

Mergers and Acquisitions by Foreign Entities in China

By Kelly Wang and Matthew Murphy

MMLC Group Beijing

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Since China's adoption of the "Open Door" policy and entry into the World Trade Organization ('WTO'), merger and acquisition activities in China have become an increasingly attractive alternative to foreign investors as compared to foreign direct investment. Despite the global economic crisis, China is still Asia's largest mergers and acquisitions market. Foreign investors are increasingly using mergers and acquisitions to establish or expand their Chinese business operations. This article gives an overview of the laws and regulations governing mergers and acquisitions by foreign entities in China.

Relevant laws and regulations

Mergers and acquisitions by foreign entities in China are examined and approved by a number of different Chinese government departments, with the Ministry of Commerce (and in most cases, the local level departments of this Ministry) being the main government approval department to be concerned with.

This section of this article provided a snapshot of the major Chinese regulations applicable to mergers and acquisitions by foreign entities in China.

1) The ***Notice concerning the Relevant Issues on Strengthening the Approval, Registration, Foreign Exchange Control and Taxation Administration of Foreign-funded Enterprises***, which was issued by the Ministry of Foreign Trade and Economic Cooperation (now, called the "Ministry of Commerce"), State

Administration of Taxation, State Administration for Industry and Commerce, State Administration of Foreign Exchange on 30 December 2002, and became effective on 1 January 2003. It applies to the case where a foreign investor acquires equity in a domestic enterprise, and such domestic enterprise is re-established as a foreign-invested enterprise.

2) The *Company Law of the People's Republic of China*, which was substantially revised by the Standing Committee of the National People's Congress on 27 October 2006, and became effective on 1 January 2006, generally regulates the constitution and corporate actions of local and foreign invested companies in China.

The Chinese Company Law also stipulates requirements for the increase and decrease of capital, assignment of debts, and change of registration during company absorption or consolidation. This law contains some provisions that are inconsistent with the Chinese foreign investment laws, so it must be applied carefully and not in isolation.

3) The *Catalogue of Industries for Guiding Foreign Investment* is revised from time to time with the most recent version having been issued in 2007, by the NDRC. The 2007 catalogue divides industries into three basic categories: encouraged, restricted, and prohibited. Foreign-invested enterprises investing in an area listed as an “encouraged” industry are often permitted to establish wholly foreign-owned enterprises. More environmental and energy-saving technologies appear in the encouraged category.

4) The *Interim Provisions on the Takeover of Domestic Enterprises by Foreign Investors* which was revised by Ministry of Commerce, State Asset Supervision and Administration Commission, China Securities Regulatory Commission, State Administration of Taxation, State Administration for Industry and Commerce, State Administration of Foreign Exchange on 8 August 2006, and became effective on 9 August 2006. The Ministry of Commerce revised this Provision slightly with respect to a few procedural and definition provisions on 22 June 2009:

- The phrase “takeover of a domestic enterprise by a foreign investor” means that the foreign investor purchases by agreement the equity interests of the

shareholder(s) of a domestic non-foreign-funded enterprise or subscribes to the increased capital of a domestic company, and thus changes the domestic company into a foreign-funded enterprise ; or, a foreign investor establishes a foreign-funded enterprise, and through which it purchases by agreement the assets of a domestic enterprise and operates its assets, or, a foreign investor purchases by agreement the assets of a domestic enterprise, and then invest such assets to establish a foreign-funded enterprise and operate the assets.

- To take over a domestic enterprise, a foreign investor shall satisfy the requirements of the laws, administrative regulations, and rules of China concerning the qualifications of investors, and shall comply with the policies on the industry, land, environmental protection, etc. Where a foreign investor intends to establish a foreign-funded enterprise by merging a domestic enterprise, it shall, in accordance with these Provisions, be subject to the approval of the examination and approval organ and modify the registration or go through the establishment registration in the registration administrative organ. “Examination and approval organ” refers to the Ministry of Commerce. The term “registration administrative organ” refers to the State Administration for Industry and Commerce (SAIC) or its authorized local administrations for industry and commerce. The term “foreign exchange control organ” refers to the State Administration of Foreign Exchange (SAFE) or its branches.
- If the takeover of a domestic enterprise by a foreign investor involves the transfer of state-owned property rights of the enterprise and management of state-owned property rights of listed companies, the relevant provisions on the management of state-owned assets shall be followed.
- According to *Decision of the Ministry of Commerce on Amending the Provisions on the Merger or Acquisition of Domestic Enterprises by Foreign Investors*, which was issued by Ministry of Commerce on 22 June 2009, and became effective on 22 June 2009, for the purpose of ensuring that the *Provisions on the Merger or Acquisition of Domestic Enterprises by Foreign Investors* are consistent with the *Anti-monopoly Law* and the *Provisions of*

the State Council on the Standards for the Declaration of Business Concentration, Chapter 5 of this Provision “Anti-monopoly Review” was deleted, and a new article was inserted in the “Supplementary Provisions” as Article 51: “In accordance with the Anti-monopoly Law, if the merger or acquisition of a domestic enterprise by a foreign investor reaches the declaration standards in the Provisions of the State Council on the Standards for the Declaration of Business Concentration, a declaration shall be made to the Ministry of Commerce in advance and no transaction shall be conducted without declaration.”

5) The *Law of the People’s Republic of China on Foreign-funded Enterprises (revised 2000)*, which was issued by Standing Committee of the National People's Congress on 31 October 2000, and became effective on 31 October 2000, regulates the establishment of "Foreign-funded Enterprises" or “Foreign-Invested Enterprises” - these refer to those enterprises established in China by foreign investors, exclusively with their own capital, in accordance with relevant Chinese laws. Foreign-funded enterprises are meant to be established in such a manner as to “help with the development of China's national economy.”

