The Chinese government is approving a multitude of new institutional investors in such domestic funds, including provincial governments, national pension funds, insurance companies and others. Local funds, so long as not organized by a foreign fund management company, are treated as domestic investors and therefore do not have to go through the foreign investment approval process, thereby giving them a substantial advantage in regard to the speed of closing.

§ 2:31 Joint venture and cooperative enterprise acquisitions

Many acquisitions take the form of joint ventures, since the Chinese partner to the venture either contributes, sells or contributes a part and sells a part of its existing business to the newly created joint venture. In many circumstances, such a method of acquiring a business is more straight-forward and less cumbersome that a share or asset acquisition of the same business. The acquisition of a business by the creation of a joint venture is described in Chapter 4.

§ 2:32 Foreign acquisition of a domestic enterprise

Most M&A activity by foreign acquirers in China follows the traditional methods of either a share or asset acquisition. Such acquisitions are governed by special regulations that were specifically adopted to regulate foreign acquisitions of existing businesses, which China found to be growing alarmingly and wanted to control.[1] Foreign acquisitions of domestic enterprises are discussed in detail in Chapter 6.

§ 2:33 Takeovers of listed companies

Takeovers of listed companies are possible, though infrequent, in China. Takeovers are discussed in detail in Chapter 7.

§ 2:34 Foreign investment to restructure state-owned enterprises

One may also invest in Chinese companies by dealing directly with SASAC and agreeing to invest in a State-owned enterprise to facilitate its restructuring. This method, which is seldom used, but has potential, is discussed in Chapter 9.

[Section 2:32]

[1]Domestic Acquisition Regulations.

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Part II

TYPES OF ACQUISITIONS

Chapter 3

Examining the Target

I. INTRODUCTION

§ 3:1 Due diligence
§ 3:2 Common issues in due diligence
§ 3:3 Multiple sets of books

II. PUBLICLY AVAILABLE MATERIAL ON CHINESE COMPANIES

§ 3:4 In general
§ 3:5 Limited companies
§ 3:6 Limited companies without foreign investment
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IV. DUE DILIGENCE INVESTIGATION TOPICS

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§ 3:41 — —Copyrights
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§ 3:56 —Social welfare benefits schedule
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I. INTRODUCTION

§ 3:1 Due diligence

This Chapter discusses how to conduct due diligence in a China acquisition, including sources of information and accepted business protocols for requesting and reviewing such information. While it is certainly the case that Chinese companies are less used to providing standard corporate information to unrelated third parties, which is what happens in a due diligence investigation, they are gradually beginning to accept the practice as necessary when they are the seller and to adopt the practice themselves when they are the buyer.

§ 3:2 Common issues in due diligence

All acquisitions in China involve some due diligence investigation of the target, though the amount varies considerably depending on the acquirer (and its expected standard of investigation) and the target (and its willingness to provide information). Due diligence is a fundamental feature of any successful acquisition in China. The more one knows, the more likely that the acquisition documents will cover all of the acquirer's concerns. Generally, due diligence is conducted in the same manner within China as in other countries. The seller should be requested to provide documents for review pursuant to the terms of a standard due diligence checklist, which has been modified to account for certain special situations in China. As in due diligence exercises with Western companies, the acquiring entity wants to examine corporate documents creating the target, principal contracts with suppliers and customers, debt obligations, land and building ownership and leases, taxation and customs records, environmental compliance and risks, intellectual property rights, and ongoing litigations and arbitrations. A number of such specific items and how they should be addressed in China are discussed below.

The three due diligence problems frequently discovered in many Chinese domestic enterprises are:

- A failure over a number of years to pay-up the full amount of the social insurance fees due for each of the workers;
- Failure to pay Chinese taxes by submitting untrue financial documents to Chinese tax authorities; and

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- A sales methodology that either violates Chinese commercial bribery rules[1] or the Foreign Corrupt Practices Act or both.

While there are other common problems, such as a failure to comply with environmental regulations, fraudulent financial statements, or unrecorded business transactions, these deficiencies are normally outside the realm of legal due diligence.

It is unclear why domestic enterprises do not pay the full amount of social insurance fees. Depending on the case, the problem may be that no payments are made, the salaries of the workers on which the fees are calculated are under-declared, or the number of workers employed is more than the number for whom fees are paid. What is even more surprising is that many of the enterprises that do not pay the social insurance fees go through an annual inspection each year and their books are examined to check compliance with law, including labor laws.

Too often a Chinese seller considers the underpayment of social insurance fees to be a routine business practice. However, if ownership is transferred to a foreign acquirer, the labor bureau for the first time takes the underpayment seriously and it is not unusual for the new owner, shortly after closing, to be presented with a bill for the prior years' underpayments. While at first blush it would seem that such a liability is precisely why an acquirer should do an assets deal and not invest in the existing company, asset acquisitions in China are frequently different. As noted below, in order to acquire the business and avoid paying severance to all of the workers (each of whom is treated as being technically discharged from the old employer and rehired by the new employer), generally the acquirer agrees to take all of the workers on the same terms and conditions and to carry-over from the old enterprise to the new all accrued welfare and salary benefits. The Labor Bureau treats prior social insurance charges as falling within this category.

