

NEW FOREIGN INVESTMENT GUIDELINES

China's foreign investment policy at any given time is primarily reflected through the government-issued *Catalogue on Industry Guidelines for Foreign Investment* (the Guidelines). The Guidelines classify foreign investment in various industry sectors as "encouraged," "restricted" or "prohibited." Where a particular industry sector is not identified in the Guidelines, it is presumed to be "permitted" and generally treated in the same manner as "encouraged" industry sectors for foreign investment purposes. Foreign investment in "encouraged" industries will be subject to less scrutiny and review, while investment in "restricted" industries will be subject to more detailed and time-consuming review, and potentially other restrictions. Foreign investment in "restricted" industries will also often require a foreign investor to take on a local partner, although this is also required for certain "encouraged" sectors. Investment in "prohibited" industry sectors is generally not permitted. As a general rule, it will be easier and less time consuming for foreign investors to establish foreign-invested enterprises in "encouraged" sectors, although in some cases this is specifically excluded by the Guidelines.

The Guidelines were originally published in 1995 and have subsequently been revised in 2002, 2004 and 2007 to reflect changes in China's foreign investment policy. The trend of these revisions has generally been to open an increasing amount of industry sectors to foreign investment and to permit foreign investors to invest in an increasingly large amount of industry sectors without a Chinese joint venture partner. On January 30, 2012, a new revision to the Guidelines will gain force, reflecting China's current inbound foreign investment policy objectives.

The latest revision of the Guidelines reflects several developments in China's inbound investment policy:

1. Generally speaking, the Guidelines continue the trend of opening up China's economy to foreign investment.
2. China particularly encourages foreign investment in innovative and high-tech industry sectors.
3. The manufacture of automobiles has been removed as an encouraged industry.
4. Commercial franchising has been removed from the list of restricted industries, coinciding with China's growing consumer market and appetite for foreign brands and products.
5. The Guidelines include venture capital enterprises as an encouraged industry sector.

Existing and potential investors are encouraged to review the new Guidelines to determine whether there are any policy changes that are relevant to their interests.

NATIONAL SECURITY REVIEW

In 2011, China's State Council and Ministry of Commerce released regulations adding a formal national security review procedure for foreign acquisitions of Chinese companies. In determining the impact upon national security, the review procedure will consider the impact of a proposed transaction on national defence and security, basic livelihood of the national economy, basic livelihood of the public, and research and development capacity for key technologies that have a bearing on national security. The review procedure applies to acquisitions in a non-exhaustive list of industry sectors, including "important" or "key" agricultural product, energy and resource, infrastructure, technology, and equipment manufacturing sectors. The review is triggered by both direct acquisitions (such as the purchase of equity or assets) and indirect arrangements (such as contractual arrangements) that result in a foreign investor having legal or *de facto* control over a Chinese company.

According to the new regulations, the main steps in the review procedure will be as follows:

1. If a foreign investor proposes to conduct an acquisition that falls within an industry that is subject to security review, the investor shall submit a security review application to the Ministry of Commerce. Interested third parties such as members of other government departments and members of industry may also submit an application to the Ministry of Commerce suggesting a review of a foreign investor's proposed transaction.

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2. Assuming the submitted documentation is complete, the Ministry of Commerce will conduct a preliminary review to determine whether the proposed transaction falls within the scope of a security review. The Ministry of Commerce is required to inform the foreign investor whether or not a security review will proceed within 15 days of receiving a complete set of application documents. If a security review is to proceed, the Ministry of Commerce will, within five business days after informing the foreign investor, submit the application to an inter-ministerial joint conference formed under the guidance of the State Council and led by the National Development and Reform Commission and the Ministry of Commerce (the Joint Conference).
3. Upon receipt of an application from the Ministry of Commerce, the Joint Conference will conduct a “general review” of the transaction. This process, which will take up to 30 working days to complete, involves the Joint Conference soliciting written opinions from relevant government departments as to whether or not the proposed acquisition poses a threat to national security. In conducting this analysis, the foreign investor will be required to submit detailed documentation about itself and the target, including the negotiated purchase agreement and the proposed constitutional documents for the entities that the foreign investor may acquire or establish in China as part of the transaction. If any of the opinions state that the acquisition could have an impact on national security, the Joint Conference will proceed to a “special review.”
4. The exact scope of a “special review” process is not clear in the new regulations but essentially involves a more detailed review and assessment of the proposed transaction by the Joint Conference. The Joint Conference may also submit the application to the State Council for a decision. The Joint Conference must complete its review or submit the matter to the State Council within 60 working days after the initiation of the special review. There is no time limit provided for the State Council to make a decision.
5. The Joint Conference will communicate its ultimate decision to the Ministry of Commerce, which will then be relayed within five business days to the foreign investor. If it is ultimately determined that the proposed transaction poses a threat to national security, the Joint Conference will require the Ministry of Commerce to terminate the transaction or take other measures.

The national security review is not a new process in China but has been conducted less transparently in the past. The new regulations formalize the process and add some parameters with respect to scope and timing. As with the developments in Chinese competition law over the past few years, it will be interesting to see how the security review process is applied in practice. For the moment, foreign investors should at least be aware of the potential for significant delay when contemplating potentially reviewable transactions.