

E-ALERT | China Practice

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CHINA ISSUES FINAL IMPLEMENTATION PROVISIONS FOR NATIONAL SECURITY REVIEW RULES

On August 25, 2011, China's Ministry of Commerce ("MOFCOM") issued final provisions on the security review system for mergers and acquisitions by foreign investors in China. The Provisions of the Ministry of Commerce on Implementing a Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors ("Final Provisions") become effective September 1, 2011. The Final Provisions follow two earlier pronouncements on this topic: Interim Provisions of the Ministry of Commerce on Matters Relating to the Implementation of the System of Security Review of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors ("Interim Provisions") that were issued on March 4, 2011; and the original notice from China's State Council, published on February 12, 2011, establishing a new process for reviewing the national security implications of foreign investments in Chinese companies. A translation of the Final Provisions is provided [here](#), and our summaries of the earlier pronouncements on this topic are available [here](#) and [here](#).

While, as explained below, the Final Provisions clarify certain aspects of China's security review system for mergers and acquisitions, fundamental questions remain, including:

- The ultimate timeframe for the national security review process, particularly for transactions that are submitted to the State Council for a final decision;
- The extent and circumstances under which MOFCOM may apply these provisions retrospectively to cover transactions that have already closed; and
- The definition or other defining criteria of "national security" or, for that matter, the criteria by which MOFCOM will determine whether a transaction merits a review in the first instance. (Article 9 of the Final Provisions includes new language on this front, but it provides little clarity or guidance to transaction parties. Specifically, Article 9 states that in assessing whether a transaction should be subject to a security review, the relevant authorities will consider "essential content and actual impact of the transaction" (从交易的实质内容和实际影响来判断).)

CHANGES FROM THE INTERIM PROVISIONS TO THE FINAL PROVISIONS

Notwithstanding the overarching similarities with the Interim Provisions and the important ambiguities that remain in the Final Provisions, MOFCOM has included certain clarifications in the Final Provisions, as follows:

Explicit Warning Against Circumvention Via Alternate Corporate Structures

Article 9 of the Final Provisions, a clause not present in the Interim Provisions, prohibits foreign investors from circumventing the national security review via "any means" such as "commissioned shareholdings, trusts, multi-level investments, leases, loans, contractual control, [and] overseas transactions." This new clause appears to target corporate structures that have been used in China

but are not explicitly permitted or prohibited under Chinese regulations. In certain sectors where China has stringent regulations restricting foreign participation, such as online services and telecommunications, non-Chinese companies have used these structures, including variable interest entities, to do business in China. Such corporate structures may be more closely scrutinized in future transactions, and it is unclear what impact the security review system will have on such corporate structures that are already in existence.

Confidentiality Provision

The Final Provisions include language ensuring confidentiality by requiring MOFCOM and any other person or entity involved in a national security review to maintain confidentiality with regard to state secrets, trade secrets, and any other information that should be kept confidential. The Interim Provisions did not include a confidentiality requirement. This addition, found at Article 11 of the Final Provisions, appears to have been inserted in response to concerns voiced by the business community over disclosure of proprietary information submitted during the review process.

Clarification of Pre-Filing Consultation with MOFCOM

The Final Provisions (Article 4) clarify that a request for consultation with MOFCOM prior to filing is not a prerequisite for filing an application, and furthermore, the consultation does not have a legal and binding effect and shall not be treated as the basis for submitting a formal application.

Termination of Transaction Impacting National Security

The Final Provisions (Article 7) clarify that a transaction that may have an impact on national security and has not yet been consummated should be terminated by the Applicant.

Participation by Related Parties

Article 3 of the Final Provisions continues to allow domestic parties, including Chinese national industry associations, enterprises in the same industry as the transaction parties, or “upstream or downstream” enterprises, to propose to MOFCOM that a security review be conducted. (This provision previously appeared in Article VIII of the Interim Provisions.) However, the Final Provisions also add that MOFCOM may request “interested parties” to “submit relevant explanations” (商务部可要求利益相关方提交有关说明) — in other words, MOFCOM may ask a company to provide information on a merger or acquisition. This appears to be a clarifying point to permit but not require MOFCOM to seek advice from external stakeholders regarding the impact of the transaction on national security. The prospect of domestic competitors participating in MOFCOM’s review process is particularly relevant — and raises concerns — as Articles 7 and 10 of the Final Provisions retain language from the Interim Provisions that allows MOFCOM, based on the review opinion of the Ministerial Panel, to unwind a transaction after it has closed if it is determined to have a potentially serious impact on national security.

Supplemental Information

The Final Provisions (Article 8) clarify that the Ministerial Panel that reviews the transaction may require the parties to supplement the application materials after the transaction has been submitted to the Ministerial Panel for review.

FUTURE DEVELOPMENTS

We understand that MOFCOM has yet to issue an approval for a transaction under the security review system. The Chinese [press](#) has reported that MOFCOM is circulating a document internally that identifies 60 sectors that will be subject to national security review. This document has not been made public, but according to reports, medical equipment and machinery are included among the sectors identified.

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We will continue to closely monitor future developments and are well-positioned to advise clients regarding the application of these new rules.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

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