

ADVISORY | China Outbound Investment

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CHINA RELAXES APPROVAL REQUIREMENTS FOR OUTBOUND INVESTMENT

China has taken a significant step to encourage outbound investment by eliminating certain pre-closing government approval requirements for a wide range of projects. Pursuant to the *Catalogue of Investment Projects Requiring Government Approval (2013)* (the “2013 Catalogue”), issued on December 2, 2013 by the State Council, outbound investment projects of under US\$1 billion in size that do not involve “sensitive countries or regions” or “sensitive industries” will not require pre-closing approval by the National Development and Reform Commission (“NDRC”), the Ministry of Commerce (“MOFCOM”) or their respective provincial offices (“Local DRCs” or “Local MOFCOMs”). This advisory describes the rule change and considers its ramifications.

PREVIOUS APPROVAL AND FILING REQUIREMENTS

Prior to issuance of the 2013 Catalogue, outbound investment projects required the following:

- **NDRC or Local DRC Approval.** Nearly all such projects required the approval (sometimes translated as “verification”) of NDRC or a Local DRC. Whether such approval was required by one or the other was determined by the identity of investor, the size of the investment and the industry and location of the investment. Only investments by entities administered by the central government (“Central SOEs”) that did not involve “sensitive countries or regions” or “sensitive industries” and that did not exceed US\$100 million in size (or US\$300 million for natural resources-based transactions) were allowed to proceed without approval, merely upon the investor’s “filing for the record” with NDRC. “Sensitive countries or regions” included countries or regions “without a formal diplomatic relationship with China or under international sanctions, at war, or in a state of unrest,” and “sensitive industries” included “basic telecommunication operations, cross-border water resources development and utilization, large-scale land development, main electrical grids, and news media.”
- **MOFCOM or Local MOFCOM Approval.** Projects involving the establishment of a non-financial overseas entity also required an “overseas investment approval certificate” from MOFCOM or a Local MOFCOM. As in the NDRC process, the issuing body was determined by a range of factors, including the size of the investment, the target industry and the destination country or region. For projects smaller than US\$10 million, investors could apply for expedited review and receive the certificate upon a determination that their applications were complete and in appropriate legal form.
- **SAFE Registration.** The transfer of funds offshore, or the retention of profits or other foreign exchange generated offshore, for use in direct investment projects required registration with the State Administration of Foreign Exchange (“SAFE”).
- **Other Approvals.** Certain projects required approvals from additional bodies, such as the State-owned Assets Supervision and Administration Commission (for transactions by state-owned or state-controlled companies) or the China Banking Regulatory Commission (for certain financial services investments).

NEW REQUIREMENTS

The following summarizes the 2013 Catalogue’s changes to the regulation of outbound investment projects. Notably, interpretive regulations have yet to be issued at the central or—with the exception of Shandong Province—provincial government levels, and new regulations from SAFE or other authorities may also be forthcoming.

- NDRC or Local DRC Approvals.** NDRC approval will only be required for projects larger than US\$1 billion in size or that involve sensitive countries or regions or sensitive industries. All other projects will require only filing for the record—specifically, with NRDC (in the case of projects involving Central SOEs or larger than US\$300 million in size) or a Local DRC (in the case of all other such projects). The 2013 Catalogue defines neither “sensitive countries or regions” nor “sensitive industries,” but we expect such terms to have similar meanings to those set forth in current regulations. NDRC has yet to clarify whether, when approval is required, the procedures specified by current regulations—e.g., regarding application documentation or, in the case of investors other than Central SOEs, whether a Local DRC must “examine” an application before it is sent to NDRC—will continue to apply. Likewise, NDRC has yet to identify what information must be contained in the filing for the record, when approval is not required.
- MOFCOM and Local MOFCOM Approvals.** Establishing a non-financial offshore entity in an outbound investment project will only require MOFCOM approval when “sensitive countries or regions” or “sensitive industries” are involved. We expect such terms to be defined consistently with NDRC regulations. Non-sensitive projects will need only to be filed for the record with MOFCOM (in the case of projects involving Central SOEs) or with a Local MOFCOM (in the case of all other such projects).

