

January 11, 2021

Comparing China’s New Measures on National Security Review of Foreign Investments with the U.S. CFIUS Review Process

On November 27, 2020, China’s National Development and Reform Commission (the “**NDRC**”) and Ministry of Commerce (“**MOFCOM**”) issued *The Measures for the Security Review of Foreign Investments* (the “**Measures**”) in an effort to formalize the framework of China’s national security review of foreign investments (“**China’s NSR**”).¹ The Measures will take effect on January 18, 2021.

Attorneys
Peng Yu
Ama A. Adams
Oliver Nip
Brendan C. Hanifin
Boxin Wang
Emerson Siegle
Yuliang (Leon) Huang

Under the Measures, certain types of investment activities in China by foreign investors (the “**Notifiable Transactions**”) may be restricted on national security grounds. Regulatory filings are mandatory before the Notifiable Transactions are “implemented,” and a national task force led by the NDRC and MOFCOM (the “**NSR Office**”) is established for the review. If the NSR Office deems a Notifiable Transaction to impact China’s national security, it can either prohibit/unwind such Notifiable Transaction or impose mitigation conditions. Should the relevant parties “implement” the Notifiable Transactions without submitting the requisite filings or following the mitigation conditions imposed by the NSR Office, they will be ordered to do so within a grace period to be specified by the NSR Office. And should they refuse to comply within the grace period, they will be ordered to unwind their Notifiable Transactions within a period of time to be specified by the NSR Office. Violations of the requirements under the Measures may also be recorded by the relevant credit systems in China (which we understand may affect the relevant parties’ reputation in the market and their relationship with the government and subject them to penalties by other regulators). The Measures set forth the review period during which the NSR Office must make a decision, although extensions are allowed under “special circumstances.”

According to the NDRC, the Chinese government introduced the Measures partly in consideration of the global trend to launch or enhance similar frameworks by other major jurisdictions in the world, including the expansion of jurisdiction of the Committee on Foreign Investment in the United States (“**CFIUS**” or the “**Committee**”) through the enactment of the Foreign Investment Risk Review Modernization Act of 2018 (“**FIRRMA**”).² Given the resemblance in function and some of the features between the two regimes, a comparative analysis can be helpful in both understanding the upcoming framework of China’s NSR legal regime and anticipating the ongoing developments in this area.

China’s NSR vs. U.S. CFIUS Review

Key similarities and distinctions between China’s NSR legal regime under the Measures and the CFIUS review process include:

- Both regimes involve the review of foreign investments by interagency working groups at the national level. Similar to CFIUS, the NSR Office appears to enjoy broad discretion in determining what constitutes “national security” under the Measures. Under both regimes, the regulator may consider imposing mitigation conditions in lieu of prohibiting the transactions altogether, but ultimately has the power to prohibit/unwind any in-scope transactions that are deemed to impair national security.
- Filings are mandatory for all in-scope transactions under China’s NSR legal regime. By contrast, only a limited subset of transactions—involving critical technology and/or foreign government-affiliated investors—trigger a mandatory filing under the CFIUS regime.
- The ambit of in-scope transactions is not precisely the same. Under China’s NSR regime, transactions that touch on “national defense” are within scope even if they are completely passive investments (see II.1 in the table below),

while transactions that do not touch on “national defense” are outside the scope of China’s NSR regime so long as they do not confer “control” to foreign investors. By contrast, CFIUS’s expanded jurisdiction under FIRRMA covers certain non-controlling non-passive investments relating to U.S. critical technology, U.S. critical infrastructure, and sensitive personal data businesses (in addition to CFIUS’s traditional jurisdiction over transactions in which a “foreign person” obtains “control” over a “U.S. business” with a nexus to homeland security or national defense). Whether this apparent distinction is significant in practice remains to be seen, however, as we gain further clarity on the scope of “national defense” and the threshold for “control” under China’s NSR regime.

- Both regimes set forth definitive timelines under which the respective decision body must complete its review, but give the decision body flexibility to extend such timelines if needed. Both CFIUS and the NSR Office may extend the timeline for the final review stage under special/extraordinary circumstances. In practice, CFIUS can also extend the timelines by requesting the parties pull and refile a submission, and the Measures do not explicitly restrict the NSR Office from doing the same.