It is interesting to note that when a state-owned enterprise or SOE is restructured in order to make it ready to receive foreign investment, unpaid social insurance fees are for the account of the enterprise's state-owner and are to be paid before sale.[2] Non-state-owned enterprises, however, are not required to pay such

[Section 3:2]

[1]Interim Provisions on the Prohibition of Bribery in Commercial Transactions {关于禁止商业贿赂行为的暂行规定} (State Administration of Industry and Commerce (Nov. 15, 1996) (herein "Commercial Bribery Rules").

[2]Interim Provision on the Use of Foreign Investment to Reorganize State-Owned Enterprises, {利用外资改组国有企业暂行规定}, Art. 8(2) (State Economic and Trade Commission, Ministry of Finance, State Administration for Industry and Commerce, and the State Administration of Foreign Exchange, January 1, 2003) (herein "SOE Reorganization Regulations").

fees before the sale of the business,[3] unless the acquiring enterprise is aware of the issue and insists upon it as a condition to closing. Therefore, particular due diligence attention needs to be paid to the welfare benefits roll of the seller and the record of their payment.

The third issue relates to commercial bribery, which is rampant in China. There is no doubt that an assets deal protects the acquirer from punishment for prior practices that may have breached the law. The problem is that the sales force has learned one way of doing business, and the acquirer is going to have to insist on another method entirely. Similarly, if government approvals are a requirement for business operations, it is quite possible that payments have been made in the past to government officials to obtain the required approvals or to avoid making payments (such as social benefit payments) required by law. If commercial bribery is eliminated, the sales force may not be able to maintain prior revenue. When the payments to government officials are ended, the authorities begin to question everything the company does in order to put pressure on the now "honest" company. Thus, when conducting due diligence on an entity to be acquired considerable attention should be paid to its accounting system and the likelihood for "off-book" expenses to be commonplace.

§ 3:3 Multiple sets of books

It is frequently alleged that Chinese companies have multiple sets of books and records. In general, this is not true for State-owned enterprises, since the Ministry of Finance continues to assign its personnel to serve in the accounting departments of SOEs. For private companies, however, more caution is required, since private companies see the advantage in paying less tax or turning over less in social benefits. Corruption encourages such bookkeeping in two ways: first, the corrupt payments cannot appear on the company's book for fear of criminal prosecution and second, corrupt payment can frequently cure the problem if the existence of multiple sets of books is discovered by the tax or other regulatory authority.

II. PUBLICLY AVAILABLE MATERIAL ON CHINESE COMPANIES

§ 3:4 In general

When foreign investors first began to travel the halls of Chinese bureaucracy looking for the correct official of a state company with whom to discuss a commercial matter, they might meet an

[3]*See* Domestic Acquisition Regulations.

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individual who proudly presented a name card with the individual's name followed by possibly the name of the company, such as China National Cereals, Oils and Foodstuffs Corporation, and the title "Relevant Officer Concerned." Other than the corporation and possibly the branch of the state company with which one was dealing, a foreign businessman knew little about with whom he was dealing. This situation has changed for the better, but there are still many areas of uncertainty.

There are two basic types of companies in China: limited companies and companies limited by shares.[1] While both forms of company enjoy limited liability, the limited company may not have more than 50 shareholders and is therefore somewhat similar to a private company, while companies limited by shares must have at least two (2) shareholders and may eventually list its shares of a securities exchange and have any number of shareholders.[2] Depending on whether a company is a limited company or a company limited by shares, the amount of information publicly available about the company varies considerably. In the case of private companies, the record remains something like the former days when a businessman was forced to look for the "Relevant Officer Concerned," while companies limited by shares have a great deal of information publicly available.

§ 3:5 Limited companies

While The Company Law is quite specific on the information that a limited company must include in its articles of association,[1] it is the Administration of Industry and Commerce that specifies what information must be filed with it and whether such information is available to the public. The Administration of Industry and Commerce divides the responsibilities for registration of enterprises between the State Administration of Commerce (the "SAIC") and the local provincial and municipal administrations (the "local AICs").

The SAIC is responsible for the registration of companies where more than 50% of the capital is contributed by entities under the control of SASAC, all foreign invested companies, enterprises that by law may only be registered with SAIC, while the local AICs register enterprises where more than 50% of the capital is contributed by local government authorities, companies established by individuals, enterprises that by law may only be

[Section 3:4]

[1] *See* The Company Law.

[2] *See* The Company Law, Arts. 24 and 78.

[Section 3:5]

[1] The Company Law, Art. 25.

registered with the local AICs, and companies where the SAIC has entrusted the registration to local AICs.[2]

Whether a company is registered with the SAIC or the local AICs, the following items must appear on the registry:

1. The company name;
2. Domicile;
3. Legal representative;
4. Registered capital;
5. Paid-in capital;
6. Type of enterprise;
7. Business scope; and
8. Term of operation.

