

China Corporate Bulletin

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- China Introduces National Security Review Procedures for Mergers and Acquisitions



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Welcome to White & Case's monthly China Corporate Bulletin. This bulletin covers recent corporate regulatory developments and news in the PRC and Hong Kong, ensuring you stay up to date on the latest market issues.

China Introduces National Security Review Procedures for Mergers and Acquisitions

On February 3, 2011, the General Office of the State Council issued the Notice of the General Office of the State Council on Launching Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (国务院办公厅关于建立外国投资者并购境内企业安全审查制度的通知) (hereinafter referred to as "**Circular 6**"), which will come into effect on March 5, 2011.

Circular 6 requires security reviews on mergers and acquisitions conducted by foreign investors (hereinafter referred to as "**M&A**") relevant to the "national security" of China. Circular 6 also provides specific procedures, additional regulatory hurdles and possible barriers to approvals for foreign investors and raises concerns about the ability of foreign companies to pursue M&A growth strategies in China.

The key contents of Circular 6 are summarized as follows:

■ Review Scope

A security review will be conducted on an M&A transaction involving a domestic Chinese enterprise by a foreign investor if the foreign investor takes actual control of a domestic Chinese enterprise and the domestic Chinese enterprise is engaged in the following industries:

- > A military or military-related enterprise, or an enterprise surrounding a key or sensitive military infrastructure.
- > A national security-related enterprise engaged in the business of important agricultural products, key energy or resources, key infrastructure, key transportation, key technology or major equipment manufacturing. (However, Circular 6 does not specify under which circumstances companies in these industries shall be deemed as "key".)

■ M&A of a Domestic Chinese Enterprise by a Foreign Investor

Circular 6 specifies that the following types of M&A transactions involving an existing domestic Chinese enterprise by a foreign investor are subject to the security review procedure:

- > A foreign investor purchases equity interests of a domestic Chinese enterprise or subscribes to increased capital of a domestic enterprise.
- > A foreign investor purchases equity interests of a Chinese shareholder of a domestic foreign-invested enterprise (an “FIE”) or subscribes to the increased capital of a FIE.
- > A foreign investor sets up an FIE, and uses the FIE to purchase and operate the assets of a domestic enterprise or uses the FIE to purchase equity interests of a domestic enterprise.
- > A foreign investor directly purchases the assets of a domestic enterprise, and sets up an FIE in use of the assets, which then operates on the assets.

Please note that the scope of M&A transactions stipulated under Circular 6 is broader than that regulated under the *Rules on Merger and Acquisition of Domestic Enterprises by Foreign Investors* (the “M&A Rules”) promulgated in 2006 and most recently amended in 2009. The M&A Rules govern the foreign acquisition of equity interest or assets of domestic companies only, while Circular 6 brought transactions with existing FIEs into its purview.

■ Actual Control

“Actual control” of a domestic enterprise by a foreign enterprise refers to the foreign enterprise becoming a controlling shareholder or an actual controller of the domestic enterprise via an M&A transaction. Circular 6 specifies the following situations for recognizing the existence of an “actual control”:

- > A foreign investor, its controlling parent company and/or its controlled subsidiary individually or jointly take more than 50 percent of the equity interests of the merged or acquired domestic enterprise.
- > One or more foreign investors take more than 50 percent of the equity interests of the merged or acquired domestic enterprise.
- > A foreign investor has a major influence over the decision of the meeting of the shareholders or the board of directors of the merged or acquired enterprise although the foreign investor acquires less than 50 percent of the equity interests of the merged or acquired domestic enterprise.

- > A foreign investor takes actual control over business decision-making, finance, human resource or technology of the merged or acquired domestic enterprise.

■ Contents of the Security Review

According to Circular 6, a national security review will focus on the following aspects of a proposed M&A transaction:

- > Influence of the M&A transaction over national defense (including capacity of manufacturing domestic products, providing domestic services or providing facilities and equipment for national defense);
- > Influence of the M&A transaction over the stability of China’s economy;
- > Influence of the M&A transaction over basic social life and order;
- > Influence of the M&A transaction over research and development of key technology relating to national security.

