

CHINA LAW LIBRARY 中国法律典藏

MERGERS
AND
ACQUISITIONS
IN CHINA

Owen Nee
and
Jingzhou Tao

SWEET & MAXWELL

Table of Contents

PART I. BACKGROUND

CHAPTER 1. THE EARLY DEVELOPMENT OF CHINA'S ECONOMY AND THE ORIGIN OF M&A ACTIVITY

I. ECONOMIC GROWTH SINCE 1979

- § 1:1 The economy
- § 1:2 —Economic structure
- § 1:3 —Economic plans and development
- § 1:4 —Economic reforms
- § 1:5 The transformation to a Soviet planned economy (1949–1978)
- § 1:6 State planning and the functioning of the economy
- § 1:7 The Open Door Policy (1979–2008); stages of evolving policy
- § 1:8 —The origin of foreign investment
- § 1:9 —Intended and unintended changes

II. EARLY EXAMPLES OF M&A ACTIVITY

- § 1:10 In general
- § 1:11 Foreign investment through joint ventures
- § 1:12 The contract management system
- § 1:13 Hong Kong Compensation Trade investment
- § 1:14 State restructuring to form group companies

III. THE UNINTENDED DEVELOPMENT OF M&A LAW

- § 1:15 In general
- § 1:16 The Company Law
- § 1:17 The regulation of acquisitions by foreigners

IV. PRESENT M&A LAW IN CHINA

- § 1:18 Summary of present M&A law

CHAPTER 2. THE CURRENT STATE OF M&A ACTIVITY IN CHINA

- § 2:1 Introduction

I. THE PLAYERS

§ 2:2 In general

A. THE ACQUIRERS

§ 2:3 State-Owned Assets Supervision and Administration Commission (SASAC)

§ 2:4 State Holding Companies

§ 2:5 China publicly listed companies

§ 2:6 Foreign investors

§ 2:7 —Strategic investors

§ 2:8 —Private equity investors

§ 2:9 —Venture capital development

§ 2:10 —Progress toward opening private equity in China

B. THE DISPOSERS

§ 2:11 SASAC and local entities

§ 2:12 Asset management companies

§ 2:13 Private entrepreneurs

§ 2:14 Foreign companies with China subsidiaries

C. THE REGULATORS

§ 2:15 National Development and Reform Commission (NDRC)

§ 2:16 Ministry of Commerce (MOFCOM)

§ 2:17 State Administration of Industry and Commerce (SAIC)

§ 2:18 State Administration of Foreign Exchange (SAFE)

§ 2:19 China Securities Regulatory Commission (CSRC)

§ 2:20 Anti-monopoly authority

§ 2:21 Industry specific regulators

§ 2:22 Function specific regulators

§ 2:23 —Tax Bureau

§ 2:24 —Customs

§ 2:25 —Labor

II. TRENDS IN DOMESTIC M&A ACTIVITY

§ 2:26 Consolidation of state-owned enterprises under SASAC

§ 2:27 Foreign M&A activity

§ 2:28 Factors inhibiting foreign acquisitions by private equity

§ 2:29 Joint venture and cooperative enterprise acquisitions

§ 2:30 Foreign acquisition of a domestic enterprise

§ 2:31 Takeovers of listed companies

§ 2:32 Foreign investment to restructure State-owned enterprises

PART II. TYPES OF ACQUISITIONS

CHAPTER 3. EXAMINING THE TARGET

I. INTRODUCTION

§ 3:1 Due diligence

§ 3:2 Common issues in due diligence

II. PUBLICLY AVAILABLE MATERIAL ON CHINESE COMPANIES

§ 3:3 In general

§ 3:4 Limited companies

§ 3:5 Public companies

III. PRIVATE INVESTIGATORS AND BACKGROUND CHECKS

§ 3:6 In general

IV. DUE DILIGENCE INVESTIGATION TOPICS

§ 3:7 In general

§ 3:8 Organization and establishment of target

§ 3:9 —Business license

§ 3:10 —Joint venture contracts

§ 3:11 —Feasibility study

§ 3:12 —Articles of Association

§ 3:13 —Capital verifications

§ 3:14 —Investment certificates

§ 3:15 —Annual inspections

§ 3:16 Structure of the company and affiliates

§ 3:17 Accounting statements

§ 3:18 Taxation

§ 3:19 —Multiple sets of books

§ 3:20 —Transfer payment schemes

§ 3:21 —Under-reporting of salaries

§ 3:22 —Unauthorized local incentives

§ 3:23 —Senior officer underpayment of tax

§ 3:24 —Corporate entertainment and government relations

§ 3:25 Customs

§ 3:26 Financing

§ 3:27 —Registration of foreign debt

§ 3:28 —Fixed assets and property register

§ 3:29 —Land and buildings

§ 3:30 —Urban land

- § 3:31 ———Allocated land
- § 3:32 ———Grant land
- § 3:33 ———Collectively owned land
- § 3:34 ———Private land
- § 3:35 ———Condominium ownership
- § 3:36 —Intellectual property registrations
- § 3:37 ———Copyrights
- § 3:38 ———Patents and trademarks
- § 3:39 —Intangible assets
- § 3:40 ———Patented technology
- § 3:41 ———Trade secrets
- § 3:42 ———Categorization of technology
- § 3:43 Operational considerations
- § 3:44 —Labor contracts and labor rules and regulations
- § 3:45 ———Noncompete agreements
- § 3:46 ———Lay-offs
- § 3:47 ———Severance pay
- § 3:48 ———Open-ended contracts
- § 3:49 ———Special training
- § 3:50 ———Collective contracts
- § 3:51 ———Labor dispatch agencies
- § 3:52 —Social welfare benefits schedule
- § 3:53 —Labor bureau or labor union disputes
- § 3:54 —Contracts with key persons and managers
- § 3:55 —Industry related licenses
- § 3:56 —Material contracts
- § 3:57 —Related party transactions
- § 3:58 —Suppliers and customer lists
- § 3:59 —Product warranty claims
- § 3:60 —Insurance
- § 3:61 Disputes, arbitration, and litigation
- § 3:62 Environmental protection investigation
- § 3:63 Anti-monopoly investigation and reporting

CHAPTER 4. JOINT VENTURE METHOD TO ACQUIRE A CHINA BUSINESS

- § 4:1 Structure of transaction

I. THE JOINT VENTURE LAW: DISCUSSION AND ADOPTION

- § 4:2 Discussion
- § 4:3 Adoption
- § 4:4 Nature of joint ventures in China
- § 4:5 Feasibility study

TABLE OF CONTENTS

- § 4:6 Joint venture implementing regulations and standard forms

II. PRINCIPAL DOCUMENTS AND TERMS

- § 4:7 In general
- § 4:8 Feasibility study
- § 4:9 Joint venture contract
- § 4:10 Articles of Association
- § 4:11 Other documentation
- § 4:12 —Land use contract
- § 4:13 —Technology transfer agreement
- § 4:14 —Labor contract
- § 4:15 —Trademark license contract(s)
- § 4:16 —Management services contract
- § 4:17 —Assets purchase agreement
- § 4:18 —Other agreements

III. GOVERNMENT INVOLVEMENT IN THE PROCESS

- § 4:19 In general
- § 4:20 Determining the governmental approval authority
- § 4:21 —MOFCOM and provincial approval authorities
- § 4:22 —Administration of Industry and Commerce

IV. STANDARD STRUCTURES: MAJORITY, MINORITY, AND 50/50

- § 4:23 What determines equity ownership
- § 4:24 —Catalogue for the Guidance of Foreign Investment in Industries
- § 4:25 Comparison of subsidiaries and joint ventures
- § 4:26 Current preference

V. FOREIGN INCORPORATED JOINT VENTURES

- § 4:27 In general
- § 4:28 Use in acquisitions: round-tripping joint ventures
- § 4:29 China China Foreign Joint Ventures

CHAPTER 5. ACQUIRING AN INTEREST IN AN EXISTING FIE

- § 5:1 Introduction
- § 5:2 Rules governing equity transfers
- § 5:3 —Equity Joint Ventures
- § 5:4 —Cooperative Joint Ventures
- § 5:5 —Wholly Foreign Owned Enterprises

- § 5:6 Transfers to affiliates and third parties
- § 5:7 —Procedure for transfer
- § 5:8 Purchase price, appraisals, and equity/asset exchanges
- § 5:9 Purchase price, appraisals and equity/asset exchanges—Equity and asset exchange
- § 5:10 —Exception for joint venture interests
- § 5:11 —Required documentation
- § 5:12 Other transfer methods
- § 5:13 —Pledge
- § 5:14 —Transfer by operation of law
- § 5:15 —Replacement of FIE investor
- § 5:16 Converting a joint venture into a subsidiary
- § 5:17 Converting a joint venture into a domestic enterprise
- § 5:18 Mergers of foreign invested enterprises; acquisition of one FIE by another
- § 5:19 —Merger procedures
- § 5:20 —Notice to creditors
- § 5:21 —Capitalization and rights and obligations
- § 5:22 —Documentation requirements
- § 5:23 —Consent and approval

