



HAN KUN LAW OFFICES

Legal Commentary



CHINA PRACTICE • GLOBAL VISION

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Merger & Acquisition by Foreign Investor

Notice of the General Office of the State Council regarding the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors

On February 3, 2011, the Notice of the General Office of the State Council regarding the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the “Notice”) was issued by the General Office of the State Council. The Notice, effective 30 days thereafter, requires for a national security review by a ministerial panel (the “Ministerial Panel”) for any merger or acquisition of a domestic enterprise by a foreign investor (an “M&A”) that may have potential impact on China’s national security. If an M&A transaction has exerted, or is likely to exert, significant impact on China’s national security, the Ministerial Panel would order relevant departments to take measures to eliminate the influence of the transaction on the national security, including termination of the transaction and transfer of relevant equity or assets.

M&A Transactions Subject to National Security Review

- (1) Mergers and acquisitions of military industrial enterprises or military related supporting enterprises, enterprises located near key and sensitive military facilities, and other entities in relation to national defense security;
- (2) Mergers and acquisitions of entities involved in industries such as major agricultural products, energy and resources, infrastructure, transportation, technology and assembly manufacturing of national security importance, whereby the foreign investors may acquire the actual controlling right thereof.

It should be noted that, in respect of an M&A, the Notice sets forth a broader scope than that specified in the Decree No.10 (i.e. the Regulations of the Ministry of Commerce regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors). ‘Foreign investors’

acquisition of Chinese shareholders' equity interest in foreign invested enterprises" is covered under the Notice, but not specifically under the Decree 10.

M&A transactions involving domestic financial institutions will be separately addressed by regulations to be formulated.

No clarification is made under the Notice regarding "major agricultural products, energy and resources, infrastructure, transportation, technology and assembly manufacturing". By common sense, grain and oil, sugar, cotton, water, electricity, petroleum, natural gas, highway transportation, telecommunication, power grid and irrigation would likely be included.

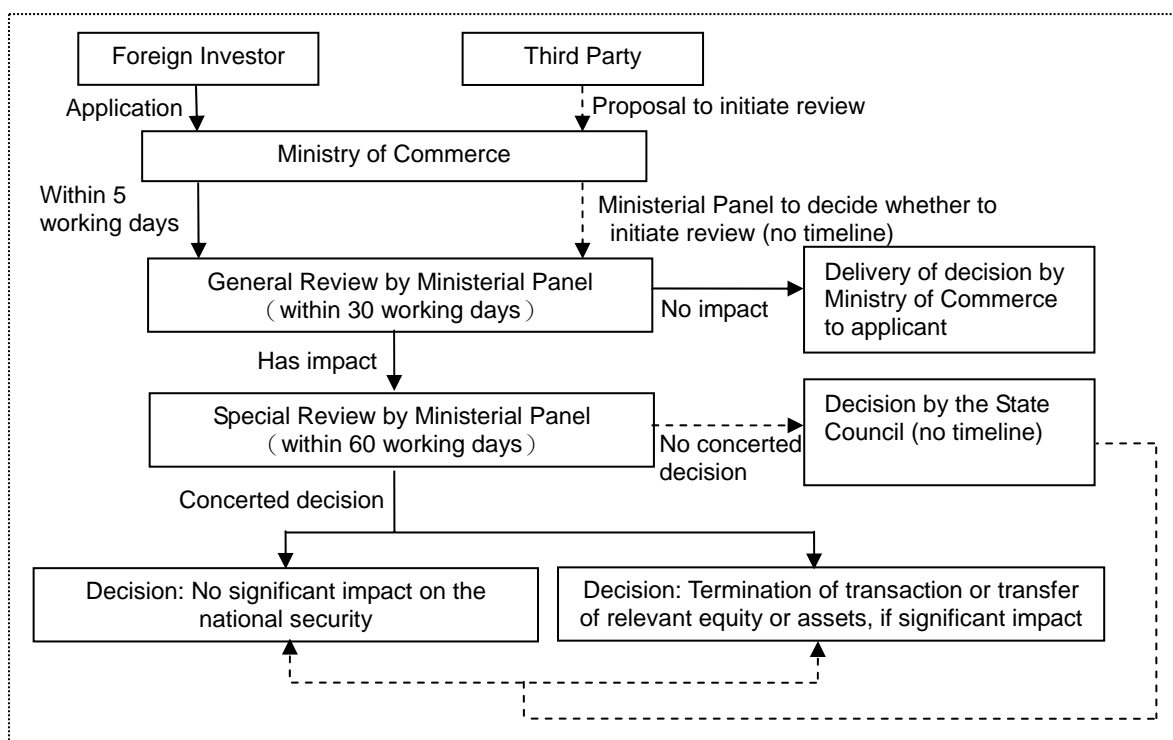
Under the Notice, "a foreign investor's acquisition of actual controlling right" is interpreted as follows: (a) a foreign investor, or its parent company or subsidiary holds a 50% stake or more in the newly-established foreign-invested company after the M&A; (b) more than one foreign investor holds an aggregate of 50% stake or more in the newly-established foreign-invested company after the M&A; (c) a foreign investor holds less than 50% stake in the newly-established foreign-invested company after the M&A, but the voting rights actually enjoyed by the foreign investor is sufficient to exert major impact on the resolution of the shareholders' meeting, general meeting of shareholders, or the board of directors; or (d) other circumstances that may result in the actual controlling right in business decision-making, financial affairs, human resources, technologies, etc. being transitioned to the foreign investor.

Procedures of National Security Review

The Ministerial Panel is responsible for the review work. Under the guidance of the State Council, the Ministry Panel is consisted of the National Development and Reform Commission, the Ministry of Commerce(or "the MOC"), and other concerned departments based on the specific industries or fields of the transaction. Not only the foreign investor involved in the M&A may apply with the Ministry of Commerce for a national security review on the transaction, but also the third parties (such as the target company, relevant departments of the State Council, national industrial associations, enterprises in the same trade, and other enterprises on the upstream and downstream sides) may make proposal to the Ministry of Commerce for the Ministerial Panel to decide whether to initiate a review. There are uncertainties with respect to reviews triggered by a third-party's proposal, especially whether the Ministerial Panel may decide to initiate a review solely based on the documents provided by the third party or take any initiatives to verify the details of the transaction before the review.

The two stages of the review - general review and special review – are illustrated in the chart below based on our understanding of the Notice. In the general review stage, which may take

up to 30 working days (based on the literal interpretation of the provisions of the Notice), each participant of the Ministerial Panel will review the case and submit written opinions to the Ministerial Panel. If any participant believes that the transaction may impact the national security, the Ministerial Panel will initiate a special review. The special review may take up to 60 working days. If no concerted decisions are made by the participants of the Ministerial Panel, the case should be submitted to the State Council for final decision. It remains unclear, however, if the State Council will have to make its decision within any specific timeline. Decisions made in the reviews will be delivered by the Ministry of Commerce to the applicants. In the course of the reviews, the foreign investor may apply to the Ministry of Commerce for any modification to or cancellation of the transaction.



Summary

While the Notice protects China's national security interest, it will increase foreign investors' costs in acquiring Chinese domestic enterprises in certain industries. The Notice only provides for an outline of the scope and procedures of the national security review, and we are yet waiting for implementation details. Whether the review system may be made use of by bad-faith competitors will also depend on the practice, especially in relation to the system for reviews triggered by third party proposals. Besides, it is worthwhile pointing out that the Notice does not target greenfield foreign-investment in the industries relating to national security.

If you have any questions regarding the foregoing, please feel free to contact us. Thank you!

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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