be used as the contribution assets into an FIE. However, such contribution with non-monetary assets shall comply with the general rules of the Company Law that:

- the contribution in cash shall be at least thirty per cent of the registered capital; and
- such non-monetary contribution assets shall be duly appraised and verified.[26]

As compared with the old Company Law, which set forth a twenty per cent cap for contribution with IPRs, the new Company Law follows a different approach, adopting the thirty per cent threshold of contribution in cash while not specifying the cap of intangible assets contribution.

As for the valuation requirement for the non-monetary contribution assets, two points are to be stressed. On the one hand, an exception exists to this valuation requirement: as expressly contemplated under the EJV Law (Article 5), non-monetary assets (excluding land use rights) contributed into the EJV are *not* subject to the valuation requirement, and their price may be determined by the shareholders through negotiation.[27] On the other hand, the valuation of land use rights is subject to stricter requirements: land use rights contributed to all FIEs, including an EJV, is subject to the valuation requirement; and the valuation shall be conducted by a firm particularly qualified for the valuation of land use rights, and the valuation result shall be filed for record with the land administration authority.

Furthermore, subject to the SAFE approval, certain other particular assets can also be used as the contribution to the same FIE's capital increase: (a) surplus or capital reserve of an FIE; (b) undistributed profits or payable dividends and interests thereof in an FIE; or (c) principal and interests thereof of an FIE's foreign debts, which shall have been lent from the foreign shareholder of the FIE and duly registered with the SAFE.[28]

To clarify, however, the following non-monetary assets cannot be used as capital contribution: labour, credit, individual's name, goodwill, franchise, and assets subject to mortgage or other encumbrances.[29]

In addition, assets leased from third parties by an investor cannot be used as its contribution assets.[30] Nor can the investor use assets of the FIE itself, regardless of whether they are self-owned, lent or leased from third parties, as the former's contribution assets to the latter.[31] As a rule, the investor shall have the title

26. Company Law, Art. 27. According to Art. 10 of the Implementing Opinions, Art. 27 of the Company Law applies to the contribution of foreign investors into an FIE as well.
27. This exception is confirmed under Art. IX of the Implementing Opinions.
28. See the *Circular on Issues Concerning the Improvement of the Foreign Exchange Controls over Foreign Direct Investment*, which was promulgated by the SAFE (*HuiFa* No. [2003] 30) and became effective as of 1 April 2003.
29. Registration Regulations, Art. 14.
30. See the circular (*WaiJingMaoFaZi* No. [1986] 12) issued by the then MOFTEC on 19 May 1986.
31. See *Certain Provisions on Contribution by Investors to an EJV*, which were jointly promulgated by the then MOFTEC and the SAIC upon approval by the State Council and became effective as of 1 March 1988.

to or the disposal rights over the non-monetary assets it uses as the capital contribution to an FIE.

2.5.3 Capital Injection Schedule

2.5.3.1 Injection in One Lump Sum

The laws and regulations or the AOA of an FIE may require all the registered capital to be fully injected in one lump sum. In that case, as clarified under the Implementing Opinions (Article IX), the injection shall be made within six months of the establishment date specified in the Business Licence.

2.5.3.2 Injection by Instalments

It is a long-standing practice for shareholders of an FIE to inject their capital contribution by instalments. That desiring discussion here is what implications the new Company Law brings to this long-standing practice of FIEs.

One very important development under the new Company Law is to allow shareholders of a company, either those of an LLC or a CLS, to inject their capital contribution by instalments,[32] provided (a) the initial capital injection shall be at least twenty per cent of the registered capital and above the statutory minimum capital requirement, and be made when registering with the SAIC; and (b) the balance shall be injected within two years of the establishment date or five years thereof for a company of the investment company nature.[33]

What implications would the above rules of the Company Law bring to the long-standing practice of FIEs? In this regard, the Implementing Opinions undertake the continuing application of the long-standing practice of FIEs to a limited extent: the long-standing practice of FIEs in respect of the initial capital injection is followed, while the injection of the balance shall follow the general rules of the Company Law.[34] Specifically, for shareholders of a common FIE to inject capital by instalments, the following schedule shall be complied with:

- the initial capital injection shall be at least fifteen per cent of the registered capital and above the statutory minimum capital requirement, and shall be made within three months of the establishment date; and
- the balance shall be injected within (a) two years of the establishment date or (b) five years thereof for a foreign invested holding company.[35]

32. To be noted, this injection by instalments does not apply to the CLS established by share offer, which requires a one lump injection. (See Company Law, Art. 81.)
33. Company Law, Arts 26, 81.
34. Implementing Opinions, Art. IX.
35. In the past practice of FIEs, the timing for balance injection differs some from the general rule of the Company Law: for a WFOE is three years after the establishment registration; for EJV or CJV, one to three years or a longer limit depending on the amount of the registered capital; for

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SAIC registration, the foreign investor shall submit the following documents for review:

- the application letter (sample available at local SAICs) signed by the investor(s), including list of the shareholders, list and appoint letters of the directors, manager and supervisors, registration form of the legal representative,[70] as well as the ownership certificate or lease agreement of the domicile office;
- the AOA and (for EJV/CJV) shareholders' agreement;
- the notarized and authenticated business registration certificate of the foreign investor (or the ID copy of an individual investor);
- the registration letter of the company name;
- the authorization letter to the person responsible for handling specific procedures;
- the power of attorney for domestic service of the legal documents;
- the precedent approvals (if applicable); and
- any other necessary documents that may be required.

Within fifteen days of receipt of all the required documents, the competent SAIC shall make a decision and, if registered, issue the Business Licence to the proposed FIE, on the strength of which the FIE may then commence its business operation.

Of mention here, the SAIC registration application shall be submitted within ninety days of receipt of the MOFCOM approval and FIE Approval Certificate; otherwise, a confirmation by the competent MOFCOM on the effectiveness of original approval and FIE Approval Certificate is necessary.[71]

Step 5: Post-establishment registrations

Within thirty days of obtaining the Business Licence, the FIE shall continue to handle a set of post-establishment procedures and registrations, mainly including:

Seal carving: The FIE shall have its official seal carved with a qualified firm specifically licensed by the local public security authority. In China, official seals play a very important role in many aspects and hold higher evidencing power than signatures. In having seals carved, the FIE shall comply with the *Provisions on the Administration of Seals of Administrative Authorities, Enterprises and Governmental and Social Institutions* (**Seals Rules**), which were promulgated by the State Council (*GuoFa* No. [1995] 25) and became effective as of 31 October 1999.

NOC Certificate: A new FIE shall, within fifteen days of the establishment registration with competent SAIC, apply to the local AQSIQ for the NOC Certificate in accordance with the *Measures on Administration of Codes of Enterprises, Entities and Social Institutions* (**NOC Rules**), which were promulgated by thirteen Chinese authorities (*JiJianJuFa* No. [1993] 14) and became effective as of 13 July 1993. To apply for such an NOC Certificate, which is proof for the granting of a sole and perpetual national organization code to the FIE, the FIE shall submit the following documents to the local AQSIQ: (a) the Business Licence; (b) the FIE Approval Certificate; (c) the NOC allocation letter issued prior to the establishment registration; (d) the official seal of the FIE; and (e) ID copy of the FIE's legal representative.

70. According to the new Company Law (Art. 13), not only the chairman of the board of directors, but also the executive director or general manager may act as the legal representative.

71. Registration Regulations, Art. 20.

Foreign exchange (Forex) registration and opening of Forex account: One most important post-establishment registration for an FIE is the Forex registration with the local SAFE. Specifically, within thirty days of obtaining the Business Licence, the FIE shall apply to local SAFE for the Forex Certificate in accordance with the *Tentative Measures on Administration of the Foreign Exchange Registration of FIEs* (**Forex Registration Rules**), which were promulgated by the SAFE (*HuiZiHanZi* No. [1996] 187) and became effective as of 28 June 1996. To obtain a Forex Certificate, the FIE shall submit the following documents to the local SAFE for review: (a) the Business Licence; (b) the MOFCOM approval on establishment and the FIE Approval Certificate; (c) the shareholders' agreement and AOA; and (d) the NOC Certificate. Then, on the strength of the Forex Certificate, the FIE shall open a foreign exchange account with local bank, which account is to be used to remit in or out capital including without profits and dividends, in accordance with the *Provisions on Administration of Foreign Exchange Accounts inside China* (**Forex Accounts Rules**), which were promulgated by the People's Bank of China (PBOC) (*HuiFa* No. [1997] 19) and became effective as of 15 October 1997.

