft implementation regulations released for public consultation"* dated November 2019 (the "**Previous Note**"). In a surprise move, the regulators made a great number of changes in the final version of the Implementation Regulations as compared to the Draft. Some of these changes were merely adjustments to wording or reorganization and rephrasing of language, but some were, in our view, quite substantial. We will briefly mention what these changes are, but given that the provisions of the Draft are now largely only of historical interest, we will place the emphasis here on the practical and legal implications of the new provisions of the Implementation Regulations.

2. Key Changes As Compared To The Draft

2.1 VIE structure remains in the grey area

Subject to a review by the relevant competent departments under the State Council and approval by the State Council (which seems in itself to be quite a high threshold), the Draft proposed to exempt enterprises established overseas which were wholly-owned by Chinese natural persons, legal persons or other organizations (excluding FIEs) which invest within the PRC from complying with the restrictions under the *Market Access* by *Foreign Investors Special Administrative Measures* (Negative List) (the "**Negative List**"). However, as we analyzed in the Previous Note, the "wholly owned" requirement significantly narrows the scope of applicability of this carve-out provision, as many offshore vehicles raising offshore funds will have minority foreign investment, even if they are ultimately controlled by their Chinese founders.

In the Previous Note, we also pointed out that if, however, this "wholly owned" requirement could be reduced to a "control" requirement, then such exemption could potentially reshape the landscape of many Chinese businesses structured under the variable interest entity ("**VIE**") arrangement, in that such offshore vehicles would no longer be treated as foreign investors for the purpose of the FIL and therefore not subject to the restrictions under the Negative List. Apparently, the regulators, after some rethinking, have, by removing the provision, chosen to take the path of least resistance by closing this door rather than opening it wider. While this is understandable

[1] Given the amount of time and effort expended in making this, availability will be limited to existing and potential clients of the firm.

as this would be an unprecedented relaxation which could have had somewhat unpredictable consequences, it is a missed opportunity to make a bold statement and positive change to the regulatory approach to VIE structures. With this exemption being removed, there are now no provisions in either the FIL or the Implementation Regulations that directly or indirectly touch upon the sensitive issue of VIE structures, except that many take the view that VIE structures may potentially be regulated as 'an acquisition of other similar rights and interests of domestic capital enterprises' or under the catch-all leg of the definition of "Foreign Investment", which provides that investments made through other means, as specified by laws, administrative regulations or by the State Council, may also be regulated as foreign investment. As a result, the question of whether the VIE structure is lawful and how it should be regulated remains unanswered.

It is, however, worth noting that under the SPC FIL Interpretations, it is made clear that an investment contract, which is widely defined to include any contract for the transfer of shares, equity, asset shares or **similar rights and interests** – so possibly capturing contracts and agreements in relation to a VIE arrangement, that involves a foreign investment in a business sector that is subject to the Negative List will be held null and void if the investment is made in a prohibited sector, or if the investment is made in a restricted sector and the relevant restrictive special administrative measures are not complied with. Given that the VIE structure is commonly used in connection with foreign investments made into restricted sectors, this could potentially become a more relevant legal basis than the *PRC Contract Law* that could be used to attack the validity of VIE agreements[2], but it is too early to say how this will play out. What is clear is a full-frontal assault on the VIE structure would have a huge negative impact on literally thousands of red-chip companies and start-ups in China, affecting Chinese and foreign investors alike.

2.2 New foreign investment administration system

The Draft proposed to have SAMR take over MOFCOM's responsibility as the gatekeeper of foreign investment in China. Article 38 of the Draft stated that where a foreign investor invests in sectors in which investment is restricted under the Negative List, the competent SAMR will, at the time of registration, conduct a review to ascertain whether the Foreign Investor satisfies the restrictive requirements under the Negative List concerning shareholding ratios, senior management personnel and so forth. But the Draft was silent on whether a record-filing with MOFCOM that was previously required after October 2016 under the *Record-filing of the Establishment of, and Changes to, Foreign Invested Enterprises Interim Administrative Measures* promulgated by MOFCOM (the "**MOFCOM Record-filing Rules**"), would be still be required after January 1, 2020. It was the common understanding at the time that the MOFCOM record-filing system would likely be repealed in its entirety and replaced by the information reporting system proposed to be established under the FIL. This understanding has now been confirmed by MOFCOM under its *Bulletin on Matters in relation to Foreign Investment Information Reporting* ("**Bulletin 62**"), promulgated by MOFCOM on December 31, 2019, which provides that after January 1, 2020 the establishment of, or changes to, FIEs no longer needs to be record-filed with MOFCOM.

