

Shanghai Free Trade Zone Further Relaxes Foreign Investment Restrictions on First Anniversary

Shanghai FTZ Celebrates First Anniversary

Since its official launch in 2013, the China (Shanghai) Pilot Free Trade Zone (“Shanghai FTZ”) has recently celebrated its first anniversary. Over the past year, various policies relating to foreign investment have been promulgated in the 29 square kilometre Shanghai Free Trade Zone in the outskirts of Shanghai, which has generally been viewed as an important testing ground for the country’s policymakers. These policies include a “negative list” approach on company establishment, the reform on RMB liberalisation and the opening up of several industrial sectors to foreign investment (such as finance, telecommunication and shipping, etc).

Notwithstanding the above, the implementation of most of the reforms in the zone is slower than what has been expected. While setting up a presence in Shanghai FTZ is a lot easier for sectors falling outside the “negative list”, 139 industries remain on the list even after a revision of the list in July 2014 – these sectors are either prohibited to foreign investors or subject to stringent government approval. Steps taken on financial liberalisation have also fallen short of the promised freeing of RMB and of interest rates. While the reform on capital account settlement for foreign-invested enterprises (“FIEs”) is a welcome move to foreign investors, practical hurdles still exist which hinder the FIEs to fully benefit from the new policy.

Latest Development

During his visit to the Shanghai FTZ in September 2014, Premier Li Keqiang addressed the above implementation issues and echoed complaints that the “negative list” was much too long. Shortly after his visit, the State Council issued a Decision¹ to further open up 27 sectors to foreign investors in Shanghai FTZ.

According to the Decision, restrictions on foreign investment in certain sectors are further relaxed in Shanghai FTZ, in terms of foreign equity ratio, qualification requirements and limitations on business scope. We set out below some highlights. Please refer to the end of this article for a full list of the restrictions removed under the 27 sectors.

MANUFACTURING SECTOR

The Decision allows 100% foreign ownership in the manufacture of certain types of equipment and machinery (which is only permitted for joint ventures outside the zone), for example:

- R&D, design and manufacture of passenger service facilities, track and bridge equipment for high-speed rail, passenger rail lines and intercity railway; equipment manufacturing for electric railway and railway passenger sewage facilities. Key electrical equipment used on the high-speed trains in China has always been largely relying on importation from abroad. However, foreign investment in the high-speed railway industry is highly restricted. Some major international players have entered the market in the form of joint ventures with local Chinese companies. Since sole foreign ownership in this industry is now allowed in the Shanghai FTZ, foreign investors are able to have full control over the business operation and the sector is expected to attract more foreign investment.
- R&D and manufacture of automobile electronic network technologies and electronic controllers for electric power steering system.
- Manufacture of motorcycles with low emission capacity ($\leq 250\text{ml}$) and motorcycles with electronically-controlled fuel injection technology with high emission capacity ($>250\text{ml}$).

¹ Decision of the State Council on Temporarily Adjusting the Special Access Administrative Measures Prescribed by Certain Administrative Regulations and Ministerial Rules approved by the State Council in the China (Shanghai) Pilot Free Trade Zone / 国务院关于在中国（上海）自由贸易试验区内暂时调整实施有关行政法规和经国务院批准的部门规章规定的准入特别管理措施的决定

ENERGY SECTOR

According to the Decision, foreign investors are permitted to hold 100% ownership in a Shanghai FTZ entity to provide service in developing new technologies in oil extraction, as well as developing and applying new technologies related to oil exploration, drilling, well logging, mud logging and down-hole operation.

MARITIME TRANSPORTATION

Under the current regulatory regime, foreign investors have to set up a joint venture with a Chinese party in order to provide international maritime cargo loading and unloading service, container yard service or any operate of international maritime container freight station. The Decision cancels such restrictions in the Shanghai FTZ and allows 100% foreign ownership in these sectors.

The Decision further relaxes restrictions in public international shipping agency service by extending the cap on foreign equity from 49% to 51%.

WHOLESALE AND RETAIL

- Wholesale of salt

In China, wholesale of salt is monopolised. The *Administrative Measures on Foreign Investment in Merchandising Sector* specifically prohibits FIEs from engaging in this business. The Decision allows a wholly foreign owned enterprise incorporated in Shanghai FTZ to engage in the wholesale of salt, provided that the distribution is limited within the zone.

- Distribution of plant oil, sugar, fertilisers, grain and cotton

Under the existing national regulations, if an FIE engages in retail business distributing different brands of plant oil, sugar, fertiliser, cotton or grain from different suppliers and has more than 30 retail stores across the country, then the proportion of equity held by the foreign investors in such FIE shall not exceed 49%. The Decision now removes such foreign equity cap and allows 100% foreign ownership with respect to the wholesale and retail of plant oil, sugar and fertilisers and the retail of cotton and grain, regardless of the number of stores that the FIE has established.

