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## China's National Security Review of Mergers and Acquisitions: Permanent Implementing Regulations Issued

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China's Ministry of Commerce (MOFCOM) on August 25 issued the Regulations on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the "Regulations") (see PDF Version above). The Regulations, which took effect on September 1, replace the Temporary Regulations on which we reported earlier this year in a Client Alert entitled, "[China's Temporary 'CFIUS' Implementing Regulations](#)."

The Regulations in some respects provide less detail on the national security review filing procedure. While the documentation requirements for a national security review notification under Article 5 are carried over from the Temporary Regulations, the earlier details on the duration of a national security review have been deleted. In other words, a national security review may have an open-ended duration. This is particularly important given that the review is suspensory in nature, i.e., the transaction may not be concluded until a required review is completed, and also may be unwound if a transaction subject to review is not notified.

The Regulations provide more clarity on the issue of indirect control. An M&A transaction that otherwise falls within the scope of review under

Article 9 will be subject thereto even if foreign control is exercised indirectly through such means as nominee shareholders, trusts, multi-level reinvestments, leases, loans, control by agreement or offshore transactions. Control by agreement refers to contractual arrangements through so-called variable interest entities ("VIEs") in which domestic agents obtain licenses on behalf of a foreign party in industries where direct foreign investment is otherwise prohibited or restricted, such as telecommunications and media. It is conceivable that the disclosure of indirect foreign control in the course of a national security review could then be invoked by the relevant regulatory agency to bar an M&A transaction that would not itself be determined to materially impact China's national security, e.g., a foreign company's indirect acquisition of control of a Chinese lifestyle or sports magazine publisher. Reports of a broad internal list of industries subject to national security review may make this possibility particularly likely.

Article 3 separately invites national-level industry or trade associations, competitors, and upstream and downstream enterprises to request a national security review of a proposed transaction. This provision, which has counterparts in anti-dumping and anti-monopoly regulations, would seem to be misplaced in a national security review where the government, rather than private parties, would be most aware of threats to national security. It effectively gives domestic parties another weapon to inhibit expansion into China by foreign companies through mergers and acquisitions.

A fundamental shortcoming of the Regulations is the lack of clarification with respect to the scope of industrial sectors subject to national security review. The Notice Concerning Establishment of the Security Review System on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (State Council, February 2011, the "Notice") (see Client Alert

entitled "[China Adopts Its Own 'CFIUS' Regulations](#)") only provides in general terms that the scope of review includes military and national defense-related transactions; transactions involving important agricultural products, energy and resources, infrastructure facilities, and transportation services; core technologies; and important equipment manufacturing enterprises. However, we understand that MOFCOM has subsequently circulated an internal document listing 50 to 60 specific industries subject to security review. This document is currently being implemented by commerce bureaus and commissions at the provincial and municipal levels, even though it has not been formally promulgated. The list of industries in the internal document appears to be overly broad as it includes industries without apparent nexus to national security, such as medical device companies. Unless MOFCOM provides specific guidance in this regard through formally promulgated rules and regulations, we would expect that the security review will be widely applied to raise additional regulatory hurdles or even block many M&A transactions by foreign investors involving China.

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