New MOFCOM Rules to Further Facilitate China Outbound Investments

September 22, 2014

The Chinese government has taken another step to further liberate outbound investments. On September 6, 2014, the Ministry of Commerce ("MOFCOM") issued the Outbound Investment Administrative Rules ("Order 3"), which becomes effective on October 6, 2014, to replace the old MOFCOM rules regulating outbound investment projects. With certain exceptions, Order 3 removed the investment-size-based approval requirement and simplified the application process. This client alert discusses the background and highlights of Order 3, and examines issues that may impede Order 3 from speeding up investment approvals. Overall Order 3 promises to be a positive development for speedier and easier outbound investment from China.

Outbound Investment Regulations — Background

2013 Catalogue issued by the State Council

In 2013, the Chinese government began reforming its regulatory regime, including areas affecting outbound investments. The State Council issued a new Catalogue of Investment Projects Subject to Government Approval (the "2013 Catalogue") on December 2, 2013 which aimed to, among other things, relax investment approval requirements for outbound investments from China. The 2013 Catalogue redefined the roles of the primary
regulatory agencies, including the National Development and Reform Commission of China ("NDRC"), MOFCOM, and their respective local counterparts.

**Order 9 issued by NDRC**

The State Council’s 2013 Catalogue set forth a framework to replace the previous NDRC approval requirements with a filing process for outbound investments (with the exception of projects involving investment from Chinese party that exceeds US$1 billion). To formalize this framework, NDRC issued the *Measures for the Administration of Approval and Filing of Outbound Investment Projects* ("Order 9") in April 2014. Under Order 9, (i) filing with NDRC is required where (a) a Chinese party’s investments exceed US$300 million or (b) investments are made by centrally-administered state-owned enterprises, and (ii) approval by NDRC is required where (a) a Chinese party’s investment exceeds US$1 billion or (b) the project involves a sensitive country, region or sector.

**Integrated filing regime adopted by Shanghai Free Trade Zone**

Even before the issuance of the 2013 Catalogue and Order 9, the China (Shanghai) Pilot Free Trade Zone (the "FTZ") adopted an integrated filing regime in October 2013 for outbound investments by enterprises domiciled in the FTZ. Under the FTZ rules, outbound investments by enterprises located in the FTZ are no longer subject to approval requirements (with the exception of certain significant or sensitive investment projects). Instead, these enterprises only need to make filings with the Management Commission of the FTZ. The FTZ makes a fairly efficient “one-stop outbound investments filing” system available to Chinese outbound investors.

**Order 3 issued by MOFCOM**

According to the State Council’s 2013 Catalogue, MOFCOM approval is only required for non-financial sector investments[1] involving a sensitive country, region or sector. Other outbound investments are only subject to filing with MOFCOM or its local counterparts, depending on the nature of the Chinese investor (please see details in the section "Filing-focused System" below). Unlike NDRC’s relatively conservative approach, MOFCOM took further steps to liberalize the regulatory regime for outbound investments from China.

**From Approval-based System to Filing-focused System**

**Approval-based System**

Under the old MOFCOM rules, Chinese investors had to obtain MOFCOM’s approval for investments exceeding a specified amount, investments in sensitive countries, regions and sectors, and for formation of offshore special purpose vehicles. The size of the transaction determined whether
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The Chinese government has taken another step to further liberate outbound investments. From Approval-based System to Filing-focused System, the Chinese government launched the new MOFCOM measures for the administration of approval and filing by NDRC is approval from central MOFCOM or its local counterpart was required. For example, an outbound investment by a Chinese investor of over US$100 million had to be approved by MOFCOM at the central level, a process that could not be initiated until the NDRC approval was obtained. The entire approval process could take several months.

**Filing-focused System**

Under Order 3, MOFCOM **approvals** are only required for non-financial sector outbound investments in “sensitive countries and regions” and “sensitive sectors.” Otherwise, all outbound investments in non-financial sectors are only subject to **filing** with MOFCOM (where the investment involves centrally-administered state-owned enterprises) or its provincial counterparts, regardless of the deal size. MOFCOM also eliminated the approval requirement on the formation of offshore special purpose vehicles.

“Sensitive countries and regions” are defined under Order 3 as countries or regions that do not have established diplomatic ties with China or that have been sanctioned by the United Nations. “Sensitive sectors” are defined under Order 3 as those industries pertaining to export-restricted products and technologies or industries involving interests of more than a single nation or region. It is worth noting that these definitions in Order 3 are different than those in NDRC’s Order 9. In addition to the countries and regions covered in Order 3, “sensitive countries and regions” definitions under Order 9 also cover countries and regions embroiled in ongoing wars or riots. As for “sensitive sectors”, Order 9 doesn’t give a definition but only listed basic telecommunications, cross-border utilization of water, large-scale land development, main electricity transit line, electricity grid, news and media as examples of sensitive sectors.

Order 3 requires that any change to items filed with or approved by MOFCOM or its local counterparts (e.g., project scale, legal entity utilized by the Chinese investor, shareholding structure and the amount of Chinese investment), the applicant needs to obtain an amended filing or amended approval from MOFCOM or its local counterparts.

**Major Changes to the Application Process**

**Simplified Application Process**

The new MOFCOM rules greatly simplify approval and filing procedures and reduce the time for reviewing outbound investments.

In the filing process, an applicant is only required to complete an information form and file a copy of its business license. MOFCOM, in turn, should make its determination within three working days based on a set of straightforward criteria, i.e., MOFCOM should accept the application and complete the filing if the form is complete and accurate. By adopting straight-forward and objective criteria, MOFCOM has attempted
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The Chinese Ministry of Commerce ("MOFCOM") recently released new outbound investment regulations to further facilitate outbound investments by Chinese companies. MOFCOM's new rules clearly go a long way in enhancing Chinese government’s approval process for outbound investments.

