

Tsinghua Chinese Law Series

# Foreign Investment Law in China: Regulation, Practice and Context

Tarrant Mahony



Tsinghua University Press

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Tsinghua University Press  
Beijing

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#### 图书在版编目(CIP)数据

中国外商投资法=Foreign investment law in China:regulation, practice and context:  
英文/(美)麦泰伦(Mahony,T.)著. —北京:清华大学出版社,2015

ISBN 978-7-302-39589-8

I. ①中… II. ①麦… III. ①外国投资—涉外经济法—中国—英文  
IV. ①D922.295

中国版本图书馆CIP数据核字(2015)第048802号

责任编辑:李文彬 刘昊阳

封面设计:傅瑞学

责任校对:宋玉莲

责任印制:李红英

出版发行:清华大学出版社

网 址: <http://www.tup.com.cn>, <http://www.wqbook.com>

地 址:北京清华大学学研大厦A座 邮 编:100084

社总机:010-62770175 邮 购:010-62786544

投稿与读者服务:010-62776969, [c-service@tup.tsinghua.edu.cn](mailto:c-service@tup.tsinghua.edu.cn)

质量反馈:010-62772015, [zhiliang@tup.tsinghua.edu.cn](mailto:zhiliang@tup.tsinghua.edu.cn)

印刷者:三河市君旺印务有限公司

装订者:三河市新茂装订有限公司

经 销:全国新华书店

开 本:170mm×240mm 印 张:33 字 数:470千字

版 次:2015年3月第1版 印 次:2015年3月第1次印刷

定 价:78.00元

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产品编号:063441-01

## **Dedication**

**This book is dedicated to the loving memory of**

**my parents,**

**Leslie Perkins Mahony, Jr., and Ann Byington**

**Mahony**

**And my uncle,**

**Lewis Ryan Byington**

## Preface

This book is the unintended but happy byproduct of the “PRC Foreign Investment and Trade Law” course that I have had the pleasure to teach in Tsinghua University Law School’s Chinese Law LLM program since 2006. Several years ago, Dean Wang Zhenmin asked those of us teaching in the program to write a course book in English for the benefit of our students. I originally thought it would be a fairly straightforward process of giving my class notes a certain amount of structure, thereby turning them into a book. As it turned out, the process was not as simple as expected and it took significantly longer to complete than originally planned. Now that it has reached the stage of publication, however, I would like first and foremost to express my gratitude to Dean Wang, and to his predecessor, the former Dean, Professor Wang Chenguang, for their support and encouragement, without which this book would never have been written at all. In addition, I would also like to record my gratitude to the Zheng Yu Tong Committee for its generous financial support of this book, which greatly facilitated the process of research and writing.

The original audience and users of the book (in draft form) were the students in my PRC foreign investment law class, students from all parts of the world who came to Tsinghua to study Chinese law. Many of these students are now working as lawyers serving clients investing and doing business in China, and others are serving Chinese clients doing business in countries all over the

globe. The questions, comments and feedback from my students helped shape the form and greatly improved the content of the book. To all of them I am grateful. The writing also draws upon my China practice experience in the Hong Kong and Beijing offices of two international law firms from 1995 to 2009, where I worked with and learned from a number of outstanding lawyers. The discussions and debates (often late night) that we engaged in were a tremendous experience for me.

The purpose of this book is to assist students learn and understand PRC foreign investment law. To facilitate the process, the book adopts a hypothetical client story to help students reflect on and work through various real life questions that are often encountered in the course of legal practice involving foreign investment in China. The relevant laws and regulations are discussed in relation to China's evolving legal system and, in particular, within the context of the unfolding process of "reform and opening" that began in the late 1970s and continues to the present as China attempts to develop a "socialist market economy with Chinese characteristics". In addition to being a text for students studying Chinese foreign investment law, it is hoped that it will be also be a useful general reference work for foreign attorneys in private practice, in-house counsel, business people and others who wish to gain an overall knowledge of the legal aspects of foreign investment in China.

