

Automotive Industry

The “Loose” and “Tight” of the Administrative Provisions on Investment in the Automotive Industry

At the end of 2018, the long-preparing *Administrative Provisions on Investment in the Automotive Industry* (“**Provisions**”) was finally promulgated on the website of the National Development and Reform Commission. As an industry regulation to replace the *Policies for the Development of the Automotive Industry*, the Provisions will come into force on January 10, 2019.

Throughout the Provisions which consist of nine chapters and forty-eight articles, it purposely targets and deals with the problems that have been existing in the automotive industry for many years, such as low efficiency of the administrative approval process, irrational investments in the industry and so on. Moreover, in light of the new trend of development, the Provisions draw the "red line" and "green areas" for the future development of the automotive industry.

I. New Explanation of Automobile Investment Projects

Compared with the *Policies for the Development of the Automotive Industry*, the Provisions expand the scope of automobile investment projects. In addition to the original whole vehicle and engine projects, investment projects in automobile

components such as power batteries, fuel cells, automobile assemblies and etc. as well as power battery recycling and automobile components remanufacturing have also been included in the scope of automobile investment projects. Accordingly, the Provisions set forth the access requirements for each type of such investment projects. By this way, it indicates the state's regulatory supervision will cover the entire industrial chain of vehicles.

II. The New Standard of Vehicles Classifications

In accordance with the Provisions, the whole vehicle investment projects are divided into fuel vehicle and pure electric vehicle investment projects (including the two product categories: passenger vehicles and commercial vehicles) based on the driving power system, among which, the fuel vehicle investment projects refer to the investment projects of vehicles which are driven by engines (including alternative fuel vehicles), including traditional fuel vehicles, ordinary hybrid vehicles and plug-in hybrid electric vehicles, while the pure electric vehicle investment projects refer to the investment projects of vehicles which are powered by electric motors, including investment projects of pure electric vehicles (including

extended-range electric vehicles) and fuel cell electric vehicles.

It is noteworthy that the Provisions play down the development of the hybrid products, which is reflected by the fact that ordinary hybrid vehicles are still excluded from the category of new energy vehicles, and investment projects in plug-in hybrid electric vehicles still apply the administrative provisions on traditional fuel vehicles.

III. Strict Control on Capacity Expansion of Fuel Vehicles

1. Prohibited Construction Projects

The Provisions prohibit the construction of the following fuel vehicle investment projects:

- 1) establishment of new independent fuel vehicle enterprises;
- 2) building production capacity of fuel vehicle across the categories of passenger vehicles and commercial vehicles by existing automobile enterprises;
- 3) relocation of the existing fuel vehicle enterprises as a whole to other provinces (except for projects that have been listed in the regional development plan issued at the state-level or keep unchanged the existing shareholding structures of the enterprises);
- 4) investment in fuel vehicle enterprises that have been specially publicized by the industry administrative departments (except for the investment by original shareholders of the enterprises or the investment projects transforming the enterprises into non-independent legal persons).

2. Restricted Construction Projects

The Provisions strictly restrict existing automobile enterprises from expanding their production capacity of fuel vehicles. If the expansion is indeed required, the following conditions shall be met:

- 1) the utilization rates of automobile production capacity in the past two years are higher than the industry average of the same product category (passenger and commercial vehicles);
- 2) the proportions of the output of new energy vehicles in the past two years are higher than the industry average;
- 3) the proportions of R&D expenses spent in the past two years are more than 3% of the main business income;
- 4) the products have international competitiveness;
- 5) the annual utilization rates of automobile production capacity in the province where the project located for the past two years are higher than the industry average of the same product category, and the same province has no fuel vehicle enterprise of the same product category which has been specially publicized by the industry administrative departments;
- 6) in terms of investment projects for capacity expansion of fuel passenger vehicles, the average fuel consumption of relevant enterprises shall meet the requirements of national standards and relevant regulations, and in terms of the investment projects of expanding new capacity in different places, the construction scale shall be no less than 150,000 vehicles and the total output of the enterprises of the past year shall be no less than 300,000 vehicles.

