

Mergers & Acquisitions in China: Law and Practice



CCH

a Wolters Kluwer business

Lutz-Christian Wolff

4th Edition

Mergers & Acquisitions in China: Law and Practice

4th Edition

By Dr. Lutz-Christian Wolff

Professor, School of Law - The Chinese University of Hong Kong
Solicitor (England & Wales), Rechtsanwalt (Germany)

© 2010 CCH Hong Kong Limited

Fourth edition.....2010
Third edition2009
Second edition2008
First edition.....2006

Disclaimer

This publication is sold with the understanding that (1) the authors and editors are not responsible for the results of any actions taken on the basis of information in this work, nor for any errors or omissions; and (2) the publisher is not engaged in rendering legal, accounting or other professional services. The publisher, and the authors and editors, expressly disclaim all and any liability to any person, whether a purchaser of this publication or not, in respect of anything and of the consequences of anything done or omitted to be done by any such person in reliance, whether whole or partial, upon the whole or any part of the contents of this publication. If legal advice or other expert assistance is required, the service of a competent professional person should be sought.

Legislation reproduced

The publisher advises that the laws and regulations in this publication are not the authorised official versions of those laws and regulations. In their preparation, however, the greatest care has been taken to ensure exact conformity with the law as enacted or gazetted. While copyright in all laws and regulations resides in the government of the People's Republic of China, copyright in indexes and annotations is vested in the publisher.

All rights reserved. No part of this work covered by copyright may be reproduced or copied in any form or by any means (graphic, electronic or mechanical, including photocopying, recording, recording taping, or information retrieval systems) without the written permission of the publisher.

Published by CCH Hong Kong Limited

Printed by Ocean Printing Co., Ltd

ISBN 978-988-19348-5-7

About CCH Hong Kong Limited

CCH Hong Kong Limited is a member of the Wolters Kluwer group, the world's leading publisher for professionals. CCH Hong Kong Limited provides its subscribers with the highest standard of reporting for which the CCH group of companies has an established reputation worldwide.

CCH publications keep business managers, accountants, lawyers and other business professionals up-to-date with developments in a wide range of topics including taxation, company law, securities law, business law and employment law. The essence of CCH publications is accuracy, authority, practicability and ease of reference achieved by the presentation of information in a highly readable form and by the use of comprehensive indexes and other locators.

CCH Hong Kong Limited publishes a range of print and electronic reporting services and publications on taxation, company, business and employment law in China and Hong Kong. Our range of publications will continue to expand to serve the needs of subscribers in the region.

For enquiries contact your local CCH office.

CCH Hong Kong Limited

Room 1608, 16/F, Harcourt House, 39 Gloucester Road, Wanchai, Hong Kong

Customer Service Hotline: 800 968 667 Facsimile: 800 933 814

E-mail address: support@cch.com.hk Website: <http://www.cch.com.hk>

CCH (Beijing) Publication Distribution Co Ltd

Suite 2503, Tower A, TYG Centre, C2 North Road, East 3rd Ring Road, Chaoyang District, Beijing 100027

Telephone: (8610) 5863 7888 Customer Service Hotline: (8610) 5863 7887 Facsimile: (8610) 5863 7999

E-mail address: support@cchchina.com.cn Website: <http://www.cchchina.com.cn>

CCH Asia Pte Limited (Registration No: 199703606K)

8 Chang Charn Road, #03-00 Link (THM) Building, Singapore 159637

Telephone: (65) 6225 2555 Customer Service Hotline: 800 6162 161 Facsimile: 800 6162 176

E-mail address: support@cch.com.sg Website: <http://www.cch.com.sg>

Commerce Clearing House (Malaysia) Sdn Bhd (Registration No: 216303-M)

Suite 9.3, 9th Floor Menara Weld, 76 Jalan Raja Chulan, 50200 Kuala Lumpur, Malaysia

Telephone: (603) 2026 6003 Customer Service Hotline: 1800 181 151 Facsimile: 1800 181 173