The book is divided into six chapters, each focusing on a particular area of foreign investment law and practice, and takes the reader through the relevant issues in logical progression. Chapter 1 reviews the history of foreign investment in China since

the country first emerged from the Cultural Revolution and began its program of “reform and opening” in the late 1970s. Chapter 2 begins with a hypothetical initial client meeting and discusses the overall legal framework for foreign investment in China. In particular, Chapter 2 discusses the foreign investment approval process, the role of key government regulators and the primary reference document for foreign investment, the Foreign Investment Guidance Catalogue. Chapter 3 introduces the primary vehicles and structures available to foreign investors: the representative office, equity joint venture, cooperative joint venture, wholly foreign-owned enterprise, foreign invested company limited by share (FICLS), foreign invested partnership enterprise (FIPE), the foreign invested commercial enterprise (FICE) and the so-called variable interest entity (VIE) structure. Also discussed in Chapter 3 are the foreign invested holding company (strictly speaking, the “foreign invested investment style company”) and foreign invested research and development centers (FIE R&D centers).

Chapter 4 analyzes the post-approval establishment process for FIEs, together with major operational issues, labor and employment, functioning of the board of directors and supervisors, and government registration requirements. Chapter 5 looks at transaction structures for FIE and foreign-related mergers and acquisitions, including antitrust and national security review requirements for such transactions. Chapter 6 considers land and building issues, bidding procedures, rules relating to secured interests and project finance structures. Key laws and regulations are listed at the beginning of each chapter, and further references can be found in the footnotes. The book concludes with a brief

essay (in Appendix 1) on programs of legal education and opportunities for foreign-qualified lawyers in China. A second appendix sets out the 2013 list of foreign investment projects subject to government approval.

Nowhere in the world is the saying, “if it is in print, it is out of date”, truer than it is in China, and probably for no field of study is it truer than it is for law. Indeed, just as this book was being readied for the publisher a new draft for public comment of the Foreign Investment Guidance Catalogue was issued. While I have tried to capture the key changes that the new draft will likely introduce, there are sure to be other new laws and regulations that will follow rapidly, no doubt rendering statements made in this book obsolete or incorrect. It goes without saying that any mistakes in the book are mine, and I would be very grateful for any suggestions for improvement, corrections, questions or comments. Please send feedback to me at [prcf dibook@gmail.com](mailto:prcf dibook@gmail.com).

Tarrant Mahony, Beijing, November 2014



## Acknowledgements

My interest in Asia in general and China in particular was perhaps a matter of 缘分 (fate, for lack of a better word in English). My mother, my father and my uncle all studied Mandarin at different points in their lives and growing up our house was filled with beautiful and intriguing mementoes of Asia. My mother took Chinese courses in college and my father had to learn Mandarin when he was in the US army, stationed in India and Burma, where part of his assignment was to train Chinese troops fighting the Japanese. His letters home were peppered with phrases like “ting hao” (挺好) and “ting po hao” (挺不好). My uncle, Lewis Ryan Byington, spent two years in Kunming and Chongqing towards the end of the war, as part of the US Air Force air search and rescue operations. This book is dedicated to them, my mother and my two favorite men. Were they still alive I hope they would find this work to be of interest; I wish they were here to share more of their life stories.

My personal connection with Asia deepened when I went to college, and appropriately it began with a story of food. Every Friday noon the Volunteers in Asia (VIA) office at Stanford University hosted a free ramen and tofu lunch for interested students. So one early winter day during my freshman year I showed up at the VIA office to learn more about its programs. I still remember the ramen, the green plastic bowls and chopsticks, and the eager, enthusiastic advocates of VIA. I had not been planning

to go to Asia at that point, but they said there was an opening for a volunteer in Japan... and six months later, in June 1983, I found myself on a Korean Airlines flight to Tokyo, via Anchorage and Seoul, to teach English in Yamaguchi University Medical School. It might have ended there, but in the prescient phrase of Dwight Clark, the stalwart founder of VIA, “there is no such thing as one trip to Asia”. Thirty years (of which two were spent in Japan, three in Taiwan, three in Hong Kong, and 16 in Beijing) and countless trips have proven Dwight correct in so many ways. My thanks to him and all the other VIA volunteers who started me on this journey.