CHAPTER 6. ACQUIRING AN INTEREST IN A LIMITED LIABILITY COMPANY

I. NATURE OF A LIMITED LIABILITY COMPANY FORMED UNDER THE COMPANY LAW

- § 6:1 In general
 - A. COMPARISON BETWEEN LIMITED LIABILITY COMPANIES AND JOINT VENTURES
 - § 6:2 Term of existence
 - § 6:3 Transfer of shares
 - § 6:4 Director liability and election
 - § 6:5 Organizational structures
 - § 6:6 The supervisory board
 - § 6:7 Capital structures
 - B. SPECIAL TYPES OF COMPANIES
 - § 6:8 In general
 - § 6:9 Wholly State-owned companies
 - § 6:10 Single shareholder limited liability companies
 - § 6:11 Scope of business

II. ACQUISITION OF DOMESTIC ENTITIES BY FOREIGN INVESTORS

- § 6:12 In general
 - A. BASIC SYSTEM OF REGULATION
 - § 6:13 In general
 - § 6:14 Enterprises with less than 25% foreign investment
 - § 6:15 MOFCOM as approval authority
 - § 6:16 Key industry and famous trademark qualification
 - § 6:17 Expatriation of domestic companies
 - § 6:18 Notice to sellers' creditors
 - § 6:19 Appraisal
 - § 6:20 Payment of purchase price, contributed capital and total investment
 - § 6:21 Debt-equity rules
 - B. EXAMINATION, APPROVAL, AND REGISTRATION
 - § 6:22 Approval authority
 - § 6:23 Form of agreement
 - C. ANTI-MONOPOLY EXAMINATION
 - § 6:24 Rules applicable to foreign acquisitions
 - § 6:25 Guidelines
- III. THE ASSET PURCHASE AGREEMENT
 - § 6:26 In general
 - A. PRELIMINARY MATTERS PRIOR TO DOCUMENTATION
 - § 6:27 In general
 - § 6:28 State appraisal
 - § 6:29 Employee settlement plan
 - § 6:30 State and local tax bureau liaison
 - § 6:31 Customs' review
 - § 6:32 Anti-monopoly report
 - § 6:33 Due diligence
 - B. THE STRUCTURE OF AN ASSET PURCHASE AGREEMENT
 - § 6:34 General structure and sample index

C. ASSET PURCHASE AGREEMENT CLAUSES AND PROBLEMS

- § 6:35 In general
- § 6:36 Notice to creditors
- § 6:37 Purchase price and payment
- § 6:38 Effectiveness of closing conditions
- § 6:39 Equity/asset exchanges
- § 6:40 Non-competition agreements

IV. THE SHARE PURCHASE AGREEMENT

- § 6:41 In general

A. PRELIMINARY MATTERS PRIOR TO DOCUMENTATION

- § 6:42 Overview

B. THE APPROVAL PROCESS

- § 6:43 General procedure

C. THE STRUCTURE OF A SHARE PURCHASE AGREEMENT

- § 6:44 Minimum requirements

D. COMMON REPRESENTATIONS AND WARRANTIES

- § 6:45 In general
- § 6:46 Organization
- § 6:47 Financial statements
- § 6:48 Taxes
- § 6:49 Inventory
- § 6:50 Intellectual property
- § 6:51 Real property
- § 6:52 Employees
- § 6:53 Environmental matters
- § 6:54 Product liability

E. VARIOUS APPROVALS

- § 6:55 In general
- § 6:56 Tax
- § 6:57 Customs
- § 6:58 Governmental

- § 6:59 Anti-monopoly

E. USING FOREIGN LISTED SHARES TO ACQUIRE A DOMESTIC ENTERPRISE

- § 6:60 In general
- § 6:61 Use of advisors
- § 6:62 Required approvals

V. SPECIAL PURPOSE VEHICLES

- § 6:63 Special purpose vehicle companies

CHAPTER 7. ACQUISITION OF SHARES IN LISTED COMPANIES

I. THE COMPANY LIMITED BY SHARES

- § 7:1 In general
- § 7:2 General characteristics of the stock company
- § 7:3 Corporate management
- § 7:4 —Shareholders
- § 7:5 —Board of Directors
- § 7:6 —Supervisory Board
- § 7:7 —Managers
- § 7:8 Stock company shares
- § 7:9 Domestic and foreign listings
- § 7:10 Domestic securities markets; Shanghai Stock Exchange
- § 7:11 Domestic securities markets; Shenzhen Stock Exchange
- § 7:12 Types of domestic shares
- § 7:13 Completion of restructuring of major SOEs into stock companies
- § 7:14 Corporate debt

II. SHARE PURCHASE AGREEMENTS

- § 7:15 In general
- § 7:16 Purchase of listed shares
- § 7:17 —B Shares
- § 7:18 —QFIIs
- § 7:19 —FIE investment companies
- § 7:20 —Strategic investors
- § 7:21 Purchase of non-tradeable, unlisted shares
- § 7:22 Form for subscription/shareholder agreements
- § 7:23 —Corporate subscription
- § 7:24 —Private placements
- § 7:25 —Special provisions in a subscription agreement

Professional Bookshop
www.pbookshop.com

- § 7:26 —Board of directors and cumulative voting
- § 7:27 —Legal representative
- § 7:28 —Board of directors voting procedures
- § 7:29 —Majority ownership
- § 7:30 —Advantages and disadvantages of corporate subscription method
- § 7:31 —Shareholder agreement
- § 7:32 —Investments of less and more than 25%
- § 7:33 —Offshore transfers

III. VOTING TRUST ARRANGEMENTS

- § 7:34 Control through a voting trust

IV. SHARE ACQUISITIONS BY TENDER OFFER

- § 7:35 Takeovers; gradual acquisition of shares
- § 7:36 —Takeover by offer

V. LIKELIHOOD OF STRATEGIC INVESTORS AND FOREIGN TAKEOVERS

- § 7:37 In general

VI. ASSET SALES BY LISTED COMPANIES

- § 7:38 In general
- § 7:39 Listed companies acquisition and restructuring review committee

VII. FOREIGN INVESTMENT JOINT STOCK COMPANIES

- § 7:40 In general
- § 7:41 Nature of companies
- § 7:42 Promotion method; formation by promoters
- § 7:43 —Approval procedure
- § 7:44 —Registration procedure
- § 7:45 Transformation method; formation by investors
- § 7:46 —Approval procedure
- § 7:47 —Registration procedure
- § 7:48 —Future prospects for the FIJSC

VIII. PUBLIC ISSUE OF SHARES BY A FOREIGN INVESTMENT JOINT STOCK COMPANY

- § 7:49 Types of shares
- § 7:50 —Requirements for an A share issue by an FIJSC

TABLE OF CONTENTS

- § 7:51 —Additional requirements for an FIJSC to issue B shares
- § 7:52 —Affect of an FIJSC share issue
- § 7:53 —Listing procedures
- § 7:54 Future of FIJSCs as M&A vehicles

CHAPTER 8. MERGERS

- § 8:1 In general
- § 8:2 Types of mergers
- § 8:3 —Merger by absorption
- § 8:4 —Merger by new establishment
- § 8:5 —Corporate approval
- § 8:6 —Notification of creditors
- § 8:7 Merger agreement under Company Law
- § 8:8 Merger of foreign invested enterprises
- § 8:9 —Approval authority
- § 8:10 —Merger conditions
- § 8:11 —Successor entity
- § 8:12 —Capitalization rules
- § 8:13 —Establishment date
- § 8:14 —FIE mergers with China-owned companies
- § 8:15 —50% limitation
- § 8:16 —Required documentation
- § 8:17 —Merger agreement
- § 8:18 —Assumption of debts
- § 8:19 —Payment in some mergers
- § 8:20 —Resolving contradictions
- § 8:21 Mergers of domestic enterprises with payment in foreign shares
- § 8:22 —Preconditions to the use of shares
- § 8:23 —Required use of M&A advisors
- § 8:24 —Approval documentation
- § 8:25 —Approval procedure
- § 8:26 —Domestic company alteration of registration
- § 8:27 —Payment in shares
- § 8:28 Offshore special purpose vehicles
- § 8:29 —Regulatory scheme
- § 8:30 —CSRC approval to list
- § 8:31 —MOFCOM approval to merge or acquire a domestic company
- § 8:32 —Approval implementation
- § 8:33 —Use of proceeds
- § 8:34 —Secondary offering proceeds, gains, and dividends
- § 8:35 —Revival of offshore SPVs
- § 8:36 Mergers of domestic enterprises without foreign involvement

CHAPTER 9. REORGANIZATION OF STATE-OWNED ENTERPRISES BY FOREIGN INVESTORS

- § 9:1 Reorganizing versus joint venture
- § 9:2 —The Xugong case
- § 9:3 —Restructuring
- § 9:4 —Original plan
- § 9:5 —First setback
- § 9:6 —Concession to minority shareholding
- § 9:7 —Structuring alternatives
- § 9:8 Investment process; types of reorganization
- § 9:9 —Government approval
- § 9:10 —Types of investors
- § 9:11 —Restructuring program
- § 9:12 —Reorganization principles
- § 9:13 —Asset appraisal
- § 9:14 —Labor settlement plan
- § 9:15 —Reorganization procedure
- § 9:16 Likelihood of SOE reorganizations
- § 9:17 Equity and asset exchanges; functions
- § 9:18 —Relationship to SOE reorganizations
- § 9:19 —Asset and equity exchange procedure
- § 9:20 —Purchasing state assets?