E-mail address: support@cch.com.my Website: <http://www.cch.com.my>

Wolters Kluwer India Pct. Ltd

501-A, Devika Tower, 6, Nehru Place, New Delhi – 110019

Telephone: (9111) 4653 0000 Customer Service Hotline: (9111) 4653 0325 Facsimile: (9111) 4653 0399

E-mail: support@cchindia.co.in Website: <http://www.cchindia.co.in>

CCH Japan Limited

Towa Misaki-cho Bldg 5F 3-6-2 Misaki-cho, Chiyoda-ku Tokyo 101-0061 Japan

Telephone: 81 3 3265 1161 Facsimile: 81 3 3265 1166

E-mail: support@cch.co.jp Website: <http://www.cch-japan.jp>

About the Author

Professor Dr. Lutz-Christian WOLFF is admitted to practice as a German attorney-at-law and also as a solicitor in England and Wales. He works on a regular basis with companies, government entities and law firms on international business transactions in the Greater China region. He has authored numerous books and articles on Chinese law and is a frequent speaker at international conferences, professional development courses and in-house seminars.

Professor WOLFF has been based in Hong Kong since 1999 after several years working in Shanghai, Taipei, Düsseldorf, Beijing, New York and Frankfurt. He is a Professor of Law at the Faculty of Law of The Chinese University of Hong Kong.

For more information and Professor WOLFF's contact details please visit: www.wolff-hk.com.

Foreword

A number of significant developments affecting M&A projects in China have taken place since the publication of the third edition of this book as China's quick recovery from the global financial crisis has caused legislators as well business operators in China and abroad to take action in response to the opportunities offered by China's re-emerging M&A market. The Ministry of Commerce has clarified many important questions concerning the *PRC Anti-Monopoly Law* through the enactment of additional implementing rules and regulations as well as the publication of further information on the handling of anti-trust cases by its Anti-Monopoly Bureau. As far as taxation is concerned the State Administration of Taxation has further refined China's anti-avoidance regime by enacting a number of important circulars and measures which are of major concern in the M&A context and which have sparked widespread discussion. Moreover, on 25 November 2009 the State Council has finally promulgated the *Administrative Measures for the Establishment of Partnership Enterprises by Foreign Corporations and Individuals in China* which have entered into force on 1 March 2010 accompanied by related implementing rules. In particular the funds industry has observed these new enactments with great interest as foreign-invested partnerships may serve as investment vehicles for onshore private equity purposes. Finally, the *SPC Regulations on Several Issues Concerning the Trial of Cases of Disputes Related to Foreign-invested Enterprises (I)*, in force since 16 August 2010, provide among others welcome clarifications regarding the transfer of equity interests in foreign-invested enterprises. Important new laws and regulations have also taken effect in other areas covered by this book.

This fourth edition aims at incorporating all these new developments. I have added a new section on outbound M&As reflecting the increasing importance of Chinese investments overseas. A new chapter on 'Problem M&A Projects' is meant to offer guidance in case of M&A related disputes.

The concept of this book has remained unchanged also for the fourth edition. It is designed to give a structured introduction to the legal regime governing M&A transactions in mainland China with a focus on laws and regulations applicable to deals with the involvement of non-Chinese parties. Again, I have tried to flag practical problems arising out of the current regime and to discuss practical solutions where this seemed to be helpful. However, like the previous editions also this fourth edition is not intended to replace legal advice, which can only be provided based on the facts of any particular case by taking into account the then applicable law.

I would like to thank Ms Bonny Wong, Hong Kong, and Mr Garrick Chung, Hong Kong, for valuable research support. I am also grateful for the diligent editorial work conducted by Sharon Yap and Chris Long with the team of CCH Hong Kong Ltd. and the generous support of the publisher at any stage of this project.

I have received many helpful and encouraging comments after the publication of the previous editions and would like to express my gratitude to all those who have contacted me. I would be much obliged to receive further suggestions and comments also in relation to the fourth edition.