If the company is owned by an individual or corporate entity, the wording "solely funded by a natural person or a juridical person" shall be written on the company registration and on the business license of the company.[3] If any item of information that an enterprise must register is subsequently changed, then the change must also be registered.[4] Companies must also register their branches, including the name, location of business premises, person in charge, and business scope.[5] In the event that the branch in the new location is approved, the company must register the business license of the branch with the AIC of the head office.[6] Other than the items listed above, the SAIC or local AICs may hold certain information on other subjects, such as information on chattel mortgages over movables or the ownership of trademarks.

There is one other important source of information on limited liability companies, but the source is not always available to the enquiring party. All Chinese companies are required to go through an Annual Inspection process during which many registered and some unregistered items are checked by either the SAIC or the local AICs.[7] If the company passes the annual inspection, the AIC will affix its 'Annual Inspection Seal' to the duplicate copy of the business license of the company, which is

[2] Regulations of the People's Republic of China on Administration of the Registration of Companies {中华人民共和国公司登记管理条例}, Arts. 6 to 8 (State Council, Decree No. 156 [1994], June 24, 1994, as amended Dec. 18, 2005, eff. Jan. 1, 2006) (herein the "Company Registration Regulations").

[3] Company Registration Regulations, Arts. 9 and 15.

[4] Company Registration Regulations, Art. 26.

[5] Company Registration Regulations, Art. 47.

[6] Company Registration Regulations, Art. 48.

[7] Measures on Annual Inspection of Enterprises {企业年度检验办法} (State Administration of Industry and Commerce, Feb. 24, 2006) (herein "Annual Inspection Measures").

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held in the company's headquarters.[8] Items included in the inspection include checking that the company's legal representative, registered capital, payment of required paid-in capital, receipt of all required operating licenses, transfer of shares between shareholders, and the existence of branch offices.[9] While the inspection report would appear to be a public document since it is required to be prepared by a public body and must be filed in a public registry, whether one can see the most recent inspection report depends on the local AIC or the SAIC in Beijing.

While the information listed above is not voluminous, an acquirer or potential acquirer will always start with this bare bones list of data. The SAIC and local AICs are generally cooperative when a lawyer presents a power of attorney from the lawyer's client requesting the right to review the file of the designated limited liability company. The problem, however, is that even in those cities where the local AIC is cooperative, such as Beijing and Shanghai, the AIC will request to see a power of attorney from the client of the lawyer requesting an inspection of the record of the company at the AIC. Whether such information will work its way back to the enterprise is a concern for an acquirer that may not be ready to disclose its interest in the target.

§ 3:6 Limited companies without foreign investment

The Company Law amendment that went into effect on March 1, 2014, revised the minimum registered capital rules, the ratio of cash contributions, the timing of capital contributions, and the registration of paid-in capital and the amount of shareholders' contributions. The previous registration of paid-in capital rule was supported by a requirement that such paid-in capital be audited and verified by an accounting firm and the capital verification report filed with the AIC. The amendment to the Company Law cancels this requirement and therefore an examination of a company's business license will show the amount of registered capital, but an examination of the company's records at the AIC will not show how much of the registered capital has been paid-in to the company.[1]

[8] Annual Inspection Measures, Art. 12.

[9] Annual Inspection Measures, Art. 13.

[Section 3:6]

[1] Decision of the Standing Committee of the National People's Congress on Revising the "Marine Environment Protection Law of the People's Republic of China" and Other Six Laws {全国人民代表大会常务委员会关于修改《中华人民共和国海洋环境保护法》等七部法律的决定} (Standing Committee of the National People's Congress,Order No. 8 of the President of the People's Republic of China, Dec. 28, 2013, eff. Dec. 28, 2013) (herein the "Company Law Amendment"). The Company Law Amendment only became effective on March 1, 2014. The amendments regarding paid-in capital appear in Company Law Amendment §§ 5 to 7.

§ 3:7 Limited companies with foreign investment

The requirement to specify the amount of a company's registered capital and subsequently to verify its contribution appearing in the un-amended Company Law originally were derived from the laws governing foreign investment enterprises. There was a question when the Company Law Amendment was first announced as to whether the deletion of the requirements regarding paid-in capital reporting will apply to foreign investment enterprises. Both the Joint Venture Law Implementing Regulations and various SAIC regulations on FIE registered capital require such reporting to confirm that the FIE remains in compliance with the debt-equity restrictions. Moreover, such paid-in capital frequently is paid-in in foreign exchange and there are strict requirements as to when and for what purpose such foreign exchange in the capital account can be converted to RMB. The State Council did not find these complexities too daunting. On March 1, 2014, the day the Company Law Amendment went into effect, a State Council announcement cancelled various administrative regulations and amended others that required the timing of capital contributions to be specified (within a definite period) that capital contributions be roughly contemporaneously made by each party, that no more than a specified portion of registered capital may be intangibles, and the penalties for failing to pay-in such capital on time.[1] The parties (or investor) is completely free to provide in the Articles of Association the amount of registered capital to be contributed.

With no minimum capital and the parties at liberty to decide the amount of registered capital, one would expect that the Debt-Equity Regulations no longer apply. However, according to the AIC, SAFE, and MOFCOM, this is not the case, since the State Council decision did not eliminate or amend the Debt-Equity Regulations.

