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# MOFCOM Issues Tentative Implementation Provisions on the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors

**By David Yu and Sam Feng**

On 4 March 2011, the Ministry of Commerce ("**MOFCOM**") issued *Tentative Provisions of the Ministry of Commerce on Issues Related to the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors* (Announcement of the Ministry of Commerce [2011] No. 8) ("**Tentative Provisions**") to support the *Notice on Establishing a Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors* (Guo Ban Fa [2011] No. 6) ("**State Council Notice**"),[1] issued by the State Council on 3 February 2011. The Tentative Provisions provide further guidance to the implementation of the security review system for mergers and acquisitions ("**M&A**") of domestic enterprises by foreign investors.

It is important to note that, while both the Tentative Provisions and the Notice of the State Council came into effect on 5 March 2011, the Tentative Provisions are only valid till 31 August 2011. Also, MOFCOM will receive public comments on the Tentative Provisions till 10 April 2011. Hence, MOFCOM may look to revise the Tentative Provisions based on the effectiveness of its implementation and comments from the public and local commerce authorities.

We summarize main provisions of the Tentative Provisions below.

➢ The Scope of M&A Transactions Subject to Security Review

The Tentative Provisions provide that the security review system shall be applicable to M&A transactions by foreign investors under *Rules on Merger and Acquisition of Domestic Enterprises by Foreign Investors*, *Several Provisions for the Alteration of Investors' Equities in Foreign Investment Enterprises* and *Interim Provisions on Investment in China by Foreign Investment Enterprises*. In conjunction with the definition of M&A transactions by foreign investors provided in the State Council Notice, we understand that, for the purpose of the security review

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system, the definitional scope of M&A transactions is expanded from direct M&A of non-foreign-invested enterprises by foreign investors to also include alteration of domestic investors' equities in foreign-invested enterprises and downstream investments in China by foreign-invested enterprises.

➢ The Approval Process

The Tentative Provisions provide more details regarding MOFCOM approval process based on the State Council Notice. We believe it is important to note the following:

- Article 2 of the Tentative Provisions provides that, in accordance with *Rules on Merger and Acquisition of Domestic Enterprises by Foreign Investors*, the *Several Provisions for the Alteration of Investors' Equities in Foreign Investment Enterprises* and other relevant regulations, where applicants fail to submit a security review application along with approval applications for M&A transactions that are within the scope of security review, the local competent commerce authorities shall not accept such approval applications and shall request the applicant to submit a written security review application with MOFCOM and report the same to MOFCOM. Thus, the local commerce authorities may rely on the Tentative Provisions to not accept such approval application and require that the applicant submit security review applications. This is likely to reduce the possibility of evading security review.

- Article 3 of the Tentative Provisions provides that applicants may seek consultation with MOFCOM concerning procedural issue related to M&A of domestic enterprises ("**Consultation Mechanism**") prior to submitting a formal application for security review. The Consultation Mechanism is similar to the consultation procedure under *Guide for Application for Anti-monopoly Review for Merger and Acquisition of Domestic Enterprises by Foreign Investors*. However, the Tentative Provisions do not explicitly describe how to apply for such consultation and the content of the consultation.

- The Tentative Provisions also provide that, if MOFCOM has not issued, within 15 working days after it has notified the applicant of its acceptance of the security review application, a written notice to the applicant on whether the M&A transaction falls within the scope of security review, the applicant may go ahead with relevant procedures in accordance with the relevant laws and regulations. Such "implied approval" encourages MOFCOM to conduct the security review process efficiently while helping to facilitate M&A transactions for the applicants.

