

Summary of PRC Legal Updates relevant to foreign investors

In the past years, the Peoples Republic of China promulgated a range of new pieces of legislations, which may have a substantive impact on foreign investors.

In this newsletter Magnusson's China Desk has summarized those most relevant for foreign investors interested in the PRC market to pay attention to.

I. Corporate Social Credit System

On July 9, 2019, the General Office of the State Council published a guiding opinion on accelerating the construction of the social credit system as well as the introduction of a new-credit-based regulation mechanism.

The system is to set up a database to monitor the companies' behaviours and trustworthiness across China in real time.

Two key points are worth noting by foreign investors in China are:

1. Companies will be subjected to comprehensive evaluation of public credit, including without limitation in relation to judicial complaints and litigation related information, defaults, illegal or irregular operations, qualifications and permits, honours, etc., and be rated as "excellent", "good", "medium" or "bad". Such ratings are provided for references to the public, and to the authorities to implement graded and categorized regulation, and to the financial institutions which may affect companies' financing requests. For example, for companies conducting import and export business rated as "excellent" or "good", local customs expect to implement a lower inspection rate for those companies, in which case, the custom clearance procedures will surely be faster, and it is more likely for them to get bank loans with higher amounts comparing to those rated as "medium" or "bad".
2. Companies having seriously illegal and dishonest acts will be included in a dishonesty list, and in such case, those companies may be faced with restricted or prohibited access to the market or the industry, disqualification of certain product certificates, restricted participation in government procurement and punishments of their key personnel-in-charge.

Companies are advised to pay close attention to the information disseminated about them in the public sphere and quickly take measures correct wrongful or misleading information. Communication with the authorities regarding any inappropriate disclosure or information is also highly recommended. Meanwhile, conducting routine monitoring of compliance is also undoubted.

II. New Foreign Investment Law and Implementing Regulations

The new Foreign Investment Law ("FIL") and its Implementing Regulations took effect on January 1, 2020, according to which the widely-known three FDI (foreign direct investment) laws have been replaced by this unified FIL.

Subsequently, the PRC administrative authorities published a series of rules to further implement FIL. The FIL and relevant rules and regulations are good signals for promoting foreign investment in China in many ways, including:

1. As a principle, foreign investment companies (“FIE”) should be treated equally with domestic companies in the respect of government funding, land supply, tax reductions and exemptions, permitting, standards formulation, public procurement, and project approvals;
2. FIL simplifies the government procedures for foreign investment, including streamlining MOFCOM approval/filing and company registration procedures, and establishing a foreign investment information reporting system;
3. Corporate governance requirements for FIEs are clarified and unified by FIL;
4. Foreign exchange control is relaxed by increasing the threshold of foreign debt quota and permitting FIEs to convert capital contribution proceeds to equity investment; and
5. IP protection is strengthened by encouraging voluntary technical cooperation and respecting the terms and conditions of technical cooperation agreed by the companies.

FIL is a reform of the FIE related laws and regulations. The intention is to make China more welcoming to foreign investment by better protecting the rights and interests of foreign investors and simplifying and standardizing both substantive rules and procedures for foreign investment. Foreign investors will be provided a better access to the China market despite of certain regulatory scrutiny, and for those existing FIEs, it is time to revisit their corporate governance structure and future business plans under the FIL.

III. Newly Revised Securities Law

The Securities Law of PRC was revised in December 2019 and came into effect on March 1, 2020.

Shanghai Stock Exchange set up the Science and Technology Innovation Board and is piloting the registration system in the beginning of 2019 on a trial basis. Following the successful operation by Shanghai Stock Exchange, the newly revised Securities Law creates a new chapter in PRC securities history to feature a unified registration-based IPO system, more strict disclosure requirements to protect investors and tougher penalties for malpractice in China and abroad.

The securities offerings approval system is officially replaced by the registration system, and meanwhile, discretion remains for specific scope and implementation steps which are to be stipulated by the authority gradually.

Under the registration system, the requirements for both public offering and bond issuance are reduced, to align with the principle of promoting a more market-oriented mechanism.

Obligations of companies on disclosure requirements and compliance are increased in terms of both public offering and bond issuance. The disclosure requirements will help eliminate the

information bias that troubles foreign investors. For example, scope and contents of required disclosure are heavily expanded, fines for fraudulent issuance increased from 5% of raised funds to two times of raised funds, and controlling shareholders and actual controllers may presume joint liabilities for fraudulent issuance, disclosure violations and such.