In the event that one is doing due diligence on a foreign

[Section 3:7]

[1] Announcement of the State Council on the Repeal and Revision of Various Administrative Regulations {国务院关于废止和修改部分行政法规的决定} (State Council, No. 648, Feb. 19, 2014, eff. Mar. 1, 2014) (herein "Company Law Amendment Administrative Notice"). As discussed below, this innocuous notice changes much of the law governing foreign investment enterprises for almost 30 years. The Several Provisions on Capital Contributions, which had been in effect since 1988, and required that investors use their own funds for investment, pay-in according to a stipulated schedule, and the remedies for failure to do so is now repealed. Similarly, provisions in each of the Company Registration Regulations, Joint Venture Implementing Regulations, CJV Detailed Rules, WFOE Detailed Implementing Rules requiring verification have been deleted.

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invested company, more information should be available since FIEs are required annually to file a Joint Annual Inspection Report. There is a standard annual reporting form for foreign invested enterprises in China.[2] Known as the Joint Annual Inspection Report or JAIR, the form is completed by each foreign invested enterprise in China annually and submitted to the local AIC.

The JAIR in its present form was issued in 1998.[3] While the form is filed with the local AIC, the AIC is only one of a number of local bodies that are supposed to receive a copy of the form. Thus, the form is required to cover a number of subjects, including basic company information, contributions of capital, investment in other companies, foreign exchange earned, and goods exported and imported. The Ministry of Commerce (formerly known as the Ministry of Foreign Trade and Economic Cooperation) is principally responsible for the content of the form, since it only applies to foreign invested enterprises.[4]

The purpose of the form is to reduce the burden on foreign invested enterprises to report regularly to a number of different departments. As stated in the 1998 JAIR Notice:

> In the past two years, the implementation of the joint annual inspection of foreign investment enterprises has played an important role in improving the investment environment, **lessening the burden on enterprises,** strengthening the administration of enterprises by government departments and supervising and urging enterprises to conduct their business operations in accordance with the law. In order to further standardize and improve the work, a notice on relevant matters is hereby issued as follows:
>
> 1. All regions and departments must use the joint annual inspection of foreign investment enterprises as an important means to improve the investment environment, strengthen the administration of foreign investment enterprises and to urge enterprises to conduct their business operations in accordance with the law, and must act on the basis of their experience in the past two years to

[2]Foreign Invested Enterprise (FIE) Joint Annual Inspection Report (State Administration for Industry and Commerce (SAIC) of the People's Republic of China), available in Chinese at http://www.saic.gov.cn.

[3]Notice on Carrying Out Joint Annual Inspection of Enterprises with Foreign Investment {对外贸易经济合作部、国家经济贸易委员会、财政部、海关总署、国家税务总局、国家工商行政管理局、国家外汇管理局关于对外商投资企业实行联合年检实施方案的通知}(Ministry of Foreign Trade and Economic Cooperation; the State Economic and Trade Commission; the Ministry of Finance; the General Administration of Customs; the State Administration of Taxation; the State Administration for Industry and Commerce; the State Administration of Foreign Exchange, December 10, 1998) (herein "JAIR Notice").

[4]The other departments that receive copies of the form are the local planning authority, the local financial authorities, Customs, tax, the AIC and foreign exchange.

> further strengthen leadership and coordination. They must carefully study and make arrangements for the joint annual inspection. In order to make it convenient for enterprises to submit their declarations and for the purpose of coordination among government departments, all localities should make efforts to establish a joint office to carry out the joint annual inspection work.[5]

Not only is the object of the form to lessen the burden on foreign invested enterprises, it is also to allow the government—not the public or investors—to decide whether the filing enterprise conforms to existing laws and regulations relating to the registration of enterprises. In other words, this report is enterprise to government, not enterprise to investor.

It is also the only document, by way of an annual report, that the local government can extract from companies. As provided in the JAIR Notice, the State Council—China's cabinet—has decided:

> The various departments in charge of joint annual inspections must not organize, within their respective jurisdiction, any separate annual inspection of foreign investment enterprises. No department or unit, other than the seven departments participating in the joint annual inspections, may carry out annual inspections of foreign investment enterprises without the approval of the State Council.[6]

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According to the JAIR Notice, the following government bodies are entitled to receive a copy of the form: the department of foreign economic relations and trade, the local AIC, the local finance department, the local foreign exchange department, and the local tax bureau.[7] Each department receives the JAIR and certain basic documents, including in the case of the AIC a copy of the "(2) the annual balance sheet and profit and loss statement audited by an accounting firm."

Each recipient has 10 days from receipt of the report to voice any objections. If an objection is lodged, then the problem is to be sorted out between the enterprise and the objecting report recipient within another 10 days. If no objection is received or any objection resolved, the AIC issues a stamp on the company's business license certifying that it has passed the annual inspection.[8]

The form contains a cover page with the enterprise's name, a

[5]JAIR Notice, Art. 1.

[6]JAIR Notice, Art. 8.

[7]JAIR Notice, Appendix: THE IMPLEMENTING PLAN FOR JOINT ANNUAL INSPECTION OF FOREIGN INVESTMENT ENTERPRISE{关于对外商投资企业实行联合年检的实施方案}, Section 2 (Dec. 10, 1998) (herein the "JAIR Notice, Appendix on Implementation Plan").

