

Alerts & Publications



MOFCOM Releases Interim Measures to Implement the New Foreign Investment National Security Review Mechanism

March 11, 2011

On March 4, 2011, the Ministry of Commerce of People's Republic of China ("MOFCOM") issued initial procedural rules to implement the new mechanism, announced on February 3, 2011, by which certain foreign direct investment transactions will be reviewed on national security grounds.

The "Interim Measures of the Ministry of Commerce on Security Review Mechanism for Merger & Acquisition of Domestic Enterprises by Foreign Investors" (the "Interim Measures")^[1] became effective on March 5, 2011, the same date as the "Notice of the General Office of the State Council on Establishing the Security Review Mechanism for Merger with and Acquisition of Domestic Enterprise by Foreign Investors" (the "Notice").^[2] MOFCOM has invited comments on the Interim Measures, for which the deadline is April 10, 2011. The Interim Measures will remain in effect until August 31, 2011, after which MOFCOM may further revise the measures based on the comments received and the experience in implementing them.

The Interim Measures resolve some (but not all) of the procedural uncertainties that have surrounded the national security review notification obligation in the Notice. In particular, the Interim Measures clarify the relationship between the national security review mechanism and the general foreign direct investment ("FDI") review regime. This client alert highlights key elements of the Interim Measures.

Highlights

1. The Interim Measures clarify one important ambiguity in the Notice and the informal guidance on the Notice previously posted by the National Development and Reform Commission (the "NDRC Q&A").^[3] The NDRC Q&A suggested that foreign investors would not be required to make a separate filing to initiate a security review; instead, investors might be asked to provide information necessary for the security review in the course of the general FDI reviews. The Interim Measures, however, make clear that foreign investors must file a separate application with MOFCOM. (The Interim Measures and Notice contemplate applications only from foreign investors, not from the domestic parties.)
2. Foreign investors may consult with MOFCOM before officially filing an application for review.^[4] Such consultation, however, will be limited to "procedural issues" - MOFCOM will not provide substantive opinions on the potential issues. Unfortunately, it is not clear whether MOFCOM will advise investors whether a proposed transaction is within the scope of the Notice. As in the

United States under the practice of the Committee on Foreign Investment in the United States (“CFIUS”), foreign investors may be required to file a full application in order to receive a determination that a transaction is not covered by the Notice.

3. Although the Notice does not make clear when a national security review application must be filed, the Interim Measures effectively require prospective foreign investors to file before the general FDI application is submitted: Local commercial authorities responsible for the FDI approval must suspend a FDI application upon determining that the investors have not filed with MOFCOM if a proposed transaction is covered by the national security review mechanism.^[5] As noted above, it may be possible to determine whether a transaction is covered only by filing such a notice.

4. The Interim Measures list the major documents to be submitted for the application.^[6] The required information focuses on the nature of the transaction and the target business. While the requirements are not as detailed as provided in the CFIUS rules, for example, they cover very similar ground, and MOFCOM may require other documents to be submitted concerning any particular transaction.

5. The Notice established a timeline for the review process that contemplates a final determination no later than about 90 days after the review commences. The Interim Measures provide several deadlines regarding MOFCOM’s activities in the process. Notably, after accepting an application, within 15 business days MOFCOM will make an initial determination whether a transaction is subject to national security review. If MOFCOM does not notify the applicant otherwise within that period, then the applicant may proceed with the applicable FDI approval processes. Again like the CFIUS process, however, MOFCOM will not “accept” the application until it deems the materials to be complete and to meet “legitimate requirements.” Thus, the 15-day initial review period may not commence for some time after the applicant has filed its notice.^[7]

6. The Interim Measures prohibit an applicant from proceeding with a transaction without resolving national security concerns that emerge from the review process. (Although the Interim Measures refer only to “national security” concerns in this provision, presumably the same prohibition applies with respect to the two other bases for review in the Notice: “economic stability” and “social order.”)