Interestingly, the Implementation Regulations have somehow blurred the boundaries of responsibilities by providing that the relevant regulators (without naming which), when performing their duties in accordance with law, shall not grant the applied permit or license and registration of enterprises to foreign investors

[2] This typically includes an exclusive business cooperation agreement, an option agreement, a proxy agreement or power of attorney, an equity pledge agreement and a spousal consent letter.

who propose to invest in business sectors that are subject to the Negative List but who do not meet the requirements as set out in the Negative List, and if such foreign investment requires approval in relation to fixed-asset investments (e.g. big infrastructure projects which historically have required National Development and Reform Commission ("**NDRC**") approval), such approval will not be granted. This may give regulators more flexibility in terms of scrutinizing a foreign investment project at different phases of the process, but certainly makes it less clear and certain to foreign investors as to whether and when they will feel they have received a 'green light' to proceed with the investment plan, knowing that any competent regulator in the investment and establishment process may take a different view and now potentially has the authority to stop the investment project in its tracks.

Moreover, with the elimination of the project-based foreign investment approval and record-filing requirements, it is possible that the national security review system will evolve into a CFIUS-like review and take more of a front-seat role in regulating sensitive projects and transactions involving foreign investment. Historically very few projects appear to have been blocked by the national security review system.

2.3 Remedy for expropriations

Article 21 of the Implementation Regulations reiterates that any expropriation targeting any investment made by foreign investors shall be made pursuant to statutory procedures in a non-discriminatory manner and compensation shall be provided based on the market value of the expropriated investment. It is worth noting that under both the FIL and the Draft, the standard used for determining the level of compensation is "fair and reasonable". But this was changed to "market value" in the Implementation Regulations. Admittedly market value is much easier to determine than what is fair and reasonable, words which are open to interpretation and debate. However, the market value of something does not necessarily equate to the fair and reasonable value of the same, and so these two terms are not completely interchangeable. This could potentially give rise to a discrepancy between the FIL and the Implementation Regulations, as in some cases, the amount of compensation determined using the two different standards may be different. Presumably in this case, as a technical matter of statutory interpretation, the FIL (as a law) should prevail over the Implementation Regulations (lower-level administrative regulations issued by the State Council). The Implementation Regulations have also made it clear that foreign investors may challenge an expropriation decision by applying for an administrative review or bringing an administrative suit in accordance with law.

2.4 Protection of intellectual property rights

The Implementation Regulations maintained most of the provisions included the Draft concerning intellectual property ("**IP**") protection. One notable change is that, while the Draft proposed that the State would establish a punitive damages system, the Implementation Regulations only provided a more general commitment, stating that the State will increase penalties for IP infringement and continue to strengthen IP law enforcement. This change appears to be merely rewording as we are already seeing the concept of punitive damages being systematically introduced in IP-related legislation. The *PRC Trademark Law* and the *PRC Anti-Unfair Competition Law* as amended in 2019 both allow the courts to award punitive damages of up to five times the actual damages in cases of serious infringement. The draft amendments to the *PRC Patent Law* and the third draft of the *PRC Civil Code* published for public comments in 2019 similarly proposed to allow the courts to award punitive damages for IP infringement.