[8]JAIR Notice, Appendix: THE IMPLEMENTING PLAN FOR JOINT ANNUAL INSPECTION OF FOREIGN INVESTMENT ENTERPRISE{关于对外商投资企业实行联合年检的实施方案}, Section 2 (Dec. 10, 1998) (herein the "JAIR Notice, Appendix on Implementation Plan").

§ 7:54 Future of FIJSCs as M&A vehicles

It is unclear whether FIJSC will ultimately become an important vehicle for merger and acquisition activity in China. On the one hand, strategic investors and foreign investment companies can take controlling positions in listed companies and virtually any form of foreign investment entity may acquire the business of a domestic limited liability company. Thus, alternatives are easily available for acquisitions in China. On the other hand, however, the FIJSC does have the advantage of being both a stock company under the Company Law and also a foreign investment enterprise. Should it be permitted to list its shares at some point in the future, those publicly traded shares could be used to acquire other domestic companies.

The FIJSC's use as an acquisition vehicle will likely wait until such time as foreign companies come to China not only for manufacturing or acquiring companies with growth potential, but also as a source of capital for expansion. At such time as FIEs experience difficulty in importing capital into China, either because of a shortage of capital from their parent corporations or Chinese regulations limiting foreign capital investment, the FIJSC as a domestic vehicle to raise capital and also do acquisitions will become considerably more attractive than the existing alternatives.

Chapter 8

Mergers

§ 8:1 In general
§ 8:2 Types of mergers
§ 8:3 —Merger by absorption
§ 8:4 —Merger by new establishment
§ 8:5 —Corporate approval
§ 8:6 —Notification of creditors
§ 8:7 Merger agreement under Company Law
§ 8:8 Merger of foreign invested enterprises
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§ 8:10 —Merger conditions
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§ 8:22 —Preconditions to the use of shares
§ 8:23 — —Required use of M&A advisors
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§ 8:28 Offshore special purpose vehicles
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§ 8:31 — —MOFCOM approval to merge or acquire a domestic company
§ 8:32 — —Approval implementation
§ 8:33 — —Use of proceeds
§ 8:34 — —Secondary offering proceeds, gains, and dividends
§ 8:35 —Revival of offshore SPVs
§ 8:36 Mergers of domestic enterprises without foreign involvement

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§ 8:37 Reverse mergers of domestic enterprises and VIE structures

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§ 8:1 In general

This chapter examines the formal requirements for a merger under Chinese law. Both domestic mergers and mergers between foreign invested enterprises are discussed. The tax analysis of mergers as a form of acquisition activity is to be found in Chapter 13.

§ 8:2 Types of mergers

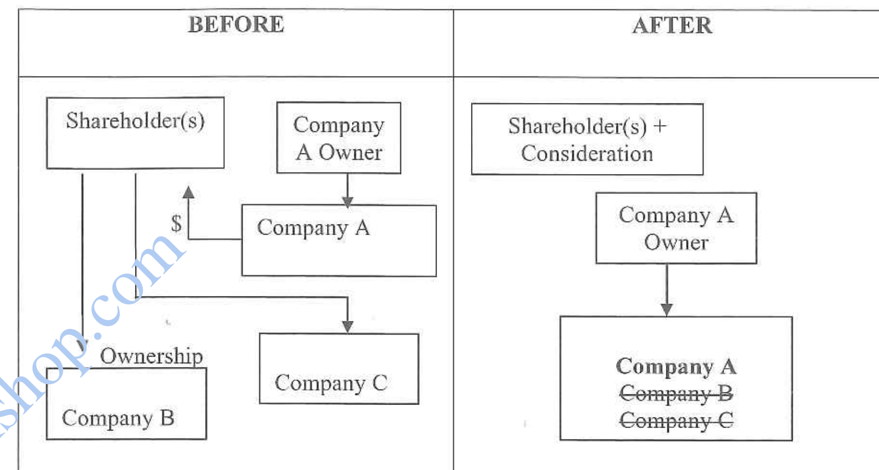
The basic statutory framework for all mergers in China appears in The Company Law.[1] There are two basic types of merger: a merger *by absorption* and a merger *by new establishment.*

[Section 8:2]

[1]The Company Law, Arts. 172–179.

§ 8:3 Types of mergers—Merger by absorption

A merger by absorption is one in which one or more companies is/are absorbed into another company and the absorbed company or companies are dissolved in the process.[1] In the simple diagram below, Company A acquires Companies B and C from their shareholders by transferring the appropriate consideration to the shareholders, followed by the merger by absorption of Companies B and C into Company A and the dissolution of Companies B and C (shown by strike through).



[Section 8:3]

[1]The Company Law, Art. 172.