CHAPTER 10. SHAREHOLDER AGREEMENTS IN ACQUISITIONS

- § 10:1 Introduction
- § 10:2 Continuing use of offshore shareholder agreements
- § 10:3 —Foreign corporate joint ventures
- § 10:4 —United States limited liability company
- § 10:5 Requirement to use PRC law governed shareholder agreements
- § 10:6 —Form for shareholder agreements
- § 10:7 —Corporate subscription
- § 10:8 —Board of directors and cumulative voting
- § 10:9 —Legal representative
- § 10:10 —Board of directors voting procedures
- § 10:11 —Majority ownership
- § 10:12 —Advantages and disadvantages of the subscription method
- § 10:13 —Shareholder agreement
- § 10:14 —Investments of less than 25%

CHAPTER 11. ACQUISITION OF INTERESTS IN CERTAIN REGULATED CHINESE ENTERPRISES

- § 11:1 Acquisition of financial institutions
- § 11:2 Banks
- § 11:3 —Regulations affecting foreign-funded bank expansion
- § 11:4 —Subsidiaries; registered capital
- § 11:5 —Asset thresholds
- § 11:6 —Other requirements
- § 11:7 —Acquisitions
- § 11:8 —Approval procedures
- § 11:9 —Branches of a subsidiary bank
- § 11:10 —Branches
- § 11:11 —Foreign bank penetration
- § 11:12 Insurance companies
- § 11:13 —Permissible methods of entry
- § 11:14 —Approval process
- § 11:15 —Penetration of the domestic insurance business
- § 11:16 —Acquisition of shares in domestic insurance companies
- § 11:17 Securities companies
- § 11:18 —Foreign invested securities companies
- § 11:19 —Securities company subsidiaries
- § 11:20 —Fund management companies
- § 11:21 Acquisitions in publication, news, and other media
- § 11:22 Acquisitions in publication, news and other media—Publications
- § 11:23 —Internet supervision
- § 11:24 —Organizational structure
- § 11:25 Other types of restricted acquisitions
- § 11:26 —Acquisitions in major infrastructure projects

CHAPTER 12. ANTITRUST LAW ISSUES

- § 12:1 Development of antitrust law
- § 12:2 Structure of AML
- § 12:3 Concentrations
- § 12:4 —Merger review: prior system
- § 12:5 —Investor-initiated review
- § 12:6 —Governmental discretion
- § 12:7 —Exemptions
- § 12:8 —Filing guidelines
- § 12:9 —Filing party
- § 12:10 —Filing deadline
- § 12:11 —Filing materials
- § 12:12 —Review period

§ 12:13 — — — Discussion prior to filing
 § 12:14 — — — Confidentiality
 § 12:15 — — — Submission times and location
 § 12:16 — — — MOFCOM experience
 § 12:17 — — — Merger review: AML system
 § 12:18 — — — Review authority
 § 12:19 — — — Reporting thresholds
 § 12:20 — — — Reporting exemption
 § 12:21 — — — Documentation requirements
 § 12:22 — — — Document review period
 § 12:23 — — — Substantive review factors
 § 12:24 — — — Practice pointers
 § 12:25 Monopoly agreements
 § 12:26 — — — Horizontal agreements
 § 12:27 — — — Vertical agreements
 § 12:28 — — — Broad list of possible exemptions
 § 12:29 — — — Effect on M&A due diligence
 § 12:30 Prohibition of abuses of a dominant position
 § 12:31 — — — Dominant position criterion
 § 12:32 — — — Market dominance rule
 § 12:33 — — — Prohibited conduct
 § 12:34 — — — Effect on M&A due diligence

CHAPTER 13. THE TAXATION OF MERGERS AND ACQUISITIONS

§ 13:1 Tax administration
 § 13:2 Principal taxes affecting mergers and acquisitions
 § 13:3 Income taxes
 § 13:4 — — — Resident and non-resident enterprises
 § 13:5 Transfer and *ad valorem* taxes
 § 13:6 Application to business transactions
 § 13:7 — — — Mergers
 § 13:8 — — — Equity transfers
 § 13:9 — — — Asset acquisitions
 § 13:10 — — — EITL
 § 13:11 — — — VAT
 § 13:12 — — — Business tax
 § 13:13 — — — Land appreciation tax
 § 13:14 — — — Deed tax
 § 13:15 — — — Stamp duty
 § 13:16 Tax perspective on acquisition of a PRC business

CHAPTER 14. LABOR LAW EFFECTS ON MERGERS AND ACQUISITIONS

§ 14:1 Introduction

§ 14:2 Labor Law
 § 14:3 Labor law—The Labor Contract Law
 § 14:4 — — — The legislative process
 § 14:5 — — — The FIE reaction
 § 14:6 — — — The legislators' game plan
 § 14:7 — — — Significant features of the law—Noncompete agreements
 § 14:8 — — — Lay-offs
 § 14:9 — — — Severance pay
 § 14:10 — — — Open-ended contracts
 § 14:11 — — — Special training
 § 14:12 — — — Collective contracts
 § 14:13 — — — Labor dispatch agencies
 § 14:14 Other new labor laws
 § 14:15 — — — The Employment Promotion Law
 § 14:16 — — — Regulation on the employment of the disabled
 § 14:17 — — — Effect on M&A transactions
 § 14:18 — — — The Labor Dispute Law
 § 14:19 Trade unions in the PRC
 § 14:20 — — — Development of the trade union law
 § 14:21 — — — Effect of labor unions on M&A activities
 § 14:22 — — — Labor unions in foreign investment enterprises
 § 14:23 — — — Organization of unions
 § 14:24 — — — Nature and implications of required contributions by companies
 § 14:25 — — — Expenditure of union funds
 § 14:26 — — — Increased efforts to unionize
 § 14:27 — — — Unrest in domestic enterprises
 § 14:28 — — — Increasing difficulty in controlling workers in FIEs
 § 14:29 — — — Mandatory formation of FIE labor unions
 § 14:30 — — — Effect on acquisition of FIE

CHAPTER 15. FOREIGN CORRUPT PRACTICES ACT

§ 15:1 Introduction
 § 15:2 Bribery
 § 15:3 — — — Crime of bribery of a state functionary
 § 15:4 — — — Bribery of enterprise employees
 § 15:5 Commercial bribery
 § 15:6 — — — Concurrent criminal and commercial bribery
 § 15:7 Enforcement of China's domestic corruption laws
 § 15:8 The Foreign Corrupt Practices Act
 § 15:9 — — — Accounting standards
 § 15:10 — — — Foreign corrupt practices
 § 15:11 — — — Application to foreign entities
 § 15:12 — — — Knowledge

- § 15:13 ——Affirmative defenses
- § 15:14 ——Payments for routine governmental action
- § 15:15 ——Penalties
- § 15:16 ——OECD Convention
- § 15:17 Anti-corruption and FCPA effects on M&A transactions—
Inheriting prior problems—The FCPA effect
- § 15:18 ——Domestic effects
- § 15:19 ——Contract negotiation expenses
- § 15:20 ——Inheriting prior problems—FCPA concerns
- § 15:21 ——China law concerns
- § 15:22 ——Foreign officials
- § 15:23 ——Partially state-owned companies
- § 15:24 ——Unions
- § 15:25 ——Agents, representatives, and partners
- § 15:26 Avoiding corruption problems in M&A transactions—Agents
and intermediaries
- § 15:27 ——Due diligence
- § 15:28 ——Contract provisions

APPENDICES

- APPENDIX A. List of Chinese Legal Texts with Official Mandarin
Titles
- APPENDIX B. Due Diligence Checklist
- APPENDIX C. The Company Law of the People's Republic of China
- APPENDIX D. Provision on Foreign Investors' Merger and
Acquisition of Domestic Enterprises
- APPENDIX E. Provisions of the Ministry of Foreign Trade and
Economic Cooperation and the State Administration
for Industry and Commerce on Merger and Division
of Foreign-Invested Enterprises

Table of Laws and Rules

Index

Part I

BACKGROUND

Chapter 1

The Early Development of China's Economy and the Origin of M&A Activity

I. ECONOMIC GROWTH SINCE 1979

- § 1:1 The economy
- § 1:2 —Economic structure
- § 1:3 —Economic plans and development
- § 1:4 —Economic reforms
- § 1:5 The transformation to a Soviet planned economy (1949–1978)
- § 1:6 State planning and the functioning of the economy
- § 1:7 The Open Door Policy (1979–2008); stages of evolving policy
- § 1:8 —The origin of foreign investment
- § 1:9 —Intended and unintended changes

