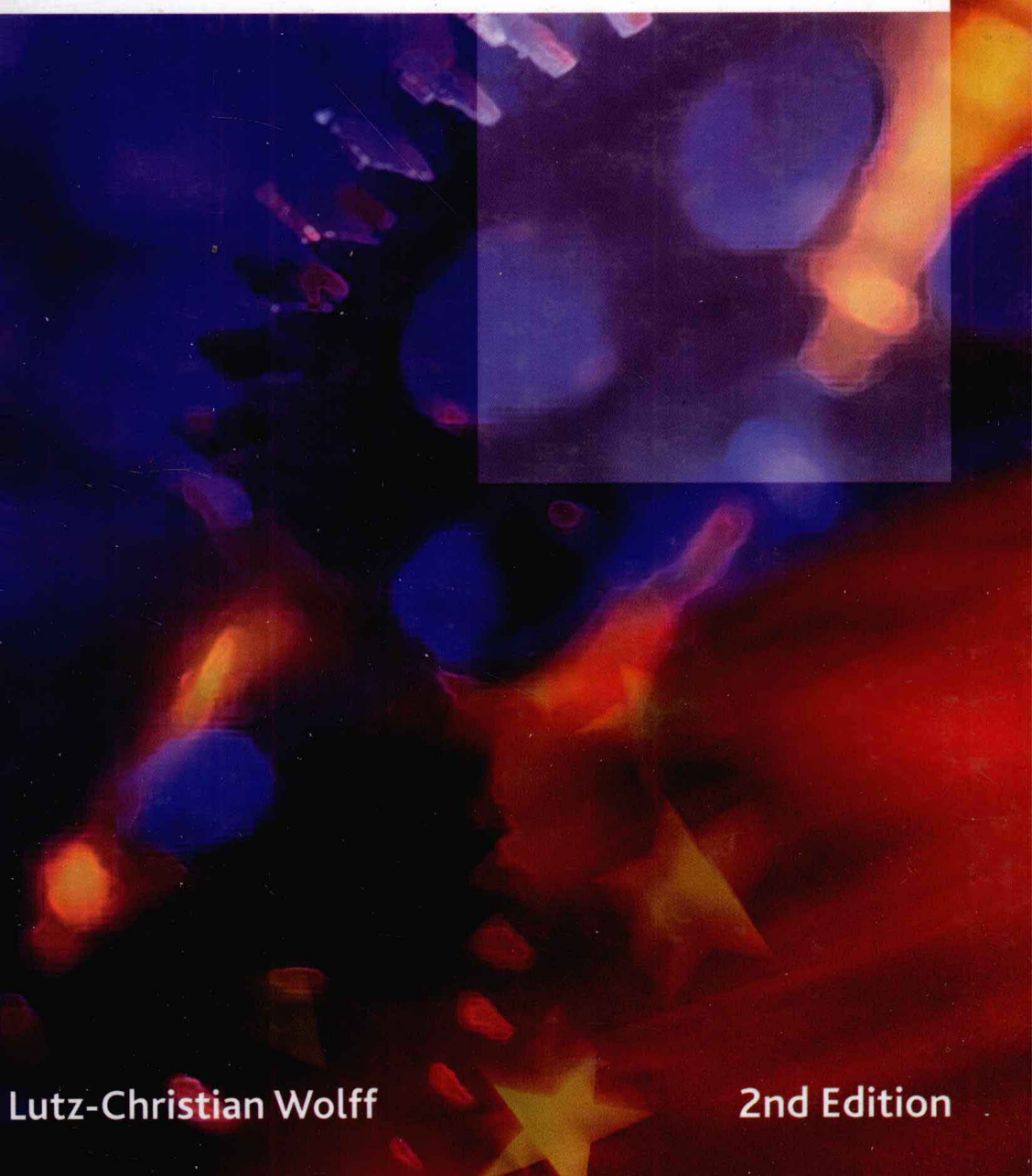


Mergers & Acquisitions in China: Law and Practice



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Lutz-Christian Wolff

2nd Edition



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Mergers & Acquisitions in China: Law and Practice

2nd Edition

By Dr. Lutz-Christian Wolff

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Foreword

Since the publication of the first edition of this book, China's M&A market has seen significant developments and changes drawing a lot of attention from potential investors, legal practitioners and members of the academic community. A number of new laws and regulations have been passed which are, or will soon be, of considerable importance for M&A transactions on the Chinese mainland. The *PRC Anti-monopoly Law*, the rules and regulations supporting China's corporate income tax reform, the *PRC Employment Contract Law*, the *PRC Law on Property Rights*, the *Provisions of the Supreme People's Court Regarding some Questions Concerning the Law Applicable in Relation to Trials of Foreign-related Civil and Commercial Contract Disputes*, as well as legislative developments in China's capital market, are only some examples in this regard. These new developments, as well as the fact that the first edition has sold quickly, suggested that time was ready for an updated and enlarged second edition.