2.5 Change of policy commitments

Article 25 of the FIL requires local governments and their respective departments to strictly fulfil the policy commitments they make to, and the contracts entered into with, foreign investors and FIEs, provided that such policy commitments and contracts are made or entered into in accordance with law. Article 28 of the Implementation Regulations, which was previously Article 29 of the Draft, expressly forbids local governments and the relevant departments within them from breaching or reneging on such contracts or commitments on the grounds of administrative divisions being readjusted, changes in government leadership, institutional or functional adjustments, changes to the relevant persons in charge and so forth (which sounds suspiciously like a laundry list of excuses previously presented to foreign investors to justify reneging on such commitments). The Implementation Regulations also added that if any policy commitments or contracts need to be changed in the interest of the State or the public interest, such changes must be made in accordance with statutory authority and procedures and fair and reasonable compensation shall be paid to foreign investors or FIEs who have suffered any losses as a result of such changes. It is interesting that here the regulators have applied the "fair and reasonable" standard here instead of the "market value" standard used for expropriations, presumably because it may be hard to determine the market value of the loss of a special treatment or a tax concession.

2.6 Complaint mechanism

Article 26 of the FIL provides that the State will establish a working mechanism through which FIEs can lodge complaints, so as to promptly resolve the problems reported by FIEs and their investors, and coordinate and improve the relevant policies and measures. The Draft provided that a national working mechanism would be established to process the complaints involving issues that have a nationwide material impact and other material or complex issues, and that local governments at the county level or above **could**, subject to actual needs, establish a local complaint working mechanism to resolve the problems reported by FIEs and their investors within the applicable region. The Implementation Regulations have changed this approach, providing that local governments at the county level or above **must** establish a local working mechanism, and MOFCOM and other relevant departments under the State Council will establish an inter-ministerial joint meeting mechanism to coordinate and advance the work relating to complaints made by FIEs at the central level and to provide guidance and exercise oversight at the local level with respect to such work. This is clearly a better approach in terms of providing immediate and direct remedies to all foreign investors and FIEs. However it remains to be seen how effective this mechanism is in practice: essentially it will mean local government investigating its own alleged wrongdoing, with all the potential for conflicts of interest that implies.

2.7 Restriction on use of foreign invested partnership

The 2019 version of the Negative List expressly forbids foreign investors from investing in restricted sectors by way of setting up a foreign invested partnership enterprise ("**FIPE**"). On the face of it, this prohibition does not make much sense (except to the limited extent that it might be seen as a 'restatement' of the previous rules that prohibited making foreign investments using a FIPE in any sector subject to equity restrictions), as the restriction on foreign ownership is supposed to be placed based on specific business sectors rather than tied to the type of investment vehicle. But it appears to be a more technical requirement that has been included because the Negative List uses the term "equity ratio", so partnerships have to be completely carved out to prevent foreign investors from using a FIPE as a workaround. Under the Draft, the regulators

made an attempt to address this issue by allowing foreign investors to invest in restricted sectors which are subject to restrictions under the Negative List with respect to the foreign investor shareholding ratio by way of establishing a partnership (i.e. a FIPE), provided that the proportion of *voting rights* of the foreign investors under the partnership agreement complied with the restrictive provisions of the Negative List concerning shareholding ratios. But this also raised an interesting question – why did the Draft use voting rights instead of equity ownership rights, the expression which is used under the Negative List? Does this mean that a foreign investor will be able to own a higher percentage of the asset shares in a partnership that does restricted business and therefore the corresponding portion of the economic return, as long as it does not have voting control over the operations of the partnership? We will never have an answer to this question as this provision was deleted from the promulgated final version of the Implementation Regulations. Presumably the drafters deleted to remove the potential ambiguity. Consequently, it is still not possible for foreign investors to set up a FIPE to make investments in a restricted sector where there is a restriction on foreign ownership.

