



CLIENT UPDATE



Foreign Investments in China New Legislation for National Security Review

December 30, 2020

Israeli companies and businesspeople that are looking for business and investment opportunities in China should get acquainted with the new National Security Review regime that has been enacted in China.

Over the past decades China has been progressively opening up more industries to foreign investors, while carefully taking gradual steps to regulate the foreign investments that may have impacts on national security.

On December 19 2020, China's National Development and Reform Commission ("NDRC") and the Ministry of Commerce ("MOFCOM") jointly promulgated the *Measures for the Security Review on Foreign Investment* (the "**Measures**") which will become effective as of January 18, 2021.

The promulgation of the Measures signals that the Chinese government is taking a more active approach to scrutinize foreign investment transactions that may raise national security concerns.

This introduction provides an overview of the Measures, including the review authority and its jurisdiction, the process through which the review shall be conducted and the penalties for non-compliance.

I. Review Authority and its Jurisdiction

Review Authority

A working office led by NDRC and MOFCOM is authorized by the Measures (the "**Office**") to review certain foreign investment transactions within its jurisdiction (as further introduced below) in order to determine the effect of such transactions on the national security of China.

In connection with the review, if any foreign investment transaction poses national security risks, the Office may prohibit the transaction or impose conditions on the transaction to eliminate the perceived risks.

Scope of the Office's Jurisdiction

The Office's statutory jurisdiction stipulated in the Measures is quite broad.

Investment directly or indirectly made by foreign investors (and investors from HK, Macau and Taiwan) within the territory of China (the "**Foreign Investment**") that are included within the Covered Scope (as defined below) shall be subject to the security review in accordance with the Measures.

Foreign Investments may include the following:

- (i) investment in a new project or establishment of a new enterprise in China by any foreign investor alone or jointly with other investors;
- (ii) acquisition of equity or assets of a Chinese enterprise by any foreign investor;
- (iii) investment made by any foreign investor within the territory of China by other means.

It is a mandatory requirement for the foreign investors or relevant domestic parties involved in a Foreign Investment transaction (each, a "**Related Party**"; collectively, "**Related Parties**") to file a report for review by the Office prior to closing, provided that such Foreign Investment is covered by any of the following categories (the "**Covered Scope**"):

(i) investment in military industry, military industrial supportive field and other fields relating to the security of national defense, and investment made in proximity to military facilities and military related industrial facilities;

(ii) investment that concerns national security in the below sectors, which will result in Actual Control (as defined below) by the foreign investor of the invested enterprise: important agricultural products;

- important energy and resources;
- important manufacturing equipment;
- important infrastructure;
- important transportation services;
- important cultural products and services;
- important information technology and internet products and services;
- important financial services;
- critical technologies; and
- other important fields concerning national security.

"**Actual Control**" shall include circumstances in which the foreign investor obtains (i) the ownership of more than 50% of the share capital of the invested enterprise; (ii) the voting rights which have a significant impact on resolutions of the board of directors or shareholders of invested enterprise, without the ownership of more than 50% of the share capital; or (iii) other significant impact on the matters with respect to the invested enterprise's business decision, human resources, finance and technology etc.

II. Review Process

Pre-Filing

The Related Parties may consult the Office with regard to relevant matters before filing of the proposed Foreign Investment with the Office.

Filing

For a Foreign Investment included in the Covered Scope, a Related Party shall submit a filing, as a mandatory requirement, to the Office which shall include a report form specifying the foreign investor's name, residency and business scope, an investment plan, an explanation whether the investment will impact national security, and any additional information or material requested by the Office (collectively, the "**Filing Materials**").

The Office has authority to require the Related Parties to file the report for the Office's review of any Foreign Investment included in the Covered Scope when the Related Parties fail to fulfill their filing obligation.

