

Mergers & Acquisitions in the People's Republic of China

In the past, the majority of foreign investors in the People's Republic of China ("PRC") chose to establish a new foreign investment enterprise ("FIE") in order to gain access to the PRC market rather than to acquire an already existing domestic entity. In the meantime, this situation changed and M & A transactions become increasingly important. Possible targets of M & A activities in the PRC can either be already existing FIEs or domestic Chinese enterprises.

Acquisition of Foreign Investment Enterprises

The legal basis for the acquisition of shares in an already existing FIE are the relevant investment laws and mainly the Certain Regulations on Changes to Shareholder's Rights in Foreign Investment Enterprises of May 28, 1997.

In the acquisition of such shares, the restrictions imposed on foreign investment by the Guideline Catalogue on Foreign Investment Industries have to be complied with. If according to these regulations in a certain industry only a Sino-foreign joint venture is permitted, it is not possible for a foreign investor to transform such Sino-foreign joint venture into a wholly foreign-owned enterprise by acquiring all shares of the Chinese partner.

Generally, the transfer of shares requires a resolution of the board of directors of the FIE, the change of the Articles of Association of the FIE as well as the consent of the other shareholders, if any. According to PRC law, the other shareholders, if any, also have a pre-emption right. Further, both the share transfer agreement as well as the transfer of the shares are subject to the approval of the competent examination and approval authority, i.e. the competent Authority of Commerce, and have to be registered with the competent Administration for Industry and Commerce.

Acquisition of Domestic Enterprises

The legal basis for the acquisition of domestic Chinese enterprise are the Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors ("Provisions") which were revised with effect of September 8, 2006.

The Provisions cover both share deals and asset deals.

- A share deal is legally defined as the purchase of the equity interests of a domestic company or the subscription to a domestic company's capital increase, resulting in the conversion of the domestic company into a FIE.
- An asset deal is legally defined as either the foreign investor's establishment of a FIE and the purchase, through such enterprise, of the assets of a domestic enterprise and operation of such assets, or the foreign investor's purchase of the assets of a domestic enterprise and the use of such assets to invest in and establish a FIE to operate such assets.

In case of acquisition of a domestic enterprise by foreign investors, regardless if by means of a share deal or by an asset deal, all restrictions imposed on foreign investment by PRC law apply. That means in particular, that the rules of the Guideline Catalogue on Foreign Investment Industries have to be complied with. The Provisions expressly demand that before the acquisition, the shares or assets have to be appraised by an assets evaluation institution registered in the PRC. The assets appraisal shall be conducted in accordance with common international appraisal methods.

The share or asset transfer agreement is mandatorily subject to PRC law. Both, the acquisition of shares in as well as the acquisition of assets of a domestic Chinese company by a foreign investor are subject to the verification by the competent Development and Reform Commission, the examination and approval by the competent Authority of Commerce and the registration with the competent Administration for Industry and Commerce.

Special Regulations for Acquisition of State-owned Assets

Special regulations apply in case of acquisitions of so-called State owned assets, i.e. of assets or shares of State-owned enterprises. In this case, the assets or shares must be appraised by a local Chinese CPA who has the qualification to evaluate State-owned assets. The appraisal report must be submitted to the competent State owned Assets Administration Bureau. The transaction price generally must not fall short more than 10 % of the value stated in the above appraisal report. Further, the transfer of State-owned assets must be conducted via an official Equity Exchange Center. This authority will make a public announcement of the intended transaction. If there is more than one interested party, the shares or assets must be transferred by means of public auction or bidding.

Merger Control Filings

If the transaction meets certain thresholds, it is also subject to merger control according to the PRC Antitrust Law which took effect on August 1, 2008. The authority in charge of merger control is the Anti-Monopoly Bureau under the PRC Ministry of Commerce.

Summary

In case of acquisition of shares of domestic Chinese enterprises, foreign investors should be aware of particular risks. It is absolutely necessary to conduct a detailed financial, tax and legal due diligence. In some cases, however, an assessment of the existing risks nevertheless turns out to be difficult. In these cases foreign investors are well advised to conduct an asset deal rather than a share deal.

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