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December 2008 / Special Alert

A legal update from Dechert's Mergers and Acquisitions Group

China's Ministry of Commerce Delegates More Foreign Investment Authority to the Provinces

China's Ministry of Commerce (MOFCOM) issued two circulars in August and September of 2008 delegating additional authority to provincial officials. The first of these circulars (Notice of the Ministry of Commerce on the Decentralization of Approval on the Alteration of Foreign-funded Joint-stock Companies and Enterprises, No. 50 [2008] of the Ministry of Commerce, or Circular 50) contains an important provision for foreign corporations with a large existing presence in China that wish to expand their operations. In the past, regulations required foreign-invested enterprises (FIEs) approved in the first instance by MOFCOM to re-apply to MOFCOM to increase their total investments or registered capital. The new circular permits many FIEs originally approved by MOFCOM to seek approval directly from provincial authorities for increases of registered capital or total investment by any amount less than US$100 million. Circular 50 also delegates authority to approve the creation or conversion of foreign-funded joint stock companies. The second of the two circulars (Notice of the Ministry of Commerce on the Decentralization of the Authority to Approve Foreign-funded Commercial Enterprises, No. 51 [2008] of the Ministry of Commerce, or Circular 51) delegates authority to approve foreign-invested wholesale and retail enterprises. In the past, these enterprises in most cases required central MOFCOM approval. After the new circular, many foreign-invested retail and wholesale enterprises can be established with the approval of provincial authorities. We expect that the delegation of approval authority to provincial authorities may expedite the approval process for covered enterprises.

Increases in Investment in Existing Enterprises

FIEs in China are required to specify upon their establishment a registered capital (the equity of the company) and total investment (the maximum amount the company can raise through equity and debt). When a foreign investor wishes to inject additional capital into an FIE, it must first obtain the government's approval for the contemplated increase in registered capital or total investment. In the past, approval of increases came from whichever authority originally approved the establishment of the FIE. For FIEs initially approved by MOFCOM, that meant that any subsequent capital injection generally had to be submitted to MOFCOM as well, no matter how small the planned capital increase.

Circular 50 delegates approval of increases in registered capital or total investment in part to the provincial level. Under the new rules, for an FIE originally approved by MOFCOM in a "permitted" or "encouraged" category, any increase in registered capital or total investment by an amount less than US$100 million can now be approved at the provincial level. For an FIE originally approved by MOFCOM in a "restricted" industry, any increase in the registered capital or total investment by an amount less than US$50 million can now be approved at the provincial level. The determination as to whether an FIE's industry is considered encouraged, permitted, or restricted is made with reference to China's Foreign Investment Catalogue (officially, the

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"Catalogue for the Guidance of Foreign Investment Industries"), which is revised periodically. To view the complete catalogue, click here.

This is an important development for FIEs that were originally approved by MOFCOM and now wish to expand operations. It will facilitate additional investment by the FIE to a certain extent. Although review and approval at the provincial level must still be obtained, some centrally-approved FIEs may find additional capital injections are approved more quickly than would have been possible at the central level.

Advantages for Private Equity Foreign Investors Seeking Domestic IPOs

Circular 50 also contains a provision of potential benefit to private equity investors. In the past, any foreign-invested enterprise limited by shares (a Foreign-Invested Joint Stock Company, or FIJSC), or any conversion of an FIE to a FIJSC, required approval by MOFCOM. A FIJSC is the only corporate vehicle that can be listed on a domestic stock exchange. Under Circular 50, for enterprises with total investments less than the limits described above, FIJSCs can now be approved by provincial authorities.

The new rules in Circular 50, as to both capital increases and FIJSCs, are subject to certain exclusions for restricted industries, which remain subject to special rules applying to such industries and to the former approval process. Investments in listed companies also continue to require MOFCOM approval and, in many cases, the approval of the securities regulatory authorities as well.

Foreign-Invested Wholesale and Retail Enterprises

Prior to Circular 51, the establishment of or a material change to a "commercial" FIE (any foreign-invested retail or wholesale enterprise) was in most cases subject to a two-step approval process, with initial review at the provincial level and final review by MOFCOM. The process was supposed to take no more than four months, but in practice often took longer.

The new circular permits commercial FIEs to be approved solely at the provincial level, which should facilitate approval of new foreign-invested commercial enterprises.

Certain retailers and wholesalers must continue to seek MOFCOM approval, including direct sellers (i.e., sellers who operate through mail order, television, radio, the Internet, or vending machines) and sellers of books, periodicals, audiovisual materials, and certain other regulated merchandise and goods.

Conclusion

Circulars 50 and 51 follow just months after MOFCOM's Circular 23 delegated to the provincial level approval authority for certain foreign-invested real estate enterprises. Taken as a whole, there appears to be a trend toward devolving authority from the center to the provinces. These recent developments are consistent with MOFCOM's longstanding effort to streamline the approval process and increase efficiency. MOFCOM's recent delegation of additional authority to the provincial level may signal its intention to concentrate on macro issues such as round-trip investment, outbound investment, and antitrust.

Regardless of the motivations, however, the effect of the new circulars is to streamline the examination and approval process for many foreign investors who previously would have been required to seek approval from MOFCOM in Beijing.

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