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## SPONSORED UPDATE CHINA

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### PRC Security Review for Mergers and Acquisitions: Changes to the Review Process

In February 2011, a Circular by the PRC State Council instituted a national security review for transactions through which a foreign investor acquires control over a Chinese company that is either (i) active in designated defense related businesses or (ii) "important" in specified industries and relevant to national security. The security review is conducted by an inter-ministerial conference at the request of the Ministry of Commerce ("MOFCOM").

When MOFCOM issued the Provisions on the Implementation of the Security Review System for Merger & Acquisition Transactions of Domestic Enterprises by Foreign Investors (the "Provisions") on August 25, 2011, investors and commentators were worried about the impact on foreign investment in restricted industries through "variable interest entities" (VIEs). In addition to defining the establishment of a VIE structure as an acquisition of control, the Provisions also introduce new features to the review process itself, which may become a source of concern.

To facilitate the sometimes difficult decision whether or not a foreign investor should apply for security review, MOFCOM allows the acquiror to consult MOFCOM prior to making a formal application. The Provisions clarify that the advice given by MOFCOM is not binding and does not have legal effect, nor should it be treated as the basis for formal submission. In other words, no advance ruling or simplified procedure is available to expedite transactions in which the national security implications are uncertain.

Under the State Council Circular, in addition to the acquiror, various third parties (national level government authorities, industry associations, enterprises in the same industry as the target company and enterprises whose business is upstream or downstream

of the target company) may request MOFCOM to conduct a security review. The Provisions now allow MOFCOM to hold an informal enquiry into such a third party request by obtaining statements from interested parties, before referring the transaction to the inter-ministerial conference for security review.

This consultation process might not involve the parties to the transaction, who may not even be aware of it. The Provisions do not require MOFCOM to inform or consult the buyer and seller. Thus, MOFCOM could invite competitors of the parties or the target company or opponents of the deal to state their objections, without seeking the buyer's and seller's views. Without being involved, the parties to the transaction also cannot control the information provided by MOFCOM to the international third parties.

The information could be incomplete, incorrect or confidential.

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