2.8 Information reporting

The information reporting mechanism as proposed to be established under the FIL has been rolled out. Article 39 of the Implementation Regulations clarifies that the contents and scope of foreign investment information reports, the frequency of reporting, as well as the detailed procedures will be determined by MOFCOM, SAMR and other relevant departments. On December 30, 2019, MOFCOM and SAMR jointly promulgated the *Foreign Investment Information Reporting Measures*, effective from January 1, 2020 (the "**Reporting Measures**"). The Reporting Measures expressly provide that the MOFCOM Record-filing Rules shall be repealed on January 1, 2020, putting an end to the foreign investment record-filing regime that was only put in place in 2016. Although they may welcome the overall direction of travel towards simplification, foreign investors could be forgiven for feeling somewhat exhausted at the constant stream of changes to the regulatory environment in China in recent years, from across-the-board approval pre-2016, to approval/record-filing from 2016-2019, to simply SAMR registration from 2020. It sometimes feels a little like foreign investors have been treated as guinea pigs while China worked out the optimum way to regulate foreign investment. For example, having previously imposed the record-filing process with MOFCOM under the post-2016, pre-2020 regime, there was often a sense that it had largely become a mechanical rather than substantive review process, so the requirement was dropped (or perhaps, more accurately, the whole involvement of MOFCOM in the process and the overlap with SAMR was rethought).

Under the Reporting Measures, foreign investors or FIEs shall report information through the existing *Enterprise Registration System* (the "**ERS**") and the *National Enterprise Credit Information Publicity System* (the "**NECIPS**"), both of which are managed and maintained by SAMR, and SAMR shall forward the reported information to MOFCOM. MOFCOM will establish a Foreign Investment Information Reporting System to receive and process the information forwarded or shared by SAMR and other relevant departments, but such system will not generally be used by foreign investors and FIEs to directly report information required to be submitted.

Under the Reporting Measures, foreign investors and FIEs are required to submit the following reports:

a) an initial report, to be submitted through the ERS, at the time of establishing an FIE or acquiring the equity interests of a domestic capital enterprise;

b) reports on changes, to be submitted through the ERS, when an FIE needs to change the information in the initial report;

c) a de-registration report, deemed to have been submitted when an FIE has completed the registration procedures for de-registration or conversion into a domestic capital enterprise. No separate submission is required; and

d) an annual report, to be submitted annually through the NECIPS between January 1 and June 30 of each calendar year.

The forms of the initial reports, reports on changes and annual reports were included by MOFCOM in Bulletin 62.

We note that under the Reporting Measures and Bulletin 62, it has been made clear that information in relation to investments made by foreign invested investment enterprises (also known as holding companies), foreign-invested venture capital enterprises and FIPEs with making investments as their principal business activities in China shall be reported pursuant to the Reporting Rules, but information in relation to FIE Re-investments (as defined below) will be shared by SAMR with MOFCOM directly and do not need to be separately reported. The Reporting Measures also provide that foreign investments made in non-enterprise forms shall be reported by reference to the provisions of the Reporting Measures.

2.9 Transitional period reduced

Under the FIL, existing FIEs are allowed to maintain their original governance structures for five years after the FIL takes effect (the "**Transitional Period**"). To cushion the blow, the Draft took a softer approach by providing that the State 'encourages' all FIEs to make changes in accordance with law within the Transitional Period, and if an FIE that should have made the change fails to do so within the Transitional Period, then it will have another grace period of six months to complete the change procedures, failing which the competent SAMR will not accept its applications subsequently made for other changes and may disclose such non-compliance in the enterprise information publicity system. The Implementation Regulations, however, took a harder line and removed the 6-month grace period, meaning that existing FIEs who fail to make the switch before January 1, 2025 will immediately be banned from making other changes that require registration with SAMR. Therefore, our recommendation in the Previous Note stands – attacking the transition early enough while you have time on your side seems to be the better strategy and will help to avoid a damaging impasse and business interruption down the line.