Hong Kong, September 2010

LUTZ-CHRISTIAN WOLFF

Abbreviations

AIC	Administration for Industry and Commerce
Art.....	Article
Artt.....	Articles
CBRC	China Banking Regulatory Commission ¹
CIETAC.....	China International Economic and Trade Arbitration Commission
CIRC.....	China Insurance Regulatory Commission ²
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)
CMAC	China Maritime Arbitration Commission
COFCOM	Commission(s) of Commerce
CSRC.....	China Securities Regulatory Commission ³
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
FIP	Foreign Invested Partnership Enterprise
FOREX	Foreign Exchange
GAQSIC	General Administration of Quality Supervision and Quarantine
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 ⁴
MOFCOM	Ministry of Commerce ⁵
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 ⁶
NPC	National People’s Congress ⁷
PBOC	People’s Bank of China ⁸
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
RC	registered capital
SAFE	State Administration of Foreign Exchange ⁹
SAIC	State Administration for Industry and Commerce ¹⁰
SASAC	State-owned Assets Supervision and Administration Commission of the State Council ¹¹
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 ¹²
SPV	Special Purpose Vehicle
TAI	total amount of investment
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 1 August 2010).

² See www.circ.gov.cn (last visited on 1 August 2010).

³ See www.csrc.gov.cn (last visited on 1 August 2010).

⁴ See www.mof.gov.cn (last visited on 1 August 2010).

⁵ See www.mofcom.gov.cn (last visited on 1 August 2010).

⁶ See www.sdpc.gov.cn (last visited on 1 August 2010).

⁷ See www.npc.gov.cn (last visited on 1 August 2010).

⁸ See www.pbc.gov.cn (last visited on 1 August 2010).

⁹ See www.safe.gov.cn (last visited on 1 August 2010).

¹⁰ See www.saic.gov.cn (last visited on 1 August 2010).

¹¹ See www.sasac.gov.cn (last visited on 1 August 2010).

¹² See www.court.gov.cn (last visited on 1 August 2010).

TABLE OF CONTENTS

Chapter 1 Introduction

General	¶1-100
The Meaning of M&A	
Definition	¶1-200
M&A in Numbers	¶1-210
The Significance of China-related M&A Transactions	¶1-220
The Historical Development of China's M&A Regime	
China's Economic System	¶1-300
Foreign Investment in Mainland China	
Introduction	¶1-310
Governing Law	¶1-311
Government Control	¶1-312
Equity Joint Ventures	¶1-313
Co-operative Joint Ventures	¶1-314
Wholly Foreign-owned Enterprises	¶1-315
Foreign-invested Companies Limited by Shares	¶1-316
Foreign-invested Partnerships	¶1-317
M&A Legislation since 1978	
The Company Law Background	¶1-320
Important M&A Laws and Regulations	¶1-321
M&A Law and Legal Practice — a Caveat	¶1-322

Chapter 2 Due Diligence

General	¶2-100
Legal Due Diligence in China	
Introduction	¶2-200
Establishment	¶2-210
Organisational Structure	¶2-220
Material Contracts	¶2-230
Land Use Rights and Buildings	¶2-240
Other Main Assets	¶2-250

Finance	¶2-260
Tax	¶2-270
Labour and Social Insurance	¶2-280
Intellectual Property Rights and Technology Transfer	¶2-290
Product Liability.....	¶2-300
Environmental Issues	¶2-310
Anti-trust Issues	¶2-320
Legal Proceedings	¶2-330
Sensitive Payments and Activities	¶2-340

Chapter 3 The Law Governing M&A Transactions and Government Control

General.....	¶3-100
M&A-related PIL Rules.....	¶3-200
Contracting out PRC Law?	¶3-300
Government Control	¶3-400

Chapter 4 Structuring Options — an Overview

General.....	¶4-100
Direct Investment vs Offshore Structures	¶4-200
FIE Establishment vs M&A.....	¶4-300
Share Deals vs Asset Deals.....	¶4-400
Acquisitions vs Mergers	¶4-500
Combinations	¶4-600

