

## China to Scrutinize M&A by National Security

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On 12 February 2011, the Office of the State Council issued a circular to launch a state-level investment review body to check that merger and acquisition deals struck by non-Chinese firms in China do not endanger “national security.” The circular covered the following key areas:

### Review Scope

A review will be conducted on a merger and acquisition (M&A) of a Chinese enterprise by a non-Chinese investor if the non-Chinese investor takes a *de facto* control of the Chinese enterprise and the Chinese enterprise is:

- A military or military-related enterprise, enterprise surrounding a key or sensitive military infrastructure or a unit related with military otherwise.
- A national security-related enterprise regarding an important agricultural product, important energy and resource, important infrastructure, important transportation, key technology, or major equipment manufacturing.

### M&A of a Domestic Chinese Enterprise By a Non-Chinese Investor

The merger and acquisition of a domestic Chinese enterprise by a non-Chinese investor is defined as any one of the following:

- A non-Chinese investor purchases the equity interests of a domestic Chinese enterprise or subscribes to the increased capital of a domestic enterprise.
- A non-Chinese investor purchases the equity interests of a Chinese shareholder of a domestic foreign-invested enterprise (FIE) or subscribes to the increased capital of a domestic FIE.
- A foreign investor sets up an FIE, and uses the FIE to purchase and operate the assets of a domestic enterprise or uses the FIE to purchase the equity interests of a domestic enterprise.
- A foreign investor directly purchases the assets of a domestic enterprise, and sets up an FIE in use of the assets, which then operates on the assets.

### ***De facto Control***

A *de facto* control of a domestic enterprise by a non-Chinese enterprise refers to the non-Chinese enterprise becoming a controlling shareholder or a *de facto* controller of the domestic enterprise via the concerned M&A, which includes:

- A non-Chinese investor, its controlling parent company and/or its controlled subsidiary takes more than 50 percent of the equity interests of the merged or acquired domestic enterprise.
- More than one non-Chinese investors take more than 50 percent of the equity interests of the merged or acquired domestic enterprise.
- A non-Chinese investor(s) has a major influence over the decision of the meeting of the shareholders or the board of directors of the merged or acquired enterprise although the non-Chinese investor(s) acquires less than 50 percent of the equity interests of the merged or acquired domestic enterprise.
- A non-Chinese investor takes over a *de facto* control over business decision-making, finance, human resource or technology of the merged or acquired domestic enterprise.

### **Factors to Consider on National Security**

- Influence of a M&A over national defence (including capacity of manufacturing domestic products, providing domestic services or providing the concerned facilities and equipments for national defence)
- Influence of a M&A over the stable running of China's economy
- Influence of a M&A over basic social life and orders
- Influence of a M&A over research and development of key technology regarding national security

### **Review Mechanism**

- An inter-ministry roundtable conference (Conference) shall be established to conduct a security review.
- Under the leadership of the State Council, the Conference shall be jointly initiated by the National Development Reform Conference (NDRC) and the Ministry of Commerce (MOFCOM) involving the ministry of the industry related with the concerned M&A.
- The Conference shall analyze the influence of a M&A over the national security of China, conduct research on the major national security issues and resolve the issues, review the M&A and make a decision.

## Review Process

- The concerned non-Chinese investor shall make an application with MOFCOM, and MOFCOM shall submit the application for the review of the Conference within five working days if the M&A falls within the review scope.
- An entity other than the concerned non-Chinese investor may apply with MOFCOM for a national security review as well, which includes a governmental agency under the State Council, national industry association, competing enterprise, or upstream or downstream enterprise. A review will be conducted if the Conference deems it necessary to conduct a national security review.
- The Conference shall make a general review first. If the M&A does not pass a general review, the Conference shall make a special review.
- The parties to the M&A under the review shall co-operate with the reviewing work of the Conference by submitting materials and information that are necessary for the review, and answer the inquiry of the Conference.
- A general review shall be conducted in writing. The Conference shall seek the opinions of the concerned governmental agency in writing within five working days from the day when the Conference receives the application of MOFCOM for a national security review. The agency shall produce its opinions in writing within 20 working days from the day it receives the written inquiry from the Conference.
- If the concerned agency deems that a M&A does not have any impact on national security, there will be no special review. The Conference shall reach a written opinion and send the opinion to MOFCOM in writing within five working days from the day when it receives all of the feedback in writing.
- If an agency deems that a M&A has an impact on national security, the Conference shall launch a special review within five working days from the day when the Conference receives the written opinion of the agency. The Conference shall make a decision if there is a consensus on the evaluation of national security. If there is a major discrepancy among the members, the Conference shall report the review to the State Council for its decision.
- The Conference shall complete a special review or report the review to the State Council for its decision within 60 working days from the day when the Conference commenced the special review.
- An applicant for a review may apply to alter or withdraw from the concerned M&A deal.
- The Conference shall ask MOFCOM and the concerned agency to terminate an M&A deal if the deal has impacted or may cause an impact on national security; or divest the concerned equity interests or assets or adopt some other effective measures to offset the impact on national security.
- The circular shall take effect on or around March 14, 2011 (*i.e.*, 30 days from the day when the circular was issued).

### **Regional Considerations**

The circular shall apply to investors from Hong Kong, Taiwan and Macao.

### **Potential Implications**

Currently, the circular does not provide information on what the penalties are for not abiding by the circular.

MWE China Law Offices will keep abreast of the development regarding the new rules on the national security review, and provide analysis in a timely manner.

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