Tax registration: Another very important registration that is to be gone through is the registration with local tax bureaus. Specifically, the FIE shall handle registrations with both Local Tax Bureau and local State Tax Bureau in accordance with the *Measures on Administration of the Tax Registration* (**Tax Registration Rules**), which were promulgated by the SAT (SAT Order No. [2003] 7) and became effective as of 1 February 2004. To obtain the Tax Registration Certificate, the FIE shall, within thirty days of obtaining the Business Licence, submit the following documents to the competent tax bureaus for review: (a) the Business Licence; (b) the MOFCOM approval on establishment and the FIE Approval Certificate; (c) the shareholders' agreement and AOA; (d) the NOC Certificate; and (e) the ID document of the FIE's legal representative.

In addition, within thirty days of the establishment registration with the SAIC, the FIE shall handle, by submitting the Business Licence, FIE Approval Certificate and NOC Certificate, (a) financial registration with local MOF in accordance with the *Measures on Administration of the Financial Registration of FIEs* (**Financial Registration Rules**), which were promulgated by the MOF (*CaiGongZi* No. [1996] 126) and became effective as of 8 May 1996; (b) statistics registration with local statistics bureau in accordance with local administrative regulations on statistics registration; and (c) labour registration with local labour bureau in accordance with local administrative regulations on labour and social insurance.

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vehicle for foreign investors to go public and list shares in China, makes the FICLS a vehicle of particular attractiveness to certain foreign investors, especially in light of China's booming capital market. Furthermore, the FICLS is also a 'powerful legal vehicle' for foreign investors in that it may afford more flexibility in terms of majority shareholder's control,[1] perpetual existence,[2] and wider range of business scope, etc.[3]

On the other hand, an FICLS is subject to stricter requirements and procedures than those applicable to a common FIE. Among other things, establishment of an FICLS requires approval of the national MOFCOM. Specific requirements and procedures in this regard are set out in the FICLS Rules promulgated in 1995. Some of them have been developed to a certain extent by the developing FIE laws and, in particular, the new Company Law, which applies to FICLSs as well. Details of such requirements and developments will be given below where relevant.

One latest development concerning the FICLS is to be noted from the outset. On 27 February 2007, the MOFCOM issued its Announcement No. 11, 2007 authorizing certain approval matters within its authority down to its provincial counterparts. Before this authorization, apart from the establishment matter, all follow-on corporate changes of material importance (such as shares transfer, merger or division, capital increase or reduction, changes of business scope or other matters causing amendments to the Articles of Association (AOA)) of an FICLS required approval of the national MOFCOM. Following the authorization, such matters of an existing FICLS may be approved by the provincial MOFCOM, except that (a) changes in a listed FICLS and (b) changes made for the listing purpose (such as capital increase or shares issue) remain subject to the approval of the national MOFCOM. In addition, it is to be clarified that the establishment of an FICLS remains subject to the approval of the national MOFCOM.

4.2 GENERAL MATTERS OF THE FICLS

4.2.1 The Promoters

At least two promoters,[4] but not exceeding two hundred promoters, are necessary for the incorporation of an FICLS. Among such promoters, at least half shall be

1. A common FIE usually requires a unanimous resolution of the directors present at the board meeting for certain corporate matters of substantial importance. In contrast, for an FICLS, a simple or two-thirds majority of the voting rights held by shareholders present at the shareholders' general meeting suffices for such matters.
2. Most common FIEs have to specify a term of operation (usually thirty to fifty years) and, when the expiry date comes to close, run risks of re-negotiation among shareholders or re-application for governmental approval or registration of the extension.
3. For additional advantages of an FICLS as compared with common FIEs, see Martin G. Hu (Boss & Young Law Office), 'Company Limited by Shares (CLS): A Powerful Legal Vehicle for Group Restructuring' (2004) 4 *China Law & Practice*; also Charles Qin (Llinks Law office), 'Companies Limited by Shares' (2001) 6 *China Law & Practice*.
4. Under the old Company Law, there must be at least five promoters.

domiciled in China; and, specific for an FICLS, there shall be at least one foreign promoter, which may be either investors registered or domiciled outside of China or a foreign invested holding company (FIHC) registered in China.[5]

4.2.2 Establishment Ways

The FICLS Rules, in line with the Company Law, contemplate two means of establishing an FICLS, namely:

- by means of promotion, whereby the promoters shall subscribe for all the outstanding shares; or
- by means of a share offer, whereby the promoters shall subscribe for at least thirty-five per cent of the outstanding shares while the balance is offered to the investors.

However, it is scarcely the case that an FICLS has been established by means of a share offer, as this requires (a) the approval of the State Council (an authority above the national MOFCOM),[6] and (b) a record of the promoter's consecutive profitability for the most recent three years.[7] In light of this scarcity, the following discussions will focus on the establishment by means of promotion.

On the other hand, there exist two main models to establish an FICLS by way of promotion:

- incorporating a new company in the FICLS form; or
- restructuring an existing company into the FICLS.

In addition, the FICLS may be established as the result of subscription by foreign investors of the shares listed overseas by a CLS registered in China, so-called H Shares (listed on HKex) or N Shares (listed on NYSE) company.

4.2.3 The Twenty-Five Per Cent Foreign Capital Requirement

The FICLS Rules define the 'FICLS' as a CLS that has at least twenty-five per cent foreign capital.[8] Does this means that a CLS with less than twenty-five per cent foreign capital would not be approved? The answer is no. The establishment of a CLS with less than twenty-five per cent foreign capital is possible, still subject to

5. China deems the FIHC as a foreign investor, though it is registered in the PRC and an FIE in nature. In particular, Art. 14 of the FIHC Rules clearly states that an FIHC may act as a promoter to establish an FICLS by means of promotion. (For details of the FIHC and the FIHC Rules, see Chapter 3.)
6. Of particular relevance here, the IPO Rules promulgated by the CSRC in May 2005 (for details on IPO Rules, see Chapter 19) clearly state (in Art. 8) that the establishment of a CLS (including FICLS) by means of share offer requires the approval of the State Council.
7. FICLS Rules, Art. 6.
8. *Id.*, Art. 2.

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while other sectors may require a 'controlling shareholding' or 'relatively controlling shareholding' by Chinese parties. As reiterated in the FIPE Rules, such industrial controls apply to FIPEs as well.[9]

On the other hand, in light of the particular nature of an FIPE, the FIPE Rules clarify certain matters in regard to the application of the foreign investment industrial controls in the event of an FIPE. Specifically, they clarify that

- to engage in a sector 'limited to equity or contractual joint venture' with Chinese parties, the FIPE shall have at least one Chinese *general* partner;
- to engage in a sector requiring a 'controlling shareholding' by Chinese parties, an aggregate distribution ratio is set for all the Chinese partners of fifty-one per cent or above; and
- to engage in a sector requiring a 'relatively controlling shareholding' by Chinese parties, an aggregate distribution ratio is set for all the Chinese partners above the ratio for any single foreign partner.[10]

Moreover, in an FIPE requiring 'controlling' or 'relatively controlling' position by Chinese partners, the Chinese partner(s) shall have the final decision power for the matters other than those requiring a unanimous consent by all the partners.[11]

Of mention here, the FIPE Rules expressly prohibit an FIPE from bypassing the otherwise applicable industrial controls through arrangements such as a pledge, transfer or enforcement of certain share to property in the partnership, particular voting rules or conditions of admission or withdrawal, or particular transformation mechanism from a limited partner to a general partner or vice versa.[12]

5.3 PARTNERS

5.3.1 The Partners in an FIPE

The FIPE may be either (a) a general FIPE, which is established by general partners that bear joint and several liability to, without limit for the debts of, the FIPE; or (b) an FILLP, which is established by general partners jointly with limited partners that bear limited liability for the partnership's debts to the extent of their subscribed capital contribution to the FILLP.[13]

9. FIPE Rules (draft), Art. 7.
10. *Ibid.*
11. *Ibid.* (According to Art. 31 of the Partnership Law, the following matters require a unanimous resolution by all the partners: (a) change of the name of the partnership enterprise; (b) change of the business scope or principal business premises; (c) disposal of real properties of the partnership enterprise; (d) transfer or disposal of the IPRs or other property rights of the partnership enterprise; (e) provision of security or guarantee for third parties in the name of the partnership enterprise; and (f) appointment of persons other than the partners as the management personnel of the partnership enterprise.)
12. FIPE Rules (draft), Art. 7.
13. FIPE Rules (draft), Art. 2; Partnership Law, Art. 2.