Chapter 5 Acquisition of FIE Equity Interest

Foreign Investors Acquiring FIE Equity Interest	
General	¶5-100
Compliance with FIE Rules	¶5-110
Verification	¶5-120
Approval.....	¶5-130
Registration	¶5-140
Purchase Price	¶5-150
Assignment Agreement.....	¶5-160

Effective Date	¶15-170
Chinese Investors Acquiring FIE Equity Interest	¶15-200

Chapter 6 Foreign Investors Acquiring Equity Interest in Non-FIE Chinese Companies

General	¶16-100
Compliance with FIE Rules	¶16-200
Verification, Approval and Declaration	¶16-300
Registration	¶16-400
Purchase Price	¶16-500
Assignment Agreement	¶16-600
Effective Date	¶16-700

Chapter 7 Asset Deals Conducted by Foreign Investors

General	¶17-100
Acquisition Modes and Compliance with FIE Rules	¶17-200
Transfer of Title to the Target Enterprise's Assets	¶17-300
Verification, Approval, Declaration and Registration	¶17-400
Purchase Price	¶17-500
Asset Purchase Agreement	¶17-600
Effective Date	¶17-700
Quasi-asset Deals	¶17-800

Chapter 8 Acquisition of Listed Companies by Foreign Investors

General	¶18-100
Companies Limited by Shares	¶18-200
Share Deals	¶18-300
Introduction	¶18-310
Takeover Rules	¶18-320
General	¶18-321
Disqualified Investors	¶18-322
Disclosure Requirements	¶18-323
General Offer	¶18-324
Financial Adviser	¶18-325

Management Buyout	¶8-326
Share Deals Conducted by Foreign Investors	¶8-330
Listed Shares	¶8-331
Unlisted Shares	¶8-332
Verification, Approval and Registration	¶8-333
General Offer	¶8-334
Asset Deals	¶8-400

Chapter 9 Foreign Investors Buying into Partnerships

General	¶9-100
Procedure	¶9-200

Chapter 10 Onshore Acquisitions

General	¶10-100
Acquisitions by FIEs	
Holding-FIEs	¶10-200
FIEs without Holding Status	
Share Deals	¶10-210
Asset Deals	¶10-211
Venture Capital Investments	¶10-212
Acquisitions by Domestic Enterprises without FIE Status	¶10-300

Chapter 11 Mergers

General	¶11-100
Onshore Mergers with FIE-involvement	
Introduction	¶11-200
Merger Modes and Compliance with FIE Rules	¶11-210
Approval and Verification	¶11-220
Registration	¶11-230
Consideration	¶11-240
Merger Agreement	¶11-250
Effective Date	¶11-260
Onshore Mergers without FIE-involvement	¶11-300
Cross-border Mergers	¶11-400

Chapter 12 Industry-specific M&A Regulations

General	¶12-100
The Acquisition of Financial Institutions	¶12-200
Background.....	¶12-210
M&A Rules.....	¶12-220
The Acquisition of Insurance Companies	¶12-300
Background.....	¶12-310
M&A Rules.....	¶12-320
Acquisitions in the Real Estate Sector.....	¶12-400
Background.....	¶12-410
M&A Rules.....	¶12-420

**Chapter 13 Special Rules Regarding M&A Projects in the
State-owned Sector**

General	¶13-100
Qualification of Foreign Investors.....	¶13-200
Reorganisation Plan.....	¶13-300
Owner's Consent in Case of Asset Deal.....	¶13-400
Appraisal	¶13-500
Sale and Purchase	¶13-600
Verification, Approval, and Registration	¶13-700
Purchase Price and Capital Contribution.....	¶13-800
Prohibition of Collusion	¶13-900

**Chapter 14 Offshore Special Purpose Vehicles, Outbound M&As and
Round-trip Investments**

General	¶14-100
Offshore Special Purpose Vehicles	¶14-200
Outbound M&As.....	¶14-300
Introduction.....	¶14-310
NDRC Approval	¶14-320
MOFCOM Approval	¶14-330
Industry-specific Regulatory Issues.....	¶14-340
Round-trip Investments	¶14-400

