

CLIENT ALERT

China Issues Rules Governing National Security Reviews of Foreign Investment

Dec.23.2020

On December 19, 2020, China's National Development and Reform Commission ("NDRC") and Ministry of Commerce ("MOFCOM") released anticipated "Measures for the Security Review of Foreign Investments" (the "Measures"). These Measures, which implement China's Foreign Investment Law that went into effect on January 1, 2020, and established the country's new foreign investment regulatory framework, are effective on January 18, 2021.

For purposes of the Measures, "foreign investment" refers to the investment activities carried out by foreign investors directly or indirectly within China, including the following circumstances:

- if foreign investors invest, solely or jointly with other investors, in new projects or companies in China;
- if foreign investors acquire equity or assets of domestic companies through mergers and acquisitions; or
- if foreign investors make investments in China in any other form.

Given the potential breadth of the third category and the number of sectors deemed important to national security, these Measures could have far-reaching effects on investments and transactions involving companies in China, depending on how "investment" is interpreted. The Measures also make clear that transactions involving investors from Hong Kong, Taiwan, and Macau are subject to national security reviews.

Notably, Article 22 of the Measures states that China's securities regulatory authority, in conjunction with a newly-established office in the NDRC that will conduct the national security reviews (the "Security Review Office"), will promulgate separate measures governing foreign investors' purchase of shares of a China-owned company through stock exchanges where that purchase may affect China's national security.

Targeted Industries

The Measures direct parties to a transaction to notify the Security Review Office of investments in certain industries before the investments are made. Failure to do so may result in an order to file a declaration within a certain time period and potentially an order to divest. Accordingly, investors should consider whether their pending transactions are subject to the national security reviews and, if so, consider suspending the close of the transaction pending review. Other government agencies, companies, and organizations can refer investments or transactions to the Security Review Office for consideration (for example, following an antitrust filing), signaling that the scope of the national security reviews may be broader than the industries noted below. The industries explicitly mentioned in the Measures include the following:

- investments in the military and military industrial industries and other fields related to the security of the China's national defense, and in areas near military facilities and military industry facilities; and

- investments in certain agricultural products, energy and resources, equipment manufacturing, infrastructure, transport services, cultural products and services, information technology and Internet products and services, financial services, key technologies and other fields relating to national security, in which the foreign acquirer obtains a controlling stake in the PRC business.

A “controlling stake” occurs in the following circumstances:

- if the foreign investor holds more than 50% of the equity of an enterprise;
- if the foreign investor holds less than 50% of the equity of an enterprise, but the voting rights held by it can have a significant impact on the resolutions of the board of directors, the board of shareholders, or the general meeting of shareholders; or
- other circumstances in which the foreign investor may have a significant impact on the company’s business decision-making, human resources, finance, and technology.

Established Timelines: Suspensory Review

National security reviews pursuant to the new measures follow a timeline similar to that of the United States Committee on Foreign Investment in the United States (“CFIUS”) and include three stages of review that can culminate in clearance of the transaction, mitigation of national security concerns, or a prohibition of the transaction. The Measures also include a provision for monitoring and enforcement of any mitigation agreement that the parties enter into with the Security Review Office.

- The Security Review Office (SRO) will make a determination within fifteen (15) days after receipt of the parties’ materials as to whether a national security review is required. Parties are notified in writing of this decision.
- If a national security review is required, the SRO has thirty (30) days to complete the initial general review. Upon the conclusion of that review, the SRO may approve the transaction, or initiate a second review of the transaction. Parties are notified in writing of this decision.
- The second stage of review will be completed within sixty (60) days, though the deadline for completion of the review may be extended at the discretion of the SRO (it is unclear under what circumstances the reviews may be extended). Upon the conclusion of the second stage of the review, the SRO may then condition clearance of the transaction on certain mitigation terms, prohibit the transaction, or approve the transaction.

The Security Review Office may request additional information from the parties during the course of its review, which will stop the clock for purposes of the timeline described above.

National Security Reviews in China

Leading up to the adoption of the 2020 Foreign Investment Law, China initiated several national security review processes, beginning in 2009 with the initial introduction of national security reviews. In 2011, MOFCOM and the NDRC established a ministerial review panel responsible for national security reviews of foreign investments in domestic companies. The scope of these national security reviews was extended from a review of foreign acquisitions to cover all foreign investment transactions in 2015 through the Trial Measures on National Security Review for Foreign Investments in Pilot Free Trade Zones. The latest announcement brings this process to the current Measures.

These Measures come on the heels of recent reforms to China’s export control laws and expanded national security laws, including China’s Export Control Law, which went into effect on December 1, 2020; its “Unreliable Entity List” framework that empowers MOFCOM to launch investigations against foreign companies acting against China’s “national sovereignty, security, and development interests;” and a proposed draft Personal Information Protection Law, which seeks to impose restrictions on entities and individuals, including those operating outside of China, that collect and process personal data and sensitive information on subjects in China.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Olivier N. Antoine

Partner – New York
Phone: +1 212.803.4022
Email: ointoine@crowell.com

Caroline E. Brown

Partner – Washington, D.C.
Phone: +1 202.624.2509
Email: cbrown@crowell.com

Evan Y. Chuck

Partner – Los Angeles, Shanghai
Phone: +1 213.310.7999
Email: echuck@crowell.com

Aurora Zhang

Associate – Shanghai
Phone: +86.21.8030.1688
Email: azhang@crowellmoring.asia

Zhongdong Zhang

Senior Counsel – Shanghai
Phone: +86.21.8030.1688
Email: zzhang@crowellmoring.asia