For further details, the table below compares certain specific features of the China’s NSR legal regime under the Measures with the CFIUS process:

	China’s NSR	CFIUS Review
I. Decision Body	A national task force led by the NDRC and MOFCOM.	An interagency committee chaired by the Secretary of the Treasury with a total of nine permanent member agencies and departments. In certain cases, recommendations from CFIUS are escalated to the President of the United States for review and possible action.
II. Jurisdiction Scope		
1. Notifiable Transactions/ Covered Transactions	<p>Two categories of investments conducted “<i>directly or indirectly</i>” by foreign investors are covered by China’s NSR legal regime.</p> <p><u>Category I</u></p> <ul style="list-style-type: none"> • Any investment activities in sectors relevant to the security of national defense, such as military industry and military industrial support; and • Any investment activities in locations within the proximity of military facilities and military industry facilities. (“National defense,” “military facilities,” “military industry facilities” and “proximity” are not defined in the Measures.) <p><u>Category II</u></p> <p>Any investment activities conferring “control” of the target company and in sectors relevant to national security such as:</p>	<p>CFIUS has jurisdiction over any transaction in which a “foreign person” obtains “control” over a “U.S. business” (defined broadly as any business engaged in U.S. interstate commerce).</p> <p>Pursuant to FIRRMA, CFIUS has jurisdiction over certain non-controlling, non-passive investments by foreign persons, where:</p> <ul style="list-style-type: none"> • The foreign person obtains qualifying rights (including access to “material nonpublic technical information,” board membership or observer rights, and/or involvement in “substantive decision-making”); and • The U.S. business is a “TID U.S. business.” This term includes U.S. businesses that (1) produce, design, test, manufacture, fabricate, or develop “critical technology”; (2) perform

	China's NSR	CFIUS Review
	<ul style="list-style-type: none"> • important agricultural products; • important energy and resources; • important equipment manufacturing; • important infrastructure; • important transport services; • important cultural products and services; • important information technology and Internet products and services; • important financial services; and • key technologies (which is not defined in the Measures). 	<p>certain functions with respect to “covered investment critical infrastructure”; and/or (3) collect or maintain “sensitive personal data.”</p> <p>In addition, CFIUS has jurisdiction over (1) transactions that could result in changes in control, even where no new equity is acquired; and (2) certain real estate transactions, which are governed by separate regulations.</p>
2. Monetary Threshold	There is no monetary threshold for a transaction to qualify for China's NSR review.	There is no monetary threshold for a transaction to qualify for CFIUS's jurisdiction. However, the value of a transaction will impact the filing fees (see below).
3. “Control”	<p>“Control” includes:</p> <ul style="list-style-type: none"> • holding 50% or more interest in the target company by one or more foreign investors; • holding less than 50% interest but having sufficient voting rights to cast significant influence over the board of directors meetings and the shareholders meetings; and • otherwise holding the power to cast significant influence on matters such as the target company's strategic decisions, human resource, finance and technology. 	<p>The CFIUS regulations do not define “control” in terms of a specified ownership percentage or number of board seats. Rather “control” is defined as the power, direct or indirect, whether or not exercised, to determine, direct, or decide important matters affecting an entity, including (without limitation):</p> <ul style="list-style-type: none"> • sale, lease, mortgage, pledge, or other transfer of any tangible or intangible principal assets; • reorganization, merger, or dissolution; • closing, relocation, or substantial alteration of production, operational, or R&D facilities; • major expenditures or investments, issuances of equity or debt, dividend payments, or approval of the annual budget; • selection of new business lines or ventures; • entry into, termination of, or non-fulfillment of significant contracts; • appointment or dismissal of officers, senior managers, or other key personnel; and

	China's NSR	CFIUS Review
		<ul style="list-style-type: none"> amendment of the organizational documents with respect to the above decisions.
4. "National Security"	Not defined in the Measures.	Not defined in the CFIUS regulations, but understood to apply broadly.
5. Relevant Types of Investments	<p>Any investment activities conducted "directly or indirectly" by "foreign investors" would be relevant, including:</p> <ul style="list-style-type: none"> establishment of projects or enterprises in China, independently or jointly with other investors, including greenfield projects; and mergers and acquisitions of Chinese domestic companies (including both asset and equity acquisitions). <p>The Measures likely cover investments in "red-chip" companies and investments via VIE structures, given its inclusions of indirect investment activities by any means.</p> <p>The Measures imply that stock purchases on securities exchanges are also covered but will be subject to a tailored set of specific implementation rules, to be developed by the China Securities Regulatory Commission in collaboration with the NSR Office.</p>	<p>CFIUS has jurisdiction over, <i>inter alia</i>, (1) any transaction that could result in "control" over a U.S. business by a foreign person; and (2) any investment in a TID U.S. business that provides a foreign person with qualifying rights. In general, the CFIUS regulations do not distinguish between particular categories of transactions—the Committee can have jurisdiction over mergers and acquisitions, investments, joint ventures, and other commercial arrangements.</p> <p>Although the CFIUS regulations recognize an exception for greenfield investments, the exception is very narrow in practice.</p>
4. "Foreign Investors"	<p>"Foreign investors" include those in Hong Kong, Macao and Taiwan.</p> <p>The term is otherwise undefined in the Measures.</p>	The term "foreign person" includes (1) foreign governments, foreign nationals, and foreign entities; and (2) any entity over which control is exercisable by a foreign government, foreign national, or foreign entity.
III. Filing Procedures		
1. Mandatory/Voluntary Filing	Filings are mandatory for all Notifiable Transactions, which cannot be "implemented" before the NSR Office has made a decision.	Filings are mandatory where (1) there is a qualifying investment in a TID U.S. business that deals in critical technology and "U.S. regulatory authorization" would be required to export the critical technology to certain foreign persons; and (2) a foreign person in which a foreign government holds a 49% or greater interest obtains equity of at least 25% in a TID U.S. business.