Specific for the foreign partner of the FIPE, (a) for a foreign individual person, it shall be a person with full capacity for civil conduct; or (b) for a foreign entity person, it shall be a person with goodwill and having never been imposed a disciplinary punishment by the industrial association within its home country. Furthermore, if it is a natural person or entity that has been sentenced a crime by Chinese or foreign judicial authorities due to an economic crime, then such a person cannot act as a partner within five years of the expiration of the crime's enforceability period.[14]

On the other hand, there is no particular requirement for a minimum number of the Chinese partners in an FIPE. In an FIPE, all the partners can be foreign investors; or, foreign investors may establish an FIPE jointly with Chinese partners. However, for an FIPE engaging in sectors that require 'controlling shareholding' or 'relatively controlling shareholding' by Chinese partners under the Industrial Catalogue, it is evident that there shall be at least one Chinese partner, general or limited. On the other hand, if it is an FIPE engaging in sectors that have been specified as 'limited to equity or contractual joint venture [with Chinese parties]' under the Industrial Catalogue, the FIPE shall have at least one Chinese *general* partner.[15]

To be further noted, in cases where a Chinese general partner is necessary by law, or, in cases where the foreign partner decides at its own discretion to establish an FIPE jointly with one or more Chinese general partners, the foreign investor should keep in mind that such Chinese general partners cannot be (a) wholly state-owned companies, (b) state-owned enterprises (SOEs), (c) listed companies, or (d) charitable institutions or social organizations.[16]

Of additional mention, generally, there is no requirement of a maximum number for partners in an FIPE, save that if it is an FILLP, in which there shall be at least one *general* partner, the number of partners cannot exceed fifty.[17]

5.3.2 Limited Liability Legal Person as a General Partner

Can a legal person with limited liability perform as a general partner in an FIPE (a general FIPE or an FILLP)?

In this regard, it is recalled that the *PRC Company Law* (Company Law) clearly states that a legal person company, either an LLC or a CLS, cannot become an investor that bears joint and several liability for the debts of the enterprises in which it invests, unless the *law* otherwise provides for.[18] Now, the Partnership Law clearly states that a partnership enterprise may be established by individuals, legal persons and other business organizations.[19] It thus implies that there is no problem

14. FIPE Rules (draft), Art. 8.
15. *Id.*, Art. 7.
16. Partnership Law, Art. 3.
17. *Id.*, Art. 61.
18. Company Law, Art. 15.
19. Partnership Law, Art. 2.

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pharmaceutical industry; and (c) the NDRC approval for acquisition involving investment in manufacturing or fixed assets.

Step 3: Approval by the national or provincial MOFCOM

Cross-border acquisitions require approval of the MOFCOM.[14] Of particular notice here is that only the national MOFCOM and its provincial counterparts are authorized the approval power under the M&A Rules.[15] That is to say, the M&A Rules do not empower authorities at levels below the provincial MOFCOM to approve a cross-border acquisition deal, regardless of how small the total investment amount of the post-acquisition FIE will be. In practice, however, some provincial MOFCOMs, e.g., the Beijing MOFCOM (provincial), have authorized their counterparts at lower levels to approve the M&A transaction. The M&A Rules makes no express prohibition of such downward authorization.

As for which specific level, national or provincial, is competent to the deal, it depends on (a) the total investment amount of the post-acquisition FIE – above USD 100 million for 'encouraged' or 'permitted' projects or above USD 50 million for 'restricted' projects requires the national MOFCOM approval; (b) the nature of the target company – e.g., acquisition of a CLS, listed company or holding company requires the national MOFCOM approval; and (c) the business scope of the post-acquisition FIE – foreign investment in certain particular industries, e.g., direct sale, requires the national MOFCOM approval.[16]

Of particular mention here is that the M&A Rules have expressly singled out two particular cases where approval of the national MOFCOM is required (for details on such two particular cases, see Chapter 7):

- the acquisition conducted via an offshore special purpose vehicle (SPV) established by domestic PRC residents who have a connected relationship with the domestic target company; and
- the acquisition conducted through a share swapping arrangement.[17]

As for the application documents, the purchaser shall submit (via the seller or the target company) for review the acquisition agreement, together with the documents listed in Table 6.1, to the provincial or national MOFCOM:[18]

14. M&A Rules, Art. 6.
15. *Id.*, Art. 10.
16. *Id.*, Arts 10, 21.
17. *Id.*, Arts 11, 32.
18. *Id.*, Art. 21; also see the list published at the MOFCOM's official website <www.mofcom.gov.cn/>.

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Table 6.1 Application Documents for the Equity Acquisition

No.	*File Name*	*Check*
I. Documents of the foreign purchaser		
1	Its identity document[19]	
2	Creditworthiness certificate, which shall certify the purchaser's account with at least an amount sufficient for the payment of the first instalment of the price	
3	Statements relating to its basic identity information, existing investments in China, and performance in the relevant markets	
4	Statement on whether there is a connected relationship between the parties	
II. Documents of the target company		
5	Application letter on its conversion into an FIE	
6	Corporate approval on the acquisition	
7	Assets valuation report of the target equity or shares	
8	Audit report of the most recent year	
9	Its Business Licence	
10	Shareholders' agreement and AOA of the post-acquisition FIE	
11	Statements on its performance in the relevant markets, and basic identity information of its subsidiaries or affiliates	
12	Business Licences of its subsidiaries	
13	Staff resettlement scheme[20]	
III. Documents in particular		
14	*Particular for connected relationship*: If the parties are actually controlled by the same person, then (a) information of such a de facto or ultimate controlling person, including its offshore shareholding and transaction structures, shall be additionally disclosed to the MOFCOM; and (b) the parties shall further clarify the purposes underlying the deal and explain whether the assets valuation has been conducted on an arm's length basis. Such additional disclosures cannot be bypassed through arrangements such as trust or proxy holding.[21]	

19. It refers to the foreign purchaser's business registration certificate or license (or ID card or passport for an individual purchaser), including ID card or passport of its legal representative or authorized director, which shall be both notarized by a notary officer in its home country and authenticated by the PRC embassy or consulate in that country. However, if the purchaser is from Hong Kong or Macao, a notarization suffices.
20. While the staff resettlement issues are in nature within the responsibility of the seller or target company, their handling may impact the progress of the acquisition, therefore they should be seriously considered by the purchaser as well.
21. M&A Rules, Art. 15.

MOFCOM for approval. On the other hand, even after the establishment of the new FIE upon the MOFCOM approval and SAIC registration, for the new FIE to operate the acquired assets onshore (e.g., to commence the manufacturing of the acquired pharmaceutical products), it may have to go ahead to apply for particular licences or permits necessary for such an onshore operation (e.g., the GMP certification by the SFDA on the manufacturing workshop). It is here recalled that, in an assets deal, governmental licences or permits pertaining to the target company cannot be passed on to the purchaser or the new FIE established by the purchaser to operate the acquired assets onshore. In contrast, as discussed in §6.2 above, in an equity deal, the post-acquisition FIE can carry on the particular licences or permits originally granted to the target company by the industry regulators. That is to say, in an equity deal, post-acquisition FIE does not have to apply for such particular licences or permits after the acquisition; this provided, at the acquisition stage, precedent approvals of such industry regulators have been obtained.

On the other hand, there is a particular precedent government approval requirement in the assets deal. Specifically speaking, if the target assets are certain imported equipments, then precedent approval of the customs may be necessary. Under PRC laws, the seller of certain imported equipments may have enjoyed an exemption of the customs duties and the seventeen per cent VAT. In that case, such equipments are usually subjected to a customs supervision period of five to seven years depending on the nature of the equipments. To transfer such equipments within the supervision period, the seller must obtain precedent approval of the customs. In practice, customs usually would grant such an approval only where the exempted or reduced duties or tax has been compensated by the seller. Accordingly, the seller would usually consolidate such costs in the transfer price.