7. The foreign investors will be requested to re-submit their transaction for national security review even if they have obtained clearance from MOFCOM or the Joint-Ministry Committee (the “Committee”) if the transaction is revised at a later stage and falls within the scope of national security review. In addition, MOFCOM and other authorities are empowered to take direct measures to alter a transaction in order to remove a threat to national security.

Summary of the Interim Measures

The Application Process

According to the Interim Measures, in addition to any FDI approval applications, the foreign investors should file a separate application with MOFCOM if the proposed transaction with a domestic enterprise falls under the scope of national security review as provided in the Notice.[8]

Where two or more foreign investors are involved, they may jointly file or they may designate one foreign investor to submit the application for security review.[9] The local commercial department will not accept an application for general FDI approval, and it will instruct the foreign investor to make the security filing with MOFCOM first if that department finds the pending transaction is subject to the national security review.[10]

The Materials Required for the Application

Applicants must provide various documents and information in the national security filing, including:

- An application letter and description of the transaction;
- The identity certification of foreign investors and a bank credit letter (all notarized and duly certified), as well as identity certifications for the legal representative and authorized representative of the foreign investor(s);
- A description of the foreign investors and their affiliates, including the person having ultimate *de facto* control, any persons acting in concert with the investors, and any relationship with foreign governments (e.g., state ownership or control);
- A description of the target domestic enterprise, including copies of its business license, articles of association, audited financial statement of the preceding year, organizational charts prior to and after the transaction, and a description of entities in which it has invested and their business licenses;
- The contract, articles of association, or partnership agreement of the proposed foreign-invested enterprise after the transaction, the proposed members of the board of directors to be appointed by the shareholders from each party, and a list of proposed directors and executives (e.g., the general manager or managing partner);
- A description of the extent and manner in which the foreign investors may exercise control of the enterprise following the transaction, such as through shareholder votes, participation on the board, or other means. The description must include a description of the foreign investors' influence over various areas of the business (e.g., finance, technology), including both onshore and offshore affiliates. Documents relevant to this exercise of control (e.g., shareholders agreement) must be provided.
- For equity M&A transactions, the applicant must provide relevant equity transfer or subscription agreements, shareholders' resolutions of the target domestic enterprise, and related asset evaluation reports;
- For asset M&A transactions, the applicant similarly must provide the relevant resolutions approving the sale of assets, the asset purchase agreement (including list of assets to be purchased and the status thereof), description of the parties to the agreement, and relevant asset evaluation report. [11]

Review and Acceptance of the Application by MOFCOM

Upon filing by the foreign investor(s), MOFCOM will review the materials and determine whether the application is “complete.” MOFCOM may ask for additional information. When it determines the application is complete, MOFCOM will accept it and notify the applicant in writing, thereby instituting the review.[12] If MOFCOM then finds that a transaction falls under the scope of the national security mechanism, MOFCOM will notify the applicant in writing within fifteen business days, and will, within five business days thereafter, forward the application to the Committee for examination.[13]

During these fifteen business days, the applicant may not implement the transaction and the local commercial authority must suspend any general FDI review that it has commenced. If MOFCOM has not otherwise notified the applicant in writing within the fifteen business days after accepting the application, the applicant may proceed to go through the formalities for the pending transaction pursuant to relevant regulations.[14]

Decision of National Security Review Committee

MOFCOM will notify the applicant and the local commercial department of the Committee’s determination. Although the Interim Measures refer only to national security concerns, presumably the procedures apply equally with respect to Committee determinations based on the additional considerations of economic stability and social order. The Interim Measures address the various possible outcomes of the review process.

- (1) If the Committee determines that there is no national security concern, the applicant may complete the general FDI approval process with the competent authorities pursuant to relevant regulations.
- (2) If the Committee determines there are unresolved concerns, the applicant may not go forward without first adjusting the transaction structure, amending the application, and re-applying for the national security review.
- (3) If the review concerns a transaction that has been completed (for example, FDI approval was granted based on an assumption that the transaction did not fall within the scope of the review mechanism) and the Committee determines that the resulting acquisition has had or may have a significant effect on national security, MOFCOM, together with relevant authorities, will terminate the transaction or take other direct action to address the concern, including by transferring relevant equity interests or assets, or by taking other means to remove the national security concern.[15]