II. EARLY EXAMPLES OF M&A ACTIVITY

- § 1:10 In general
- § 1:11 Foreign investment through joint ventures
- § 1:12 The contract management system
- § 1:13 Hong Kong Compensation Trade investment
- § 1:14 State restructuring to form group companies

III. THE UNINTENDED DEVELOPMENT OF M&A LAW

- § 1:15 In general
- § 1:16 The Company Law
- § 1:17 The regulation of acquisitions by foreigners

IV. PRESENT M&A LAW IN CHINA

- § 1:18 Summary of present M&A law

The original Acquisition Regulations¹ took effect on April 12, 2003, and have subsequently applied to almost all acquisitions in China in which foreign capital was involved. The original Acquisition Regulations were substantially modified in 2006 to add chapters governing the use of special purpose vehicles formed abroad to acquire China assets and the use of foreign registered shares as a means of payment for a Chinese acquisition.² According to Article 2 of the original Acquisition Regulations, they apply to both stock acquisitions and asset acquisitions. Article 2 stated that the original Acquisition Regulations apply to all asset acquisitions in which foreign investors either (i) establish foreign investment enterprises or FIEs to purchase assets owned by "domestic entities" and operate such assets through the FIEs, or (ii) purchase assets directly from "domestic entities" and contribute such assets as capital to establish FIEs that will operate such assets. The original Acquisition Regulations do not clearly define "domestic entities," but in practice it has become clear that all PRC enterprises, whether state-owned, privately owned or other FIEs are encompassed by the legislation. The only circumstance where the original Acquisition Regulations appear not to apply is when the acquirer is an existing FIE actively involved in business and it acquires additional assets within China for that business. Although there is no specific test as to how long the buyer's FIE has to exist before the merger or asset acquisition in order to escape the Acquisition Regulations, it is clearly the case that the FIE had to be established for some distinct purpose other than to acquire the business.

In all cases, whether under the original Acquisition Regulations or the new Foreign M&A Regulations, the Ministry of Commerce has been restored with the approval power over the proposed transaction.

IV. PRESENT M&A LAW IN CHINA

§ 1:18 Summary of present M&A law

The curious fact therefore is that China's current system of

[Section 1:17]

¹Regulations on Acquisition of Domestic Entities by Foreign Investors, Ministry of Foreign Trade and Economic Cooperation, State Administration of Industry and Commerce, State Administration of Foreign Exchange, and State Administration of Taxation (March 7, 2003) (P.R.C.) (the "Original Acquisition Regulations") (see Appendix A).

²Provisions on the Merger and Acquisition of Domestic Entities by Foreign Investors, Ministry of Commerce, State-Owned Assets Supervision and Administration Commission, State Administration of Industry and Commerce, China Securities Regulatory Commission, State Administration of Foreign Exchange, and State Administration of Taxation (Sept. 8, 2006) (P.R.C.) (the "Domestic Acquisition Regulations") (see Appendix A).

regulating mergers and acquisitions has developed from two different directions. On the one hand, China wanted more foreign capital and the development of domestic security markets. This desire required the adoption of The Company Law, which was in turn followed by the Securities Law, the Tender Offer Code, and numerous laws and regulations governing the acquisition of companies formed under the Company Law. On the other hand, regulators desire to strictly control the inflow of foreign funds into China that was acquiring existing businesses and assets. The scheme of regulation that controlled the first joint ventures and subsidiaries in China that established greenfield plants was no longer adequate to control foreign investors with large amounts of cash and acquisitive instincts for China assets.

These two separate sources of M&A law frequently lead to contradictions and confusion because of the overlapping and inconsistent regulatory burdens. It is likely that these contradictions and confusion will continue, since China seems to be pursuing a policy of a free market for domestic capital and a regulated market for foreign capital. Until such time as China liberalizes its capital account restrictions on the free flow of capital into and out of China, there will necessarily be different rules governing domestic and foreign acquirors of China businesses.

This work attempts to provide a road map for the difficult landscape of merger and acquisition law in China, recognizing that there are many dead-ends, incomplete expressways, and speed-bumps to hinder a traveler's progress.

- § 2:27 Foreign M&A activity
- § 2:28 Factors inhibiting foreign acquisitions by private equity
- § 2:29 Joint venture and cooperative enterprise acquisitions
- § 2:30 Foreign acquisition of a domestic enterprise
- § 2:31 Takeovers of listed companies
- § 2:32 Foreign investment to restructure State-owned enterprises

KeyCite®: Cases and other legal materials listed in KeyCite Scope can be researched through the KeyCite service on Westlaw®. Use KeyCite to check citations for form, parallel references, prior and later history, and comprehensive citator information, including citations to other decisions and secondary materials.

§ 2:1 Introduction

The interest in mergers and acquisitions of companies formed in the People's Republic of China has never been greater. In a survey conducted by a consulting firm, 63% of the respondents, which consisted of 75 investment bankers, private equity practitioners, and corporate executives, thought that there was a significant amount of inbound and outbound M&A activity being generated in China.¹ Almost half of the respondents thought that because China's economy was growing at a very fast rate, the market for acquisition activity was robust. The same participants also remarked that there remained considerable uncertainty as to how one made an acquisition in China and what the commercial and corporate laws governing the ownership of an enterprise in China were.

The purpose of this work is to resolve such uncertainties and explain the legal parameters for merger and acquisition activities in China.

I. THE PLAYERS

§ 2:2 In general

The purpose of this section is to describe briefly some of the principal players involved in mergers and acquisitions in China.

A. THE ACQUIRERS

§ 2:3 State-Owned Assets Supervision and Administration Commission (SASAC)

SASAC owns all national state assets, including large state shareholdings in many formerly wholly state-owned enterprises

[Section 2:1]

¹US/Chinese Cross-Border M&A Spotlight (Mergermarket Survey, Jan. 2008).

that have issued shares in the public markets. SASAC does not acquire other enterprises, but instead causes its subsidiaries to merge and acquire other subsidiaries. Since this is an extremely active portion of China's M&A market, it is correct to start with a description of SASAC as it is the decision-maker as to much of the M&A activity in China.

SASAC is a commission of the State Council, and reports directly to the State Council. SASAC acts as investor of state-owned assets on behalf of the central government and aims to strengthen the management of state-owned assets. SASAC was founded to shoulder responsibilities of:

- the former State Economic and Trade Commission in guiding state-owned enterprises' reform and management,
- the former Work Committee of Enterprises of China Central Committee of the Communist Party,
- the Ministry of Finance relating to state-owned assets management, and
- a portion of the responsibilities of the Ministry of Labor and Social Security relating to state-ownership.

SASAC manages RMB 6.9 trillion of state-owned assets. SASAC directly supervises and manages 196 enterprises that own these state-owned assets and SASAC's investment represents RMB 2.5 trillion of owner's equity.

China also set up state-owned assets supervision and administration bodies at the provincial and municipal levels. Both the state-level and the local-level commissions fulfill the responsibilities of investors of state and local assets authorized by the State Council and the local government. Apart from fulfilling the responsibility of state assets' investors, SASAC is also in charge of guiding and supervising local-level state-owned assets management according to law. All local authorities of the state-owned supervision and administration must strictly implement laws and regulations concerning state-owned assets supervision and administration.

§ 2:4 State Holding Companies

State Holding Companies came into being as China restructured its state-owned enterprises on more commercial lines. A State Holding Company's shareholder is the State itself, normally represented by SASAC.

For example, in the 1950s, China followed the Soviet model with a Ministry of Petroleum Industry and a Ministry of Chemical Industries. In the reform of 1988, the central government abolished the ministries and transferred their responsibilities to China National Petroleum Corporation (CNPC) and China National Petrochemical Corporation (Sinopec). In order to create

competition and greater efficiency, the central government further reformed the structure in July 1998 by integrating both its oilfields and petrochemical plants on regional grounds, giving CNPC control of the North and Sinopec control of the South. At this point, CNPC and Sinopec were State Holding Companies holding the state's interest in the various oilfields and petrochemical plants directly through locally incorporated subsidiaries, and, in the event that a petrochemical plant like Shanghai Petrochemical Corporation had become a stock or public company and issued shares to the public, holding the State's shares.

On February 25, 2000, China Petroleum & Chemical Corporation was established as a joint stock limited company with Sinopec Group Company as the sole shareholder.¹ Sinopec Group Company transferred to its new subsidiary the businesses of various refineries and also transferred its shareholdings in 13 then listed companies. Sinopec Group Company also agreed in the reorganization agreement to transfer to China Petroleum & Petrochemical Corporation its exploration and production licenses and all rights and obligations under the agreements in connection with its core businesses transferred. This massive reorganization permitted China Petroleum & Chemical Corporation to go public in the same year.²

Sinopec Group Company, as a State Holding Company, owns (as of April 6, 2007) 65 billion shares of China Petroleum & Chemical Corporation, constituting 75.84% of its issued and outstanding shares.³ Such a significant shareholding gives Sinopec Group Company complete control over its public subsidiary.

In addition to companies that hold the State's interest in publicly listed companies, there are many State holding companies for non-publicly listed companies.