Step 3: Approval by the national or provincial MOFCOM

The approval authority level for an assets deal is the same as in the equity deal, that is, either a provincial or national MOFCOM. What makes a difference here are certain application documents particularly required in the assets deal. Specifically speaking, as compared with an equity deal, among the documents listed in Table 6.1 above, those listed in No. 7 (except for basic identity information of the purchaser), No. 11 and No. 14 are not required here. On the other hand, the following documents are additionally required in the assets deal:

- AOA of the target company; and
- proof of notification and newspaper announcement to the creditors by the target company, and a statement on whether the creditors have raised objection.[37]

37. M&A Rules, Art. 23; also see the list published at the national MOFCOM's official website <www.mofcom.gov.cn/>.

In any event, as in the equity deal, within thirty days of receipt of all the required documents, the MOFCOM shall make a decision. Only upon the grant of the aforementioned MOFCOM approval shall the acquisition agreement become effective. Furthermore, on the strength of the MOFCOM approval of the acquisition, if granted, the new FIE can then apply for the FIE Approval Certificate.[38]

Step 4: Post-approval registrations

Post-approval registrations in the assets deal are most similar to those presented above in Step 4, §6.4.2.1, except that the applicant here is the new FIE established to operate the acquired assets, instead of the seller or target company.

Step 5: Payment and verification thereof

As for the payment in an assets deal, most important points given above in Step 5, §6.4.2.1 apply here, especially the points related to the payment assets and the verification with local SAFE.

As for the payment time limits to be applied in the assets deal, of mention here is that the purchaser shall, apart from the specification in the assets purchase agreement, additionally specify the capital contribution time limits in the shareholders' agreement and/or AOA of the new FIE. In determining the time limits for such a capital contribution, the purchaser (i.e., the shareholder of the new FIE) shall comply with the provisions of the M&A Rules. That is to say, among the capital injection into the FIE, the portion equivalent to the assets purchase price shall be injected in line with the time limits illustrated above in the Table 6.2, while the remaining portion can be injected within two years of the issuance date of the FIE Business Licence of the post-acquisition FIE.[39] This differs to a certain extent from the capital injection in a common case (for details in this regard, see §2.5).

Step 6: Title transfer of the acquired assets

As the foreign purchaser cannot be registered in the PRC as the owner of the acquired assets, the title transfer of such acquired assets are usually handled in the name of the new FIE upon its establishment after the SAIC registration, which is conditional on the MOFCOM approval of the purchase deal.

38. M&A Rules, Art. 25.
39. *Id.*, Art. 16.

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Above all, an entity seller (i.e., the domestic target company or its entity shareholder), which will hold shares offshore as a result of the share swap deal, shall obtain the Overseas Investment Certificate in accordance with the MOFCOM Overseas Investment Rules. What is particular here is that: (a) in common cases, either the national or provincial MOFCOM may have the power to approve the overseas investment, while in the particular event of an overseas investment resulted from a share swap deal, only the national MOFCOM has the power; and (b) in applying for the Overseas Investment Certificate, the seller shall submit the aforementioned annotated FIE Approval Certificate and annotated Business Licence of the domestic target company, in addition to those application documents specified in the MOFCOM Overseas Investment Rules.[19]

Furthermore, the entity seller shall apply for (a) the project initiation approval or record-filing proof with the national or provincial NDRC in accordance with the NDRC Overseas Investment Rules; and (b) the Overseas Investment Forex Certificate with the national or provincial SAFE in accordance with or by reference to the Overseas Investment Forex Rules, SAFE Circular No. 75 and Circular No. 106.

On the other hand, if the seller is an individual shareholder of the target company, which will hold shares offshore as a result of the deal, then only the registration with the provincial SAFE is required. This registration shall be conducted in accordance with or by reference to the Overseas Investment Forex Rules, SAFE Circular No. 75 and Circular No. 106. Upon registration, the individual seller will be issued the Individual Overseas Investment Forex Form.

Step 4: Closing upon formal approval and registrations

Concurrently with the issuance of the aforementioned Overseas Investment Certificate, the national MOFCOM shall issue the formal FIE Approval Certificate to the target company to supersede the annotated FIE Approval Certificate. However, it is to be recalled that if the seller is an individual shareholder of the domestic target company, for the offshore shareholding by such an individual person resulted from the share swap deal, it suffices to go through the SAFE registration procedures and currently the MOFCOM will not issue an Overseas Investment Certificate to such an individual person. It implies that in such a case the domestic target company may apply for the formal FIE Approval Certificate once the said individual person has filed the SAFE registration and obtained the Individual Overseas Investment Forex Form. Within thirty days after obtaining the formal FIE Approval Certificate, the target company shall continue to file registrations with the competent SAIC and SAFE to obtain the formal Business Licence and Forex Certificate, respectively.[20]

On the strength of the aforementioned formal FIE Approval Certificate, Business Licence and Forex Certificate, the share swap deal can be closed and the foreign purchaser officially becomes the shareholder of the domestic target company. Only

19. *Ibid.*
20. M&A Rules, Art. 35.

in that case can the target company distribute profits to its shareholders, provide security for its affiliates, or remit payments of capital count items.[21]

In addition, on the strength of the formal FIE Approval Certificate and Business Licence, the target company shall file registrations with the local tax bureaus to obtain the FIE Tax Registration Certificates.

7.4.3 The M&A Consultant in a Share Swap Deal

To prevent acquisitions by shell companies and to avoid under-priced disposal of domestic assets to foreign competitors, the M&A Rules require that, in a share swap deal, the target company or its shareholders shall engage a PRC licensed agency or intermediary entity, e.g., a law firm, accounting firm or investment bank, to act as a special consultant for the share swap transaction (M&A Consultant).[22]

A qualified M&A Consultant shall (a) possess relevant professional experience and be of good repute; (b) have no record of any material contravention of laws or regulations; and (c) have the ability to investigate and analyze financial status of the foreign company and legal systems of where that company is located and listed.[23] To perform its duties, such an M&A Consultant shall conduct due diligence in respect of the proposed acquisition to verify (a) the authenticity of the acquisition application documents, (b) the financial status of the foreign company, and (c) the compliance status of the transaction; and issue an M&A advisory report to set out its professional opinions on each of the aforementioned items.[24]

7.5 SHARE SWAP INVOLVING AN SPV

7.5.1 The Particular Structure of a Share Swap Involving SPV

As mentioned above, apart from the shares of an overseas listed company, the other type of shares that can be swapped with PRC domestic equity or shares is those of an offshore SPV that is controlled directly or indirectly by domestic PRC residents with the particular purpose of overseas listing domestic interests or assets that are actually owned or controlled by such PRC residents (for purpose of being distinguished from a common SPV without the listing purpose, the SPV in this §7.5 will be referred to as 'special SPV').[25]

The structure of this particular share swap is indeed the same as that illustrated above in Chart 7.1. The difference lies in the facts that:

- in a common acquisition deal for purpose of listing domestic interests or assets via a special SPV, typically, (a) the SPV pays *in cash* to the domestic

21. *Id.*, Art. 37.
22. *Id.*, Art. 30.
23. *Id.*, Art. 31.
24. *Id.*, Art. 30.
25. *Id.*, Arts 28, 39.

