

China Newsletter  
April 2011

## NEW NATIONAL SECURITY REVIEW REGIME FOR FOREIGN M&A IN CHINA; WHAT DOES IT MEAN FOR YOUR NEXT M&A DEAL?

New national security review provisions (i.e. the “Notice”) were introduced by the Chinese government for foreign acquisition of domestic enterprises of specific industries. The Notice and its interim Measures (“Measures”) took effect on 5 March 2011.

Foreign investors will have to evaluate carefully if a proposed acquisition will be caught under the Notice. However, at this stage, the scope of a number of the provisions under the Notice is still unclear. For example, it is not clear as to the types of products that are considered to be “key” products under the Notice. There is also a lack of inter-relationship with other elements of China’s foreign investment regime and the anti-trust approval process. The introduction of a third party’s initiation of the review procedure without any definite time constraint also creates a concern of a completed deal being unwound. It is expected that the final implementation rules to be issued will address such uncertainties.

### SCOPE OF THE NATIONAL SECURITY REVIEW

National security review covers those industries specified under the Notice, being

(i) the military sector and those relating to national defence security; and

(ii) key agricultural, energy, infrastructure, transport, technology and equipment sectors.

The Notice does not apply to acquisition of financial institutions and separate rules for security review will be promulgated.

Acquisition of domestic enterprises under the Notice covers both equity and asset acquisition. For the non-military sectors under (ii) above, foreign investors have to obtain “actual control” over the domestic enterprise, e.g. the foreign investor becomes the controlling shareholder or has obtained de facto control in terms of voting rights.

*1. Notice of the General Office of the State Council on the Establishment of a Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*

*2. Interim Measures on Implementation of the National Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (“Measures”). The Measures took effect simultaneously with the Notice on 5 March 2011 but will expire on 31 August 2011, with an initial public consultation period till 10 April 2011.*

## REVIEW AUTHORITY

A Joint Committee (“Committee”), led by National Development and Reform Commission and the Ministry of Commerce (“MOC”) will be responsible for carrying out the national security review.

## REVIEW PROCESS AND TIMING

A foreign investor acquiring a domestic enterprise within the meaning and scope of the Notice shall file an application with the MOC. The MOC will submit the application to the Committee within 5 working days if it determines that the proposed acquisition is subject to security review.

The Measures provide that the local MOC is to conduct a preliminary assessment to ascertain if national security review under the Notice is applicable, in relation to its routine review of foreign direct investment (“FDI”) applications. If it takes the view that the foreign acquisition is subject to national security review, it will notify the applicant to make the relevant application under the Notice and will not commence the FDI review until the national security review clearance is obtained.

A brief summary of the procedures and timing is provided as follows:-

- (1) Voluntary filing of application by foreign investor to MOC, or initiations by third parties to MOC for review, e.g. relevant departments of the State Council, national trade associations, companies in the same industry or upstream or downstream companies of the target company;
- (2) MOC to submit application to the Committee within 5 working days;
- (3) General review by the Committee (consultation of relevant authorities) – takes up to 30 working days;
- (4) Special review by the Committee where national security concern is triggered – takes up to 60 working days;
- (5) Final decision by State Council if matter cannot be resolved during special review – no time limit.

## REVIEW DECISION

In case of a determination or likelihood of a material impact on national security, the Committee may direct MOC to terminate the subject transaction or to impose measures to mitigate such impact, e.g. order transfer of the relevant equity interest or assets.

## WHAT DOES IT MEAN FOR YOUR NEXT M&A DEAL?

Although the Notice is a step forward in China to formalize the procedures for carrying out a national security review, due to a number of uncertainties, one has to wait for further clarifications from the final implementation rules to be issued. In case a potential acquisition is likely to be covered under the Notice, investors are advised to seek legal advice and to submit the application for national security review as early as possible.

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Should you have other enquiries, please feel free to contact us.

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