Thanks are also due to Richard Weisman, distinguished international tax partner at Baker & McKenzie, with whom I consulted when passing through Hong Kong before going to law school. When asked about working in China as a lawyer, Richard sagely advised, “either study international tax law or learn Chinese” — I wisely chose the latte. For my first general academic introduction to Chinese law, my thanks go to Professor Bob Berring at Boalt Hall, whose classes were as thoroughly entertaining as they were educational. It was a few years later in the China practice of the Freshfields Hong Kong office that my exposure to Chinese foreign investment law and practice began. My gratitude to Norman Givant and Charlie Stevens for interviewing and offering me a job, and my appreciation to Thomas Jones for hiring me. I still remember my first day of work in the then-waterfront Exchange Square Tower 2, having lunch with Tom and Colin Law at the American Club on a beautiful October day, wondering what a WFOE was. Thanks also to Lucille Barale,

Teresa Ko, James Dunlap, Susan Finder, Simon Meng, Peter Thorpe, Colin Law, Li Qiang, CJ Wysocki, Zhou Lin, Susan Hsu, Simon Kwan, Fu Yu and many others in the Freshfields Hong Kong office China team from whom I learned so much — a China legal dream team indeed. Thanks also to my colleagues in the Freshfields project finance team: Kevin Julian, Nic Johnson, Andrew Hart, Andrew Petry and Amy Chan; and to my Beijing colleagues, Douglas Markel, Randall Peerenboom, Melissa Thomas, Michael Moser, Chen Ruoying, Shirley Xu, Simon Cheong, Jeff Layman, Alan Wang, Michael Han, Huang Cheng, Yang Zhen, Seung Chong, Daniel Hilken, Gianluca Dagnolo, Antony Dapiran, Omario Kanji. Further thanks to the O'Melveny & Myers team of Howard Chao, Larry Sussman, Eric Zabinski, Todd Bissett, Nate Bush, David Roberts, Bingna Guo, and Cindy Huang.

Credit and admiration also go to my Temple and Tsinghua colleagues and friends. Deans Robert Reinstein and JoAnne Epps of Temple Law School; Deans Wang Chenguang, Wang Zhenmin, and Shen Weixing of Tsinghua Law School; Adelaide Ferguson, Zhang Mo, Chuck Fishman, Louis Thompson, John Smagula, Mary Cao, Sophia Wang Wei, Chris Norris, Li Peng and Xiao Chuan. The work that they are all doing to promote legal education in an international and cross-cultural context is exemplary. Jerry Cohen's inspiring example and fascinating stories of the early days of foreign investment in China have added greatly to my understanding and appreciation of how far the process has come. The students in the Temple and Tsinghua programs through their questions, comments and feedback have further assisted the

process of refining my understanding of law in general and Chinese law in particular. A particular thanks to Camellia Liu Jieying, who has provided invaluable assistance both with respect to the writing of the book and in connection with all the arrangements for my class.

My deepest appreciation to the many lawyers and friends in the Baha'i community who have enriched my understanding of the great civilization of China, "the country of the future" (as 'Abdu'l-Baha called it): Farzam Arbab and Sona Farid-Arbab, Kiser Barnes, Bijan Farid, Lori Noguchi, David Palmer, Shane Tedjarati, Nima Masroori, Sami Farhad, Adam Robarts, Roo Changizi, Martin Derbyshire, Joe Carter, Peter Neumann, Kong Siew Huat, Neysun Mahboubi, Neysan Sobhani, Shahla and Victor Ali, Shareen Farhad, Tebby and Sean Hinton and many others. I look forward to the future insights generated by this "on going and expanding conversation".

And last in this note, but in all other ways first, my unbounded gratitude to my wife, Elika, who has been my partner, encourager and supporter in this project from the start, and who has been the ideal mother to our two wonderful China-born and China-raised children, Taraz and Amelia.

## **Glossary of abbreviations**

AIC	Administration of Industry and Commerce (local level)
AMC	Asset Management Company
BOT	Build-Operate-Transfer
CLS	Company Limited by Shares
CSRC	China Securities Regulatory Commission
CBRC	China Banking Regulatory Commission
CIRC	China Insurance Regulatory Commission
CJV	Cooperative Joint Venture
D&O	Directors and Officers
DRC	Development and Reform Commission (local level)
EJV	Equity Joint Venture
FDI	Foreign Direct Investment
FICE	Foreign Invested Commercial Enterprise
FICLS	Foreign Invested Company Limited by Shares
FIE	Foreign Invested Enterprise
FIPE	Foreign Invested Partnership Enterprise
IPO	Initial Public Offering
M&A	Mergers and Acquisitions
MOFCOM	Ministry of Commerce
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
NDRC	National Development and Reform Commission
PBOC	People's Bank of China
PRC	People's Republic of China