■ Review Mechanism

Circular 6 provides that an inter-ministry roundtable conference (the “Conference”) shall be established to conduct a security review. Under the leadership of the State Council, the Conference shall be jointly initiated by the National Development Reform Commission (“NDRC”) and the Ministry of Commerce (“MOFCOM”) involving the ministry of the industry relating to the subject transaction. The Conference will analyze the influence of the transaction upon national security, conduct research on the major national security issues and make a decision.

■ Review Process

The review process includes the following steps:

- > The concerned foreign investor shall make an application with MOFCOM, and MOFCOM shall submit the application for the review of the Conference within 5 working days if the M&A transaction falls within the review scope.
- > Entities other than the concerned foreign investor may also apply to MOFCOM for a national security review as well. Such entities may include governmental agencies under the State Council, national-level industry associations, competing enterprises, or upstream or downstream enterprises. A review will be conducted if the Conference deems it necessary to conduct a national security review.

- > The Conference shall make a general review first. If the proposed M&A transaction does not pass a general review, the Conference shall make a special review.
- > The parties to a proposed M&A transaction under review shall co-operate with the reviewing work of the Conference by submitting materials and information that are necessary for the review and respond to any inquiries from the Conference.
- > A general review shall be conducted in writing. The Conference shall seek the opinions of the concerned governmental agency in writing within five working days from the day when the Conference receives the application from MOFCOM for a national security review. The agency shall produce its opinions in writing within 20 working days from the day it receives the written inquiry from the Conference.
- > If the concerned agency deems that a proposed M&A transaction does not have any impact on national security, there will be no special review. The Conference shall issue a written opinion and send it to MOFCOM within five working days from the day that it receives all of the feedback in writing.
- > If an agency deems that a proposed M&A transaction does have an impact on national security, the Conference shall launch a special review within five working days from the day that the Conference receives the written opinion of the agency. The Conference shall make a decision if there is a consensus on the evaluation of national security. If there is a major discrepancy among the members, the Conference shall refer the review to the State Council for its decision.
- > The Conference shall complete a special review or refer the review to the State Council for its decision within 60 working days from the day that the Conference commenced the special review.
- > An applicant for a review may apply to alter the transaction details of the proposed M&A transaction, or to withdraw the proposed M&A transaction.
- > The Conference shall ask MOFCOM and the relevant agency to terminate a proposed M&A transaction if the transaction has impacted or may cause an impact on national security; or divest the concerned equity interests or assets or adopt some other effective measures to offset the impact on national security.

According to media reports, MOFCOM is in the process of drafting the implementation rules of Circular 6

For more information on Circular 6, please visit the following Chinese language link:

http://www.gov.cn/zwgk/2011-02/12/content_1802467.htm

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Our market leading corporate practices have had the pleasure of receiving industry accolades including:

- Top 10 Global Firm—*American Lawyer* 2009
- Won Five Firm of the Year Awards—*Asian Counsel* 2009
- Tier One in Global Corporate/M&A Practice—*Chambers Global*, 2008
- One of the Top Ten Law Firms for Global M&A 2007—*Thomson Financial/Bloomberg*
- Business Services sector M&A law firm of the year 2007—*Financial Times and Mergermarket M&A Awards*

Our Firm

White & Case is a leading global law firm with lawyers in 37 offices across 25 countries. We advise on virtually every area of law that affects cross-border business and our knowledge, like our clients' interests, transcends geographic boundaries. Our lawyers are an integral, often long-established part of the business community, giving clients access to local, English and US law capabilities plus a unique appreciation of the political, economic and geographic environments in which they operate. At the same time, working between offices and cross-jurisdiction is second nature and we have the experience, infrastructure and processes in place to make it happen effortlessly.

We work with some of the world's most well-established and most respected companies—including two thirds of the *Global Fortune 100* and half of the *Fortune 500*—as well as start-up visionaries, governments and state-owned entities. Some of our independent accolades include:

- "White & Case can handle any issue with experienced lawyers and a great global network—great depth and high quality around the world."—*Chambers Global* 2010
- Top 10 US Firm—*American Lawyer* 2010
- Top International Arbitration Firm—*Global Arbitration Review* 2009
- Corporate/M&A Team of the Quarter (Q3)—*Financial News* 2009
- Top Tier in Global Project Finance—*Infrastructure Journal* 2010
- Winner of the Legal Innovation for Financial Services Award—*Financial Times* 2009