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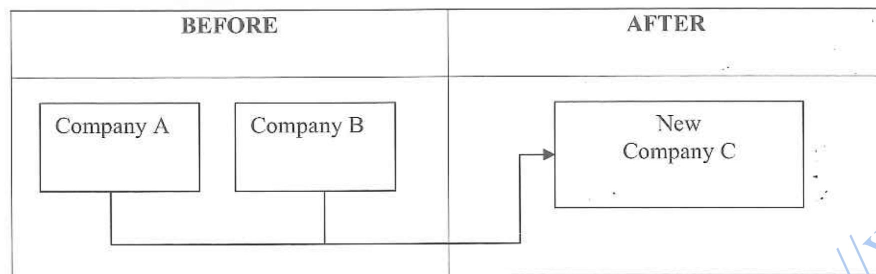
The merger by way of absorption is most commonly used when SASAC decides to reorganize a number of State-owned enterprises to assemble them into a national corporation with many branches in different provinces. Such a merger format is also used when it is the intention of the parties to move the headquarters of the combined company to a new location, which is where the owner will establish Company A as a newly incorporated entity. The merger by absorption is also used when a foreign investment enterprise, such as a holding company, wishes to consolidate several of its separate subsidiaries into one corporation with branches in the different locations where formerly the holding company had separate subsidiaries. Yet another use for the merger by way of absorption is where an FIE that has previously acquired the shares of a domestic company now desires to consolidate that company with its own operations.[2]

§ 8:4 Types of mergers—Merger by new establishment

The merger by way of a new establishment is when two or more companies merge together and thereby create a new entity that previously did not exist, while the former corporate entities are dissolved. The below diagrams such a merger.

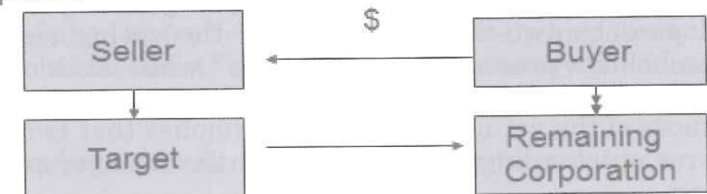


[2]FIEs have been able to invest in China directly since September 2000. Interim Provisions on Investment Made by Foreign-Invested Enterprises in China {对外贸易经济合作部、国家工商行政管理局关于外商投资企业境内投资的暂行规定} (Ministry of Foreign Trade and Economic Cooperation; State Administration of Industry and Commerce, Decree No. 6 (2000), July 25, 2000, eff. Sept. 1, 2000) (herein the "FIE Investment Regs"). Such purchases, however, were most often done as share acquisitions, but were not followed by any attempt to consolidate the new subsidiary into the existing FIE that acquired its shares.

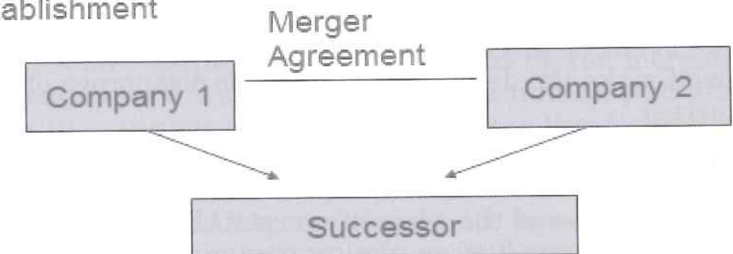
The merger by way of a new establishment is used when two entities desire to amalgamate their operations and adopt a new name for the combined business or, for reasons of comparable size and reputation, neither of the combining entities is willing to be the company that is forced to dissolve—so both dissolve.

The difference between a merger by absorption and new establishment is quite straight forward.

- Absorption:



- New Establishment



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§ 8:5 Types of mergers—Corporate approval

In order for a merger to receive appropriate corporate approval, the Board of Directors is required to formulate a plan of merger and submit the same to the shareholders for approval.[1] As with other transformative events, such as dissolution or liquidation, the shareholders' meeting must approve the plan of merger and a vote of at least two-thirds or more of shareholders holding voting rights is required.[2] There is apparently a contradiction in the law, since Article 104 of the law only requires that a merger be "adopted by two-thirds or more of the voting rights held by shareholders present at the meeting,"[3] while Article 44 suggests that it must be "adopted by shareholders representing two-thirds or more of the voting rights,"[4] which implies that two-thirds of all shares outstanding must be voted in favor of the proposition to merge.

State-owned enterprises or SOEs, which are owned by SASAC, are not generally required to hold shareholder meetings, but in the event of the merger of an SOE, it is required that SASAC itself make the decision to approve or disapprove of the proposed merger.[5]

§ 8:6 Types of mergers—Notification of creditors

Regardless of the form of merger chosen by the parties, the companies involved in the merger must notify their creditors within 10 days of the date of the resolution authorizing the merger and must publish newspaper announcements within 30 days of the resolution.[1]

> Creditors may, within a period of 30 days commencing from the date of receipt of the written notification, or with a period of 45 days commencing from the date of the announcement for those who do not receive written notification, claim full repayment or require the provision of a corresponding guarantee from the company concerned.[2]

This appears to provide creditors with complete protection against the weakening of the credit of their obligor due to a merger with a less well capitalized partner. It seems, however,

[Section 8:5]

[1]The Company Law, Art. 46(7).

[2]The Company Law, Art. 43.

[3]The Company Law, Art. 103.

[4]The Company Law, Art. 43.

[5]The Company Law, Art. 66.

[Section 8:6]

[1]The Company Law, Art. 173.