The following chart summarizes the above requirements.

Chinese Outbound Investment Projects

NDRC and MOFCOM Approval and Filing Requirements

Investor Type	Sensitivity	Project Size		NDRC Requirement	MOFCOM Requirement
Entities other than Central SOEs	Non-sensitive	<= US\$300 million	→	Local DRC Filing	Local MOFCOM Filing
		> US\$300 million; <= US\$1 billion	→	NDRC Filing	Local MOFCOM Filing
		> US\$1 billion	→	NDRC Approval	Local MOFCOM Filing
	Sensitive Countries/Regions or Sensitive Industries	All	→	NDRC Approval	MOFCOM Approval
Central SOEs	Non-sensitive	<= US \$1 billion	→	NDRC Filing	MOFCOM Filing
		> US \$1 billion	→	NDRC Approval	MOFCOM Filing
	Sensitive Countries/Regions or Sensitive Industries	All	→	NDRC Approval	MOFCOM Approval

ANALYSIS

Removal of a key Chinese government contingency. The replacement of approval requirements with filing requirements for a wide range of projects removes an obstacle to closing that has historically burdened Chinese outbound investment. Without the obligation to apply for and await such approvals, and the risk the approvals will not be obtained, Chinese investment will be more attractive to potential foreign counterparties and more competitive with bids from rival non-Chinese bidders. Outbound investment should also be more attractive to Chinese parties, who generally have borne the political and monetary costs to obtain the approvals and often have paid higher prices to compensate sellers for the risks that the approvals would be delayed or not granted.

Persistence of destination country risks. Chinese outbound investment will continue to be subject to closing risks and obstacles resulting from political and regulatory factors in destination countries, such as a national security review by the Committee on Foreign Investment in the United States (“CFIUS”). We expect the 2013 Catalogue to have the greatest impact where such risks are low and such obstacles few, as the elimination of Chinese government approval requirements will put potential Chinese investment largely on par with non-Chinese investment. In the United States, the impact may be greatest for transactions that are not “covered” under CFIUS’s regulations, such as greenfield projects or other investments that do not result in foreign “control” of an existing U.S. business. In U.S. transactions within CFIUS’s jurisdiction, the effect of the 2013 Catalogue will often be to isolate CFIUS’s review as the principal pre-closing risk. This may spur parties to structure increasingly innovative mechanics to allocate CFIUS-related risks, such as termination fees or closing conditions tied to mitigation obligations.

More than just “going global.” The changes effected by the 2013 Catalogue continue China’s “Go Global” strategy, formally adopted in 2001, of promoting outbound investment. But they also serve the goals of “reforming the administration of the [government] examination and approvals regime,” “furthering decentralization,” “changing the function of the government in managing investment,” and “causing the market to play a decisive role in the allocation of resources” listed in the catalogue’s precatory language, and which echo central themes in November’s *Decision on Major Issues Concerning Comprehensively Deepening Reforms*. With respect to the affected categories of outbound investments, regulators will shift from gatekeepers to supervisors, limiting their influence over the nature of outbound projects and altering their relationships with the enterprises they regulate, both private and state-owned.

Possible path of future reform. The 2013 Catalogue’s treatment of outbound investment is similar to the regulation of outbound investment from the China (Shanghai) Pilot Free Trade Zone. For outbound investment by entities registered in the zone, NDRC approval is only required for projects in sensitive countries or regions or sensitive industries (defined similarly to the NDRC regulations), and MOFCOM’s regulations (including the approval requirements therein) only apply to projects (i) involving select countries, regions or industries (defined slightly differently than NDRC regulations), (ii) requiring the establishment of overseas special purpose companies, or (iii) requiring further financing from domestic investors. Assuming regulations within the zone indicate the likeliest path of future reform nationwide, we should expect pre-closing approval requirements for sensitive outbound projects to persist nationwide, even as investment amount thresholds for such approvals are loosened or eliminated entirely.

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