On December 19, 2020, China issued new measures expanding its national security review of foreign investments. The measures become effective on January 18, 2021 ("2021 Measures").

China’s existing national security review system focuses on acquisitions of domestic enterprises by foreign investors. The 2021 Measures significantly expand the types of foreign investments subject to national security review as well as the list of industries relevant to China’s national security. The new measures signal China’s intention to bolster national security oversight of foreign investments in response to the increased scrutiny Chinese companies now face abroad.

Key aspects of the 2021 Measures are discussed below.

**Scope of China’s Security Review**

Under the 2021 Measures, any form of direct or indirect foreign investment that may have an impact on China’s national security is subject to security review.

"Foreign investments" include:

- a. investment in a new project or establishment of an enterprise in China by a foreign investor, alone or jointly with any other investor;
- b. acquisition of equity interests or assets of an enterprise in China; and
- c. a catchall category of "other forms of foreign investments."¹

On their face, the 2021 Measures include foreign to foreign transactions (i.e., an acquisition by a foreign investor of a wholly foreign-owned enterprise in China, or an acquisition by a foreign investor of foreign-held shares in a joint venture in China). The term “an enterprise in China” includes any business located in China, not the location of its shareholders. Thus, an offshore merger and acquisition may trigger a security review in China, if the target has a subsidiary in China. In addition, green-field investments are also subject to security review.

**Notifiable Investments**

The 2021 Measures require foreign investors or relevant domestic parties to file for review when a foreign investment:

- a. occurs in companies involved in national defense, national security, China’s military industry, in ancillary military facilities, or in areas adjacent to military facilities or military industry facilities; or
- b. results in “actual control” over companies involved in any number of “important sectors,” including “important agricultural products,” “important energy and
resources, “heavy equipment manufacturing,” “important infrastructure,”
“important transportation services,” “important cultural products and services,”
“important information technology and internet products and services,” “important
financial services,” and “key technologies”.

“Actual control” is defined as: (i) owning 50 percent or more of the equity rights, (ii)
being able to exercise “material influence” over board or shareholder resolutions of the
target even where the investor owns less than 50 percent equity rights, or (iii) other
circumstances in which the foreign investor is able to exercise “material influence” over
the operational strategy, personnel, financing, or technology of the target.

It is unclear whether China will publish official guidance clarifying these “important
sectors” to assist businesses in assessing whether their transactions trigger a
notification requirement.

In respect of “actual control,” the concept of “material influence” remains to be clarified.
Is “material influence” one and the same with “decisive influence” under the Anti-
Monopoly Law for the purposes of assessing whether control has been acquired in the
merger control context? Under China’s existing national security system, “actual
control” includes the scenario where a number of unrelated foreign investors in the
aggregate collectively hold 50 percent or more of the equity interests in the target.
Is this still the case under the 2021 Measures? The answers to these questions are
unclear at the present time.

Reviewing Authorities

The 2021 Measures call for a “foreign investment security review working mechanism”
to organize, coordinate, and guide reviews. The “office of the working mechanism”
(“Office”) will be housed in the National Development and Reform Commission
(“NDRC”) and led by the NDRC and the Ministry of Commerce (“MOFCOM”), and will
receive and review filings.

Review Process

The security review process has three steps.

- **Preliminary Review.** The preliminary review can take up to 15 business days
  after the Office receives a “complete” filing. A complete filing includes a filing form,
an investment plan, a statement explaining how the investment will impact China’s
national security, and any other materials required by the Office. At the end of the
preliminary review, the Office will notify the parties whether the investment
requires a full security review. If a full security review is not required, the parties
may complete the proposed investment subject to any other applicable regulatory
approval.

- **General Review.** If an investment requires a full security review, the Office will
  open a “general review” which may take up to 30 additional business days. If
following that review the Office determines the investment will impact or may
impact China’s national security, the Office will initiate a further review called a
“special review;” otherwise, the parties may complete the proposed investment
subject to any other applicable regulatory approval.

- **Special Review.** The “special review” can last up to 60 additional business days
  and can be further extended under “special circumstances.” The 2021 Measures
do not specify the “special circumstances” that trigger this extended form of review. As with the other reviews, if the Office concludes that the investment will not impact China’s national security, then it will clear the investment. If the “special review” concludes that the investment will impact China’s national security, the Office will prohibit the investment or impose conditions on the investment. The 2021 Measures do not specify what types of conditions the Office may impose.

During the review, the Office may interview the parties or issue requests for information. Parties may consult the Office on relevant issues before submitting a filing. They are not allowed to complete the investment unless the Office clears the investment or informs the parties that a security review is not needed.

A flowchart summarizing the national security review process is provided below.

Sanctions
There are no administrative fines for violations of the 2021 Measures. In the following circumstances, the Office will order the parties to unwind the investment by disposing of relevant shares or assets or otherwise eliminate the impact on China’s national security:

- the parties implement a notifiable investment without filing and further refuse to make a filing when ordered to do so by the Office;
- the parties fail to comply with a conditional clearance decision and further fail to make corrections as required by the Office; or
- the parties obtain a clearance decision by providing false information or concealing relevant information.

China will also record these violations in its social credit records, which may lead to disciplinary action by other Chinese regulators or be treated as an aggravating factor in investigations by other regulators.

Comments
In a Q&A session with the press, the Office rejected the notion that the 2021 Measures are protectionist and suggested that the measures align China with international practices. The Office pointed out that major jurisdictions around the world have been formulating or improving their own national security review regimes in recent years, including the U.S., the EU, Australia, Germany, Japan, and the UK.

China is now expected to take a more active approach in evoking national security oversight of foreign investments. Businesses considering direct or indirect investments in China, including parties to offshore mergers and acquisitions involving business operations in China, will need to carefully assess whether their transactions trigger a security review in China and factor the potential implications into their deals.
Security Review Process

Under China's existing national security review system, China prohibits a foreign investor from circumventing a national security review by using a nominee arrangement, trust, multilayered re-investment, lease, loan, VIE, or other similar structure. These differing investment structures are now likely within scope of this catchall category.

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2 https://www.ndrc.gov.cn/xwdt/xwfb/202012/t20201219_1255024.html

This memorandum is a summary for general information and discussion only and may be considered an advertisement for certain purposes. It is not a full analysis of the matters presented, may not be relied upon as legal advice, and does not purport to represent the views of our clients or the Firm. Ben Bradshaw, an O’Melveny partner licensed to practice law in California and the District of Columbia, Ian Simmons, an O’Melveny partner
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