The concept of this book has remained unchanged also for the second edition. It is meant to give a structured introduction to the legal regime governing M&A transactions in mainland China with a focus on laws and regulations governing deals with the involvement of non-Chinese parties. Again, I have tried to flag practical problems arising out of the current regime and to offer practical solutions where this seemed to be helpful. However, like the first edition also, this second edition is not intended, and can by no means replace legal advice regarding specific transactions. In contrast, legal advice must be based on the facts of each particular case by taking into account the then applicable law.

The work on this second edition has been partly supported by a Direct Grant of The Chinese University of Hong Kong. I would like to thank Mr Lincoln Cheung, Hong Kong, and Mr Eric Sutton, formerly Hong Kong now Pittsburgh, for very valuable research support. I am very grateful for the diligent editorial work conducted by Ms Sharon Yap of CCH Hong Kong Ltd and the encouraging support of Mr Bas Knipphorst on behalf of the publisher.

After the publication of the first edition I have received many helpful and encouraging comments, and would like to express my gratitude to all those who have contacted me. I would be much obliged for further suggestions also in relation to the second edition.

Hong Kong, February 2008

LUTZ-CHRISTIAN WOLFF

Abbreviations

AIC	Administration for Industry and Commerce
Art.....	Article
Artt.....	Articles
CBRC	China Banking Regulatory Commission ¹
CJV	Co-operative joint venture
CJV Law	PRC Sino-foreign Co-operative Joint Venture Law (date of effectiveness of latest version: 31 October 2000)
CJV Law Implementing Rules.....	<i>PRC Sino-foreign Co-operative Joint Venture Law Implementing Rules</i> (date of effectiveness of latest version: 4 September 1995)
CLP.....	China Law & Practice (Hong Kong)
COFCOM	Commission(s) of Commerce
CSRC.....	China Securities Regulatory Commission ²
eff.....	effective as of
EJV	Equity joint venture
EJV Law	PRC Equity Joint Venture Law (date of effectiveness of the latest version: 15 March 2001)
EJV Law Implementing Rules.....	PRC Sino-foreign Equity Joint Venture Law Implementing Rules (date of effectiveness of the latest version: 22 July 2001)
FDI.....	Foreign direct investment
FIE	Foreign-invested enterprise
FII	Foreign indirect investment
FOREX.....	Foreign Exchange
GAQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
GITIC.....	Guangdong International Trust and Investment Company
GPCL.....	PRC General Principles of Civil Law (date of effectiveness: 1 January 1987)
Holding-FIEs	Holding companies established in Mainland China pursuant to the Establishment of Companies with an Investment Nature by Foreign Investors Provisions (2nd Revision)
IPO.....	Initial public offering
M&A.....	Mergers and acquisitions
MOF	Ministry of Finance ³
MOFCOM	Ministry of Commerce ⁴
MOFCOM Explanations.....	Shangwubu jiu “Waishang touzizhe binggou jingnei qiye zanxing guiding” zuochu shuoming (MOFCOM publishes Explanations of the “Acquisition of Domestic Enterprises by Foreign Investors Tentative Provisions”) (30 July 2004)

MOFTEC	Ministry of Foreign Trade and Economic Co-operation (now MOFCOM)
NDRC	National Development and Reform Commission ⁵
NPC	National People's Congress ⁶
PBOC	People's Bank of China ⁷
PIL	Private International Law
PRC	People's Republic of China
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Financial Institutional Investor
R&D	Research and development
SAFE	State Administration of Foreign Exchange ⁸
SAIC	State Administration for Industry and Commerce ⁹
SASAC	State-owned Assets Supervision and Administration Commission of the State Council ¹⁰
SCMP	South China Morning Post (Hong Kong)
SETC	State Economic and Trade Commission (no longer in existence — SETC functions are partly taken over by the MOF, MOFCOM and SASAC)
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
SPC	Supreme People's Court ¹¹
SPV	Special Purpose Vehicle
UNCTAD	United Nations Conference on Trade and Development
VAT	Value-added tax
WFOE	Wholly foreign-owned enterprise
WFOE Law	PRC Wholly Foreign-owned Enterprise Law (date of effectiveness of latest version: 31 October 2000)
WFOE Law Implementing Rules	PRC Wholly Foreign-owned Enterprise Law Implementing Rules (date of effectiveness of latest version: 12 April 2001)

¹ See www.cbrc.gov.cn (last visited on 5 February 2008).

² See www.csrc.gov.cn (last visited on 5 February 2008).

³ See www.mof.gov.cn (last visited on 5 February 2008).

⁴ See www.mofcom.gov.cn (last visited on 5 February 2008).

⁵ See www.sdpc.gov.cn (last visited on 5 February 2008).

⁶ See www.npc.gov.cn/zgrdw/home.index.jsp (last visited on 5 February 2008).

⁷ See www.pbc.gov.cn (last visited on 5 February 2008).

⁸ See www.safe.gov.cn/model_safe/index.jsp (last visited on 5 February 2008).