2.10 FIE Re-investments in China

Investments made by established non-investment-type FIEs in China ("**FIE Re-investments**") have historically been regulated under the *Investments Made by Foreign-Invested Enterprises in China Interim Provisions* (the "**Re-investment Provisions**"). A new article was added to the Implementation Regulations providing that investments made by foreign-invested enterprises within the PRC shall be governed by the relevant provisions of the FIL and the Implementation Regulations. This suggests that going forward, FIE Re-investments will be treated as, and regulated as, foreign investment and subject to the same foreign investment regime under the FIL. The bright side of this is of course that FIE Re-investments will receive the same level of protection (e.g. against expropriation, forced transfer of IP and so forth) and preferential treatments as are made available to FIEs under the FIL and the Implementation Regulations, while on the less positive side it is likely that all the restrictions

(e.g. application of the Negative List) will also extend to FIE Re-investments, although on the face of the law there are not that many. We are definitely in a better place than a few years ago when there were a number of pre-conditions to be satisfied under the Re-investment Provisions before an FIE could reinvest at all which did not apply to domestic capital enterprises ("**Domestic Companies**") (and which were subsequently repealed). Query, for example, whether an FIE Re-investment will also be subject to national security review (in theory it should as we see no substantial difference between a foreign investor buying into a sensitive sector directly from offshore or indirectly from onshore). We also note that, as we mentioned above, FIE Re-investments are still treated differently than fresh establishments of FIEs for information reporting purposes under the Reporting Measures and Bulletin 62.

2.11 Survival of special agreements

The Draft proposed an agreement-over-statute carve-out from the general application of the *PRC Company Law* (the "**Company Law**") and *the PRC Partnership Law* (the "**Partnership Law**"). It stated that **following the implementation of the FIL, the distribution of profits method, the residual property distribution method** and so forth as set forth in the relevant contracts by the parties to an existing Sino-foreign equity joint venture or Sino-foreign cooperative joint venture may continue to be valid **during the term of the joint venture**. Presumably this meant that such agreement reached by the parties to a joint venture, to the extent that it is in conflict with the statutory provisions under the Company Law or the Partnership Law, could remain in place and effectively override the statutory provisions after the joint venture has adjusted its governance to reflect the structure under these if the parties so wished.

Three changes were made to this Article in the Implementation Regulations. First, the transfer of equity or interest method is now also listed as a part of the agreement that can survive the change. Second, "during the term of the joint venture" was deleted, which makes sense in that it is possible for a distribution of residual property to happen after the term of the joint venture. However, the third change, i.e. changing "following the implementation of the FIL" into "after the change of the organizational form, organizational structure and so forth" is a bit confusing, as on its face it seems to suggest that the aforesaid special agreements will only remain valid after the change of the organizational form or organizational structure has been completed. What this seems to mean is that you can amend the constitutional documents on an FIE to be consistent with the governance structures under the Company Law/Partnership Law, whilst keeping certain provisions from the legacy documents that may be technically inconsistent with the provisions of these laws. Given that a joint venture will have five years to complete the change, this perhaps unintentionally casts doubt on whether a special agreement on residual property distribution method in a joint venture contract that is inconsistent with the Company Law that has not made the transition to the new governance structure will remain valid after January 1, 2020 in the period before the changes to the governance structures are made.

2.12 Other notable changes

a) In terms of the definition of "**Foreign Investment**", the Draft attempted to clarify that "**invests in new projects within China**" as referred to in paragraph (c) of Article 2 of the FIL means investments made by foreign investors in the construction of specific projects within the PRC without establishing FIEs or acquiring the shares, equity interests, property shares or other similar rights and interests in a Chinese domestic enterprise. This clarification did

not seem to be very helpful at first blush, as it is still unclear exactly what type of specific projects would fall under this category. Perhaps because the regulators have since realised that it is difficult to provide a definition capable of capturing each and every type of investment of this kind, such provision was eventually deleted from the Implementation Regulations, leaving it again an open issue to be further clarified.

b) The Draft provided that the State will protect foreign investors' investment, proceeds and other lawful rights and interests in China in accordance with laws and regulations [of the PRC] and the international conventions and treaties that have been entered into by China. This was the first time that international conventions and treaties have been listed as the legal basis for the source of protective measures with respect to foreign investment. However, this provision was deleted in its entirety from the Implementation Regulations. While it is the prevailing academic view that international conventions generally prevail over domestic laws in China, neither the *PRC Constitution* nor the *PRC Legislation Law* has officially confirmed this view. But certain specific laws, such as the *PRC General Principles of Civil Law* and the *PRC Civil Procedure Law*, expressly provide that international conventions prevail over such laws in the event of any conflict except for reservations expressed by China in relation to the treaty. As a result of the failure to mention international conventions and treaties in the Implementation Regulations, foreign investors seeking protection thereunder might need to rely on specific laws that do have the prevailing language or argue that they express a principle with more general application.

