

A new era - from approval to filing - China streamlines foreign direct investment process



On September 30, 2016 and October 8, 2016, Chinese legislators substantiated the switch from an approval to a simpler filing process for many foreign invested enterprises (“**FIEs**”). This is a major change in China’s foreign direct investment regime. Since the opening up of China in the late 1970s, each FIE project mandatorily, and without exception, required prior governmental approval by the commerce authority for establishment and most changes.

The existing company registration process usually with the Administration for Industry and Commerce (“**AIC**”) is generally not affected by this development. In practice, the importance of the AICs is expected to increase as outlined below.

The latest developments followed the central government’s *Decision on Amending the Four Major Laws Regulating Foreign Direct Investment in China* (“**Decision**”) on September 3, 2016 (for our related prior analysis [please click here](#)). The Decision revised the three main laws on equity joint ventures, contractual joint ventures and wholly foreign owned enterprises.

- On September 30, 2016, the State Administration for Industry and Commerce (“**SAIC**”) issued a Notice on how to deal with this change on the registration authority level (“**SAIC Notice**”).
- On October 8, 2016, the Ministry of Commerce (“**MOFCOM**”), jointly with the National Development and Reform Commission (“**NDRC**”) promulgated **Decision No. 22** to define in which cases when the old approval mechanism still applied.
- On the same day, the MOFCOM also issued the expected, practically important *Interim Measures on Establishment and Change Filing of Foreign-invested Enterprise* (“**Filing Measures**”) after receiving around 530 comments since the initial publication of the Draft Filing Measures in September 2016.

Filing applies to encouraged/permitted FIEs (with exceptions)

For the time being, Decision No. 22 defines that the following projects cannot enjoy the new simplified filing procedure, i.e. are still required to carry out the old approval process:

- Foreign investment projects falling into the restricted or prohibited categories of the *Foreign Investment Industry Guidance Catalogue (amended in 2015)* (“**2015 Catalogue**”)
- Foreign Investment projects subject to requirements on shareholding or senior management in the encouraged category of the 2015 Catalogue; and
- cross-border M&A by foreign investors.

Any projects not positively listed in the 2015 Catalogue fall under the permitted category, for which now the simplified

filing applies.

Technically, the legislators thus did not immediately issue a new negative list which had been expected by many on the basis of the existing free trade zone precedents. Instead, they have referred to the 2015 Catalogue and – via Decision No. 22 – for the time being converted parts of the 2015 Catalogue into a “**Quasi-Negative List**”. Thereby, it was ensured that the Decision could be implemented immediately after the administration resumed their work after China’s Golden Week holidays.

In summary, filing for the time being applies nationwide to all encouraged and permitted FIEs except for those with shareholding or senior management restrictions under the 2015 Catalogue or cross-border M&A.

The issued Filing Measures provide guidance on how to conduct the filing process. They cover mainly the scope of filing, procedure, supervision and liability in case of violations.

Establishment and major changes subject to filing

For FIEs not listed in the Quasi-Negative List, both new establishment and “major changes” of FIEs shall generally now be filed via MOFCOM’s online system.

The term “major changes” is defined to include

- the basic registration information of the company (including actual controlling shareholder),
- basic registration information of the investor,
- equity/registered capital change,
- merger,
- division,
- termination,
- certain other transactions involving wholly foreign-owned enterprises.

Time of filing

Until September 30, 2016, approval by the commerce authority always had to be obtained prior to the following AIC registration in case of FIEs.

Under the new law, filing (if applicable) is not a pre-condition anymore and a prior filing receipt is not required anymore during the registration process with AIC. Consequently - in theory - applicants should be able to finish the AIC registration first and then complete the filing. But in very initial inquiries in the week of October 10, 2016, some AICs e.g. in some Shanghai districts have requested/recommended applicants to finish a filing beforehand. Such practice, deviating from the law, is expected to eventually disappear along with a deepened understanding of the new law.

From substantial review to procedural check

The involved check by the commerce authority shall be of solely procedural nature instead of a substantial review (as it is the commerce authority’s approval mechanism). Arguments supporting this understanding:

- Simplified documentation requirements: articles of associations and equity transfer agreements are no longer requested for filing. The whole filing shall be done online in e-form without submission of hardcopies.

- Faster, from approx. 1 month down to 3 working days: In the best case, where there is no back-forth regarding documents / information revision, the filing procedure can be completed by authority within 3 working days after successful submission of the online application. This would be much faster than for the approval procedure (which normally takes approx. 1 month). This shortening indicates that the commerce authority will normally not be able to review the documents in any substance.
- Only nominal review: In general, the commerce authority is explicitly required to conduct a nominal check only on the completeness and accuracy of the filed information.

As an exception, the commerce authority may trigger e.g. the special national security review if it deems this necessary during or after the filing. If the commerce authority finds, during the filing, that the application should be subject to the old approval mechanism, it shall notify competent authority and the applicant.

Although the filing is of only procedural nature, the commerce authority is entitled to monitor and inspect FIEs during and after the filing to ensure true, accurate and complete information according to Filing Measures. Violation of the Filing Measures can lead to administrative penalties such as fines.

Silence on important questions

The Filing Measures and SAIC Notice in its current form are silent on some important questions, e.g. how to determine the effective date of certain key documents (e.g. equity transfer agreement, joint venture contract, articles of association) which in case of FIEs used to be subject to approval of commerce authorities for their effectiveness.

Under a less liberal interpretation, the AIC registration might now become the pre-condition for effectiveness of such documents, but currently this is not stipulated for Chinese invested companies. An alternative interpretation that filing should replace the previous approval as pre-condition for effectiveness of such documents also does not appear reasonable, since it would lead to very difficult legal questions in case the filling was not carried out for whatever reason (including a reason caused by a governmental authority itself).

Based solely on the more general *Company Law*, *Contract Law* and certain relevant precedents, and similar to solely Chinese-invested companies, arguably there should be no more mandatory governmental pre-condition for effectiveness of such documents, perhaps except for the very first articles of association used for company establishment, which shall become effective upon successful registration at AIC; this was at least the view point of the Supreme People's Court as stated in one precedent from the year 2014. If so, the effectiveness of such documents (except for the very first articles of association) should be subjected only to e.g. a valid signing/stamping. We will need to await the first precedents in practice to determine whether this interpretation will be supported by the practice of the authorities.

Revised role of the AIC

Since filing is no longer a legal pre-condition of company registration, SAIC and the local AIC are now seemingly pushed into a more key position to control the access by foreign companies and individuals. This used to be and still is (where applicable) the task of commerce authority during its substantial approval.

Seemingly responding to such changed role, the SAIC Notice urges local AICs to switch to the "new task" and "new challenges" and to consult with NDRC and MOFCOM of the same level in case of questions whether or not a project might fall under the Quasi-Negative List.

The SAIC Notice also further delegated the competency of AICs to handle the registration to the lowest level AICs.

Conclusion and outlook

With effectiveness of the new law and related rules, more convenience for establishments and changes of FIEs is generally expected, which leads to a careful optimism also as to potential further future liberalizations. Foreign investment projects which had been on hold since late September 2016, can now be resumed. But at this very initial stage of the new law, it is yet too early to tell how fast the involved authorities will be able to manage and implement

this efficiently to the benefit of investors and established FIEs at all locations in China, i.e. also in second and third tier cities.

Legislative changes might also occur on several related topics. This includes whether NDRC might also adjust or even abolish the mechanism of foreign investment project approval/filing (i.e. the planning related approval/filing applicable to all foreign invested projects). It is also open whether and to what extent national free trade zones will need to adjust their practice/system or supporting documents to integrate into the new law.



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