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In addition, the transfer may be a management buy-out (MBO). In practice, however, the SASAC implements very stringent controls over MBO and has seldom permitted an MBO deal, this kind of transfer will not be detailed herein, either.[7]

8.2.2 Transfer Approval by Competent Authorities

Equity transfer in SOEs requires approval of the SASAC or other competent authorities. Generally, such a competent approval authority may be:

- *the SASAC*, which is competent to the transfer in the Investee Enterprises, respectively, (a) national SASAC competent to the transfer in central SOEs (i.e., Investee Enterprises of the national SASAC), and (b) local SASACs above municipal level competent to the transfer in local SOEs; or
- *the W-SOE* or *C-SOE*, which is competent to the transfer in its subsidiaries.[8]

As for the latter case, however, if it is a transfer in the 'major subsidiaries' of a W-SOE/C-SOE that would constitute a substantial transfer, then the approval power is vested in the competent SASAC (countersigned by the MOF) just as in the event of a transfer in the W-SOE/C-SOE.[9] Unfortunately, however, no uniform standard exists as for what constitutes a 'substantial transfer' or 'major subsidiaries'. In practice, some local governments publish a list of the so-called 'major subsidiaries' within their jurisdictions. In this regard, it is clarified in Circular No. 268 that, before the enaction of a uniform standard by the national SASAC,

- for a central W-SOE/C-SOE, it is up to the central W-SOE/C-SOE itself to determine which of its subsidiaries are among the 'major subsidiaries' and what transfer in such a subsidiaries constitutes a 'substantial transfer;' and
- for a local W-SOE/C-SOE, it is up to the competent local SASAC to publish a list of 'major subsidiaries' and specify the standard of 'substantial transfer'.[10]

On the other hand, if it is a transfer of the state controlling rights in the Investee Enterprises that would convert the target SOE into a company not controlled by the state or a private company, the approval power is vested in *the people's government* at the same level of the competent SASACs – State Council or local people's government above municipal level.[11]

7. For details on MBO, see the *Tentative Provisions Concerning the Transfer of State-owned Assets and Equity in Enterprises to Management*, which were jointly promulgated by the SASAC and MOF (*GuoZiFaChanQuan* No. [2005] 78) and became effective as of 11 April 2005.
8. SOE Transfer Rules, Arts 25, 26.
9. *Id.*, Art. 26.
10. Circular No. 268, Art. II.
11. SOE Transfer Rules, Art. 25.

In any event, approval of the competent authorities shall be obtained (a) in a public transfer, before the seller can list the equity on an equity exchange to seek for potential purchasers; or (b) in a private transfer, before the executed transfer agreement can go into effect. Furthermore, even after the approval of competent authorities has been obtained, if the parties intend to adjust the ratio or amount of the subject equity or there occur other substantial adjustments to the original transfer scheme, the parties shall again go through the approval procedures to obtain a new approval for the adjusted transfer.[12] In any event, if the transfer is conducted without approval of the competent authorities, the SASAC may halt the transfer, and, where necessary, sue to the governing court to declare invalidation of the transfer.[13]

8.2.3 Pricing of the Transfer

Pricing of the equity transfer in SOEs shall be based on the assets valuation result issued by a qualified valuation firm (valued price). Furthermore, such a valued price that may be used as the pricing basis shall be the one approved by or filed for record with the SASAC or other authority that is competent to approving the transfer at issue (for details, see §8.6 below).[14]

In a private transfer by agreement, on the one hand, *the transfer price* shall be no lower than the valued price that has been approved by or filed for record with the competent approval authority.[15]

In a public transfer through floor-based trading, on the other hand, there is a third concept apart from the valued price and transfer price, i.e., *listed price*. The initial listed price – the price at which the seller publicly seeks for potential purchasers by listing on an equity exchange – shall be no lower than the valued price that has been approved or filed for record. If no potential purchaser has proposed to accept the public invitation during the listing period, the seller may reinitiate the listing based on a new listed price. However, if the new listed price is lower than ninety per cent of the valued price, then a written confirmation of such a new price by the competent approval authority shall be obtained before the listing can be reinitiated based on the new listed price.

In any event, in the public transfer, if there appears only one qualified purchaser after the listing, the transfer price shall be the listed price (either the initial listed price or the approved new listed price). On the other hand, the transfer price shall be the price resulted from public auctions or bidding if two or more qualified purchasers propose to acquire the equity for sale during the listing period. Of particular notice here is that the seller is not entitled to provide discounts or preference to such a resultant price following the floor-based trading just because the

12. *Id.*, Art. 31.
13. *Id.*, Art. 32.
14. *Id.*, Art. 13.
15. Circular No. 306, Art. I(3).

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In cases where the target is an existing FIE (excluding a foreign invested CLS (FICLS)), the equity acquisition deal also requires a unanimous board resolution of the FIE, as in most cases the deal will result in corresponding changes to the FIE's articles of association (AOA), and, by law, such changes require a unanimous resolution of all the directors present at the board meeting. This is evidenced by an arrangement to a similar effect in the AOA of most FIEs. If the target is an FICLS, on the other hand, according to the general rules of the Company Law, which apply to an FICLS as well, a simple majority shareholders' resolution passed at the FICLS's shareholders' general meeting suffices. In light of the requirement in practice, however, a two-thirds majority of the voting rights present at the shareholders' general meeting is necessary, especially for the equity acquisition of an FICLS.

Apart from a unanimous board resolution, the Equity Changes Rules further require that the acquisition agreement be countersigned or otherwise confirmed or consented on by all the other shareholders of the FIE.[11] This rule indeed follows the requirements of the CJV Law (Article 10) and the EJV Law (Article 4), which each states that the equity transfer in a CJV or EJV shall be approved by all the other shareholders. What is particular here is that the Equity Changes Rules now extend this consent requirement by all the other shareholders to the equity acquisition or transfer in a WFOE (with more than one foreign shareholders), as the Equity Changes Rules apply not only to a CJV or EJV but also to a WFOE.[12] This fills in a gap of the WFOE Law. However, if the target is an FICLS, then the acquisition does not require consent by all the other shareholders. It suffices to pass a shareholders' resolution by a simple majority or two-thirds majority voting, unless the shareholders' agreement or AOA of the FICLS specifies otherwise.

Notably, in cases where the transaction is made between two existing shareholders of the target, instead of a transfer to third parties, there is a minor difference depending on whether the target is a domestic company or an FIE. If the parties are two shareholders of an existing FIE, the Equity Changes Rules do not, nor does the CJV Law (Article 10) or the EJV Law (Article 4), distinguish between a transfer between existing shareholders and a transfer to third parties when requiring the consent by all the other shareholders.[13] In contrast, if the target is a domestic company, according to the Company Law, only a transfer *to third parties of the equity in an LLC* requires the consent by the other shareholders. Even in that case, where the consent requirement exists, a simple majority of all the shareholders suffices and shareholders other than the seller are left with the only choice either to buy out the seller or to watch their former partner bring in someone else.[14]

11. Equity Changes Rules, Art. 9.
12. *Id.*, Art. 2.
13. Indeed, Art. 23 of the Implementation Rules to the CJV Law clearly states that even a transfer between two shareholders of a CJV requires the consent of all the other shareholders.
14. Company Law, Art. 72.

Step 3: Approval by the original MOFCOM

The acquisition of an existing FIE also requires approval by the MOFCOM. This is similar to the case of an acquisition of domestic companies. What is particular here is that the approval authority for the equity acquisition of an existing FIE is the MOFCOM that has approved the establishment of the target FIE (original MOFCOM).[15] This differs from the acquisition of a domestic company without foreign capital, where the competent approval authority is the national or provincial MOFCOM. As the level of the competent MOFCOM generally depends on the total investment amount of the FIE, which amount is to be determined in terms of the FIE's registered capital,[16] a municipal or lower level MOFCOM may have the approval power to the acquisition of an existing FIE.[17]

To be noted, however, in cases where it is a deal subscribing for the new shares or increased capital of the target FIE, if the capital increase leads to a higher total investment amount that exceeds the power limits of the original MOFCOM, then approval of the MOFCOM at a higher level is necessary.[18]

To apply for the approval of the competent MOFCOM, the parties shall submit the documents listed in Table 9.1 for review, together with the acquisition agreement:[19]

Table 9.1 Application Documents for the Equity Transfer in an FIE

No.	*File Name*	*Check*
I. Documents of the foreign purchaser		
1	Its identity document[20]	
2	Creditworthiness certificate, which shall certify the purchaser's account with at least an amount sufficient for the payment of the first instalment of the price	
II. Documents of the target FIE		
3	Application letter	
4	Corporate approval on the acquisition – board resolution (for a LLC) or resolution of the shareholders' general meeting (for a CLS)	

15. Equity Changes Rules, Art. 7.
16. For details on the relationship between registered capital and total investment amount of an FIE, see §2.5.
17. For details on the competent MOFCOM level determined in terms of the total investment amount, see §1.2.
18. Equity Changes Rules, Art. 7.
19. *Id.*, Arts 9, 10; also see the list published at the MOFCOM's official website <www.mofcom.gov.cn/>.
20. It refers to the foreign purchaser's business registration certificate or licence (or the ID card or passport for an individual purchaser), including the ID card or passport of its legal representative or authorized director, which shall be both notarized by a notary officer in its home country and authenticated by the PRC embassy or consulate in that country. However, if the purchaser is from Hong Kong or Macao, a notarization suffices.

