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Doors are opened for foreigners to set up or invest in partnerships in China—*new Measures allow foreign participation in Chinese partnerships*

On December 2, 2009, the State Council, China's central government cabinet, announced the "Measures for Foreign Entities or Individuals to Establish Partnership Enterprises in China," which will become effective on March 2010. The Measures, carrying the legal effect as a Chinese central government administrative regulation, will permit foreign enterprises and foreign individuals (or the "natural persons") to establish or invest in partnerships inside China ("foreign invested partnerships" or FIPs). Previously, only Chinese domestic enterprises or individuals could be partners in partnerships in China. After nearly 30 years since China permitted foreign investment, including those from Hong Kong, Macau, and Taiwan, mainly in the forms of joint ventures (JV) and wholly foreign owned enterprises (WFOEs), the Measures have essentially opened up partnership as a legal form for foreign investment.

Who can be partners to FIPs in China?

The Measures provide several ways that foreign entities or individuals ("foreign parties" or "a foreign party") can establish or become a party to a partnership in China. First, two or more foreign parties can establish a partnership in China. Second, a foreign party can establish a partnership with a Chinese domestic entity or a Chinese individual. Third, a foreign party can invest in an existing partnership in China.

What can foreign parties invest in FIPs in China?

The Measures provide that foreign parties can use or invest in a FIP using either "convertible" foreign currency or "legally obtained" Chinese currency. However, the Measures do not provide for what and if any minimum or required capital contribution may be required for setting up a FIP or investing in an existing Chinese domestic partnership. The Measures are also silent on the timeline or schedules of such capital contributions, as in contrast to the JV and WFOE regulations. Additionally, the Measures do not provide for how the convertible foreign currency may be obtained or repatriated, and whether any special foreign exchange rules may be applicable.

Do foreign investment industry restrictions apply to FIPs?

A FIP shall have to meet the legal requirements of the Chinese Law on Partnership Enterprises and all “other laws and administrative regulations.” In addition, a FIP shall also meet the “industrial policies governing foreign investments”; namely, various industry guidelines prescribing which industries foreign investments are encouraged, permitted, restricted, or prohibited. While FIPs in general will require “registration with the State Administration of Industry and Commerce (SAIC)” instead of “approvals by the Ministry of Commerce” (MofCom), it seems that, if a FIP falls under the restricted or prohibited industry areas, it still needs to go through the approval procedures required under such industry guidelines, and such procedures may still require MofCom approvals.

What are the procedures for establishing a FIP?

The Measures provide that foreign partners seeking approvals may file applications through a representative agent designated by all the partners, to be filed with and authorized by the local branch of the SAIC. After submitting the required documentations prescribed by the Measures on Registering Partnership Enterprises, as well as the declaration that such a partnership has met the “requirements of industrial policies of foreign investment enterprises,” the SAIC and its local branches shall be responsible for the registration, change, and dissolution of foreign invested partnerships through notifications to the departments that are in charge of commerce, i.e., the same level of local branches of the MofCom. It is interesting to note that the Measures provide that foreign invested partnerships in projects that require government approvals will have to obtain such approvals before they can be registered by a SAIC branch. Additionally, the Measures specifically provide that foreign invested partnerships, if their businesses are mainly interested in making investments, will have to meet the relevant regulatory requirements. It may suggest that, if any FIPs fall within a regulated industry or sector, including banking, insurance, securities, or legal and accounting services, it will require advance or separate approvals from the relevant government agencies.

Legal significance and practical implications

Although the Measures are relatively brief, with only 16 provisions in total, and much needs to be further provided or clarified, they nonetheless have great legal significance. First, the Measures have extended the legal concept of partnership from requiring that all partners to be Chinese to including foreign parties, and has substantially expanded the business forms that foreign parties can choose to do business in China. With the Measures, foreign parties making investments in China and wanting to establish businesses in China are no longer restricted to having to becoming parties to JVs or forming WFOEs.

Second, foreign parties can form a partnership with a Chinese individual or a Chinese entity that does not have to be a Chinese legal person. This was not commonly available under the JV or WFOE regulations, thus further expanding the types of Chinese parties with which foreign parties can formulate entities in China.

Third, the Measures open up the business benefits, or flexibilities, that may be accorded to FIPs, such as taxes, formation, capital contributions, and dissolution, although much needs to be further clarified.

Fourth, the Measures provide that only a registration by a SAIC is necessary for a foreign invested partnership to be established, without having to obtain a more substantive approval from a MofCom agency as in the cases of JV or WFOE, unless the FIP falls under special industries, is for special investment purposes, or triggers non-compliance of foreign investment guidelines.

The Measures may pave the way to further open up channels through which foreign investments may come into China, thereby improving the foreign investment environment in China. The Measures have many practical implications. First, by permitting foreign investment in Chinese partnerships, they begin to help to resolve some lingering legal difficulties involved with the permitting of foreign participation in the Chinese private equity and venture capital sectors, where foreign partners may want to be parties to the general partner or manager, or as limited partners and investors. Second, the Measures indicate a positive step forward despite 1) in the private equity sector, the long-awaited rules regarding Renminbi funds have not yet been announced; and 2) in the venture capital space, the ambiguities exist if MofCom approvals may still need to be based on the FIVCE Rules (the 2003 Regulations on Administration of Foreign-Invested Venture Capital Enterprise). Third, the Measures also seem to open up important service areas for foreign participation, including legal services and other professional service areas where domestic partnership has increasingly become the form of choice. So far, foreign partners have lacked legal grounds to invest in or become a party to these areas. Nixon Peabody and its China practice shall continue monitor the legal developments in this and related areas. For further questions, please contact:

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