⁹ See www.saic.gov.cn (last visited on 5 February 2008).

¹⁰ See www.sasac.gov.cn (last visited on 5 February 2008).

¹¹ See www.court.gov.cn (last visited on 8 February 2008).

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CHAPTER 1 INTRODUCTION

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¶1-100 General

In January 2006, commissioner Lie Deshui of the PRC's National Bureau of Statistics announced that due to strong investments and record exports, China's economy had grown by 9.9% in the year 2005 and overtaken Great Britain as the fourth largest economy in the world.¹

Since the beginning of the reform process in China² more than 25 years ago, foreign investors have been eager to take advantage of business opportunities offered by the Chinese market.³ According to a survey some years ago of 1,410 CEOs of leading global companies, 78% described the market opportunities in China as "significant". In fact, the volume of foreign investment and non-investment related business activities with Chinese partners has increased constantly over the past years, with just a temporary slow-down in 2005. China is currently close to replacing Japan as Asia's strongest trading nation.⁴ Furthermore, due to a number of China related 'mega deals' in 2004, China became the second most important target country worldwide for foreign investments.⁵ In 2005 China ranked third as a key destination of foreign investments behind the US and Britain.⁶ According to the UNCTAD World Investment Report 2007,⁷ in 2006 China was the fifth target country of FDI inflows following the US, the UK, France and Belgium. China ranked 17th worldwide in terms of FDI outflows. In 2006 China continued to host the largest number of foreign affiliates in the world.⁸

In light of these numbers and the developing global M&A markets, it is surprising that M&A transactions are a rather new phenomenon in China. Before the mid-nineties, the sale and purchase of Chinese business entities was only considered by foreign entities in exceptional cases.⁹ Since then, however, M&A transactions in China have seen explosive growth rates.¹⁰ In 2004, a Chinese investment official was quoted as saying that M&A transactions in China will multiply tenfold over the next five years.¹¹ Credit Suisse chief regional economist, Dong Tao, summarised the situation in late April 2006 as follows:

"China is about to face a major wave of mergers and acquisitions. The pattern of China's FDI [foreign direct investment] is changing from setting up new factories to acquisitions."¹²

The legal framework governing M&A transactions has long been incomplete and extremely difficult to handle.¹³ In line with the increasing volume of China-related M&A transactions, more comprehensive structures have been put in place in recent years. However, problems arising out of inconsistencies, unclear rules and legislative gaps continue to exist as will be shown in the following chapters.

The Meaning of M&A

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¶1-200 Definition

The term “M&A” stands for “mergers and acquisitions”. Generally speaking, the term “merger” means the fusion of two or more partners thus creating a totally new business entity or continuing the operation of the partners “under the roof” of any one of them.¹⁴ In contrast, the acquisition of a business entity by another indicates that one party takes over the shares, equity interest or assets of another entity. The parties to an acquisition therefore, do not appear as equal partners in the transaction.

Often, no emphasis is laid on the distinction between mergers on the one hand and acquisitions on the other. In fact, in practice the differences between these two transaction types may be marginal. Psychological aspects could be more important in the decision whether to announce a particular transaction as a merger or an acquisition as in the case of an acquisition announcement the target company may give the impression of weakness.¹⁵ However, as far as China is concerned the distinction between mergers and acquisitions is significant because different rules may apply depending on whether a particular transaction qualifies as one¹⁶ or the other.¹⁷

¶1-210 M&A in numbers

China relies less on foreign investments nowadays than only some years ago.¹⁸ Nevertheless, the total FDI volume in China for the first 11 months of 2007 was USD61.67 up 13.66 year on year.¹⁹ During the first two months of the year 2008 China’s FDI inflow surged by 75.19% year on year totalling USD18.13 billion.²⁰

The number of M&As fell for the first time during the first six months of 2005 and was down by 5% year-on-year to USD26.2 billion.²¹ In terms of target companies in global M&A activity, China ranked 9th worldwide in 2005 with 1,642 deals worth USD63.4 billion, up 7% on a year-on-year basis.²² During the first half of 2006, M&A transactions in China were reported to have set a regional record with USD41 billion in deals, up 71% from the first half of 2005.²³ According to another study conducted by PwC the overall disclosed mainland Chinese M&A volume was USD34 billion for the first half of the year 2007 as compared with USD19 million for the same 2006 period with 1,063 deals in 2007 and 879 in 2006.²⁴ China is said to have accounted for 40% of Asian mid-market deals ranging from USD50 million to USD250 million in recent years.²⁵ However, the average price of M&A deals in China was reported to being still relatively low, at around USD10 million to USD20 million.²⁶ Observers note the increasingly rapid development of purely domestic M&A deals which are being used to consolidate industries previously dominated by SOEs.²⁷

Investors remain optimistic regarding the development of China’s M&A market. China will see the biggest deals in the next two or three years according to a statement of a LBO legal expert in early 2006.²⁸