Importantly, the Interim Measures contemplate a means of addressing concerns that arise during the review process by the Committee before a final determination. The applicant may file an application to MOFCOM to revise the transaction structure or to withdraw the transaction during the review and MOFCOM shall submit these applications to the Committee within five business days. [16]

Other Matters

The Interim Measures provide a means for MOFCOM to self-initiate a review based on a request by any department or agency of the State Council, any national industry association, any enterprise in the same industry, or enterprises in the upstream or downstream industry. If such transaction falls within the scope of the national security review mechanism (a judgment apparently to be made by MOFCOM), then MOFCOM will, within five working days of receiving the request, submit the proposal to the Committee. MOFCOM will then require the foreign investor to submit an application for the national security review if the Committee determines that a review is necessary.[17]

Where any application for security review is not submitted to the Committee for review or is deemed by the Committee not to affect the national security but subsequently a change in the transaction brings it within the scope of the national security review mechanism, then the parties must halt the transaction and the foreign investor must submit a review application to MOFCOM. [18]

Conclusion

The Interim Measures provide useful procedural guidance relating to the national security review process, building out the framework established by the Notice. As a whole, a picture is taking shape of a new regulatory scheme that purposefully incorporates some flexibility in its administration, both to accommodate interaction among investors and the Committee to address possible national security and socio-economic issues, and to permit the broad exercise of discretion by the Committee to define and to address such issues as it ultimately determines to be appropriate. Nevertheless, such flexibility leaves uncertainty, and the picture is incomplete; there remains a lack of clarity about various procedural issues as well as the scope of covered transactions and the factors that the Committee ultimately will find relevant to its determination whether a transaction might raise national security or socio-economic concerns.

The Interim Measures will only be effective until August 31, 2011. Interested parties should submit comments to MOFCOM by April 10, 2011. Final rules may emerge based on such comments received and the experience obtained in implementing these measures.

Meanwhile, both the Notice and the Interim Measures are now in effect, and the Interim Measures make clear that foreign investors must add the national review process where applicable to the regulatory clearances necessary to complete an investment transaction. Thus, prospective foreign investors now must examine closely potential national security and socio-economic impacts, and develop a plan to address possible concerns in structuring the transaction to ensure a smooth and successful review process.

An English translation of the Interim Measures is available upon request.

[1] Interim Measures of the Ministry of Commerce on Security Review Mechanism for Merger & Acquisition of Domestic Enterprises by Foreign Investors, issued by Ministry of Commerce on March 4, 2011, *available at* http://www.law-lib.com/law/law_view.asp?id=343240.

[2] Guowuyuan Ban'gongting Guanyu Jianli Waiguo Touzizhe Binggou Jingnei Qiye Anquan Shencha Zhidu de Tongzhi [Notice of the General Office of the State Council on Establishing the Security Review Mechanism for Merger with and Acquisition of Domestic Enterprise by Foreign Investors] (the Notice), issued by the General Office of the State Council on Feb. 3, 2011, *available at* http://www.gov.cn/zwggk/2011-02/12/content_1802467.htm. See OMM Client Alert, "China

Establishes Mechanism for National Security Reviews of Foreign Investments,” (February 16, 2010), *available at* <http://www.omm.com/china-establishes-mechanism-for-national-security-reviews-of-foreign-investments-02-15-2011/>.

[3] NDRC Q&A, posted on February 16, 2011, *available at* http://www.sdpc.gov.cn/xwfb/t20110216_395284.htm.

[4] Interim Measures, art. 3.

[5] Interim Measures, art. 2.

[6] Interim Measures, art. 4.

[7] Interim Measures, art. 5.

[8] Interim Measures, art. 1.

[9] *Id.*

[10] Interim Measures, art. 2.

[11] Interim Measures, art. 4.

[12] Interim Measures, art. 5.

[13] *Id.*

[14] *Id.*

[15] Interim Measures, art. 6.

[16] Interim Measures, art. 7.

[17] Interim Measures, art. 8.

[18] Interim Measures, art. 9.