3. Exceptions

Taking into account the actual situation of the development of China's automotive industry, the Provisions also stipulate some exceptions:

- 1) the establishment of enterprises manufacturing fuel vehicles is permitted if their products are 100% exported;

- 2) the investment projects of existing automobile enterprises building production capacity of plug-in hybrid electric vehicles can be waived of the above two restrictions of “proportion of new energy vehicles output” and “capacity utilization rate of the province where it is located”;
 - 3) the existing automobile enterprise merging another independent automobile enterprise of the same product category and transforming it into a non-independent automobile enterprise without increasing its original production capacity can be waived of the restrictions of Article 12 (i.e., prohibited construction projects) and Article 13 (i.e., restricted construction projects) of the Provisions;
 - 4) on the premise of not increasing the total capacity of the automobile enterprise group, an independent automobile enterprise of a group is allowed to expand its own production capacity of fuel vehicles by allocating the capacity among the affiliated companies of the same group;
 - 5) on the premise of not increasing the total capacity of the province, an independent automobile enterprise is permitted to expand production capacity of fuel vehicles through M&A or restructuring.
1. Requirements on the province it is located
 - 1) the utilization rates of automobile production capacity in the past two years are higher than the industry average of the same product category;
 - 2) all the existing investment projects manufacturing pure electric vehicles of the same product category have been completed and their annual outputs have reached the planned construction scale.
 2. Requirements on enterprises
 - 1) having established product R&D organizations and employed professional R&D teams, having experiences and capabilities of concept design, system and structural design of pure electric vehicles; having the R&D capability and corresponding test and verification capability with regard to whole vehicle control system, vehicle power battery system, whole vehicle integration, lightweight body and etc.; having the R&D capability and corresponding trial production capability with regard to the body and chassis manufacturing, system integration of vehicle power battery, whole vehicle assembly and etc.; the main technical indicators of the products are leading the industry;
 - 2) being equipped with the patents and intellectual property rights of the core technologies for pure electric vehicles, which have been authorized or confirmed;
 - 3) having strong guarantee on after-market services, which is warranted through taking out insurance against the quality of products sold within 5 years after the projects are completed and put into production or seeking guarantees from relevant enterprises.
 3. Requirements on shareholders
 - 1) the shareholders are restrained from transferring their shares before the projects

Although China will abolish all the foreign investment access restrictions of the automotive industry in 2022, it is still a distant dream for multinational automobile manufacturers to newly establish a fuel vehicle enterprise on its own.

IV. Raise of the Access Threshold for Pure Electric Vehicle Projects

Compared with the *Administrative Provisions on Newly-established Pure Electric Passenger Vehicle Enterprises*, the Provisions further raise the access threshold for pure electric vehicle investment projects, which mainly include:

have been completed and the annual outputs have reached the planned construction scale;

2) the shareholders have strong control over key components and the intellectual property rights and production capabilities for key components such as whole vehicle control systems, driving motors, vehicle power batteries and etc.;

3) The major legal person shareholders shall meet the following conditions:

(a). the shares owned shall exceed one third of all the shares;

(b). the existing investment projects of pure electric vehicles where they control the majority have been completed, reached the outputs as the construction scale planned, and have no illegal or non-complaint circumstances;

(c). they have own funds and financing capabilities that are sufficient for the project construction and operation;

4) The major legal person shareholders shall also meet one of the following conditions:

(a). where the major legal person shareholders are automobile enterprises manufacturing fuel vehicles, the annual utilization rates of automobile production capacity and the proportions of the output of new energy vehicles in the past two years are higher than the industry averages; where the major legal person shareholders are automobile enterprises manufacturing pure electric vehicle enterprises, the output of the past year has reached the planned construction scale;

(b). where the major legal person shareholders are auto parts enterprises, the number of vehicles assembled with the whole vehicle control systems, driving motors or vehicle power batteries in the past two years

is more than 100,000 sets in aggregate;

(c). where the major legal person shareholders are other market entities such as design or R&D or overseas enterprises, with regard to the pure electric vehicle products which they develop and have intellectual property rights of, the number of vehicles sold and registered in domestic and overseas markets in the past two years is more than 30,000 pure electric passenger vehicles or 3,000 pure electric commercial vehicles in aggregate, or the sales revenue of pure electric vehicles in the past two years exceeds 3 billion yuan in aggregate.

Despite that the Provisions have raised the access threshold on investing in pure electric vehicles, the Provisions has eliminated the approval system for production qualification on the other hand, and the *Administrative Measures for the Access of Manufacturing Enterprises and Products of Road Motor Vehicles* released earlier by the Ministry of Industry and Information Technology also allows R&D and design enterprises which meet the prescribed conditions to make use of the production capacity of existing manufacturers to apply for the enterprise and product access qualifications for manufacturing road vehicles. That is to say the Provisions have pointed out the way out for enterprises having certain capabilities to enter the automotive industry.