RMB	Renminbi (currency of China)
SAFE	State Administration of Foreign Exchange
SAIC	State Administration of Industry and Commerce (national level)
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration of Taxation
SOE	State Owned Enterprise
SPV	Special Purpose Vehicle
USD	United States Dollars
VIE	Variable Interest Entity
WFOE	Wholly Foreign Owned Enterprise
WTO	World Trade Organization

# Table of Contents

<b>Chapter 1 The History of Foreign Investment in China—From Reform and Opening to the Xi Jinping Administration .....</b>	<b>1</b>
I. The First Decade: Early Experimentation and the Basic Foreign Investment Vehicles .....	4
a. Sino-foreign Equity Joint Ventures .....	4
b. Cooperative Joint Ventures and Wholly Foreign-Owned Enterprises .....	9
II. The Second Decade: From Deng Xiaoping's "Southern Tour" to the WTO .....	12
a. Deng's "Southern Tour" and major new legislation .....	12
b. Taxation and preferential treatment for foreign investment .....	15
c. The pilot BOT projects: international project finance comes to China .....	17
d. Taking security .....	28
e. Foreign Invested Companies Limited by Shares .....	32
f. Foreign Investment Guidance Catalogue .....	34
g. Keeping it in China: holding companies, FIE reinvestment and FIE M&A .....	36
h. The PRC Contract Law .....	46
III. The Third Decade: From the WTO to the Global Economic Crisis and its Aftermath .....	49
a. China's WTO accession .....	49
b. Reform of the foreign investment approval system .....	51
c. Buying into China: the door to M&A opens .....	53

d. Foreign M&A and state-owned assets .....	59
e. Foreign Invested Commercial Enterprises and the long-awaited opening of the retail sector .....	61
f. The Anti-Monopoly Law: Beijing joins Washington and Brussels as the third major competition regulator .....	65
g. The global economic crisis and the devolution of approval authority .....	68
h. China introduces a national security review for foreign M&A transactions .....	73
i. From separate and not equal towards a common legal regime for domestic and foreign investment .....	76
j. Reforms under the Xi Jinping Administration: dawn of a new era? .....	80
k. Overall trends and considerations .....	91

## **Chapter 2 Coming to China: The Initial Client Meeting Categorization of Foreign Investment and the Government Approval**

<b>Process .....</b>	<b>95</b>
I. Overall framework: guiding foreign investment in line with PRC government macro economic planning .....	100
a. Foreign Investment Industrial Guidance Catalogue .....	100
b. The main categories and contents of the Guidance Catalogue ....	106
II. The Guidance Catalogue and the Company's Business Scope .....	114
a. Operating within the business scope .....	114
III. Approval Process for Foreign Investment .....	118
a. Role of the National Development and Reform Commission (中华人民共和国国家发展和改革委员会) .....	121
b. Role of the Ministry of Commerce (中华人民共和国商务部) .....	130



c. Role of the SAIC (中华人民共和国国家工商行政管理总局).....	142
d. Shanghai Pilot Free Trade Zone.....	145
<b>Chapter 3 Establishing a Presence in the PRC: Investment</b>	
<b>Vehicles Available to Foreign Investors .....</b>	<b>151</b>
I. Establishing a Permanent Presence in China .....	155
a. Representative offices of foreign companies.....	155
b. Recent developments and trends for rep offices.....	160
c. The special case of representative offices of foreign law firms ...	164
II. The Three Basic Foreign Investment Enterprises: Equity Joint ventures, Cooperative Joint Ventures and Wholly Foreign-Owned Enterprises.....	173
a. General aspects of FIEs.....	173
b. Common characteristics of joint ventures and WFOEs .....	177
c. Distinctive features of Equity Joint Ventures vs Cooperative Joint Ventures.....	187
d. Establishing a CJV .....	192
e. Special provisions for non-legal person CJVs.....	195
f. Wholly-Foreign Owned Enterprises .....	198
III. Foreign Invested Holding Companies (外商投资性公司).....	206
a. Registered capital and total investment amount of holding companies .....	208
b. Operations and activities of holding companies.....	210
IV. Foreign Invested Companies Limited by Shares .....	214
V. Foreign Invested Commercial Enterprises .....	219
VI. Foreign Invested Research and Development Centers .....	221
VII. Regional Headquarters.....	226
VIII. Foreign Invested Partnership Enterprises .....	229