In consistency with FIL which encourages FIE to raise funds through public market, the newly revised Securities Law is another good news to foreign investors interested in entering Chinese securities market and buying stocks of Chinese companies listed overseas.

IV. Newly Revised Measures for Cyber Security Review

Newly revised Measures for Cyber Security Review (“Measures”) came into effect on June 1, 2020 and replaced the existing measures from 2017.

Comparing to the 2017 rules, the objects of review are narrowed down to and clearly defined as critical information infrastructure (“CII”) operator purchasing network products and services which may affect national security. Moreover, the 2017 rules were silent on review procedure and timeline, but the Measures made relatively complete specifications of application documents, review standards and timeline and special procedures.

Furthermore, CII operators are now required to proactively file to the authority for cyber security review, while in the 2017 rules, companies were only required to cooperate with the review if initiated by the authority.

The Measures indicated the core idea of the PRC authorities to take CII operators as the starting point for cybersecurity review and supervision. CII operators are imposed with new obligations and legal liabilities under the Measures. More detailed implementing rules are expected to come in the future to provide more accurate guidance. Companies engaging in CII industries (e.g. energy, finance, transportation, healthcare, education, environment protection, information networks, chemical, food and drug and such) should be more conscious and discreet about filing cyber security review application to the authority and consult with the authority ahead if the review requirement is likely to be triggered.

V. Technologies Prohibited or Restricted from Export

The authorities promulgated the newly revised Catalogue of Technologies Prohibited or Restricted from Export by China (the “**Export Restriction Catalogue**”) on August 28, 2020.

The Export Restriction Catalogue deleted nine items which were previously subject to export prohibition or export restriction (e.g. microbial fertilizer and chemical synthesized and semi-synthesized drug production technologies), and added 23 items into the list of export restriction (e.g. 3D printing, unmanned aerial vehicle, laser, artificial intelligence interactive interface technologies, and technology for personalized information push service based on data analysis).

The most sensitive item is the newly added item of technology for personalized information push service based on data analysis, as ByteDance was at that time in the process of asset sale of its video-sharing brand TikTok in US that may involve this restricted technology.

According to PRC laws, any technology transfer from China to foreign companies are required to comply with the Administrative Regulations on Technology Import and Export promulgated in 2002.

To export any technology covered by the Export Restriction Catalogue, the company should apply for a pre-approval from the authority before engaging in substantive negotiation and execution of agreements.

Moreover, after having signed a technology export contract, the company is required to submit the contract to the authority to obtain a technology export permit.

In our past experiences, such requirement was loose and not strictly implemented in practice by the local authorities. However, it is likely that such requirement and procedure will be implemented and enforced more strictly going forward. In this case, companies engaging in technology export are advised to carefully review the regulatory requirements.

VI. New Export Control Law

Following the revised Export Restriction Catalogue discussed above, the new Export Control Law (“ECL”) came into effect on 1 December 2020, which is the first consolidated framework to regulate export control sector and respond to the escalating tensions in the trade war.

Items subject to export control include dual-use items, military products, nuclear as well as other goods, technologies and services (including data) relating to safeguarding of national security and interests and fulfilment of non-proliferation and other international obligations. The coverage appears to be very broad and leaves room and discretion for the authority to interpret.

Further, the enforcement targets cover the items exported by any PRC citizens and legal entities to foreign individuals or organizations, but not only transfer from PRC to overseas.

Thus, the PRC export control regime is broadened to cover more products and transactions. Further the ECL provides a legal basis for temporary export control by giving the PRC authority the right to make announcements to implement export control of certain goods, technologies or services for no more than two years.

The new regime sees China’s export supervision regime significantly tightened up through more strict monitoring and penalty imposition, but how it will be operated by the central and local authorities still need to be further observed.

ECL delegates the enforcement authority to promulgate the implementation measures, which are not stipulated in ECL itself.

PRC registered companies with export business and foreign companies doing import business with China should carefully re-evaluate its current compliance with the laws and keep a close eye on the upcoming implementation measures and local practices. It is predictable that clauses relating to export permit and approval and consequent events of termination will need to be addressed in the sales or purchase agreements.