c) The Implementation Regulations provide that the length of time between the promulgation and implementation of any normative documents that are closely related to the production and operation activities of FIEs shall be reasonably determined based on the actual situation, presumably to allow foreign investors, FIEs and other interested parties to have sufficient time to digest and provide comments on the same. Ironically, the Implementation Regulations, being the most important of them all, and many of the Ancillary Rules, were promulgated just one day before coming into effect, and during a period when more foreign investors would have been on holiday and with their attention focused elsewhere.

d) Under the Draft, foreign investors making investments in encouraged industries, sectors and areas will be entitled to enjoy preferential treatment in terms of governmental funding support, taxation, finance-related support, use of land and so forth pursuant to the laws, administrative regulations and the provisions of the State Council. The requirement that investments eligible for preferential treatment must be made in encouraged industries, sectors and areas was deleted from the Implementation Regulations, which seems to suggest that all foreign investments may potentially be eligible for preferential treatment of some description e.g. in certain development zones, where preferential tax rates are available to all FIEs meeting the criteria, not just those in sectors technically classified as encouraged.

e) As compared to the Draft, the Implementation Regulations emphasize that compulsory standards as formulated by the State shall apply equally to FIEs and Domestic Companies. The application of any higher standards must not target FIEs only. It was once provided under the Draft that FIEs shall not be forced to apply recommended standards or group standards, but such provision was deleted from the Implementation Regulations. It is, therefore,

our understanding that FIEs could still be required to apply recommended standards or group standards as long as such requirement is imposed on FIEs and Domestic Companies on an equal footing.

f) Article 17 of the Draft forbids all organizations and individuals from obstructing or restricting, by whatever means, FIEs from accessing local government procurement markets. Under the Implementation Regulations, the phrase "all organizations and individuals" was changed to "the government and the relevant departments". This is a bit concerning, because it seems to suggest that FIEs will not have recourse directly under the Implementation Regulations against other types of organizations and individuals who sabotage an FIE's attempt to access government procurement markets. That said, FIEs may still have recourse under other laws and regulations should they be able to establish a cause of action. The regulators seem to have taken the position that the Implementation Regulations regulate acts by government, but disputes between market players should be resolved in accordance with other rules. This is somewhat disappointing as it removes one possible avenue of recourse for foreign investors where they could have required regulators to take action against a competitor blocking access to a local market.

g) Two new articles were added to the Implementation Regulations providing that FIEs may put forward inquiries and challenges to procurer and procurement agencies and file complaints with the governmental procurement supervision administration department in accordance with the *PRC Government Procurement Law* (the "**Procurement Law**") and its implementation regulations and the governmental procurement supervision administration department and other relevant departments shall strengthen the supervision and inspection of government procurement activities and rectify, investigate and penalize differential or discriminatory treatment against FIEs. However, this is not new as it is essentially a repetition of the same provisions under the Procurement Law that presumably aim to protect all suppliers in the government procurement process, regardless of whether such suppliers are FIEs or domestic capital enterprises.

h) The Draft required the government and its relevant departments which formulate normative documents involving foreign investment to conduct a legality review and a fair competition review in accordance with regulations issued by the State Council. It further provided for a remedy allowing foreign investors or FIEs to challenge the lawfulness of such normative documents by requesting a judicial review when they brought an administrative suit on the specific administrative act in accordance with the *PRC Administrative Procedure Law*. Under the Implementation Regulations, the requirement for conducting a fair competition review was deleted for unknown reasons. The establishment of a fair competition review mechanism was first proposed in a 2016 opinion issued by the State Council, and then again in the latest draft amendment to the *PRC Anti-Monopoly Law* which was promulgated by SAMR on January 2, 2020 for public comments. Also added to the Implementation Regulations was a request for review of the lawfulness of a normative document may also be made when applying for an administrative review of the underlying specific administrative act. Again, as we mentioned in the Previous Note, this is an existing right rather than a new invention.

