

National Security Review System for Foreign M&A in China

By editorial staff writer

National security review system for foreign mergers and acquisitions (M&A) was first introduced in People's Republic of China ("PRC") in 2007. Article 31 of *Anti-Monopoly Law of the PRC* provides :

Where a foreign investor participates in the concentration of business operators by merging or acquiring a domestic enterprise or by any other means and the national security is involved, besides the examination on the concentration of business operators according to this Law, the examination on the national security shall also be conducted according to the relevant provisions of the State.

This article is just a basic principle with no detailed implementation rules. Besides, it is unclear what "the relevant provisions" refer to.

On 3rd February 2011, the general office of State Council promulgated *the Establishment of the Security Review system for mergers and Acquisitions of Domestic Enterprises by Foreign Investors* ("Notice"). On 25th August of the same year, *the Ministry of Commerce on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* ("Regulation") was also released. This Regulation provides the detailed rules for implementation. The *Notice* and *Regulation* provide the framework for national security review system for foreign M&A .

A foreign investor considering an investment in the PRC by means of M & A has to deal with the issue of a national security review, in addition to considering whether the industry or field is prohibited in accordance with the *Catalogue for the Guidance of Foreign Investment Industries (Amended in 2013)* and whether he has to file notification regarding concentration of undertakings under *Anti-Monopoly Law*.

Review Body of Security Review of M&A

According to article 3 of the *Notice*, the competent authority of security review is a system of joint ministerial meeting, which is led by the State Council and organized by the National Development and Reform Commission and the Ministry of Commerce, and jointly with other relevant departments. It carries out the security review of M&A by foreign investors in the certain industries and fields.

The Scope of Review of M&A

Article 1(1) provides that:

The security review of mergers and acquisitions includes: foreign investors' mergers and acquisitions of domestic military industrial enterprises and supportive military industrial enterprises, enterprises surrounding major and sensitive military facilities, and other entities relating to the national defense

security; foreign investors' mergers and acquisitions of domestic enterprises relating to important agricultural products, important energies and resources, important infrastructural facilities, important transportation services, key technologies, manufacturing of major equipment, etc., which relate to the national security, and whose actual controlling power may be obtained by foreign investors.

However, the provision does not clarify the meaning of the words “major”, “sensitive”, and “important”, leaving the judges with too much discretion.

Two criteria are used to judge whether the M&A falls within the scope of M&A security review. One is equity ratio criterion and the other is de facto control criterion. The former means that the total shares held by a foreign investor, its parent holding company or multiple foreign investors after M&A account for not less than 50%. The latter means that the total shares held by a foreign investor after merger or acquisition account for less than 50%, but the voting power it holds is enough to have a material impact on the resolution of the shareholders' meeting, the general assembly of shareholders, or the board of directors.

Article 9 of the *Regulation* explicitly provides:

Whether a merger or acquisition of a domestic enterprise by a foreign investor falls within the scope of merger and acquisition security review shall be determined from the substance and actual impact of the transaction. No foreign investor shall substantially evade the merger and acquisition security review in any form, including but not limited to holding shares on behalf of others, trust, multi-level reinvestment, leasing, loans, agreement-based control and overseas transactions.

Contents of Security Review of Mergers and Acquisitions

Article 2 of the *Notice* provides that the contents of security review are to decide on the implications of a M&A transaction on national defence security, national economy, basic social life and the capacity of research and development of key technologies involving national security.

Process of Security Review of Mergers and Acquisitions

Pre-review Consultation

Article 4 of *Regulation* states that:

An applicant may, before filing a formal application for merger and acquisition security review with the Ministry of Commerce, submit a consultation application to the Ministry of Commerce regarding the procedural issues related to its merger or acquisition of a domestic enterprise to discuss the relevant situations in advance. Such advance consultation is not a necessary procedure for filing a formal application, and the consultation results do not have any binding force or

legal effect and do not serve as a basis for filing a formal application.

Trigger Security Review

Article 4 (1) and (2) provide the applicants' scope of Security Review of M&A. A foreign investor shall file an application with the Ministry of Commerce, which is mandatory. The relevant department of the State Council, a national industrial association, an enterprise of the same profession, or an upstream or downstream enterprise may put forward suggestions on the security review of the merger or acquisition via the Ministry of Commerce. The final decision will be made by members of the joint ministerial meeting.

Concrete Security Review Process

There are two kinds of review processes, general review and special review. Members of the joint ministerial meeting shall firstly conduct a general security review of the M&A in the form of soliciting opinions in writing. The general review period will be processed over 30 days. One-vote veto system is adopted at this stage, which means if any department holds that the merger or acquisition transaction may affect national security, the transaction will fail to pass the general review. A special review will be triggered and required to be completed within 60 workdays. If there is any major dissent, the State Council will have the final saying.

The following is the flow chart of national security review:

