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Restructuring of Chinese Military Industrial Enterprises

By Wayne Chen and Leo Wang

Following the Guiding Opinions on Participation in National Defense Science and Technology Industries by Non-public Sectors of Economy and the Guiding Opinions on Promotion of Restructuring of Military Industrial Enterprises promulgated by the Commission of Science Technology and Industry for National Defense (**COSTIND**) and other competent authorities, COSTIND recently issued the Interim Measures for Implementation of Restructuring of Military Industrial Enterprises (**Restructuring Measures**) and the Interim Regulations for Administration of Intermediary Agencies' participating in Restructurings and Listings of Military Industrial Enterprises. These two new rules have further clarified some key issues regarding the reform and restructuring of Chinese military industrial enterprises (**MIEs**), and have removed obstacles to equity financing, introducing strategic investors and overall listing by Chinese MIEs.

Promoting the Restructurings of Different Types of MIEs

The restructurings of MIEs will be managed on the basis of a catalogue management system. Domestic capital is encouraged, while foreign capital is conditionally allowed, to participate in the restructuring of MIEs. For the purpose of restructuring, MIEs may fall into four categories, namely wholly state-owned enterprises, absolutely state-owned enterprises, relatively state-owned enterprises and state-participated enterprises (including enterprises from which the state has withdrawn its stake). Meanwhile, according to the Restructuring Measures, supervision of MIEs' restructurings will be tightened in terms of supervision of procedures, supervision of military industrial equipment and establishment, supervision on confidentiality and special controls.

Overall Listing, Merger and Acquisition, and Reorganization of MIEs

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The new regulations provide that in the case of overall or partial listing of an MIE, or where the whole or part of an MIE is restructured into a listed company, it is required to apply for approval from COSTIND by submitting a framework scheme. This means that the bottleneck restricting MIEs from overall listing has been eliminated. MIEs are no longer required to carve out their military production sectors, and only need to keep their civil production sectors in the listing entity. Meanwhile, upon approval from COSTIND, state-owned domestic listed companies are allowed to wholly or partly acquire and reorganize state-owned MIEs. Foreign investors are allowed to acquire state-participated MIEs, but are forbidden from purchasing wholly state-owned MIEs or absolute state-owned MIEs, and are restricted from acquiring the relatively state-owned MIEs.

Confidentiality System and Disclosure

When an MIE is seeking equity financing in domestic or offshore capital markets, the MIE, its controlling shareholders, and the de facto controller shall comply with the relevant rules on military industrial information disclosure formulated by COSTIND, and it is required to establish a disclosure review system. Where the information to be disclosed involves military secrets, the enterprise may apply to the China Securities Regulatory Commission and the relevant securities exchanges for an exemption from disclosure, with the evidence given by COSTIND’s security and secrets department. The MIE under restructuring shall formulate strict confidentiality rules. The relevant directors, supervisors and shareholders of the MIE shall be required to assume a confidentiality obligation for the confidentiality period.

Supervision and Administration of State-Owned Assets and the Admittance System for Intermediary Agencies

After COSTIND has approved the restructuring scheme, the assets and capital verification, audit and evaluation, trade and price management, protection of employee’s legal rights and other related affairs should be carried out or handled in accordance with the Interim Measures for the Supervision and Administration of Enterprises’ State-Owned Assets, the Opinions on Standardization of the Work Relating to the Reconstructing of State-owned Enterprises and other relevant rules and regulations. Furthermore, COSTIND will examine the qualifications of the intermediary agencies. Institutions or personnel with foreign investments or other foreign backgrounds are not allowed to participate in the restructuring of MIEs.

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