§ 2:5 China publicly listed companies

There are now over 1,000 Chinese companies listed on stock markets in Shanghai, Shenzhen, Hong Kong, New York, London and elsewhere. The vast majority of these companies are owned and controlled by State Holding Companies, although some have diverse shareholdings among a number of State Holding Companies and the public. The principal stock exchanges where these

[Section 2:4]

¹FORM 20-F China Petroleum & Chemical Corporation, April 6, 2007, p. 12.

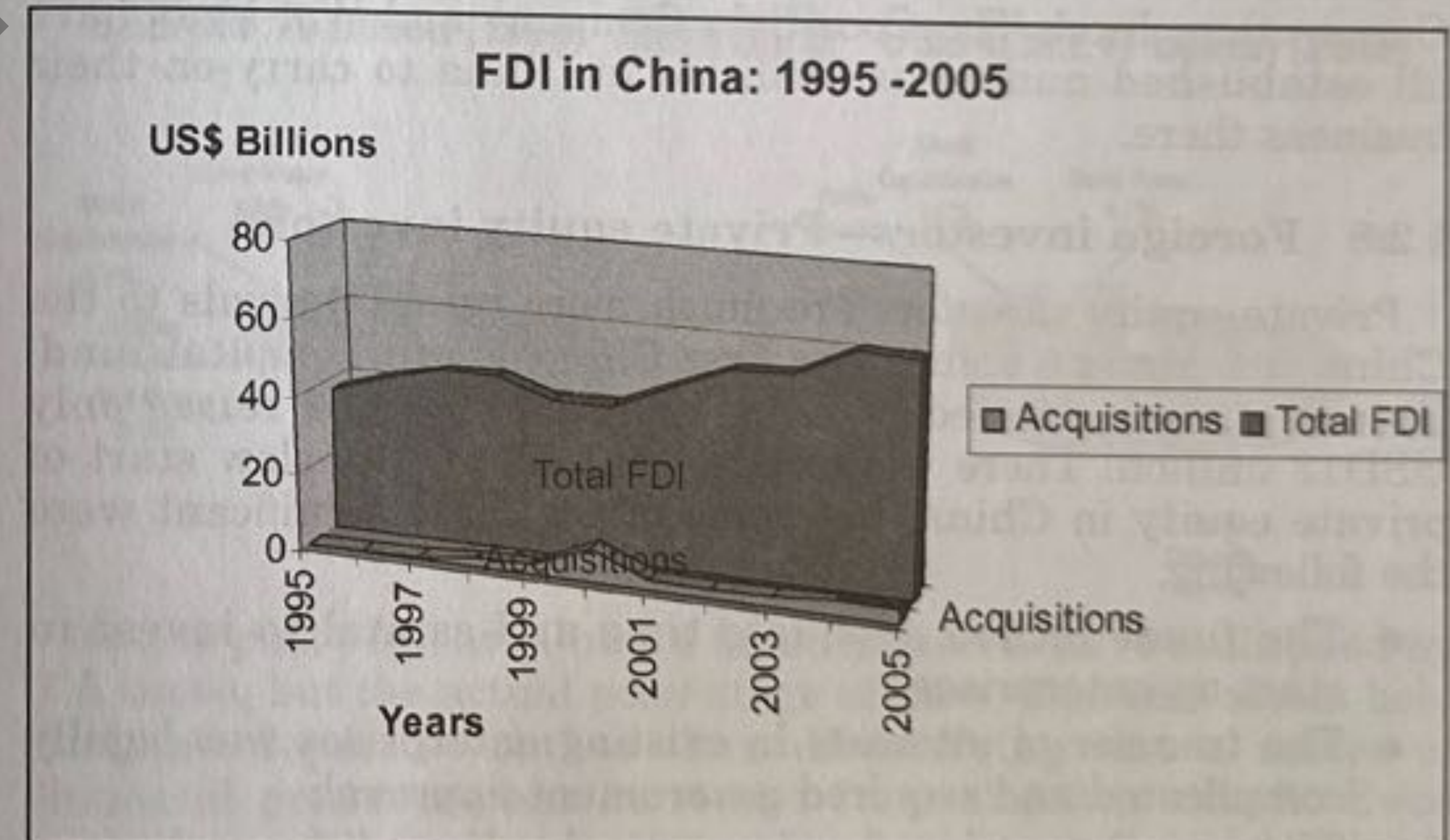
²FORM 20-F China Petroleum & Chemical Corporation, April 6, 2007, p. 12.

³FORM 20-F China Petroleum & Chemical Corporation, April 6, 2007, p. 65.

companies have listed their shares are the Shanghai Stock Exchange, the Shenzhen Stock Exchange, the Hong Kong Stock Exchange, the New York Stock Exchange, the NASDAQ, and the London Stock Exchange. The Shanghai Stock Exchange has considerably more large companies than the Shenzhen exchange, and the Hong Kong Exchange is considerably more popular than any of the other foreign exchanges.

§ 2:6 Foreign investors

There are currently 260,000 foreign investment enterprises in China and foreign investment utilized from these enterprises has exceed USD60 billion per year for several years.¹ The vast majority of this investment has gone into greenfield plants, as opposed to merger and acquisition activity. The first acquisition of an existing Chinese business was probably the 1984 investment of the S.C. Johnson Company in a Shanghai joint venture into which S.C. Johnson contributed cash that was used to purchase the assets of an existing shoe polish company in Shanghai. This lack of foreign acquisition activity is due to the difficulty of completing foreign acquisitions of domestic companies. It is also the case, however, that many joint venture deals where the Chinese party contributes its business assets to the new joint venture as a capital contribution are not treated as acquisitions, but as joint ventures.²



The majority of this foreign direct investment takes the form of

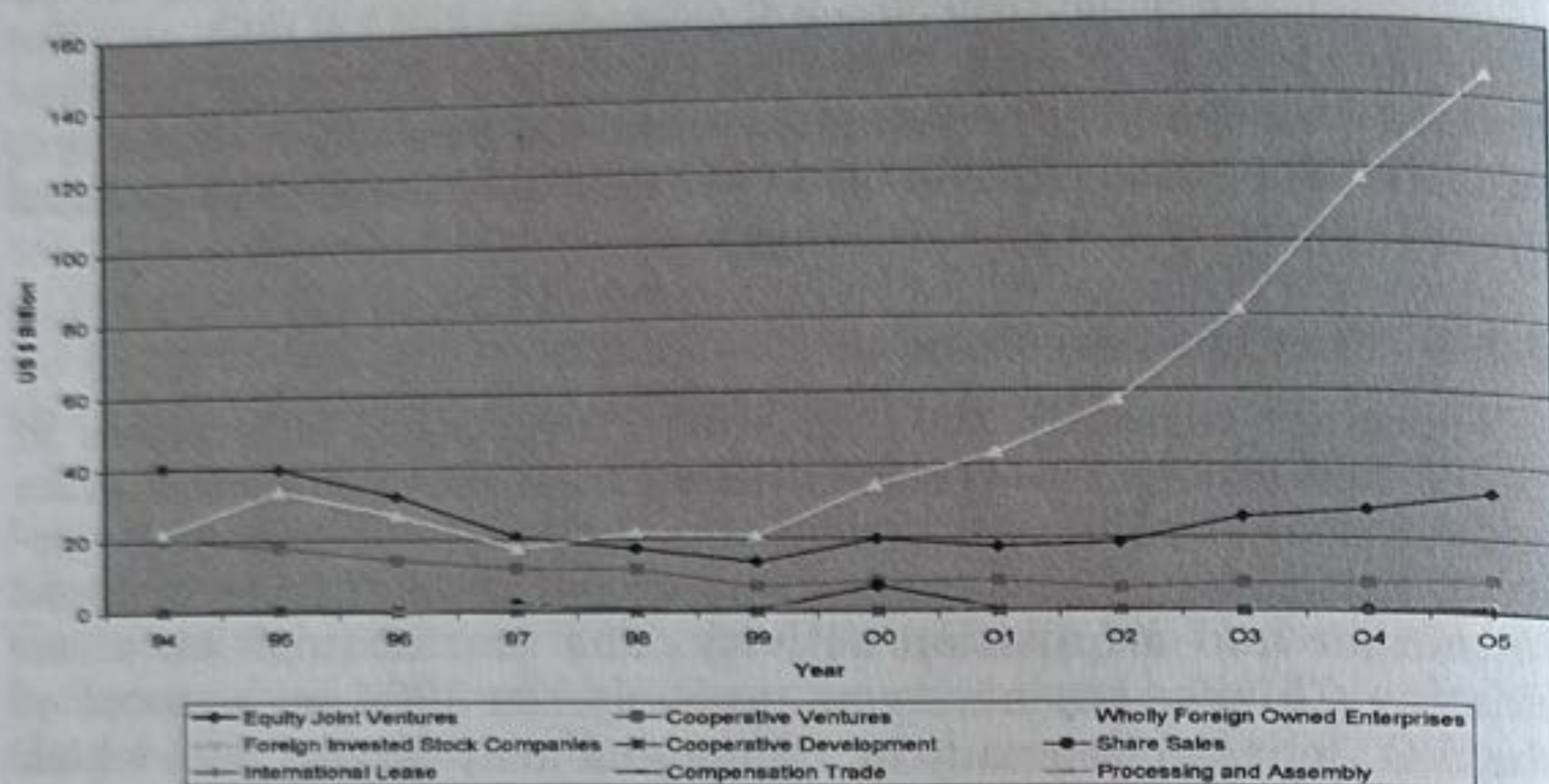
[Section 2:6]

¹National Bureau of Statistics at <http://www.stats.gov.cn/tjsj/ndsj/2006/html>.