➢ Documentary Requirements for Application

Article 4 of the Tentative Provisions provides that applicants shall submit the following documents when making formal for security review application with MOFCOM:

- Application form for security review and statement on the concerned M&A transaction signed by the applicant's legal representative or authorized representative;

- Notarized or certified identity certification, registration certification and credit certification of the foreign investors, and the identity certification of the legal representative, authorization letter from the authorized representative of the foreign investors and/or the identify certification of its authorized representative;

- Statement on information pertaining to the foreign investors and its affiliated enterprises (including its de facto controller or parties acting in concert), and statement on relationship with the governments of relevant countries;

- Statement on the operational status of the domestic target enterprises in the M&A transaction, its articles of association, photocopy of its business license, audited financial statements for the previous year, structural chart before and after the M&A transaction, and statement of information of the invested enterprises;

- Contracts, articles of association or partnership agreements of the foreign-invested enterprise that is planned to be established after the M&A transaction, and a list of senior management team members (e.g. the members of the board of directors to be appointed by the shareholders, the general manager to be employed, or the partners);

- In the case of M&A transactions involving equity transfer, the equity transfer agreement or the agreement on capital increase through subscription by foreign investors, the resolution of the shareholders' meeting or the general meeting of shareholders made by the domestic target enterprise and corresponding asset evaluation report shall be submitted;

- In the case of M&A transactions involving assets transfer, the resolution on the sale of assets approved by the relevant authority or the property right holder of the concerned domestic enterprises, asset purchase agreement (including a checklist and status report of assets to be purchased), statement on the information of all concerned parties of the agreement, and corresponding asset evaluation report;

- Statement of the impact that voting rights enjoyed by foreign investors have on shareholders' meeting resolutions, general meeting of shareholders, resolutions of the board of directors, or the enforcement of partnership affairs; statement on other issues that may result in a transfer of actual controlling power to the foreign investor or its domestic or foreign affiliated enterprises in relation to decision-making, finance, human resources, technologies or other aspects; or agreement or documents related to the aforementioned circumstances; and

- Other documents required by MOFCOM.

The required documents above signal a shift towards more stringent approval requirements compared with the previous approval process. Some of the documents not previously required include statement on "information pertaining to the foreign investor and its affiliated enterprises (including its de facto controller and parties acting in concert), and statements on relationship with the governments of relevant countries." Moreover, we draw your attention to the following:

- When submitting formal application for security review, the applicant shall submit a corresponding asset evaluation report, regardless of whether the M&A transaction involves equity transfer or asset transfer. In contrast, *Several Provisions for the Alteration of Investors'* Equities *in Foreign Investment Enterprises* and *Interim Provisions on Investment in China by Foreign Investment Enterprises* did not require such asset evaluation reports. As a result, if M&A transactions by foreign investors under the two abovementioned regulations are subject to security review, an additional evaluation procedure will be required to obtain security review approval.

- Language of the Tentative Provisions provides that applicants shall submit the "partnership agreement" of the foreign-invested enterprise to be established after the M&A transaction, a list of names of the partners and a statement describing the impact that voting rights enjoyed by foreign investors have on "the partnership's affairs". However, laws and regulations have not yet provided specific provisions on the establishment a foreign-invested partnership enterprise through M&A. Such provisions in the Tentative Provisions may reflect the fact that MOFCOM is exercising prudence with respect to potentially new forms of M&A by foreign investors involving partnership enterprises, and thus has brought foreign-invested partnership enterprises within the scope of M&A by foreign investors.

## Our Comments

MOFCOM promptly issued the Tentative Provisions to flesh out the details of the security review system for M&A by foreign investors only one month after the issuance of the Notice of the State Council. Nevertheless, the Tentative Provisions still does not clearly delineate the scope of security review by providing a detailed catalogue of industries and matters subject to such review. At the same time, certain aspects concerning cross-interpretation and interaction among the Notice of the State Council, the Tentative Provisions and the other regulations on M&A by foreign investors remain uncertain. For example, according to the *Interim Provisions on Investment in China by Foreign Investment Enterprises*, approval by the commerce authority is not required for foreign-invested enterprises investing in "encouraged" or "permitted" industries. But, it remains unclear whether approval process is nonetheless required where such "encouraged" or "permitted" M&A transactions also fall within the scope of security review. Hence, it is foreseeable that MOFCOM will provide further guidelines for implementing the Tentative Provisions.

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1 For detailed analysis regarding the *Notice on Establishing a Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors*, please see our article titled "New Security Review System for Acquisition of Domestic Enterprises by Foreign Investors", available on our February, 2011 Corporate Law Bulletin. See http://www.llinkslaw.com/shangchuan/2011216171602.pdf.