

# **Cross-Border M&A in China**

Law and Practice



*Walter Chen*



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# **Cross-Border Mergers & Acquisitions in China: Law and Practice**

**Walter Chen**

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*“Know the enemy, know yourself, and victory is never in doubt, not in a hundred battles. He who knows self but not the enemy will suffer one defeat for every victory. He who knows neither self nor enemy will fail in every battle.”*

***The Art of War***  
**Sun-Tzu**  
**544-496 B.C**

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Prior to legal practice, Mr. Chen used to be a university lecturer, a research fellow of international business law at a provincial academy of social sciences. While practicing law, Mr. Chen has been prolific in publishing articles on Chinese and international law in professional journals such as *Chinese Lawyer*, *China Law & Practice*, *International Lawyer*, and *European Law Review*. He served as Editor-in-Chief of *Legal Guidance for Establishing Corporations in 40 Countries and Regions* (2008) and *A Handbook on Laws and Regulations of Chinese Enterprises' Cross-Border Transactions* (2007). He has also been contributing authors to numerous books, such as *Selected Works of the International Symposium on WTO and Legal Services* (2002), *Financial Surveillance and Jurisdiction* (1998), *An Analysis on Contemporary Western Economy* (1994), and *A General Survey of International Economic Practice* (1993).

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# PREFACE

Ever since China started reform and opened its door to the outside world in 1978, especially the accession to the World Trade Organization in 2001, the foreign investment has poured into China's market in an accelerating speed. As a result, today's China has become one of the largest destination countries for absorbing foreign investment in the world. It is anticipated that with country's growth potential, size, dynamism and the huge market which nowhere else can replicate, this momentum will be kept on in foreseeable future.

However, as foreign investment grew up, the enormous fear and worries over the foreign investment, in particular, the foreign investor's Mergers & Acquisitions (M&A) of domestic enterprises, upon security of national economy ensued. The typical one is that foreign companies were entering into the Chinese market with a willful intention to behead China's largest companies, viz. to buy them out so as to eliminate competition from China's home-grown brands or establish monopolies in large enterprises of key industries, seeking annual rates of return higher than 15 percent. This was somehow echoed by a 2006 research report reportedly issued by the Development Research Center of the State Council, a comprehensive policy research and consulting institution directly under the State Council, that in industries opened to foreign investment so far, almost all the first five enterprises in every industry have been controlled by foreign investors, and out of 28 key industries, foreign investors controlled most assets in 21 industries. Also toward the end of 2006, the Ministry of Commerce was said to have issued a similar report expressing alarm over the "decapitation" of China's industries by foreign companies. These reports and two other high profile incidents of failed M&A transactions namely, Carlyle's bid for Xugong Group and the Coca-Cola's proposed acquisition of Huiyuan Fruit Juice Group Limited, have highlighted the issue of M&A of domestic enterprises by foreign investors in China. Over the years, China has attempted to address these and other issues arising from or in relation to M&A of domestic enterprises by foreign investors by promulgating a series of laws, regulations and rules on M&A, among which the most distinctive ones are the *Rules on Mergers & Acquisitions of Domestic Enterprises by Foreign Investors* and the *Anti-Monopoly Law*. While at this stage it is too early to come to a corollary that issues relating to foreign investors' M&A have been resolved, it is absolutely certain that the M&A transactions against the backdrop of pouring-in investment will continue to increase in China in future. Just as David Rubenstein, co-founder and managing director of the Carlyle Group, one of the three biggest US private equity firms, vividly put, "You cannot measure the importance of the Chinese market just by the size of the deals transacted so



far. It is the country's potential for further growth that excites foreign investors. The growth potential is so staggering, we are just scratching the surface."

This Book presents a thorough, authoritative discussion of the M&A of domestic enterprises by foreign investors in China with a view to providing a practical hands-on, detailed guidance for foreign investors already in or intending to enter into China, including panoramic scanning of the context and legal & regulatory framework under which the M&A transactions are conducted, a step-by-step discussion of substantive and procedural aspects of M&A in China, expert analysis of applicable laws and practical issues associated with the M&A transaction i.e., foreign exchange, taxation, intellectual property rights, labor issues and anti-monopoly review, dissection of various sample M&A documents and related documents concerning prior or post M&A incorporation of foreign invested enterprises to be followed, and a selection of the latest laws, regulations and rules on M&A for reference (Due to lack of space, most of selected laws, regulations and rules on M&A are removed at last minute at the suggestion of the editing crew, only with a few important ones being left intact. And for the same reason, the official Chinese version texts are also omitted. For purpose of reference only, a list of English titles of those laws, regulations and rules on M&A are kept in the book.) etc.

It is worth noting that authors/contributors are all seasoned senior partners with law firms from the United States, Hong Kong and mainland China, who have been fighting over the years for their clients on forefront of M&A transactions in China. Their precious professional "close quarter battle" input and expert insight into the M&A transactions in China make this Book even more valuable and trustworthy. It is therefore a must-read M&A book for any foreign investors already in China wishing to expand their businesses by means of M&A or accessing to China via M&A vehicle. Despite this, it is advisable that independent professional advice should be sought when prudent business readers are going to conduct a real scenario M&A transaction in China.

Finally, though the book is mostly addressed to the foreign investors in or coming to China, the potential readers domestic and foreign, including but not limited to governmental entities, colleges and universities, research institutions, legal and commercial professionals, might find it educational and useful.