i) A new clause was added to the Implementation Regulations making it clear

that the registered capital of an FIE may be denominated in Renminbi, being China's lawful currency, or in any other freely-exchangeable foreign currency.

j) A whole new chapter was added to the Implementation Regulations to address the legal liability of relevant government departments and their staff for violating the relevant provisions of the FIL and the Implementation Regulations.

3. REMAINING QUESTIONS

Now the dust has settled and China has officially entered into a new era of foreign investment administration, the question of whether the combined package of the FIL and the Implementation Regulations represents progress as compared to the prior regime. To some extent, the Implementation Regulations provide less detail than what we would expect to see in a typical set of implementing rules. For example, Article 40 of the Implementation Regulations that deals with national security review is merely a 'copy-and-paste' of the exact words of Article 35 of the FIL, and therefore offers little guidance on implementation and raises the obvious question of what point is served by repeating without interpreting. It almost suggests that under pressure to write something and to finalise, the path of least resistance was to repeat the same wording as in the FIL to avoid saying anything controversial.

One very important question that remains unanswered is what will happen to the vast number of administrative regulations, provisions, measures, rules, circulars and notices that were promulgated, adopted and enforced by MOFCOM, the NDRC, SAMR, the State Administration of Foreign Exchange and other ministries and departments in the past decades to micro-manage every aspect of foreign investments (collectively the "**FIE Legacy Rules**"). In an effort to answer this question, the Implementation Regulations end with a new article stating that in the event of any inconsistency between regulations concerning foreign investment enacted prior to January 1, 2020 on the one hand, and the FIL and the Implementation Regulations on the other hand, the FIL and the Implementation Regulations shall prevail. This provides the general principle of how to deal with conflicts between the FIL and the FIE Legacy Rules, but is an inherently flawed solution for two reasons – firstly, in many cases it is not entirely clear whether an article in the FIE Legacy Rules is inconsistent with the FIL and the Implementation Regulations, the provisions of which are both very generic in nature. Secondly, it does not provide any guidance on how to deal with the provisions of the FIE Legacy Rules that are not inconsistent with the FIL and the Implementation Regulations (e.g. imposing debt-equity ratios on FIEs) as both are silent on the point.

On December 28, 2019, MOFCOM issued a *Decision on Repealing Several Regulations*, repealing six important departmental regulations including amongst others the *Several Issues Concerning the Establishment of Foreign-invested Companies Limited by Shares Interim Provisions*, previously being the main piece of legislation regulating the establishment of foreign-invested companies limited by shares, and the *Change of Equity Interests of Investors in Foreign Invested Enterprises Several Provisions*, previously being the main piece of legislation regulating acquisitions of equity interests in FIEs. However, many other FIE Legacy Rules are still effective as of this date, including, interestingly, the Re-investment Provisions as mentioned above, and, perhaps most importantly, the *Merger with, and Acquisition of Enterprises in China by, Foreign Investors Provisions* (the "**M&A Provisions**"). Historically, because of the foreign exchange control regime and the M&A Provisions, certain cashless and tax-efficient structuring options commonly used in other jurisdictions, such as share swaps in cross-border transactions involving China have proven to be very difficult, if not impossible, to achieve in practice. It

remains to be seen what steps China will take to align these with the new FIL regime and whether it will result in a new mindset that unless it is expressly prohibited under the new FIL regime, it should be seen as permitted. If we can move in that direction, then investors will benefit from greater flexibility and having a broader 'palette of colours' when designing China deals, and we can clearly conclude that substantial progress has been made.

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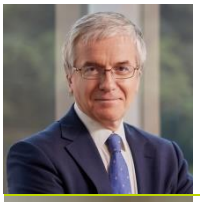

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