V. Introduction of “Collective Punishment System”

It is noteworthy that the Provisions clearly provide the "Collective Punishment System", that is, (1) when reviewing the capacity expansion of fuel vehicles as applied for by the existing enterprises, the authority will also check whether the utilization rates of automobile production capacity of the province where the project is located in the past two years have exceeded the industry average of the same product category and whether such province has any fuel vehicle enterprise of the same product category that is specially publicized

by the industry administrative departments; (2) when reviewing the pure electric vehicle projects, the authority will also assess whether the utilization rates of automobile production capacity of the province where the project is located in the past two years have exceeded the industry average of the same product category, and whether the existing investment projects manufacturing pure electric vehicles of the same product category in the province where the project is located have all been completed and their annual outputs have all reached the construction scale as planned.

Based on our understanding, the initial purpose of the above stipulations should be to curb the local governments' irrational investments and also to alleviate the excessive production capacity in currently existing the automotive industry. All of the above-mentioned factors are actually out of the control of subsequent players who may want to enter the automobile industry and may cause barriers or problems in selecting the places to land their projects.

VI. Exit of the Approval System

The most significant change of the Provisions is that the approval system of automobile investment projects will be replaced by the filing system, and the relevant administration authority will be delegated to the local departments. This may fundamentally cure the problems that have been existing for decades in the approval system of the automotive industry, such as inefficiency and lack of transparency, and furthermore lay the foundation for creating the full competition in the automotive industry.

It should be noted that the reform of the approval system does not mean to relax the supervision. Instead, the Provisions structure the supervision in another way by strengthening the interim and ex-post supervision requirements, mainly including:

1. The Provisions use a considerable lengthy

part to clarify the access standards for various types of automobile investment projects. As compared with the original automotive industry policy and scattered access requirements, the Provisions use quantifiable, traceable and examinable indicators as far as possible to systematically clarify the requirements of various types of automobile investment projects and lay the groundwork for the interim and ex-post supervisions.

2. The Provisions require enterprises to submit relevant information such as commencement of the project, construction progress, completion through the online approval and supervision platform of national investment projects, and to take the responsibility for the authenticity, legality and completeness of the information, which provides a first-hand information source for the follow-up actions and ex-post supervision by the competent authorities.
3. In terms of the enforcing the supervisions, the Provisions require local development and reform commissions to cooperate with the planning, land, environmental protection, safety production, finance and industry administration departments to carry out the law, and may revoke the filings of the automobile investment projects of which relevant violations have been verified and take other joint punishment measures.
4. It is worth noting that the Provisions specifically stipulate that anti-monopoly investigations should be conducted on major automobile investment projects in connection with their establishment, mergers and acquisitions, and change of equity where industrial safety may be concerned, and the security review is also required where foreign investment is involved. It can be foreseen that anti-monopoly review and security review will be the "new normal" for future foreign automobile investment projects.

5. The Provisions further require: (1) to establish an automobile capacity monitoring and statistical system and an automobile capacity release and early warning mechanism; (2) the provincial development and reform departments to conduct statistics and analysis of the province's automobile investment projects on a quarterly basis, and to require the enterprises with missing or inconsistent information to make supplementations or corrections in time; (3) the automobile enterprises and the provincial development and reform departments to regularly report on a yearly basis the projects under construction and being planned, and the changes in the production and capacity of automobile products in the corresponding region. These arrangements can make the industry administration departments informed of and master the specific situation of automobile projects in each region and of each enterprise, and thus they can timely release information on changes in the vehicle capacity, reinforce the capacity warnings, and guide enterprises to make reasonable investments, which may create the conditions for easing the redundant capacity and increasing the vehicle capacity utilization rate.

Since long, "control of number of companies holding qualifications" is one of the weapons of regulating the automotive industry and therefore the manufacturing qualifications have become rare and valuable "shell" resources. Many zombie enterprises that have lost its capability to do R&D and survive in the market still rise from dead by transferring the "shell" resources they hold. However, when the Provisions are implemented,

investments in specially publicized enterprises will thereafter be prohibited, and together with the replacement of the "approval system" by the "filing system" in being qualified to invest in the automobile industry, we believe that the value of "shell" resources held by many enterprises will significantly decline and transferring the "shell" resources will gradually become a historical way to obtain the vehicle manufacturing qualification.

VII. Remarks

When it comes to the second half of 2018, the short-term prospect of the automotive market looks pessimistic due to the declining statistics. However, the forerunners among China's new generations of car makers are still very optimistic about the long-term development of the Chinese automotive market, and have made great efforts in R&D and launch of new vehicles.

The enactment of the Provisions indicates on one hand China's immovable determination to vigorously develop the automotive industry as a pillar industry, and on the other hand proves that the regulatory authorities have become more rational and pragmatic on the basis of learning from the past supervision experiences, and are looking forward to guiding the industry to transform towards the pursuit of technology and quality by adopting the new regulations. We hope that under the guidance of the Provisions, China's automotive industry will usher in a healthy, orderly and positive development with innovation and vigor in the near future.

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