Chapter 15 Private Equity Funds

General	¶15-100
The Legal Framework	¶15-200
Offshore Funds	¶15-210
Onshore Funds	¶15-220
Onshore Funds with Foreign Investment	¶15-221
Onshore Funds without Foreign Investment	¶15-222
Open Questions	¶15-300

Chapter 16 Financing

General	¶16-100
FIE Capitalisation Requirements	¶16-200
Foreign Exchange Control	¶16-300
Purchase Price Payment	¶16-400
Acquisition Loans	¶16-500

Chapter 17 Labour Issues

General	¶17-100
Lay-offs following M&A Transactions	¶17-200
Re-positioning of Employees	¶17-300
Transfer of Employees	¶17-400
Special Rules for SOEs	¶17-500

Chapter 18 Anti-trust Law

General	¶18-100
Anti-trust Rules of the Acquisition of Domestic Enterprises by Foreign Investors Provisions	¶18-200
Introduction	¶18-210
Onshore Transactions	¶18-220
Offshore Transactions	¶18-230
Practice	¶18-240
The PRC Anti-Monopoly Law	¶18-300
Introduction	¶18-310

Goals and Scope	¶18-320
Authorities	¶18-330
Anti-trust Rules of the PRC Anti-Monopoly Law	¶18-340
Implementing Rules	¶18-341
Notification: Thresholds and Procedure.....	¶18-342
Anti-monopoly Investigation	¶18-343
Decision of the Anti-Monopoly Enforcement Organ.....	¶18-344
State Security Check	¶18-345
Application for Reconsideration and Judicial Review	¶18-346
Violation of the PRC Anti-monopoly Law	¶18-347
Practice	¶18-350
Introduction	¶18-351
InBev.'s proposed acquisition of Anheuser-Busch	¶18-352
Coca Cola's proposed acquisition of Huiyuan	¶18-353
Mitsubishi's proposed acquisition of Lucite	¶18-354
General Motors' proposed acquisition of Delphi	¶18-355
Pfizer's proposed acquisition of Wyeth	¶18-356
Panasonic's proposed acquisition of Sanyo	¶18-357
Novartis' proposed acquisition of Alcon.....	¶18-358
Observations.....	¶18-359

Chapter 19 Tax

China's Tax System.....	¶19-100
General	¶19-110
Enterprise Income Tax.....	¶19-120
Individual Income Tax.....	¶19-130
Other Tax Types	¶19-140
Taxation of Mergers & Acquisitions.....	¶19-200
General	¶19-210
Share Deals	¶19-220
Asset Deals	¶19-230
Mergers	¶19-240
Tax Considerations for Offshore Transactions.....	¶19-300

Chapter 20 Post-closing Considerations

General.....	¶20-100
Corporate Restructuring.....	¶20-200
Disposal and Acquisition of Assets	¶20-300
Workforce Reorganisation	¶20-400
Tax	¶20-500

Chapter 21 Problem M&A Projects

General.....	¶21-100
Preventive Measures	¶21-200
Dispute Settlement.....	¶21-300
Introduction	¶21-310
Negotiations	¶21-320
Arbitration.....	¶21-330
Court Proceedings	¶21-340
Enforcement	¶21-350

Index of Quoted Laws and References

	Page
Quoted Laws, Regulations and Quasi-legal Provisions	311
References.....	337

Legislation

Changes in Equity Interest of Investors in Foreign-invested Enterprises Several Provisions.....	362
Asset Reorganisation by State-owned Enterprises Using Foreign Investment Tentative Provisions.....	376
Investment within China by Foreign-invested Enterprises Tentative Provisions.....	386
Merger and Division of Foreign-invested Enterprises Provisions (Revised)	400
Issues Relevant to the Transfer of State-owned Shares and Legal Person Shares in Listed Companies to Foreign Investors Circular.....	422