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# MERGERS AND ACQUISITIONS IN CHINA

Second Edition

Owen Nee
and
Jingzhou Tao

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Owen Nee divides his time between the Jones Day offices in New York and in Shanghai. He was founder of the China practice at Coudert Brothers, which was the first foreign law firm to establish offices in Beijing and Hong Kong. Many of the transactions documented by Owen during this time were the first of their kind in China, including the documentation of the first equity joint venture, the first large-scale project financing, the first American offshore oil concession, and the first syndicated loan to China. For more than 25 years, Owen was based in Greater China, principally in Hong Kong but also in Beijing and Shanghai. He returned to the United States in 2005.

Owen has represented many of the world's largest corporations in a variety of China transactions, and he has advised Chinese clients on numerous matters, including the first IPO of a Chinese company on the New York Stock Exchange, the first currency swap for a Chinese bank, and the first internal investigation of corporate governance procedures for a Chinese bank.

Owen was named in the 2008 Asialaw Leading Lawyers survey as "one of the most highly acclaimed legal experts in the Asia-Pacific region" in the areas of capital markets and corporate finance He also has been named as one of New York's Super Lawyers in the most recent publication of the list.

Owen edits the Bureau of National Affair's Tax Portfolio on Business Operations in China. Owen has also written a book for West Publications on Shareholder Agreements and Joint Ventures in China. He has taught at New York University Law School and is currently an adjunct professor at Columbia Law School teaching a course on international business and investment transactions with China.

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Jingzhou Tao has more than 20 years of experience in advising Fortune 500 companies on China-related matters. His areas of practice include international mergers and acquisitions, arbitration, and corporate work. Jingzhou has represented major European, Japanese, and American companies in hundreds of transactions in China on such matters as the establishment of equity joint ventures, contractual joint ventures, and wholly foreign-owned enterprises; tax planning; strategic alliances; and intellectual property protection. He has acted as counsel, chief arbitrator, or party-nominated arbitrator in international arbitration proceedings involving letters of credit, construction projects, management contracts, joint ventures, technology transfers, trademark licensing agreements, agency agreements, and international sales of goods.

Jingzhou is a member of the ICC International Court and of the London Court of International Arbitration. He sits on the Advisory Board of the China International Economic and Trade Arbitration Commission. He is chair of the Commission on International Commercial Arbitration of ICC China, an adjunct professor at Peking University Law School, and a Fellow of the Chartered Institute of Arbitrators. In addition, he is a listed arbitrator for the Court of Arbitration for Sport, the Hong Kong International Arbitration Centre, the China International Economic and Trade Arbitration Committee, and the Beijing Arbitration Commission.

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# Preface

This is the second edition of the Business Laws of China's *Mergers & Acquisitions* treatise and, as predicted last year, the level of activity in China has begun to rise after the substantial decline of 2008 and early 2009, even though the remainder of the world is still sputtering toward economic recovery. For China, M&A volume stands at $156.9 billion to mid-December, which is the second highest level on record and an 8% rise from 2008. If Japan is excluded, China transactions account for more than half of merger and acquisition activity in Asia.[1]

It is likely that 2010 will be an even better year for M&A for several reasons. First, China is in the process of consolidating a number of major industries, such as bituminous coal, cement manufacturing, auto parts, motor vehicle manufacturing, and shipbuilding.[2] Since a large percentage of such deals are consolidations of existing State-owned enterprises that combine for reasons of economies of scale, such mergers do not require extensive financing and are normally decided by State-planners, rather than through market mechanics. Second, China's stimulus package of 2009 was $586 billion, or 15% of national yearly GDP, and was the largest in percentage terms of any country. By investing the stimulus money on hard asset construction like new railways, roads, airports and other infrastructure, China managed to keep its growth rate above 7% for 2009 and was the only major industrial country in the world to expand at such a rate. Success attracts capital and it is therefore likely that both domestic and foreign companies will want to keep investing in China. Since China now allows foreign investors to form partnerships under China's Partnership Law, it is likely that many private equity firms will both raise money in China through new domestic partnership funds and invest in such funds themselves, thereby increasing the amount of investment capital available for acquisitions.[3] Third, the Ministry of Commerce has delegated the approval for most forms of foreign investment, including acquisitions down to the provincial and other lower levels, so that local companies with good relations with local planning officials will be

[1] M.P. Saefong, *Asia-Pacific M&A value manages to rise in 2009* Market Watch, Dec. 27, 2009, at http://www.marketwatch.com/story/only-asia-pacific-marks-09-rise-in-ma-deal-value-2009-12-27?reflink=MW_news_stmp.

[2] S. Harlem and R. Schramm, *The Coming Wave of Consolidation in Chinese Industries* CHINA B. REV. (Nov.-Dec. 2009).

[3] Measures for the Administration of the Establishment of Partnership Enterprises in the Territory of China by Foreign Enterprises or Individuals (see Appendix A) (State Council, No. 567 Nov. 25, 2009, eff.

able to obtain the required approvals for acquisitions.[4] This book has been written in the expectation that M&A activity in China will quickly return to the rapid growth that characterized the first decade of the 21st century.