²Bureau of National Statistics at <http://www.stats.gov.cn/tjsj/Ndsj/2006/html>.

either joint ventures or wholly owned subsidiaries.

FDI Form of Investment



§ 2:7 Foreign investors—Strategic investors

The majority of investors in China over the years, both of those establishing new plants and those making acquisitions, have been strategic investors—that is manufacturing or service companies that came to China for the purpose of expanding their business in a new market. Such investors as General Motors Corporation, Intel, The Coca-Cola Company and Wal-Mart have all established numerous facilities in China to carry-on their business there.

§ 2:8 Foreign investors—Private equity investors

Private equity investors are much more recent arrivals to the China investment scene. The first China venture capital fund, ChinaVest, was formed in Hong Kong in 1983 and raised only USD12 million. There were many reasons for the slow start of private equity in China, but some of the more significant were the following:

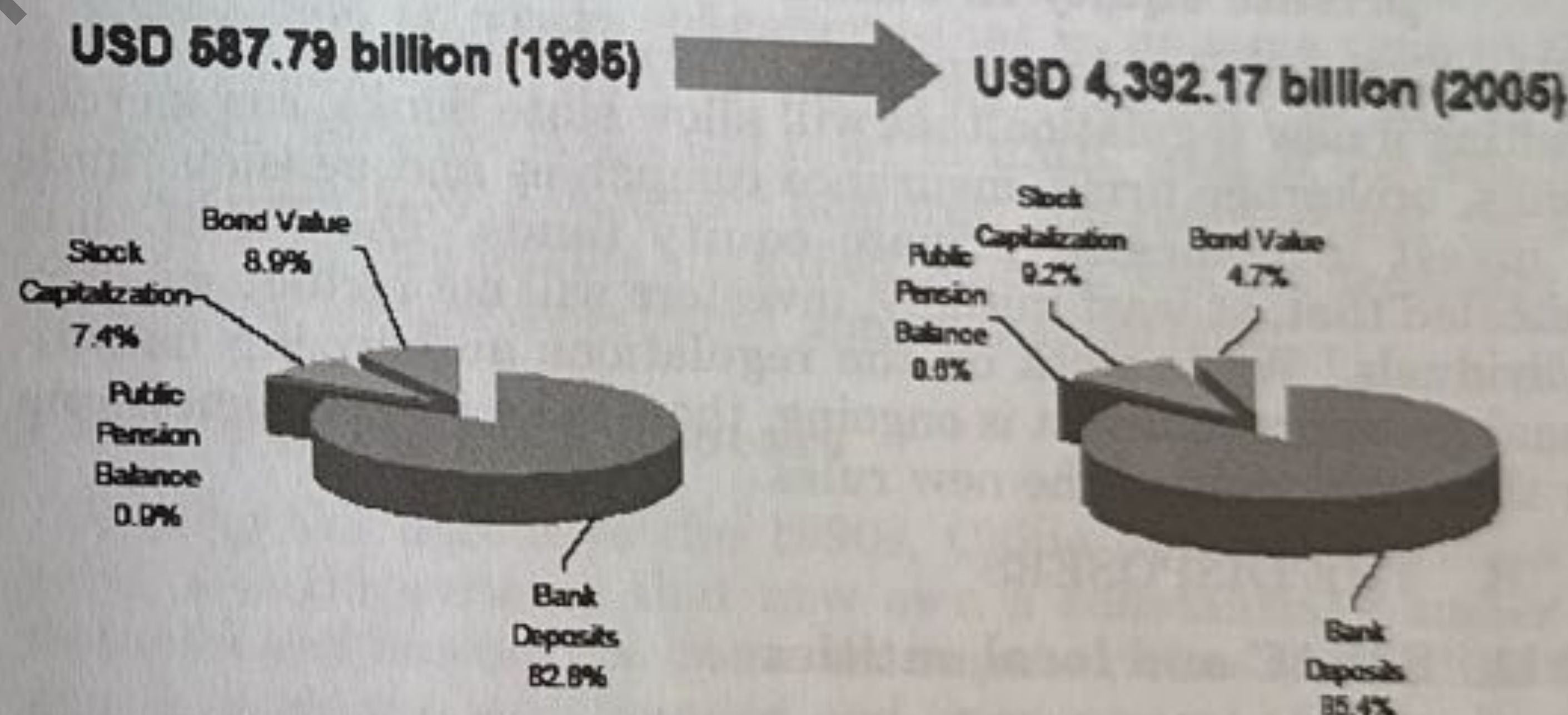
- The funds lacked adequate time and capital to invest in start-up enterprises;
- The transfer of interests in existing enterprises was legally complicated and required government approval;
- The existing rules for domestic lending did not permit foreign banks to and foreign banks were not willing to provide significant leverage for acquisitions;
- There were few experienced managers with knowledge as to how to buy and then operate a PRC company; and
- Government incentives were geared to the creation of new productive enterprises, rather than the purchase and renovation of an existing company.

Beginning with the financial crisis of 1997, when the currencies of a number of Southeast Asian countries collapsed, foreign private equity began to receive a more enthusiastic welcome generally in Asia where businesses were now up for sale at reasonable prices. Major private equity houses established offices in Hong Kong and Singapore and began to do deals throughout the region. China investments were of considerable interest, but most deals were done in Taiwan, Hong Kong, and South Korea.

Important private equity firms began to raise money in the United States and Europe specifically for investment in Asia. Names such as KKR, TPG, CVC, Carlyle, Newbridge and AIG all raised specific funds for acquisitions with China being an important part of their background planning. Although it continues to be the case that more private equity investment is occurring in Asia outside of China than in China, the number of deals and the amount invested in China is increasing.¹

Although progress to date has been slow, it is expected that China will open its doors to private equity. The principal reason China will adopt a flexible approach to foreign private equity fund managers is to diversify the country's investment alternatives.²

Proportion of Financial Assets



In the past 10 years China's financial assets have multiplied by 7.5 times, but the actual percentage of those financial assets held in bank deposits—rather than diversifying into a series of financial products—has increased from 82.8% to 85.4%. Even with the real interest rate averaging between zero and 1%, bank

[Section 2:8]

¹J. COLBY, The Growth of Private Equity in China: What Foreign Investors Need to Know (Dec. 10, 2007) speech at ACI 3rd National Symposium on M&A in China.

²Brian Murray, The Impact of China's Changing Demographics on Business, (Speech May 28, 2007, Shanghai), slide 18.

deposits have grown simply because of the absence of other viable outlets for investment. This has caused two significant problems: first, the banks need assistance in reinvesting these deposits in profitable investments, and second, the depositors, such as state-owned factories, insurance companies, securities houses and pension funds would like an alternative to depositing their funds with the banks.

§ 2:9 Foreign investors—Venture capital development

Although China has tried repeatedly to spur the development of domestic venture capital funds, its efforts to date have been less than successful. The government is aware that venture capital funds the development of new technology, and building the nation's domestic technology base is the country's highest priority. China's banks, however, are both unable to assess the risks involved in lending to technology companies and do not have the flexibility to provide mixed equity and debt products common in the industry. Moreover, most start-ups are unlikely to be able to pay the fixed interest and principal payments required by the banks.¹ Thus, without venture capital, China's domestic technology base is growing slowly.

§ 2:10 Foreign investors—Progress toward opening private equity in China

The National Development and Reform Commission (NDRC) is drafting a new regulation that will allow state banks, commercial banks, brokerage firms, insurance companies and pension funds to invest in domestic, private equity funds. The NDRC has indicated that, at least initially, investors will not include wealthy individuals.¹ While work on the regulations authorizing institutional investors to invest is ongoing, there is no specific timeframe for the publication of the new rules.

B. THE DISPOSERS

§ 2:11 SASAC and local entities

As noted above, SASAC is a major player in the mergers and acquisitions business, both encouraging its subsidiary State Holding Companies to combine to make even bigger consolidated companies, and selling state-owned enterprises to buyers that wish to enter the China market.

[Section 2:9]

¹Private Equity in China, p. 1 of 7.

[Section 2:10]

¹Chen Huiying, Hu Yu, Michelle Blance: Homemade Equity Funds on China's Menu (April 11, 2007) at http://66.92.129.177/index.php?option=com_content&task=view&id=19&Itemid=1. (herein "Homemade Equity Funds").

§ 2:12 Asset management companies

One of the obstacles to reform in China has been the large number of non-performing loans held on the books of the domestic banks. The non-performing loans were created in the 1980s and 1990s when the banks acted as conglomerators of deposits from the public, but then would disburse the treasure trove as the local government officials instructed. In order to address this problem, China created four Asset Management Companies (the "AMCs") in 1998, one for each of the four large national banks. With the backing of the Ministry of Finance, the AMCs purchased a large number of nonperforming loans from the banks, which greatly improved each of the bank's balance sheets.