VII. Draft Personal Information Protection Law

China released the draft Personal Information Protection Law (the “PIPL”) on 21 October 2020 for public comments.

It has been criticized that China was in lack of a dedicated and comprehensive legislation on personal information rights of individuals for a long time, and now PIPL is the first consolidated legislation to address and regulate this section.

With the upcoming PIPL, individuals are granted enforceable rights with regard to personal information, and it marks a new era for Chinese legislation. The principles in PIPL are aligned with GDPR to a substantive extent. Some highlights are set out below:

1. Data processing activities carried out in China will be regulated by PIPL with extraterritorial effect similar to GDPR, no matter whether such data processing companies are registered in China.
2. Consent is the predominant ground for collecting, processing and disposing of personal information like previously, in addition to various public interest grounds and where such information is essential for execution and performance of an agreement. Collection should be limited to necessary-to-have.
3. From the corporate governance perspective, companies are required to assess their compliance on a regular basis and required to appoint a data protection officer if they pass the threshold volume of information processing. The threshold is to be further stipulated by the authority.
4. Violation of PIPL will lead to sanctions for both companies and the responsible personnel. In addition to monetary penalties, companies may be entered into credit files and publicly disclosed as well.

It is worth noting that employee data protection is also subject to PIPL. In such case, employers should have legitimate grounds to collect and process employees’ personal data, which include prior consent of employees, necessity for the performance of labour contracts or statutory duties, or necessity for protection of employees’ safety and health. Further, for employers sharing and cross-border transferring employees’ personal data, separate consents from employees need to be obtained in advance.

Follow-up regulations about implementation and enforcement of PIPL will be issued in the future. It will be paramount to companies regulated by PIPL to keep a close watch on the further development and anticipate an increase in the financial spend and manpower in order to stay compliant.

VIII. EU-China Investment

On December 30, 2020, the PRC and European Commission concluded a deal in principles on investments, a Comprehensive Agreement on Investment (“CAI”).

The CAI provides for an unprecedented level of Chinese market access for European investors, fair competition for European investors (e.g. directed as China SOEs), prohibitions on the forced transfer of technology and labour related conventions.

It is deemed the most ambitious agreement China ever agreed with foreign countries and a huge promotion and encouragement of foreign investments into the PRC market.

The greater market access for European investors will be a concept similar to how Hong Kong is provided to some extent. For instance, sectors will be benefited including, without limitation:

1. cloud services: foreign investors are prohibited from entering into cloud service sector now, and thus some foreign investors entered into the market by technology cooperation subject to many restrictions; under the CAI, China will permit European companies setting up Sino-foreign joint ventures in this area subject to a 50% equity cap;
2. automobile: China is gradually opening up automobile market to foreign investors since 2018; under CAI, China will further relax the limitation on foreign shareholding percentage to European investors in passenger cars manufacturing industry and commit market access for new energy vehicles;
3. private hospitals: China will offer new market opening by relaxing current requirements for Sino-foreign joint ventures in private hospital sector in some key cities, such as Beijing, Shanghai and Shenzhen; and
4. forced transfer of technology will be prohibited, e.g. forced transfer of technology to Chinese partners and interference with contracts during the technology approval process.

Generally speaking, for the sectors benefiting from CAI, European investors will gain more certainty, transparency, predictability and fairness for their investments and operations in China.

Although the CAI is a concrete and clear signal to welcome foreign investments and operations back to China after the tough 2020, the implementations and performances are still waiting for the specific regulations and rules to be published in China in each different industry.

Amendments of the current PRC legislations and new PRC legislations need to be closely monitored by European investors.

If you have any question or comment on this topic or any other matters related to foreign companies doing business in China or Chinese investments in Europe, please do not hesitate to contact Magnusson's China Group.

Our China Group team has almost two decades of experience advising Chinese companies who conduct business in the Baltic Sea Region and local clients who conduct business in China.

We have Chinese qualified lawyers in our group as well as Mandarin speakers in most of our offices. Our lawyers are able to offer a comprehensive range of services in Mandarin and the local languages and have considerable experience of helping Chinese businesses who are looking to set up operations in the Baltic Sea Region.

Moreover, we are also there to support and advise local businesses looking to take advantage of the many opportunities that China offers. Our services include M&A and investments, dispute resolution, employment law, foreign investment screening, regulatory advice, e-trade and personal data and commercial contracts.

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