[2]The Company Law, Art. 173.

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somewhat unfair since it is clear that the existing debts of the company are transferred to and become the debts of the newly created or surviving company.[3]

In the event that merging companies fail to notify their creditors of the planned merger, the AIC may impose a fine of not less than RMB 10,000 and not more than RMB 100,000. While such fines may not seem sufficiently large to discourage potential avoidance of the requirement to notify creditors and possibly repay or arrange the guarantee of the creditor's debt, the AIC also is supposed to order "rectification" which should mean that the merged entities must, even after merger, notify their creditors and handle all objections raised by creditors.[4]

§ 8:7 Merger agreement under Company Law

Mergers governed solely by the Company Law do not have any stipulated form that the government imposes on the form of acquisition. However, some agreement is required, as are balance sheets and schedules listing all property owned by the merging entities.[1] In cases where SASAC is combining a number of SOEs into a new entity, the merger agreement takes the form of a report or plan that is submitted to the State Council describing the proposed consolidation and the purpose of the new enterprise. Since the wholly owned SASAC entities do not have a choice in the matter, the documentation does not have to appear consensual. However, on occasion, one of the SOEs will have issued stock to the public either in China or abroad and, in such a case, SASAC is required to go through the motions and have an Agreement and Plan of Merger that is ratified by the requisite number of shareholders of the public company.

§ 8:8 Merger of foreign invested enterprises

For reasons that are not entirely clear, foreign invested enterprises or FIEs are closely regulated when they attempt to merge, even though domestic entities engaged in the same conduct—at least based upon published statute law—are not highly regulated. The discrepancy may be more in appearance, than in reality, since a domestic enterprise of size is most likely still to be majority owned by SASAC and therefore unlikely to conduct such a radical maneuver as to merge with another company without SASAC's specific approval.

FIE mergers were first regulated in 1999 and the law was

[3]The Company Law, Art. 174.

[4]The Company Law, Art. 204.

[Section 8:7]

[1]The Company Law, Art. 173.

amended extensively in 2001.[1] The FIE Merger Regs apply to mergers between equity joint ventures, cooperative joint ventures with legal person status, wholly foreign owned enterprises, and joint stock companies with foreign investment. However, mergers between FIEs and wholly Chinese-owned enterprises are to be handled pursuant to "relevant laws", as well as the FIE Merger Regs.[2] It is quite unclear as to what the draftsmen were referring to in 1999 when the Provisional Regulations were first issued or, for that matter, what the draftsmen were referring to as "relevant law" in 2001 when the regulations were amended. Today, however, it is clear that at least one of the relevant laws referred to is the regulations governing the acquisition of domestic enterprises by foreign investors.[3]

The two types of merger recognized by the Company Law are also recognized by the FIE Merger Regs: that is, merger by absorption where one company is merged in to another, which survives, and merger by new establish where two entities merge to create a new establishment.[4]

As the regulation deals with FIEs, it also imposes upon them the existing obligation to conform to China's Provisional Regulations for Guiding the Direction of Foreign Investment and the Catalogue Guiding Foreign Investment in Industry. Thus, if two FIEs merge, the resulting entity must conform to the industrial guidelines and if the scope of business of the surviving entity has changed, then the appropriate procedures must be followed in order to sanction the change.[5] Similarly, a merger of FIEs must comply with applicable customs, tax and foreign exchange administrative regulations; however, importantly the surviving or newly created entity enjoys the same preferential treatment enjoyed by the original FIE.[6] This is an important difference with

[Section 8:8]

[1]Provisions of the Ministry of Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce on Merger and Division of Foreign-Invested Enterprises {对外贸易经济合作部、国家工商行政管理总局关于外商投资企业合并与分立的规定} (Ministry of Foreign Trade and Economic Cooperation; State Administration for Industry and Commerce,Order [2001] No. 8, Nov. 22, 2001) (herein the "FIE Merger Regs.")

[2]FIE Merger Regs., Art. 2.

[3]The Domestic Acquisition Regulations specifically recognize in Article 55 that the FIE Merger Regs and the FIE Investment Regs remain in force and govern their respective types of transaction; however, the Domestic Enterprise Acquisitions Regs may apply if the other regulations are "silent on any matters." *See* Domestic Acquisition Regs., Art. 55.

[4]FIE Merger Regs, Art. 3.

[5]FIE Merger Regs, Art. 5.

[6]FIE Merger Regs, Art. 6.

an asset sale, since preferential treatment is generally lost when an enterprise's assets, even if in the entirety, is sold to another FIE.