6) The *Anti-monopoly Law of the People’s Republic of China* was issued by the Standing Committee of the National People's Congress on 30 August 2007, and became effective on 1 August 2008. This law states that if a “concentration” falls under the notification criteria issued by the State Council, a report must be filed in advance by the parties with the Anti-Monopoly Bureau (part of the Ministry of Commerce) – failure to do this, will mean that the relevant transaction will not be approved in China.

“Concentration” is defined to mean:

- (1) The merger of undertakings;
- (2) The acquisition by undertakings, whether by purchase of securities or assets, of

control of other undertakings;

(3) The acquisition by contact or any other means, of control of other undertakings or of possibility of exercising decisive influence on other undertakings.

According to the *Provisions of the State Council on the Standard for Declaration of Concentration of Business Operators*, which was issued by State Council on 3 August 2008, and became effective on 3 August 2008, if one of the following thresholds are met, then the business operators shall file a report for approval of the concentration with the Anti-Monopoly Bureau:

1. the total global business revenue of last fiscal year of all business operators in the concentration is over RMB 10 billion, as well as among which the business revenue of last fiscal year in the territory of the PRC of each of at least two business operators are over RMB 400 million; or

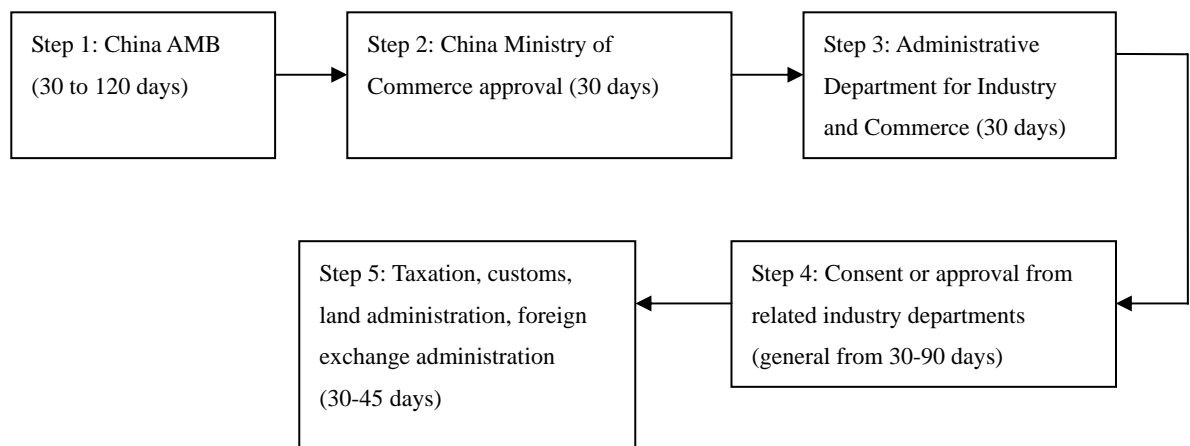
2. the total business revenue of last fiscal year in the territory of the PRC of all business operators in the concentration is over RMB 2 billion, as well as among which the business revenue of last fiscal year in the territory of PRC of each of at least two business operators are over RMB 400 million.

A large number of cases have been referred to the Anti-Monopoly Bureau under this legislation, with most of them getting approved, albeit with (occasionally onerous) conditions attached to the approval. It should also be noted, that it is not necessary for an investor to have an entity in China, nor for the target entity to have an entity in China, for these rules to apply and for approval to be required.

Government Approval Summary

The following diagram summarises the approvals required based on the regulations

discussed above – it should be noted, that Steps 1, 2 and 4 are often pursued simultaneously:



Mergers and acquisitions of State-owned Enterprises in China

Chinese State-Owned Enterprises are often the targets of foreign investors these days. It is important to note that additional rules apply to the purchase of State-Owned Enterprises by foreign investors in China:

(1) According to the ***Interim Provisions on the Takeover of Domestic Enterprises by Foreign Investors (revised in 2006)***, which was revised by the Ministry of Commerce, State Asset Supervision and Administration Commission, China Securities Regulatory Commission, State Administration of Taxation, State Administration for Industry and Commerce, and State Administration of Foreign Exchange on 8 August 2006, and became effective on 9 August 2006, a transaction that involves the acquisition of the control over state-owned assets, must be examined by the relevant authorities and assessed in accordance with the rules regarding the management of state-owned assets.

(2) According to the *Interim Measures for the Supervision and Administration of State-Owned Assets of the Enterprises*, which was issued by State Council on 27 May 2003 and became effective on 1 February 2004, where the transfer of the state-owned equity or the assignment of part of the state-owned equity would result in China no longer possessing a controlling interest in an enterprise, the parties are required to seek prior approval from the State Asset Supervision and Administration Commission;

(3) According to the *Interim Measures for the Administration of Assessment of State-owned Assets of Enterprises*, which was issued by the State Asset Supervision and Administration Commission on 25 August 2005 and became effective on 1 September 2005, any state-owned assets that are to be affected by a transaction, are to be valued and assessed prior to the relevant transaction being approved;

(4) According to the *Law of the People's Republic of China on the State-Owned Assets of Enterprises*, which was issued by the Standing Committee of the National People's Congress 28 October 2008 and became effective on 1 May 2009, any transfer of state-owned assets requires the relevant local government's approval, prior to a transaction being approved.

Conclusion

Many foreign investors looking at acquiring a Chinese entity, are often initially daunted by the web of regulations and maze of government approvals required, in order to be able to actually take control of an entity and commence controlling the entity's business activities. However, foreign investors need to realize that these paths are well walked and are becoming more transparent and predictable as each day passes. Early communication with legal and accounting advisers, as well as key government departments, is key to getting a deal approved and avoiding the mine fields.