	China's NSR	CFIUS Review
		Parties may submit voluntary filings for all other covered transactions.
2. Pre-filing Consultation	Allowed. Relevant parties may consult the NSR Office before submitting filings.	Allowed. CFIUS will accept/review draft notices, but will not accept/review draft declarations.
3. Filing Timing	<p>Filings must be submitted before the Notifiable Transactions are “implemented.”</p> <p>It is unclear whether this means the filings must be submitted before signing definitive agreements for the Notifiable Transactions or can be submitted thereafter. In any event, filings should be submitted before the closing of the Notifiable Transactions.</p>	<p>Mandatory filings must be submitted at least 30 days prior to closing.</p> <p>Voluntary filings may be submitted either before or after closing, but typically are submitted between signing and closing.</p>
4. Filing Fees	Unspecified in the Measures.	<p>For full-form filings, there is a filing fee keyed to the value of the transaction (up to a maximum of \$300,000).</p> <p>For abbreviated declarations, there is no filing fee.</p>
5. Person Responsible for the Submissions	Either the foreign investors or “the relevant parties in China” must submit the requisite filings.	Filings generally are joint submissions between the foreign person and the U.S. business.
6. Review Period	<p><u>Phase I – Screening</u> After receiving a complete filing, the NSR Office must determine if a security review is needed within 15 working days.</p> <p>If the NSR Office determines that a security review is not needed, the proposed investment will be allowed to proceed.</p> <p><u>Phase II – General Review</u> If the NSR Office determines that the security review is needed, it must proceed to determine if the proposed investment will impact China national security under a “general review” process, which must be completed within the next 30 working days (which cannot be extended).</p> <p>If the NSR Office determines that the proposed investment will not impact China</p>	<p><u>Full-Form Filing</u> For full-form joint voluntary notices, the parties generally submit a draft notice to CFIUS for review and comment, and then incorporate any additional information requested by the Committee. After a joint voluntary notice is accepted, a 45-day review period begins. At the conclusion of the 45-day review period, CFIUS can either clear the transaction or initiate a subsequent 45-day investigation period. At the conclusion of the investigation period, CFIUS will generally either clear the transaction or indicate what mitigation measures it will require, though the Committee can also indicate that it will recommend the President block or unwind the transaction and, in extraordinary circumstances, require a 15-day extension. CFIUS is also empowered to request that the parties pull and refile the submission.</p>

	China's NSR	CFIUS Review
	<p>national security, the proposed investment will be allowed to proceed.</p> <p><u>Phase III – Special Review</u></p> <p>If the NSR Office determines that the proposed investment may impact China national security, it must complete a “special review” process within the next 60 working days (which can be extended under special circumstances).</p> <p>Following the “special review” process, the NSR Office must decide:</p> <ul style="list-style-type: none"> • whether the proposed investment is allowed to proceed; and • whether any mitigation conditions should be imposed to eliminate the impacts on China national security. 	<p><u>Abbreviated Declaration</u></p> <p>After an abbreviated declaration is received and acknowledged by CFIUS, a 30-day review period begins. At the conclusion of the 30-day review period, CFIUS can either (1) clear the transaction; (2) initiate an investigation; (3) request the parties submit a full-form joint voluntary notice; or (4) take no action.</p>
7. Delays in the Review Period	<p>Revisions in the investment plan will restart the entire review period.</p> <p>During Phase II and Phase III, the NSR Office may request supplemental materials to be submitted, and the review period is paused in the meantime.</p>	<p>During CFIUS reviews, the Committee can ask additional questions of the parties. These inquiries must be answered within three business days (for full-form joint voluntary notices) or within two business days (for abbreviated declarations). Failure to respond in a timely manner can lead to CFIUS rejecting the filing, which would reset the process. The Committee is also empowered, as noted, to request the parties pull and refile the notice, which would also extend the review period.</p>
IV. Mitigation Conditions	<p>The Measures allow the NSR Office to issue a conditional approval in lieu of a prohibition in situations where the impacts on China's national security can be eliminated by imposing mitigation conditions, if the relevant parties agree in writing that they accept the mitigation conditions imposed on their transactions.</p>	<p>In addition to recommending the President block or unwind a transaction, CFIUS is also empowered to impose mitigation measures. Common examples of mitigation measures that are negotiated include (1) restructuring; (2) implementing security plans; (3) requiring only U.S. citizens play certain roles; (4) implementing supply chain agreements; (5) imposing requirements over the disposition of government contracts; and (6) imposing reporting, consent, and/or audit requirements.</p>