BEVERAGE SECTOR

Processing of green tea is classified by the *Foreign Investment Industrial Guidance Catalogue* as “prohibited” for foreign investment. The Decision allows foreign investors to set up an equity joint venture or a cooperative joint venture in Shanghai FTZ with Chinese partners (with the Chinese party being the controlling shareholder) to engage in the processing of green tea by using Chinese traditional techniques. Multinational beverage companies can now leverage the Shanghai FTZ to enter into the green tea market that has been closed to foreign investors for a long time.

Comments

Over the past year, the Chinese government has released a number of policies in Shanghai FTZ aiming to relax restrictions on foreign investment and provide more leeway to foreign investors. However, there has been perception among foreign investors that number of sectors being opened and the relaxation measures themselves are not as substantial as previously expected. While the Chinese government has taken another step to relax restrictions on foreign investments in the Shanghai FTZ by issuing the Decision, the practical benefits remain to be seen. For instance, it is not entirely clear whether there is sufficient land and infrastructure to set up manufacturing enterprises in the Shanghai FTZ and whether there is any practical hurdle for a wholly foreign owned retailer of sugar and grain incorporated in the Shanghai FTZ to set up retail stores outside the zone. Nonetheless, the Decision is still welcomed by foreign investors as it has at least provided investors with opportunities not previously available.

List of Restrictions Removed by the Decision

1. Foreign investors are allowed to engage in loading and unloading of international maritime transport cargoes, warehousing of international maritime transport cargoes, container depots and stacking yards of international maritime transport cargoes in the form of a wholly foreign-owned enterprise.
2. Foreign investors are allowed to engage in international shipping agency business in the form of equity joint venture or cooperative joint venture with the foreign equity capped at 51%.
3. Imports and exports certification business is no longer a restricted sector for foreign investors and the qualification requirements on a foreign investor are cancelled.
4. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the wholesale of salt, provided that the distribution business is limited within Shanghai FTZ.
5. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the development and application of relevant new technologies to improve oil extraction (in the form of engineering service).
6. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the development and application of new technologies for oil exploration and exploitation in areas such as geophysical prospecting, drilling, well logging, mud logging and down ground operation.
7. Foreign investors are allowed to engage in the processing of green tea with Chinese traditional techniques in the form of an equity joint venture or a cooperative joint venture (with Chinese party as the controlling shareholder).
8. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the production of i) chemical wood pulp with a single production line and an annual production capacity of 300,000 tons or more and mainly using overseas timber resources, ii) chemi-mechanical wood pulp with a single production line with an annual production capacity of 100,000 tons or more and mainly using overseas timber resources, and iii) high-grade paper or paperboard (the production lines for which is built simultaneously).
9. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the manufacturing of wheeled or crawler cranes of 400 tons or above.
10. Manufacturing of various types of P0-grade bearings and their components (steel balls and cages) and roughcasts is no longer a restricted industry sector for foreign investors.
11. Manufacturing of hydraulic excavators of less than 15 tons (exclusive) and wheeled loaders of less than 3 tons (exclusive) is no longer a restricted industry sector for foreign investors.
12. Manufacturing of equipment for ordinary polyester filament yam and short fiber is no longer a restricted industry sector for foreign investors.
13. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in manufacturing, research and development of automobile electronic network technologies and electronic controllers for electric power steering system.
14. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the R&D, design and manufacturing of passenger service facilities and equipment supporting high-speed railway, special lines for railway passenger transportation and intercity railway; R&D, design and manufacturing of track and bridge facilities for high-speed railway, special lines for railway passenger transportation and intercity railway; manufacturing of electrified railway equipment and apparatus as well as manufacturing of waste discharge equipment for railway passenger trains.
15. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the design of luxury cruise ships and yachts.
16. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the design of cabin machinery of vessels.
17. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the design, manufacturing and maintenance of aircraft engine parts.

18. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the manufacture of motorcycle (with emission capacity of no less than 250ml).
19. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the manufacture of electronically-controlled fuel injection technology for motorcycles with high emission capacity (>250ml).
20. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the manufacture of contact materials for electrical appliances in conformity with EU RoHS Directive, and Pb-free and Cd-free solders.
21. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the construction and operation of local railway lines, and related bridges, tunnels, ferries and station facilities.
22. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in the wholesale, retail, and distribution of plant oil, sugar and fertiliser; retail and distribution of grains and cotton. The restriction imposed on the number of retail stores is lifted.
23. Mail orders and online sales of general goods is no longer a restricted industry sector for foreign investors.
24. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in railway freight transport service.
25. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in air transport sale agency service.
26. Real estate intermediary or brokerage agency is no longer a restricted industry sector for foreign investors.
27. Foreign investors are allowed to set up wholly foreign-owned enterprises to engage in photography services (excluding aerial photography and other trick photography service).

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