The AMCs had the difficult job of enforcing the security that the banks had taken from the State-enterprise borrowers, a task that the banks had found to be politically impossible. Once assets were converted into the name of the buyer, the AMC would then attempt to dispose of this group of assets. While there was much interest from both private equity concerns and, to a lesser extent, strategic buyers in acquiring assets from the AMCs, it proved quite difficult to do so. On the one hand, the State Administration of Foreign Exchange, which had to approve each deal, was reluctant to do so since such a sale converted an RMB asset in to a foreign debt or equity obligation—that is, at some time in the future, China would have to use foreign currency to pay off an obligation that had originally been in RMB. And, if the acquisition was made by a domestic acquirer, the requirement for approvals was considerably simplified, since it was not necessary to involve the foreign investment approval apparatus.

§ 2:13 Private entrepreneurs

During the decade of the 1990s, China developed a class of private entrepreneurs that now own a substantial number of factories and businesses. Some are rags to riches stories like the young engineers who founded and grew several of China's successful Internet companies like Alibaba, Baidu, Eachnet and many others. Other entrepreneurs were former factory managers, who entered into contracts with the local SASAC bureau or enterprise that guaranteed a fixed profit to the government. These entrepreneurs had to pay over to the State Holding Company or government owner of the enterprise a fixed amount each year, which was based on what the prior profits of the enterprise had been. These entrepreneurs, however, were allowed to retain any profits above the stipulated amount that had to be surrendered and, over time, these savings became sufficiently large so that the entrepreneur could either start his own factory or offer to buy those of the State.

§ 2:14 Foreign companies with China subsidiaries

The final group of companies that are occasionally involved in merger and acquisition activity in China are the holding companies and China subsidiaries of foreign companies. These companies can purchase domestic enterprises just as their foreign parent corporation can and, in such cases, there is slightly less complexity in the procedural requirements. Only strategic investors can engage in such activities since private equity concerns are not permitted to form holding companies in China and, while it is conceivable that one acquired target of a private equity firm would make the firm's next China acquisition, it is not something that appears to have happened to date.

C. THE REGULATORS

§ 2:15 National Development and Reform Commission (NDRC)

The NDRC is a governmental organization directly under the State Council which is empowered to regulate the national economy at the macro level. Its general functions in relation to M&A activities and foreign direct investment are:

- supervision and analysis of the use of foreign capital;
- formulation of strategies and plans to utilize foreign investment;
- coordination with other departments to draft a catalogue guiding foreign investment in industries;
- review of issues regarding State security and industrial concentration; and
- arrangements for important and large-scale foreign invested projects.

More specifically, the NDRC and its local counterparts are responsible for approving or verifying projects with foreign investment. On July 16, 2004, the State Council promulgated its decision on the reform of the investment process (the "Decision"),¹ which on the surface replaces the traditional approval process for investment (*li xiang*) with a verification procedure (*he zhun*). The verification procedure is supposed to be less strict and simpler than the approval process, both in terms of the documentation involved and the extent of examination. The general thrust of the Decision is that in regard to any project that does not involve the use of government funds, the NDRC and local authorities are to verify and approve only those important projects and those that are restricted for the purpose of protecting the public, while all

[Section 2:15]

¹Decision of the State Council on Reform of the Investment System, State Council, Guo Fa [2004] No. 20, July 16, 2004 (P.R.C.) (see Appendix A).

other projects are simply filed for the record.² The Decision attaches a Catalogue listing types of projects which must be approved by the government notwithstanding that all funds are provided by the enterprise itself.³

Unfortunately, the Catalogue has a special section relating to foreign investment, which essentially reimposes the approval system for most foreign investment projects, including acquisitions.⁴ These rules include the fact that the NDRC is responsible for the verification and approval of projects in the encouraged and permitted categories whose total investment is over USD100 million, as well as projects in restricted categories whose total investment is over USD50 million. The provincial counterparts of the NDRC are responsible for projects in the encouraged and permitted categories whose total investment is less than USD100 million, and those in restricted industries whose total investment is less than USD50 million.

To implement the Decisions, the NDRC issued the Project Verification Measures.⁵ The Project Verification Measures restate the powers of the NDRC and its local counterparts by repeating the approval limits stated above, and additionally provide that (a) encouraged and permitted projects of not less than USD500 million and restricted projects of more than USD100 million are to be examined by the NDRC and then forwarded to the State Council for verification; (b) all restricted projects below USD50 million must be approved by the provincial level development and reform department and may not be delegated further down the hierarchy, and (c) for projects below these limits but above USD30 million, the provincial authorities must forward a copy of their verification to the NDRC.⁶ Because the Project Verification Measures require the submission of numerous details in regard to the project, including an environmental impact assessment, full details on capitalization and source of funds, the scale and main particulars of the products, and the planned pricing, the NDRC exercises much the same approval powers it once did (using the name of MOFCOM) when the investor was required to

²Decision of the State Council on Reform of the Investment System, State Council, Art. 2(1), Guo Fa [2004] No. 20, July 16, 2004 (P.R.C.) (see Appendix A).

³Catalogue of Investment Projects to be Verified and Approved by the Government 2004 Edition (attached to the Decision of the State Council on Reform of the Investment System), State Council, Guo Fa [2004] No. 20, July 16, 2004 (P.R.C.) (herein referred to as the "NRDC Catalogue") (see Appendix A).

⁴NRDC Catalogue, Article XII.

⁵Interim Administrative Measures on the Verification of Foreign Invested Projects, National Development and Reform Commission [2004] No. 22, Oct. 9, 2004 (P.R.C.) (herein the "Project Verification Measures") (see Appendix A).

⁶Project Verification Measures, arts. 3, 4, and 20 (P.R.C.).

submit the draft Joint Venture Contract and the Feasibility Study.

§ 2:16 Ministry of Commerce (MOFCOM)

MOFCOM is an administrative organization under the State Council that plays the leading role in foreign economic relations and foreign and domestic trade, including foreign trade, foreign investment, regulation of domestic trade and other important tasks. As such, MOFCOM has succeeded to the powers and authority of two different branches of the government: on the one hand, the Ministry of Foreign Trade (MOF) and the Foreign Investment Commission (FIC), which were consolidated first into the Ministry of Foreign Economic Relations and Trade (MOFERT) and later the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) were charged with regulation and supervision of foreign trade and foreign investment; on the other hand, the State Economic and Trade Commission and the Ministry of Commerce were charged with supervising domestic investment and domestic trade. The combination, which occurred in the reforms of 2001, created the new MOFCOM with regulatory powers covering foreign and domestic trade, as well as a continuing role in regard to foreign investment.

MOFCOM's principal duties are to formulate development strategies, guidelines, and policies for domestic and foreign trade and international economic cooperation, draft laws and regulations governing domestic and foreign trade, economic cooperation and foreign investment, and devise implementation rules and regulations. Additional duties of MOFCOM include to study and put forward proposals on harmonizing domestic legislation on trade and economic affairs as well as bringing Chinese economic and trade laws into conformity with multilateral and bilateral treaties and agreements.

MOFCOM must also formulate development plans for domestic trade, study the reform of the commercial distribution system, foster and develop urban and rural markets, promote the restructuring of the commercial distribution sector, and the improvement of such modern distribution modalities as chain store operation, modern logistics, and e-commerce.

MOFCOM plays an important role in foreign direct investment in China. Because of the 2004 revisions to the verification process, the NDRC and its local organs are charged with the verification or approval power, but MOFCOM continues to exercise several important functions:

- Most notably, examination and approval of foreign investment applications, articles of association and joint venture contracts of foreign investment projects and to issuance of the required approval certificates;

- Supervision of the alteration of FIE constituent documents, including the increase or reduction of registered capital, transfer of shares, or mergers and acquisitions;
- Administrative control of foreign investment projects that exceed the limits stipulated by the State, or where investment is restricted, or where quota or license administration is involved; and
- Together with the SAIC, administrative approvals relating to the antitrust provisions of foreign acquisitions.¹

There are MOFCOM counterparts in every province, centrally governed municipality and autonomous region in China that perform similar functions under its leadership and authorization.

[Section 2:16]

¹Decision of the State Council on Reform of the Investment System, State Council, Art. XII, Guo Fa [2004] No. 20, July 16, 2004 (P.R.C.) (see Appendix A).

§ 2:17 State Administration of Industry and Commerce (SAIC)

Like MOFCOM, SAIC and its local counterparts also play a major role in merger and acquisition activities in China, since the SAIC is empowered to register enterprises, issue business licenses and supervise their day-to-day operations. While the NDRC and MOFCOM are the dominant regulators before an M&A transaction occurs, the SAIC is the most important regulator once the target has been acquired.