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Table 11.1 Application Documents for the Merger between FIEs or with an FIE

No.	*File Name*	*Check*
I. Documents in general		
1	Application letter signed by legal representatives of the respective parties	
2	The merger agreement	
II. Documents of the respective parties		
3	Corporate resolutions	
4	Shareholders' agreement and AOA	
5	Business Licence; FIE Approval Certificate	
6	Capital verification report	
7	Audit report of the most recent year	
8	Balance sheets and list of assets	
9	List of creditors	
10	Business Licences of their respective existing subsidiaries	
11	Statements of their respective performance in the relevant markets	
III. Documents of the post-merger FIE		
12	Shareholders' agreement and AOA	
13	List of directors, and the directors' appointment letters, ID documents and resumes	
IV. Documents in particular		
14	Dissolution approval of the absorbed FIE, if the approval authority of the post-merger FIE is not the same authority of the absorbed FIE	

Within forty-five days upon receipt of all the required documents,[24] the Merger Authority shall make a preliminary decision on the merger.[25] However, if the merger would make necessary a merger review (see Chapter 12 for details), the aforementioned time limit for preliminary decision is to be accordingly extended.

Step 3(2): Dissolution application of the absorbed company

If the party proposed to be dissolved in the merger, i.e., the absorbed company, is an FIE and its original approval authority is not the same authority of the

24. In accordance with the *PRC Administrative Licensing Law*, the time limit of forty-five days specified in the Merger Rules of FIEs should be reduced to thirty days.
25. Merger Rules of FIEs, Art. 26.

post-merger FIE, then the absorbed FIE shall first obtain an approval of its dissolution with its original MOFCOM before the Merger Applicant can submit the merger application to the Merger Authority.[26] To be clarified here, the dissolution of a domestic company does not require approval of the MOFCOM.

In cases where a dissolution approval of the competent MOFCOM is necessary, the absorbed FIE usually shall submit the following documents for review: (a) the merger agreement, (b) its board resolution of the dissolution, and (c) its Business Licence, shareholders' agreement and AOA. In this application, within fifteen days upon receipt of all the required documents, the original MOFCOM of the absorbed FIE shall make a decision.[27] Interestingly, it is noted that the Merger Rules of FIEs deem the absorbed FIE's original MOFCOM to have consented on the dissolution application if it fails to make a decision within the said fifteen-day period.[28] However, enforceability of this rule is doubtful as the said dissolution approval, if applicable, is among the documents to be submitted to the Merger Authority for review.

Notably, in cases where the original MOFCOM of the absorbed FIE definitely rejects the dissolution application, the absorbed FIE is permitted to submit the dissolution application to the MOFCOM at a higher level above both the absorbed FIE's original MOFCOM and the Merger Authority. Such a higher MOFCOM shall reach a decision within thirty days of its receipt of the dissolution application.[29]

It is to be stressed, finally, that the dissolution approval would become void automatically once the Merger Authority rejects the merger application.[30] This implies that the absorbed FIE (or an absorbed domestic company), even granted the MOFCOM approval of the dissolution, can only handle its deregistration procedures with its original SAIC after the final merger approval has been issued by the Merger Authority.

Step 4: Notification to the creditors and public announcement

Particular protections are provided to creditors of the parties to a merger deal. As required under the Merger Rules of FIEs, the parties to the merger shall,

- within ten days of the preliminary approval of the merger, notify their respective creditors in writing; and
- within thirty days of the preliminary approval, announce the proposed merger on a nationally circulated newspaper.[31]

The parties shall prepare the said notice and announcement in accordance with the sample attached to the Merger Rules of FIEs, specifying, among other things, the

26. *Id.*, Art. 22.
27. *Ibid.*
28. *Ibid.*
29. *Ibid.*
30. *Ibid.*
31. Merger Rules of FIEs, Art. 27.

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Step 1: Filing with the AEA

If the triggering points (yet to be specified) occur and the concentration does not fall within either of the two exemption cases (see §12.3.4 above), then the parties (usually the purchaser) shall submit the documents specified in Article 23 of the Anti-monopoly Law, listed in Table 12.3, to the AEA for review:

Table 12.3 Documents of Anti-monopoly Filing

No.	*File Name*	*Check*
1	Application report[35]	
2	Explanation or assessment report on the effects that the proposed concentration may have on the competition in the relevant market	
3	The acquisition, merger or otherwise concentration agreement	
4	Audit report of the most recent year of each of the party involved in the concentration	
5	Other documents or information that the AEA may require in the specific guidelines to be issued or require on a case-by-case basis	

It should be mentioned here that the Anti-monopoly Office of the national MOFCOM has published its own filing guidelines under the M&A Rules, specifying the details of the documents and information to be submitted for review.[36] Such details are likely to be incorporated in the specific guidelines to be issued by the AEA.

Step 2: Preliminary review by the AEA

Within thirty days upon receipt of all the required documents, the AEA shall conduct a preliminary review of the filed case. Based on this preliminary review:

- if the AEA decides to review the transaction further, then it shall notify the filing parties in writing before expiration of the thirty-day period; however,
- if the AEA decides not to conduct a further review or fails to make a decision within the thirty-day period, then the filing parties can proceed to perform the transaction.[37]

35. The application report shall contain the following matters of each party involved in the concentration: names, domiciles, business scopes, *the anticipated date* on which the concentration will be implemented, and other information that the AEA may require in the specific guidelines to be issued or require on a case-by-case basis. (Anti-monopoly Law, Art. 23.)
36. The guidelines are available at <http://tfs.mofcom.gov.cn/aarticle/bb/200704/20070404597464.html>.
37. Anti-monopoly Law, Art. 25.

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In any event, before the AEA makes a decision not to conduct a further review or before the expiration of the thirty-day period without the AEA making any decision, the parties cannot proceed with the proposed concentration.[38]

Step 3: Further review by the AEA

If the AEA decides to conduct a further review and so notify the filing parties before expiration of the aforementioned thirty-day period, then such a further review shall be completed within ninety days. However, the AEA may extend the review process for an additional sixty days in the following cases: (a) the concerned parties consent on such an extension; (b) the submitted documents are inaccurate and require further verification; or (c) relevant circumstances significantly change after the filing.[39]

During this further review period, either the ninety-day period or the additional sixty-day period, the parties cannot proceed with the transaction. On the contrary, (a) if no decision has been made upon expiry of the ninety-day or additional sixty-day period or (b) if the AEA decides, based on the further review, to affirmatively approve the transaction, then the parties can proceed to implement the concentration.[40]

Step 4: Decisions by the AEA

As noted above, before completion of the review by the AEA, the parties are prohibited from implementing the concentration. After the further review, which is to be conducted based on the aforementioned substantive assessment factors (see §12.3.3 above) and the forthcoming specific guidelines, the AEA shall decide depending on the case.

On the one hand, if the further review proves that the proposed transaction has or may have an effect eliminating or restricting competition, then the AEA shall decide to prohibit the transaction, so-called 'merger clearance' order. However, the AEA may also decide not to take 'merger clearance' measures if the filing parties can substantiate that (a) the positive aspects of the transaction clearly outweighs the negative aspects; or (b) the concentration serves public interests.[41]

On the other hand, if the further review proves no effect eliminating or restricting competition, then the AEA shall affirmatively approve the transaction. This affirmative decision, however, may be a definite approval or an approval qualified with certain restrictive conditions aiming to cure perceived competition problems.[42] Of mention here is that nothing in the Anti-monopoly Law bars parties

38. *Ibid.*
39. Anti-monopoly Law, Art. 26.
40. *Ibid.*
41. Anti-monopoly Law, Art. 28.
42. *Id.*, Art. 29.

launch a general offer.[13] On the other hand, if the purchaser does not apply for the CSRC exemption, then it shall launch the offer as just discussed above.

