
TSSeveral Salient Points of the National Security Review Rules for Inbound M & A Transactions

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The General Office of the State Council published the “Notice on Establishment of Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors” (the “Notice”) on 3 February 2011, which will take effect from 5 March 2011. The Notice establishes a preliminary regime for security review of mergers and acquisitions of domestic enterprises by foreign investors, and the points that are worthy noting include:

Q1: Which categories of M & A transactions are subject to security review?

Pursuant to Article 1, Paragraph (1) of the Notice, acquisitions of the following sectors by foreign investors are subject to security review: military enterprises and enterprises ancillary to them, enterprises adjacent to key or sensitive military facilities, and other entities relating to national defense security; important agricultural products, vital energy and resources, essential infrastructure, crucial transportation services, key technologies, major equipment manufacturing, etc., and foreign investors may acquire de facto control over such enterprises.

Q2: What does “de facto control” mean?

Under Article 1, Paragraph (3) of the Notice, “de facto control” refers to the following circumstances:

1. a foreign investor as well as its parent company and subsidiaries in aggregate hold over 50% of the total shares of a domestic enterprise after acquisition;
2. several foreign investors in aggregate hold more than 50% of the total shares of a domestic enterprise after acquisition;
3. a foreign investor holds less than 50% of the total shares of a domestic enterprise after acquisition, but its voting right could have significant influence on the resolutions of the shareholders’ meeting and the resolutions of the board of directors;
4. other circumstances which may lead to a foreign investor’s de facto control of a domestic enterprise, including its operational decisions, financial matters, personnel, technologies, etc.

Q3: What procedures are involved?

The review process starts with a “general review”. The Inter-Ministerial Committee will solicit comments from other governmental departments. If all the relevant governmental departments hold the view that the M & A transaction will not affect national security, the security review process will come to an end. Generally speaking, the “general review” process will last for 35 working days at most.

If some or all of the relevant governmental departments considers that the M & A transaction is likely to affect national security, the Inter-Ministerial Committee must initiate a “special review” and conduct a security evaluation. If reaching consensus, the Inter-Ministerial Committee shall issue its review opinion; in the event of major disagreements, the Inter-Ministerial Committee shall report to the State Council for decision. The Inter-Ministerial Committee shall complete the “special review” process within 60 working days from the date of initiation, or submit to the State Council for decision.

During the review process, the applicant may apply to the Ministry of Commerce to amend the transaction plan or cancel the transaction.