	China's NSR	CFIUS Review
V. Sanctions	<p>Should the relevant parties “implement” the Notifiable Transactions without submitting the requisite filings or following the mitigation conditions imposed by the NSR Office, they will be ordered to do so within a grace period to be specified by the NSR Office. And should they refuse to comply within the grace period, they will be ordered to unwind their Notifiable Transactions within a period of time to be specified by the NSR Office.</p> <p>Failure to submit the requisite filings on time, submission of false or incomplete information and failure to satisfy the mitigation conditions will be recorded by the relevant credit systems in China.</p> <p>The Measures did not specify any fines or other penalties for violating the requirements therein.</p>	<p>If a transaction triggers a mandatory filing requirement and the parties fail to file, CFIUS is empowered to impose a penalty against the parties equal to the value of the transaction.</p> <p>CFIUS also is empowered to impose penalties of up to \$250,000 (per violation) for any false or material statements provided to CFIUS, and/or breaches of national security agreements entered into by the parties.</p> <p>In addition, failure to obtain CFIUS clearance exposes parties to the risk of CFIUS initiating its own review of the transaction, which can result in CFIUS imposing mitigation measures or retroactively requiring the parties to unwind the transaction.</p>

Stay Tuned

While the Measures have established the general principles of China’s NSR legal regime, several questions remain unanswered. The Chinese government will likely issue further guidance on how the Measures will be implemented, and as more information is unveiled, the following questions will be of particular interest:

- As implemented, will China’s NSR legal regime offer any safe harbors for investments under particular equity percentage thresholds to mitigate the uncertainties from the broad scope of the Notifiable Transactions? Similar to indirect investment fund exemption in the CFIUS regulations, will China’s NSR legal regime provide any exemptions relevant to the private equity industry?
- Will China’s NSR legal regime apply to foreign-to-foreign offshore transactions? It is not explicit in the Measures, but if interpreted broadly, the Measures may catch transactions in which a foreign company acquires another foreign company that has a legal entity registered or established in China. Note that, unlike the CFIUS review process (which uses the term “U.S. business,” as noted above), China’s NSR legal regime does not use the concept of “Chinese business.” Accordingly, even if China’s NSR legal regime is interpreted to be applicable to foreign-to-foreign offshore transactions, the parameter would presumably be narrower than the CFIUS review process.
- Is compliance with China’s NSR legal regime solely the responsibility of the foreign investors? The Measures describe the responsible parties as the foreign investors and “relevant parties in China.” Interpreted broadly, the phrase would imply that the parties receiving the Notifiable Transactions should share the responsibility of submitting the requisite filings.
- Should the filings be submitted upon signing the definitive agreements for a Notifiable Transaction or before then? The Measures require filings to be submitted before the Notifiable Transaction is “implemented,” leaving room

for interpretation. The phrase “implement” as it appears in the NDRC’s guidance for outbound investments has been explicitly defined as the contribution of assets or equity or the provision of financing or guarantees. And the same phrase as it appears under China’s antitrust laws has been in practice interpreted to permit parties to submit filings after executing definitive agreements.

- How will China’s NSR legal regime affect stock purchases on securities exchanges? According to the Measures, the “specific implementation rules” for such transactions will be developed by the China Securities Regulatory Commission in collaboration with the NSR Office. It remains to be seen how the NSR legal regime will accommodate the practical differences between open market purchases and transactions between private parties.
- How will China’s NSR legal regime interact with China’s export control legal regime, which is also promulgated by the Chinese government recently?
- To what extent will the decisions by the NSR Office be subject to judicial review?

¹ According to the NDRC, China’s national security review legal regime can be traced back to 2011. In practice, however, publicly available cases have been very rare.

² In response to queries why China promulgates this national security review law now, NDRC has cited, among other things, the enactment of FIRRMA.