13.3.1.3 Offer Period

The takeover offer shall open, upon its effectiveness, for a period (offer period) of no less than thirty days, but, save in the event of a competing offer, not exceeding sixty days.[14] An extension of an additional period is possible if a competing offer has been put forward. The extension period

- may be one or more days if the extension is made before fifteen days prior to the expiration of the original offer period; however,
- it shall be no less than fifteen days if it is made within fifteen days prior to the expiration of the original offer period.[15]

However, the extension cannot continue once the last competing offer expires.[16] It can thus be deducted that the extension can only continue for a period of no more than forty-five days after expiration of the original offer period, because the competing offer, which has a period of at most sixty days, shall be launched no later than the fifteenth day prior to the expiration of the original offer period.

In any case, during the offer period (original or extended), the purchaser cannot sell its shares in the same listed company, nor can it increase its shareholding therein in any manner or on any terms other than those specified in the takeover offer.[17]

13.3.1.4 Offer Price

In a takeover by offer, the offer price cannot be lower than the highest price that the same purchaser has paid in a previous acquisition of shares of the same class during six months prior to the reminder announcement date of the takeover offer.[18]

Furthermore, in cases where the offer price is lower than the arithmetic mean of the daily weighted average price of the shares of the same class during the thirty trading days prior to the reminder announcement date of the takeover offer, the purchaser then has to engage an independent financial advisor (IFA) to issue a special report. This report shall, among other things, analyze the shares' trading particulars during the preceding six months; clarify if there has been any manipulation of the market price or any undisclosed person acting in concert; and confirm the reasonableness of the offer price.[19]

13. *Id.*, Art. 61.
14. *Id.*, Art. 37.
15. *Id.*, Art. 40.
16. *Ibid.*
17. Takeover Code, Art. 38.
18. *Id.*, Art. 35.
19. *Ibid.*

13.3.1.5 Payment Means and Performance Bond

Three payment methods are contemplated under the Takeover Code for the takeover by offer: (a) in cash; (b) with securities; or (c) with a combination of both cash and securities. However, the purchaser must pay the price *in cash* if it issues a general offer (a) for the purpose of delisting the target company or (b) as a result of its failure to obtain the CSRC exemption of a mandatory offer. If it pays the purchase price with securities, it shall at the same time provide *a cash alternative* for the shareholders of the target company to choose.[20]

If payment in cash, (a) a performance bond of twenty per cent of the purchase price shall be deposited into the account designated by the clearing house (i.e., China Securities Depository and Clearing Corporation Limited (SD&C)); and (b) the deposit shall be made concurrently with the publishing of the reminder announcement.[21]

In the event of a payment with securities, on the other hand,

- the purchaser shall additionally submit (a) audit reports for the most recent three years of the issuer of such payment securities, and (b) an assets valuation report on such payment securities;
- if the payment security is a listed bond, such a bond shall have a tradable period of no less than one month; and
- if the payment security is an unlisted security, a cash alternative must be made available for the seller to decide which payment method it would accept.[22]

Of particular notice, if overseas securities are to be used for the payment (i.e., cross-border share swap, see Chapter 7 for details) – which quite unlikely as very complicated procedures would be involved in such an arrangement – such payment securities shall be either (a) overseas listed shares or (b) unlisted shares of an offshore special purpose vehicle (SPV) established by PRC residents with the purpose to list domestic assets overseas. In either case, additional approvals shall be obtained:

- if payment with overseas listed shares, the following approvals shall be additionally obtained: (a) approval of the national MOFCOM on the foreign investor's purchase, and (b) approvals on the overseas shareholding as a result of the share swap, including MOFCOM approval, NDRC approval and SAFE registration and SASAC approval (if applicable); while
- if payment with unlisted shares of an SPV, apart from the above additional approvals, the CSRC approval shall be obtained for the SPV's overseas listing.

20. Takeover Code, Art. 27.
21. *Id.*, Art. 36.
22. *Ibid.*

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QFII to trade A Shares and other Renminbi-denominated securities on Chinese capital market.

Recently, China has quickened the pace of allowing more foreign capital into the A Shares market. To adapt the governing rules to the market development, the CSRC, PBOC and SAFE jointly issued the formal QFII Rules, superseding the tentative QFII Rules 2002. One feature of the QFII Rules is that they only provide for regulations on certain basic matters of the investment, leaving certain specific matters to be specified by implementation rules that are to be separately issued by the CSRC or SAFE. This separation structure is intended to keep close eyes on the market developments and enables timely adjustments where necessary. In implementing the new QFII Rules, the CSRC has issued the Implementation Circular to QFII Rules. However, on the SAFE part, the QFII Forex Rules that has been in place since 2002 remain to be updated.

15.2 ENTRY STANDARDS OF THE QFII

To qualify as a QFII, the applicant, i.e., a foreign institution, shall satisfy the following entry standards:

- *financial situation*: it shall satisfy the asset size test (see Table 15.1 below) adopted by the CSRC and have a stable and healthy financial situation as well as a good credit standing;
- *corporate governance*: it shall maintain sound corporate governance and internal control systems, operate in lawful ways, and have no record of being imposed severe regulatory penalties during the most recent three years;
- *incorporation place*: it must be an institution incorporated in a jurisdiction that (a) has sound legal and regulatory systems, and (b) has entered into an MOU, and is maintaining an effective regulatory cooperation with the CSRC; and
- *professional personnel*: it must have professional staff that hold required professional qualification in the concerned jurisdictions.[3]

Of key importance here is the assets size test that an applicant must meet. Such tests, previously specified in the QFII Rules 2002, have now been separately listed in the CSRC Implementation Circular to QFII Rules,[4] which have specified various

3. QFII Rules, Art. 6.
4. This separation enables the CSRC to timely adjust the test against latest developments in the securities market. As the QFII Rules are jointly promulgated by the CSRC, PBOC and SAFE, its subsequent revision also requires the joint approval by these three authorities. If, as the present case, the test is listed in the CSRC Implementation Circular, then its future revision will become more efficient and close to the market development as such revision only requires the CSRC approval. Indeed, the QFII Rules (Art. 6) has expressly authorized the CSRC the power to determine which asset size the applicant shall meet.

Table 15.1 Assets Size Test for a QFII

QFII Applicant	*Securities Portfolio (billions USD)*	*Business Record (min. years)*	*Miscellaneous*
Fund management institution	5	5	–
Insurance company	5	5	–
Securities company	10	30	paid-in capital above USD 1 billion
Commercial bank	10	–	top 100 world-wide ranking in terms of total assets
Other institutional investor	5	5	–

asset size tests depending on the nature of the applicant. As compared with the QFII Rules 2002, the criteria have been lowered down to a certain extent:

- for a *fund management institution*, it shall have (a) a securities portfolio of no less than USD 5 (previously, USD 10) billion in the most recent financial year, and (b) a business record of at least five years in assets management business;
- for an *insurance company*, it shall have (a) a securities portfolio of no less than USD 5 (previously, USD 10) billion in the most recent financial year; and (b) a business record of at least five years since its incorporation (previously, a record of at least thirty years engaging in insurance business); (additionally, the old requirement has been deleted that such an insurance company have a paid-in capital of no less than USD 1 billion);
- for a *securities company*, it shall have (a) a securities portfolio of no less than USD 10 billion in the most recent financial year, (b) a business record of at least 30 years engaging in securities business, and (c) a paid-in capital of no less than USD 1 billion;
- for a *commercial bank*, it shall have (a) a securities portfolio of no less than USD 10 billion in the most recent financial year, and (b) a top-100 worldwide ranking in terms of total assets in the most recent financial year; and
- for *other institutional investors*, such as a pension fund, charitable foundation, endowment fund, trust company, and government investment management company, they shall have (a) a securities portfolio of no less than USD 5 billion in the most recent financial year, and (b) a business record of at least five years since its incorporation. (The QFII Rules 2002 did not specify these criteria.)

The above assets size test required for a QFII is listed in a nutshell in Table 15.1.

