MOFCOM Issues New Rules on National Security Review

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The New SR Implementation Rules retain most of the provisions in the Temporary Rules, but also contain following major changes:

1. The scope of national security review of merger and acquisition ("M&A") transactions has been explicitly extended to include acquisition of domestic enterprises by a foreign invested enterprise ("FIE").

Under the Temporary Rules, the local offices of MOFCOM can initiate national security review only when they review M&A transactions submitted under the Regulations on Acquisition of Domestic Enterprises by Foreign Investors (《关于外国投资者并购境内企业的规定》) and the Several Provisions on Changes of Investors’ Equity Interests in Foreign Invested Enterprises (《外商投资企业投资者股权变更的若干规定》). The New SR Implementation Rules added the Interim Regulations on Domestic Investment by Foreign-Invested Enterprises (《关于外商投资企业境内投资的暂行规定》) as an additional basis for initiating security review of M&A transactions by the local offices of MOFCOM. This means that beginning on September 1, 2011, any acquisition of a domestic enterprise by an FIE is theoretically subject to national security review.

2. Foreign investors are prohibited from evading national security review of M&A transactions by structuring around the requirement, such as holding equity via trusts, using multiple investment vehicles, moving the acquisition offshore, or by using leasing, lending and contractual arrangements.

3. Subsequent changes to an M&A transaction, including changes to the transactional documents, changes in business activities and/or changes of offshore ultimate
controlling entity, may trigger national security review if a subsequent change causes the transaction to fall within the scope of national security review, regardless of whether such transaction was submitted to the joint committee (which was established under the NSR Circular as the national security review enforcement authority) for review or was reviewed and approved by the joint committee in the first place. It is unclear whether a security review might retroactively unwind a completed transaction if any subsequent change to such transaction triggers the national security review.

4. According to the Temporary Rules, an applicant may apply to MOFCOM to have a pre-filing consultation with MOFCOM with respect to procedural issues concerning the applicant’s acquisition of domestic enterprises. The New SR Implementation Rules clarify that the pre-filing consultation is not a compulsory process and the results thereof will not be legally binding and cannot be relied upon as the basis for a formal filing.

5. The New SR Implementation Rules also provide for confidentiality obligations on the relevant personnel and divisions of MOFCOM as well as their local offices during national security review work with regard to state secrets, trade secrets and other confidential information.

We believe that most open issues under the NSR Circular and the Temporary Rules remain unanswered in the New SR Implementation Rules. For instance, the specific types of industries for national security review have yet to be clarified, and at what stage and with what type of submissions an applicant can apply for pre-filing consultation is still unclear. With the New SR Implementation Rules that became effective on September 1, 2011, China is set to tighten up its national security review of M&A transactions, which foreign investors and M&A practitioners should not overlook.

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2. It was promulgated by the Ministry of Foreign Trade and Economic Cooperation (the predecessor of MOFCOM) and the State Administration for Industry and Commerce on July 25, 2000, and mainly regulates establishment of a new enterprise in China or acquisition of a domestic enterprise by an FIE.

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