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Client Alert Commentary

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# China's NDRC Proposes Changes to Outbound Investment Rules

***Changes could reduce regulatory uncertainty for Chinese investors, potentially spurring significant increases on outbound Chinese investment, especially in sensitive industries.***

## Summary

Continuing a policy of gradually relaxing its control over outbound investments of Chinese companies, China's National Development and Reform Commission (the NDRC) proposed amendments (the Proposed Amendments) to the *Administrative Measures for Approval and Registration of Outbound Investment Projects* (境外投资项目核准和备案管理办法) (together with its predecessor rules, the Outbound Rules) on April 13, 2016.

The Proposed Amendments seek to accomplish several objectives, including:

- Removing the NDRC's entrance control for Chinese investors pursuing offshore assets
- Lowering the Chinese regulatory hurdle for outbound investments involving a sensitive country/region/industry (definition included below)

If the Proposed Amendments are adopted, we expect that:

- More Chinese buyers will be encouraged to bid for offshore assets.
- Chinese buyers will be more likely to pursue deals involving a sensitive industry.
- Non-Chinese sellers will be more willing to consider multiple potential Chinese buyers.

While actual timing of any rule implementation is as of yet unknown and may be subject to modifications, the Proposed Amendments suggest that further loosening of restrictions on outbound investments will be forthcoming soon.

## Background

The Outbound Rules currently require "registration" with the NDRC for outbound investments in excess of US$300 million. Prior NRDC "approval" is required for investments involving a sensitive country/region/industry, and if such investments exceed US$2 billion, approval of the State Council (central government) will also be required. Sensitive countries/regions are defined as those countries/regions with which China has not established diplomatic relationships, or which are internationally sanctioned, or where wars or civil unrest is taking place; sensitive industries include infrastructure, telecommunication, cross-border exploration of water resources, large-scale land development, electric artery, power grid, press and media.

The registration process under the Outbound Rules currently works as follows:

- In the initial stage, Chinese investors are required to submit an information report to the NDRC before any substantive work begins on a project.
  - The information report responds to specified questions enumerated by the NDRC. Usually the investors will file the report electronically with the local branch of the NDRC, which will coordinate with the central NDRC to file the information reported.
  - "Substantive work" means entering into a binding agreement, making a binding offer, or lodging an application with any government or regulatory authority in the target jurisdiction in connection with outbound acquisitions.
- To start substantive work, the investors must receive a "confirmation" from the NDRC. The current Outbound Rules provide that the NDRC has discretion over whether to issue a confirmation after considering "state outbound investment policies." It is widely believed in the market that the NDRC has used this confirmation process to softly regulate outbound transactions. For example, the NDRC may control the number of confirmations for a particular targeted foreign asset to avoid Chinese companies bidding against each other for the same asset.
- In the second stage, the Chinese investors are required to submit an application for registration with the NDRC, and the NDRC again has the discretion over whether to issue a "registration notice" after considering "state outbound investment policies." In practice, the NDRC very rarely denies registration notice after it has issued a confirmation for the same project. Among other required information, the application for registration must include details of the contemplated financing the Chinese investor would use to make the outbound investment.

## Proposed Amendments

- **State Council Approval No Longer Required**. Investments involving sensitive countries/regions or sensitive industries (exceeding US$2 billion or not) will only require NDRC approval under the proposed amendments. State Council approval will no longer be required.
- **Initial Stage – Simple "Receipt" Will Replace "Confirmation**." While "registration" will still be required, the above mentioned "confirmation" requirement will be abolished under the Proposed Amendments. Rather, upon receiving an information report from a Chinese investor seeking an outbound investment, the NDRC is required to issue a "letter of receipt" to acknowledge the registration filing, (without the ability to consider "state outbound investment policies"). Such letter of receipt will entitle the investor to begin substantive work.
- **Second Stage – Registration Still Required but With Simplified Application**.
  - Under the Proposed Amendments, Chinese investors seeking offshore assets are still required to file with the NDRC a registration application. The transaction can only proceed after the NDRC registration notice is received. When deciding whether to issue such notice, the NDRC still has discretion to take into account of "state outbound investment policies."

- However, the registration application will be simplified to no longer require details of the contemplated financing the Chinese investor would use to make the outbound investment.

## Implications / What This Means for You

- **For Chinese Buyers**. The Proposed Amendments to the Outbound Rules are a further liberalization of a key Chinese regulatory process for Chinese companies buying foreign assets. The Proposed Amendments to the Outbound Rules should significantly ease the burden on potential Chinese bidders at the initial “teaser” stage. Chinese bidders will have substantially more flexibility to pursue potential opportunities without the concern that the interests of another Chinese party will impair their ability to participate in initial stage. Specifically, if the Proposed Amendments are adopted as the final rule and implemented to letters, the Chinese buyers will not need to worry about the NDRC’s policy controls in the initial stage and will enjoy a further levelled playing field with foreign buyers, at least at the preliminary steps in auctions. However, as described below, sellers may still be wary of the risks presented by the secondary “registration” phase of NDRC consideration contemplated by the Proposed Amendments.

- **For Non-Chinese Sellers**. Overseas sellers should be able to cast a wider net over potential Chinese buyers, who should be more willing to expend initial efforts and should be less concerned that a regulatory review will preclude their participation in auctions for unknown reasons. In addition, more Chinese buyers should be expected to participate in transactions involving a sensitive industry, because only NDRC approval will be required under the Proposed Amendments. However, sellers should note that even under the Proposed Rules the NDRC retains discretion not to issue the secondary registration notice for policy considerations, which could effectively block a transaction even after the “letter of receipt,” including post-signing of a deal. Whether the NDRC will reconcile the two stage requirements in the final rules, and if the Proposed Rules are implemented without further revisions, whether the NDRC will continue its practice of rarely denying a registration notice for deals for which a letter of receipt has been issued remains to be seen. As a consequence, while the Proposed Amendments are a promising development, and should enable greater momentum for Chinese bidders, deal certainty may remain an important topic of discussion with these bidders. This certainty may come through confirmation that the NRDC registration process represents manageable risk or is completed pre-signing, or by building in reverse termination fees or similar mechanisms where appropriate to mitigate the risk and costs of subsequent NRDC opposition to the transaction.

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