One of the most common errors in commercial dealings with China is to assume that business transactions are the same the world over and therefore however it is done in New York is how it should be done in Shanghai. This cultural arrogance has led to many failed transactions that would have succeeded with a modest amount of humility. It is also almost as common an error for managers to accept explanations such as "the inscrutable Orient" or "that's China" to explain transactions that fail without explanation, since China mergers and acquisitions are highly regulated with relatively clear guidelines and openly stated government policies for or against various types of transactions. In other words, those that are willing to understand how the system works will be able to work with and in the system.

For this reason, the authors begin with a description of China's early economic reforms to show the origins of M&A activity and then attempt to describe by way of an overview the current state of activity in China today. It should be noted that the text was completed in September 2008 and therefore both economic and legal developments after that date are not reflected in the text.

Part II of the book looks at types of acquisitions that are currently done in China and the rules that regulate such transactions. In all acquisitions, a due diligence examination of the target is undertaken and therefore the type and format for such investigations is discussed in Chapter 3.

Because of the historical influence on the development of China's laws, M&A activity is regulated not so much by the form of the proposed acquisition-that is, a merger or purchase of assets-but by the nature of either the final enterprise or the target of the acquisition. Joint ventures remain a popular form of acquisition and in many cases are the only form permitted in certain industries. For this reason, doing a joint venture as a method of acquiring a business in China is discussed in Chapter 4. Similarly, acquiring an interest in an existing foreign investment enterprise is governed by special rules and these are discussed in Chapter 5. Subsequent chapters discuss acquisitions of interests in limited liability companies formed under The Company Law, the acquisition of shares in publicly listed companies, including tender offers, and mergers of both private and public companies. Separate attention is paid to the reorganization of State-owned enterprises through foreign investment in

[4] Notice of the Ministry of Commerce on Further Improving Work Relating to the Examination and Approval of Foreign Investment (see Appendix A) (MOFCOM, *Shang Ze Han* [2009] No. 7, March 5, 2009), Art. 5.

Chapter 9 and Chapter 11, in a similar vein, discusses acquisitions in areas such as financial institutions, where a special body of additional rules govern acquisitions and a different approval system is superimposed on the regular foreign investment process.

Part III discusses certain ancillary laws that affect M&A transactions in China, such as China's Anti-Monopoly Law and similar antitrust laws, the tax system and rules that affect (and frequently complicate) acquisitions, labor law treatment of the transfer of workers from one enterprise to another, and regulations governing commercial bribery and corruption.

Although the authors prepared the text so that references in footnotes showed the actual Chinese name of each law cited, due to printing constraints these references have been consolidated into a table which appears at the end of the work as the Table of Legislation. Since certain laws like The Company Law are referred to in almost every chapter, the authors have decided to include translations of these important laws after the Table of Legislation for easy reference.

Each of the authors have been practicing in China for approximately 30 years, almost all of which has been as partners in the same firm. Both are now with Jones Day, which opened its first office in China in the 1980s and now has offices in Beijing, Shanghai, Hong Kong and Taipei with more than 200 timekeepers. Jones Day worldwide is recognized as a leading mergers and acquisition firm, having been ranked #1 in M&A deals completed for nine years (2001-20080 by Bloomberg and Thomson Financial.

During the course of preparation of this book, the authors benefited from many helpful suggestions from their colleagues at Jones Day, to whom the authors extend their appreciation. The authors earnestly hope that this book proves useful to practitioners and the readership, and would be most interested in receiving comments and criticisms.

Owen D. Nee, Jr.
Jingzhou Tao
December 2009

# TABLE OF ABBREVIATIONS

| | |
|---|---|
| AMA | Anti-Monopoly Authority |
| AMLEA | Anti-Monopoly Law Enforcement Authority |
| CBRC | China Banking Regulatory Commission |
| CCPIT | The China Commission for the Promotion of International Trade |
| CEL | Cooperative Enterprise Law |
| CICT | Consolidated Industrial and Commercial Tax |
| CIETAC | China International Economic and Trade Arbitration Commission |
| CIRC | China Insurance Regulatory Commission |
| CJV | Cooperative Joint Venture |
| CSRC | China Securities Regulatory Commission |
| CT | Consumption Tax |
| EITL | Enterprise Income Tax Law |
| EIT Regs. | Enterprise Income Tax Regulations |
| EJV | Equity Joint Venture |
| ETDZ | Economic and Technological Development Zone |
| FICE | Foreign Invested Commercial Enterprise |
| FIE | Foreign Investment Enterprise |
| GAC | General Administration of Customs |
| JVL | Joint Venture Law |
| LTB | Local Tax Bureau |
| MFN | Most Favored Nation |
| MII | Ministry of Information and Industry |
| MOFCOIM | Ministry of Commerce |
| MOF | Ministry of Finance |
| Moftec | Ministry of Foreign Trade and Foreign Economic Cooperation (now the Ministry of Commerce) |
| NDRC | National Development and Reform Commission |
| NTR | Normal Trading Relationship |
| PRC | People's Republic of China |
| RMB | Renminbi (Chinese currency) |
| SAFE | State Administration of Foreign Exchange |
| SAIC | State Administration of Industry and Commerce |
| SARFT | State Administration of Radio, Film and Television |
| SAT | State Administration of Taxation |
| SAQSIQ | State Administration of Quality Supervision, Inspection and Quarantine |
| SASAC | State-owned Assets Supervision and Administration Commission |

| | |
|---|---|
| SEZ | Special Economic Zone |
| VAT | Value-Added Tax |
| WFOE | Wholly Foreign Owned Enterprise |

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