The MOFCOM approval process has been simplified as well. For example, the applicant is no longer required to submit M&A prophase reports among the application materials. The overall time frame of the approval process has been reduced by five working days: approval decisions should be made by MOFCOM within 20 working days for applications submitted by centrally-administered state-owned enterprises or by provincial MOFCOM within 30 working days for applications submitted by other enterprises after the approval applications are accepted by the authorities, each of which includes time for consulting Chinese embassies and consulates.

However, one should not assume that Order 3 will entirely free outbound investments from scrutiny of the Chinese government. For example, NDRC’s amended “road pass” regime could delay outbound projects. Unlike MOFCOM’s reviewing criteria, NDRC’s Order 9 allows NDRC to exercise a fairly broad regulatory discretion. For instance, NDRC may refuse to accept an outbound investment filing on grounds that it fails to comply with industrial policies and outbound investment policies.

More Disclosure for Outbound Re-investment

Consistent with the old MOFCOM rule, Order 3 requires a related applicant to report its outbound re-investment activities after completion of the legal affairs for re-investment. Order 3 requires the applicant to disclose more information about re-investments: the applicant should provide a brief introduction on the project (including information such as business scope, investment scale, products, markets, facilities, investment return schedule, target company and merger plan) and details on any multi-tier re-investment structure (if multiple investment holding vehicles are used for re-investment purposes). These requirements may increase the reporting and compliance burden on the Chinese investors, especially Chinese private equity funds seeking investment opportunities outside China.

It is worth noting that the applicant is required to make certain representations when submitting the application forms, including as to the accuracy of the information and the project’s consistency with public interests, compliance with Chinese laws, international treaties and export control policies. It is expected that MOFCOM will no longer conduct substantial review on the accuracy of representations for outbound investment projects before issuing the registration certificate. Instead, MOFCOM will rely on the representations made by the applicants during the filing process and will impose legal liability (such as warning, or suspension of outbound investment applications for one year or three years depending on the severity of violation) on applicants for any misrepresentation.

Some Points to be Clarified
We await further guidance on certain issues regarding implementation of Order 3. Order 3 is not clear on the timing of the filing for outbound investment projects. Under the old MOFCOM rule, Chinese outbound investors needed to obtain MOFCOM’s approval after the execution of the definitive agreements and before the closing of the transactions. However, such provision is removed from Order 3; Order 3 is silent on the deadline for obtaining MOFCOM approval and fulfilling the filing obligation and it is not clear whether NDRC’s “road pass” remains a condition precedent to the initiation of MOFCOM review. It is likely that the timing for obtaining MOFCOM approval will remain the same after Order 3. However, we will need to wait and see how MOFCOM implements Order 3 in this regard and how it sets the deadline for fulfilling the filing obligation.

In 2005, MOFCOM and the State Administration for Foreign Exchange (the “SAFE”) jointly issued a circular that requires a domestic company to report to MOFCOM and SAFE after it decides to purchase an overseas company’s assets or shares. In April 2014, MOFCOM expressly confirmed in a notice that such circular remains valid. However, this pre-reporting requirement is not mentioned in Order 3 and it is not clear whether MOFCOM will abolish or enhance such pre-reporting requirement after Order 3 takes effect.

MOFCOM’s new rules clearly go a long way in enhancing Chinese enterprises’ competitiveness in outbound transactions and furthering the Chinese government’s “go global” policy. However, pending further detailed implementing rules, Chinese outbound investors should bear in mind that extensive communication with applicable regulatory agencies, including NDRC, MOFCOM and SAFE is essential to ensure a smooth and successful filing or approval process, as the case may be.

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[1] Outbound investments in financial sector are regulated by separate rules issued by the Chinese government.

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The Chinese government has taken another step to further liberate investment projects through a new set of rules released by the Ministry of Commerce ('MOFCOM') to further facilitate China outbound investments. The new rules on overseas investment administration Order 3 (Orders and Regulations), as from 1 October 2014, will reduce the regulatory burden on the companies that wish to expand their business across borders.

Major Changes to the Application Process

In the filing process, an applicant is only required to complete an application that contains the following information: (i) project name and purpose, (ii) project duration, (iii) the name and address of the target company and merger plan, (iv) the amount of the Chinese investment, (v) the target company’s business size, (vi) the target company’s credit rating, and (vii) whether the target company’s operations are located in a free trade zone (FTZ).

Approval-based System

Under the new rules, a related applicant can be imposed a penalty of up to 1 million yuan (US$160,000) for any misrepresentation. Additionally, if an applicant is determined to have misrepresented any information, the MOFCOM will rely on the representations made by the applicants during the review process and may refuse to accept an outbound investment filing if it fails to meet the criteria.

More Disclosure for Outbound Reinvestment Activities

MOFCOM requires that any change to items filed with or approved by MOFCOM should be reported to MOFCOM. This includes changes in the names of the target companies, the amount of Chinese investment, and the project duration. The MOFCOM will rely on the representations made by the applicants and may refuse to accept an outbound investment filing if it fails to meet the criteria.

Consistent with the Old MOFCOM Rule

The new MOFCOM Order 3 requirements are consistent with the previous MOFCOM Order 3 and the National Development and Reform Commission's Order 9. They are also consistent with the Ministry of Commerce regulations and the National Development and Reform Commission regulations. The MOFCOM rule will be applied to MOFCOM and SAFE after it decides to purchase an overseas investment project and MOFCOM has determined that the project meets the criteria.

More for Outbound Reinvestment Activities

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