**Walter Chen**  
**18 August 2009**

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# **Part I**

## **Introduction**

The subject of Mergers & Acquisitions (M&A) of domestic enterprises by foreign investors, virtually unknown a mere decade ago, is now a hot topic in China for policy makers, scholars, practitioners and business entrepreneurs. The “M&A” has even become a catchword across public documents and academic literatures. In practice, foreign investors’ M&A transaction has increased dramatically in China over the last several years though there is no exact official figure found to pinpoint it due to imperfect statistics approach adopted by the government. To meet the challenge of M&A, address the escalating concern over safety of national industry and further safeguard the rights and interests of foreign investors and Chinese domestic enterprises, China has over the last few years promulgated a series of laws, regulations and rules with a view to building up a regulatory regime of foreign investors’ M&A transaction. Inter alia, the most distinctive rule and law respectively are the *Rules on Mergers & Acquisitions of Domestic Enterprises by Foreign Investors* (M&A Rules) and the Anti-Monopoly Law (AML). The former was promulgated by the Ministry of Commerce (MOFCOM), State-owned Assets Supervision and Administration Commission of the State Council (SASMC), the State Administration of Taxation (SAT), the State Administration for Industry and Commerce (SAIC), China Securities Regulatory Commission (CSRC), and the State Administration of Foreign Exchange (SAFE) on 8 August 2006, which superseded the old M&A rules in China that were in place since 12 April 2003 - *the Interim Provisions for Foreign Investors to Merge and Acquire Domestic Enterprises*.<sup>1</sup> Albeit it is still at lower legislature level, the M&A Rules is after all the most comprehensive set of rules in relation to foreign investors’ M&A to date. And the later was adopted by the 29<sup>th</sup> Session of Standing Committee of the 10<sup>th</sup> National People’s Congress – China’s legislature, a chapter of which specifically devotes to the M&A review by MOFCOM that can exert enormous impact upon the fate of foreign investors’ M&A transaction.<sup>2</sup>

With the enactment of the M&A Rules and the AML - the so called “economic constitution” in place, it is anticipated that the M&A transactions in China will be further boosted and more standardized.

This Book consists of ten parts which are divided into numerous chapters. Part I: Introduction; Part II: briefly reviews the foreign direct investment in China, and against such backdrop, sketches the status quo of the Mergers & Acquisitions in China; Part III: delineates the legal and regulatory framework

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<sup>1</sup> *Rules on Mergers & Acquisitions of Domestic Enterprises by Foreign Investors* was promulgated on 7 March 2003 and revised by MOFCOM, SASAC, SAT, SAIC, CSRC and SAFE on 8 August 2006, and came into force on 8 September 2006. The latest revision was made on 22 June 2009 by Decree No.6 of the MOFCOM which only removes the anti-monopoly section due to enactment and application of the AML and makes a few minor changes in wording.

<sup>2</sup> Chapter 4 ‘Concentration of Undertakings’ of the AML, promulgated by the 29<sup>th</sup> Session of Standing Committee of the 10<sup>th</sup> National People’s Congress, and came into effect on 1 August 2008.

applicable to Mergers & Acquisitions by categorizing laws, regulations and rules of China's legal system into four pillars, and based on such detailed discussions, summarize the practical legal issues relevant to foreign investors' M&A of China's domestic enterprises; Part IV: outlines the usual forms of foreign invested enterprises(FIEs)applicable to foreign investors' access to China prior to or post M&A transaction. Further from a practical perspective, it walks the business readers through formalities of incorporating FIEs in China. Lastly, sample documents for incorporating one of FIEs - a wholly foreign-owned enterprise(WFOE) are provided; Part V:discusses in great detail the primary types of cross-border M&A in China, the application of laws and government approvals in connection to each and every type of M&A, special type of M&A such as M&As relating to listed companies, state-owned enterprises (SOEs), and compares each type of M&A so that the strength and weakness of each type of M&A are revealed; Part VI: expounds the lengthy and complicated processes involved in the M&A transaction from identifying & screening target to conduct due diligence, structure the transaction, prepare the documents needed, participate in negotiating and executing transaction documents, obtain consents and approvals, and file the deal with competent authorities for industry and commerce; Part VII: analyzes practical issues involved in cross-border M&A transaction which mainly relate to foreign exchange control, taxation, intellectual property rights, employment issues and anti-monopoly review; Part VIII: lists sample M&A documents handpicked from practical legal precedents, and from legal practitioner's perspective, provides authoritative commentaries on each and every M&A document, such as confidentiality agreement, letter of intent, due diligence, acquisition agreements; Part IX: specifically gives a brief and concise introduction to the main regulatory authorities relating to the M&A transaction for foreign investors' quick reference; Part X: gleans partial Chinese laws, regulations and rules on or relevant to mergers & acquisitions which are made piecemeal by competent authorities at different levels over the years and nevertheless shall be strictly observed in conducting the M&A transactions in China.

The roundup of each and every parts of the Book as illustrated above will give readers a brief look at what they can expect from each part so they can get started right away with the part that interests them most about conducting M&A transaction or doing business in China.

It should be noted that when we almost finished writing all parts of the book, the MOFCOM unilaterally announced the revision of the M&A Rules on 22 June 2009 by removing the Chapter 5 "Anti-Monopoly review" from the M&A Rules with the rest of chapters partially renumbered. Apparently the reason for this is the integration of the M&A Rules with the AML. Due

to substance of the M&A Rules being virtually unchanged and due to time constraint for delivery of the book papers, therefore, we did not make efforts to make any amendment accordingly to original reference to the M&A Rules as the 2006 M&A Rules in the book (or most references made to the M&A Rules in the book still refer to the M&A Rules issued in 2006). However, we did attach in the book the new version of the M&A Rules for readers' reference. It is advisable that readers may refer back to the 2006 M&A Rules if any numbering found in the new version of the M&A Rules does not completely match.



## **Part II**

# **Context for Considering Cross-Border Mergers & Acquisitions in China**