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cases, particulars of the concerned arrangements shall also be disclosed. These include, among other things,

- the specific method of the arrangement;
- the scope of authority of the trustee;
- the amount and proportion of the target shares;
- trust or management fees;
- the disposal of the assets under the trust or otherwise management; and
- the term, conditions of amendment or termination, execution date, and other special clauses of the trust or otherwise management agreement.[15]

In addition, it is noted, in cases where the de facto controlling person of the target company will be changed following the indirect takeover, the Takeover Code has implemented stricter disclosure or reporting requirements for (a) the original de facto controlling person and the existing shareholder(s) controlled by it; (b) the target company itself; and (c) the board of directors of the target company.[16]

17.5 CONCEPTS CRITICAL TO THE DISCLOSURE

17.5.1 Acting in Concert

The 'purchaser' in the sense of the Takeover Code includes both the direct purchaser and the persons 'acting in concert' with it.[17]

Accordingly, for disclosure purpose (as well as for purpose of determining whether a mandatory offer has been triggered), the shares owned or controlled by a person in a listed company shall include the followings:

- the shares registered in its name;
- the shares underlying the voting rights that are controlled by it but which are not registered in its name; and
- the shares registered in the name of the person(s) acting in concert.[18]

'Acting in concert', as defined under the Takeover Code, refers to an act or fact whereby the purchaser and other persons, through a contractual or otherwise arrangement, jointly increase the quantity of the share voting rights that they can control in a listed company.[19] As an important development, the Takeover Code now introduces a rebuttable presumption that certain persons specified in its Article 83 shall be deemed persons 'acting in concert', which enumeration is neither exhaustive nor final. There may be other connected relationship between the persons indicating they are acting in concert. On the contrary, if the suspected

15. CSRC C&F Guidelines No. 15, Art. 24; CSRC C&F Guidelines No. 16, Art. 25.
16. Takeover Code, Arts 58, 59, 60.
17. *Id.*, Art. 5.
18. *Id.*, Arts 12, 83.
19. *Id.*, Art. 83.

persons believe they should not be deemed persons acting in concert, they may provide supporting evidence to defend against the rebuttable presumption.

In any case, as compared with the definition under the Disclosure Rules 2002, the definition under the new Takeover Code is expanded. This expansion of 'acting in concert', which concept is of particular importance in the context of an indirect takeover, will subject more persons, including foreign persons, to the disclosure obligations or make the purchaser vulnerable to the mandatory offer obligation.

17.5.2 Controlling Rights

A purchaser may acquire the controlling rights in the target company through

- becoming the 'controlling shareholder' by acquiring shares of the target company;
- becoming the 'de facto controlling person' of the target company via shareholding relationship or contractual or otherwise arrangement with the direct purchaser or existing shareholder; or
- a combination of the aforementioned two approaches.[20]

Whichever approach is to be followed, if the transaction would lead to any of the following cases, then the purchaser will be deemed having acquired the controlling rights of the target company, thereby subject to stricter disclosure requirements:

- the purchaser becomes the controlling shareholder holding fifty per cent or more outstanding shares of the target company;
- the purchaser effectively controls over thirty per cent of the target company's voting rights;
- the purchaser can determine the appointment of more than half of the target company's directors; and
- the purchaser, by virtue of its effective control over the target company's voting rights, can exert a major influence on the resolutions of the shareholders' general meeting of the target company.[21]

On the other hand, the 'de facto controlling person', as defined under the Company Law, refers to a person who, although not a shareholder of the listed company, can effectively control the act or decisions of the listed company through shareholding relationship, contractual or other arrangements.[22]

20. *Id.*, Art. 5.
21. *Id.*, Art. 84.
22. Company Law, Art. 217.

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authorization has been corrected or subsequently recognized by the shareholders' general meeting.[76]

If there are certain idle proceeds, however, the issuer can use them as a temporary supply to its current funds. In this regard, the CSRC provides some guidelines by promulgating the *Circular on Further Normalization of the Use of Proceeds by Listed Companies* (*ZhengJianGongSiZi* No. [2007] 25), which became effective as of 28 February 2007. According to this circular, temporary use of the idle proceeds to supply the issuer's current funds does not require approval of the shareholders' general meeting, provided that the idle proceeds are used in the manufacturing or operation related to the issuer's core business, instead of for the subscription (via direct or indirect arrangements) in a new shares offering or placement or the trading of shares or derivative products thereof. However, if more than ten per cent of the total proceeds are to be used as idle proceeds to supply the issuer's current funds, approval of the shareholders' general meeting is required. Furthermore, in this latter case, (a) the issuer shall provide a network voting system for the shareholders when deciding on this motion; and (b) the issuer's independent directors and the sponsor shall respectively issue an independent opinion, which both shall be disclosed to the public.

On the other hand, the offering proceeds shall be used in projects that fall within the issuer's core business. In particular, except for a financial issuer, the issuer cannot use the proceeds to conduct (a) financial investments such as the holding of tradable or saleable financial assets, the lending to third parties, or the entrustment of financial management; or (b) direct or indirect investments in those companies whose core business is the trading of negotiable securities. Furthermore, the proceeds cannot be used in projects that may cause horizontal competition with the issuer or have an adverse effect on the issuer's independence; nor can they be used in projects not in compliance with the State industrial policies or other industry specific regulations.[77]

20.7 KEY PROVISIONS AT ISSUE

1. *Measures on Administration of the Offering of Securities by Listed Companies* (**Additional Securities Rules**), promulgated by the CSRC (CSRC Order No. [2006] 30), effective as of 8 May 2006;
2. *PRC Securities Law* (**Securities Law**), promulgated and amended by the Standing Committee of the PRC NPC (Present Order No. [2005] 43), effective (as amended) as of 1 January 2006;
3. *PRC Company Law* (**Company Law**), promulgated and amended by the Standing Committee of the PRC NPC (Present Order No. [2005] 42), effective (as amended) as of 1 January 2006;

76. Securities Law, Art. 15.
77. Additional Securities Rules, Arts 10, 38.

4. *Circular on Relevant Notable Issues Concerning the Improvement by Listed Companies of the Directors' and Shareholders' Resolutions on Non-public Offering of Shares* (**Private Placement Circular**), promulgated by the CSRC (*FaXingJianGuanHan* No. [2007] 194), effective as of 4 July 2007;
5. *Implementing Rules on the Non-public Offering of Shares by Listed Companies* (**Private Placement Rules**), promulgated by the CSRC (*ZhengJianFaXingZi* No. [2007] 302), effective as of 17 September 2007;
6. *Guidelines on Non-public Offering of Shares by Listed Companies* (**Private Placement Guidelines**), promulgated by the Shenzhen Stock Exchange, effective as of 2 February 2007;
7. *Measures on Administration of the Offering and Underwriting of Securities* (**Securities Offering Rules**), promulgated by the CSRC (CSRC No. [2006] 37), effective as of 19 September 2006;
8. *Measures on Administration of the Registration and Clearing of Securities* (**Securities Registration Measures**), promulgated by the CSRC (CSRC Order No. [2006] 29), effective as of 1 July 2006;
9. *Securities Registration Rules of the China Securities Depository and Clearing Corporation Limited (SD&C)* (**Securities Registration Rules**), promulgated by the SD&C upon approval of the CSRC, effective as of 25 July 2006;
10. *Shares Listing Rules of the Shanghai Stock Exchange*, promulgated and amended by the Shanghai Stock Exchange upon approval by the CSRC, effective (as amended) as of 19 May 2006; *Shares Listing Rules of the Shenzhen Stock Exchange*, promulgated and amended by the Shenzhen Stock Exchange upon approval by the CSRC, effective (as amended) as of 19 May 2006 (collectively, **Shares Listing Rules**);
11. *Measures on Administration of the Information Disclosure by Listed Companies* (**Disclosure Rules**), promulgated by the CSRC (CSRC Order No. [2007] 40), effective as of 30 January 2007;
12. *Guidelines on Contents and Formats for Information Disclosures by Companies Publicly Offering Securities (No. 10): Application Documents for the Public Offering of Securities by Listed Companies* (**CSRC C&F Guidelines No. 10**), promulgated by the CSRC (*ZhengJianFaXingZi* No. [2006] 6), effective as of 18 May 2006;
13. *Guidelines on Contents and Formats for Information Disclosures by Companies Publicly Offering Securities (No. 11): Prospectus for the Public Offering of Securities by Listed Companies* (**CSRC C&F Guidelines No. 11**), promulgated by the CSRC (*ZhengJianFaXingZi* No. [2006] 2, effective as of 18 May 2006; and
14. *Guidelines on Contents and Formats for Information Disclosures by Companies Publicly Offering Securities (No. 25): Preliminary Offering Scheme and Offering Result Report for the Non-public Offering of Shares by Listed Companies* (**CSRC C&F Guidelines No. 25**), promulgated by the CSRC (*ZhengJianFaXingZi* No. [2007] 303, effective as of 17 September 2007.

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