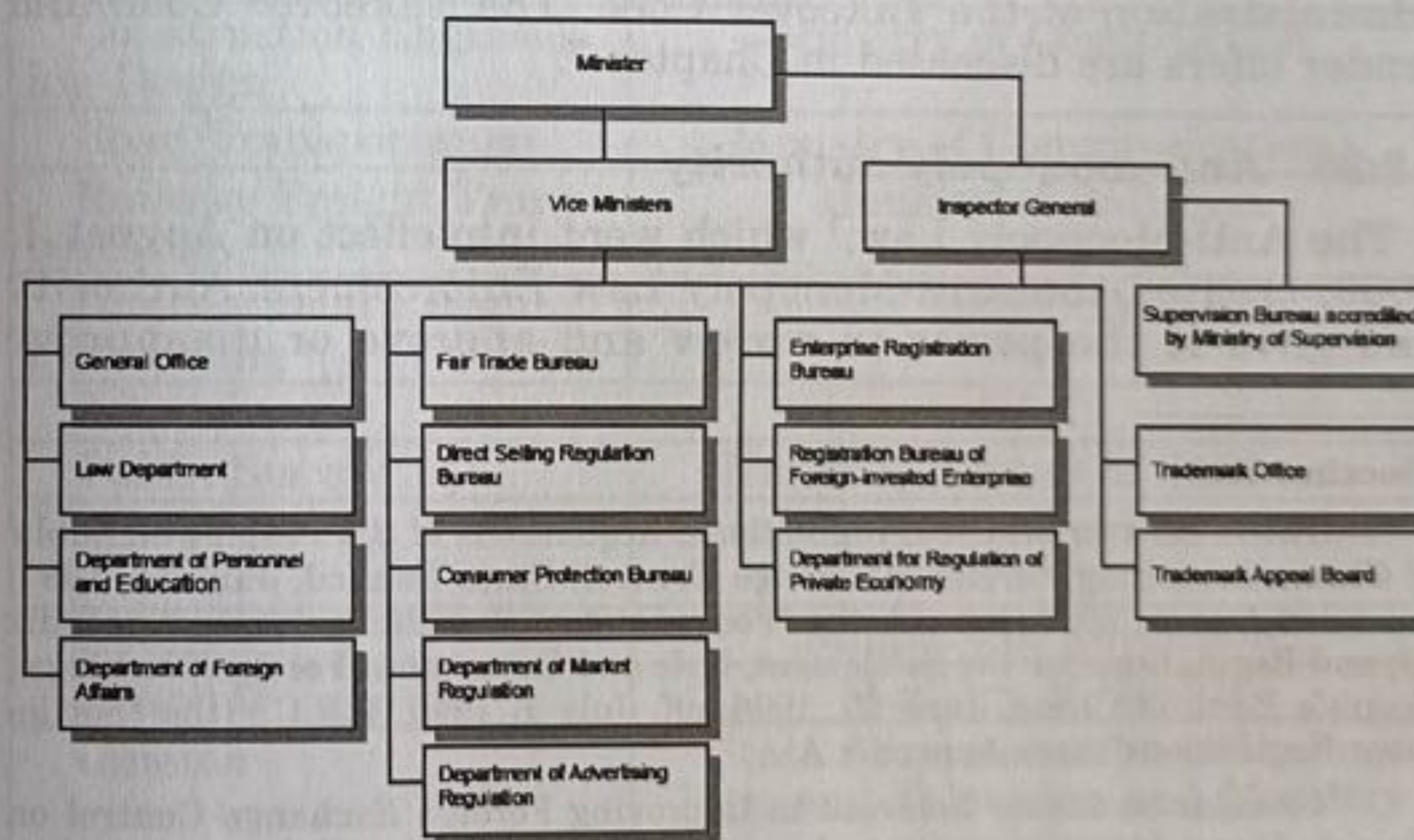
The SAIC and its local counterparts conduct annual inspections of enterprises in China to confirm that their operations are in accordance with the law. Such annual inspections frequently have stated specific areas of interest that the SAIC will announce in advance for all of its local inspectors to pay particular attention to when conducting their examinations. The breadth of the SAIC's responsibilities are evidenced by the number of its subsidiary bureaus, some of the more important of which are:

Table 2.1

Bureau	Responsibilities
Enterprise Registration Bureau	Examines and approves business names, issues business licenses to enterprises and other operating units.
Registration Bureau of Foreign Invested Enterprises	FIEs and resident representative offices must apply for registration. The bureau approves names, issues business licenses, and regulates registration behavior.
Fair Trade Bureau	Initiates investigation regarding economic offenses such as monopoly, unfair competition, smuggling, and selling smuggled goods.
Direct Selling Regulatory Bureau	Enforces the laws relating to direct selling and prohibiting pyramid selling.
Consumer Protection Bureau	Investigates and penalizes violations of consumer legislation, oversees the quality of marketed goods, and investigates and penalizes the sale of fake or substandard goods.

Department of Market Regulation	The Department administers the registration of chattel mortgages, regulates auction sales, and investigates contract frauds and other illegal market acts.
Department of Advertising Regulation	Investigates and punishes fraudulent advertising and supervises advertising review agencies and associations.
Department for Regulation of the Private Economy	The Department researches the development of the private economy and develops regulations on the administration of the private economy.
Trademark Office	The Office acts as the registry for trademarks in China.
Trademark Appeal Board	The Board reviews, at the request of the concerned party, trademark registration and assignment applications rejected by the Trademark Office.

The SAIC's organizational structure is set forth below:
Organizational Chart of SAIC



§ 2:18 State Administration of Foreign Exchange (SAFE)

SAFE administers China's foreign exchange control regulations.¹ With over USD1.5 trillion in foreign exchange reserves, it would appear that China no longer needs to be concerned about its foreign exchange position. Nevertheless, while the repatriation of profits is no longer a serious problem in China, there are a number of capital transactions that do require the approval of SAFE before they can be made. For example, the following items are treated as capital account items and therefore their payment to parties outside of China is subject to SAFE approval:

- Development and reserve funds in an enterprise;
- Undistributed profits, dividends payable and any accrued interest;
- Duly registered foreign loans borrowed from abroad and any accrued interest; and
- Assets acquired by a foreign investor through the advance withdrawal of investment capital, liquidation, share transfer and reduction of capital of an FIE.²

§ 2:19 China Securities Regulatory Commission (CSRC)

The China Securities Regulatory Commission or CSRC is in charge of the regulation of stock exchanges and all market participants in stock trading, including issuers, underwriters, broker-dealers, banks, and advisors. Because of its powers to regulate the securities markets, the CSRC is responsible for the administration of the Takeover Code. The Takeover Code and tender offers are discussed in Chapter 7.

§ 2:20 Anti-monopoly authority

The Anti-Monopoly Law,¹ which went into effect on August 1, 2008, created the Anti-Monopoly Law Enforcement Authority and gave it the power to review and approve or disapprove

[Section 2:18]

¹There are two principal regulations: Regulations of the People's Republic of China Governing Foreign Exchange Control, State Council, Jan. 14, 1997, amended Aug. 5, 2008 (P.R.C.) (the "Forex Control Regulations") (see Appendix A); and Regulations for the Settlement, Sale and Payment of Foreign Exchange, People's Bank of China, June 20, 1996, eff. July 1, 1996 (P.R.C.) (the "Settlement Regulations") (see Appendix A).

²Circular on Issues Relevant to Improving Foreign Exchange Control on Foreign Direct Investment, State Administration of Foreign Exchange, Art. I-3, Mar. 3, 2003, eff. Apr. 1, 2003 (P.R.C.) (see Appendix A).

[Section 2:20]

¹The Anti-Monopoly Law of the People's Republic of China, 29th Session of the Standing Committee of the 10th National People's Congress, Aug. 30, 2007, eff. Aug. 1, 2008 (P.R.C.) (see Appendix A).

concentrations. Concentrations specifically include all mergers and acquisitions, except where one of the parties already owns more than 50% of the other.² The operation of the Anti-Monopoly Law Enforcement Authority is discussed in Chapter 12.

§ 2:21 Industry specific regulators

There are specific laws and regulations governing domestic and foreign investment in the various industrial sectors. Accordingly, the acquisition of a domestic company in a certain sector is subject to the supervision of the government authority specifically in charge of that industry:

Table 2.2

Industrial Sector	Supervising Authority
Securities	China Securities Regulatory Commission (CSRC)
Finance	China Banking Regulatory Commission (CBRC)
Insurance	China Insurance Regulatory Commission (CIRC)
Telecommunication	Ministry of Information Industry (MI)
Distribution	MOFCOM
Construction	Ministry of Construction
Construction Engineering Design	Ministry of Construction
Road Transportation	Ministry of Communications
Railway Freight Transportation	Ministry of Railways
International Freight Forwarding	MOFCOM
Advertising	SAIC
Public Survey	National Bureau of Statistics
Travel Agency	China National Tourism Administration
Education	Ministry of Education
Hospital	Ministry of Health
Cinema	State Administration of Radio, Film and Television and Ministry of Culture

²The Anti-Monopoly Law of the People's Republic of China, Art. 22, 29th Session of the Standing Committee of the 10th National People's Congress, Aug. 30, 2007, eff. Aug. 1, 2008 (P.R.C.) (see Appendix A).