Preliminary Screening

Within 15 working days following the date on which the Office has received all requested Filing Materials, the Office shall decide whether the proposed Foreign Investment is subject to its security review. If the Office determines that the proposed Foreign Investment is not subject to its security review, then the involved parties can proceed with the investment. Otherwise, the Office will commence the conduction of a security review in accordance with the procedures set forth in the Measures.

Security Review and Decision Making

The security review procedure is divided into general review and special review. The Office has 30 working days under the general review procedure (the "**General Review Period**") to decide whether to clear a proposed Foreign Investment transaction which will not pose national security risks or to commence the special review procedure of 60 working days (with a possible extension under special circumstances) for further investigation and review (the "**Special Review Period**").

Prior to the expiration of the Special Review Period, the Office shall decide whether to either (i) clear the transaction if it will not pose national security risks, (ii) prohibit the transaction if it will pose national security risks, or (iii) impose conditions on the transaction to eliminate the perceived risks to national security and conditionally approve the transaction, provided that the Related Parties undertake in writing to accept implementing such conditions.

During the General Review Period and Special Review Period, as applicable, the Related Parties shall not proceed with the proposed Foreign investment until the Office makes decision to clear the transaction.

The Office may require the Related Parties to provide supplementary materials during the security review period. The time during which the Related Parties prepare the supplementary materials shall not be counted into the applicable review period.

During the Office's security review period, the Related Parties may amend the review plan or cancel the investment. If the investment plan is amended, the review period will be recounted after the receipt of the amended investment plan by the Office. If the investment is canceled, the Office will terminate the security review.

III. Penalties for Non-Compliance

The Office can issue orders to dispose of the equity interests or assets, and take other necessary measures to unwind the transaction and eliminate any impact on national security, in the event that:

- (i) the Related Parties refuse to initiate the filing for the Office's review of any Foreign Investment included in the Covered Scope;
- (ii) fraudulent filing materials were provided or key facts were concealed for the clearance; or
- (iii) the Related Parties fail to comply with the conditions imposed by the Office.

Any of the above violations will be recorded in China's social credit system and associated penalties may be imposed in accordance with applicable laws.

China's current foreign investment approval procedures and access restrictions already make it very difficult for foreign investors to acquire actual controlling positions in various sectors critical to national security as covered by the Measures. The Measures will, however, add increased complexity and create an additional layer of uncertainty with respect to foreign investment in China.

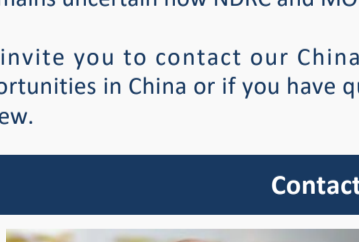
The broad-covered nature of the Measure, vague definition of foreign investment, wide scope of foreign investments and uncertain criteria for determining the 'importance' of the subject matter of a transaction, might lead to expansive application of the Measures.

This will require foreign investors to conduct relevant assessments for the contemplated investment transactions in China and ensure the compliance with the filing requirement under the Measures.

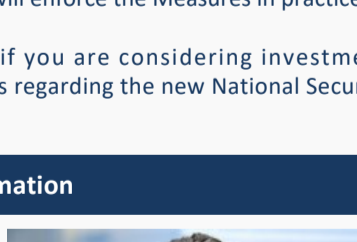
It remains uncertain how NDRC and MOFCOM will enforce the Measures in practice.

We invite you to contact our China team if you are considering investment opportunities in China or if you have questions regarding the new National Security Review.

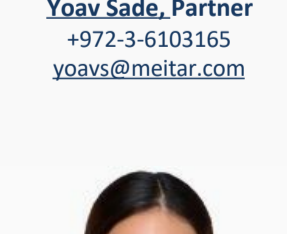
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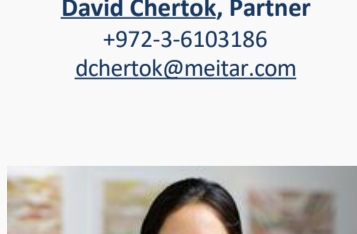
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