§ 8:9 Merger of foreign invested enterprises—Approval authority

As with other investments, a merger should be approved by the original approval authority of the FIE or FIEs involved. In the event that more than one FIE is involved and each had a different approval authority, then the approval authority where the merged entity will be domiciled becomes the approval authority. However, if the approval authority where the surviving entity is to be domiciled does not have adequate approval authority—normally determined by the amount of total investment of the surviving or newly established entity—then the matter is to be referred up to an approval level that does have to correct amount of authority.[1] Making the approval authority located in the domicile of the surviving entity has increased substantially the number of FIE mergers and consolidations. Prior to this clarification, it was difficult to get an approval from both local approval authorities, since one approval authority would be approving the transfer out of its jurisdiction of the head office of an important local company, which presumably paid substantial taxes locally. To ameliorate the hard feelings, the regulation does require that in cases where a merger leads to a dissolution in one locality, then the opinion of the examination and approval authority of the location where the Company to be dissolved must be obtained.[2]

The language draws a rather elusive distinction between 'receiving an opinion' and approval of the transaction, which apparently remains with the domicile location of the survivor. Nevertheless, where there are two different approval authorities and one of the parties to the merger is to be dissolved, then the application is supposed to be first submitted to the approval authority of the jurisdiction where the constituent company will be dissolved.[3] After submission, the approval authority has 15 days to notify the applicant as to whether or not the merger is approved and a failure to notify constitutes an approval.[4] If the approval authority does not consent to the merger (i.e. does not consent to the dissolution of the company in its jurisdiction), then the matter is to be referred to the next higher relevant level of the foreign trade and economic cooperation system, which in

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[Section 8:9]

[1]FIE Merger Regs, Art. 7.

[2]FIE Merger Regs, Art. 8.

[3]FIE Merger Regs, Art. 22.

[4]FIE Merger Regs, Art. 22.

most cases should be the Ministry of Commerce in Beijing, but could be a Provincial Commission if both entities are within the same province.[5] Thus, while the jurisdiction of the surviving entity gets to approve the overall merger with only an "opinion" required from the jurisdictions that will loose control over the absorbed entity, the jurisdiction where the entity will be dissolved gets to approve or disapprove the *dissolution* and the only appeal is administrative in nature and to the higher level approval authority. Thus, the balance weighs only slightly in favor of the jurisdiction of the surviving entity.

It is also necessary to factor in the situation where the original approval authority was MOFCOM due to the size of the company when originally formed, but now MOFCOM has delegated its approval authority to the relevant local government.[6] Again, this issue will be decided by the location of the surviving entity.

§ 8:10 Merger of foreign invested enterprises—Merger conditions

A merger may not be conducted unless both FIEs involved have been fully capitalized or, in the case of cooperative enterprises, met their cooperative conditions, and the FIE has commenced productive business operations. An FIE may merge with a domestic enterprise so long as its capital has been paid-in or cooperative conditions met, so there is not the requirement to have commenced operations.[1] However, since such a merger is now governed the Domestic Acquisition Regulations, which impose a number of complicated conditions, it is doubtful that the absence of a requirement to have commenced operations means anything.

§ 8:11 Merger of foreign invested enterprises—Successor entity

The FIE Merger Regulations also specify the type of entity that must be the successor. If two limited liability companies, which might be wholly foreign owned enterprises, equity joint ventures or cooperative enterprises with legal personality or, by extension, two limited liability companies formed under the Company Law, then the resulting or successor entity must also be a limited liability company. If a foreign invested joint stock company or FIJSC merges with another FIJSC, then the resulting entity is also an FIJSC. Similarly, if an FIJSC, which is listed, merges with a limited liability company, then the successor entity must

[5] FIE Merger Regs, Art. 22.

[6] *See* MOFCOM Notice Delegating Approval; and MOFCOM Further Delegation of Approval Powers.

[Section 8:10]

[1] FIE Merger Regs, Art. 9.

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be a FIJSC, but if the FIJSC is not listed, the successor entity may be either an FIJSC or a limited liability company.[1]

§ 8:12 Merger of foreign invested enterprises—Capitalization rules

There are rules as to the capitalization of such combinations. The basic rule is that when two entities merge, the registered capital of the successor entity must equal the sum of the registered capital of the original FIEs. In the event that a limited liability company merges with a FIJSC and the resulting entity is an FIJSC, then the registered capital of the successor entity is the sum of the shares into which the net asset value of the original limited liability company converts according to the net value of each share of the FIJSC and the total number of shares of the FIJSC.[1]

It would appear that the merger parties may either agree as to the ratio of each investor's equity in the post-merger company, in which case the relevant ratio should appear in the company's articles of association or agree to have the ratio determined in accordance with an appraisal to be conducted by an appraisal institution.[2] This apparent flexibility probably does not exist where one of the merger parties is a state-owned enterprise since separate regulations specifically require that state-owned assets not be transferred without an appraisal determining the price of the transfer and in many cases the transaction must be conducted on an asset and equity exchange to ensure the fairness of the price.[3]

§ 8:13 Merger of foreign invested enterprises—Capitalization rules—Establishment date

In a merger by way of absorption, the surviving entity into

[Section 8:11]

[1] FIE Merger Regs, Art. 10.

[Section 8:12]

[1] FIE Merger Regs, Art. 11.

[2] FIE Merger Regs, Art. 12.

[3] SOE Measures for State-Owned Asset Transfers; the Measures have been reinforced by a circular to the effect that in most cases any transfer of assets or equity by an SOE should be made over an asset and equity exchange in a competitive bidding process: *see* Notice of the State-owned Assets Supervision and Administration Commission of the State Council and the Ministry of Finance on Issues Concerning the Transfer of State-owned Property Rights of Enterprises {国务院国有资产监督管理委员会、财政部关于企业国有产权转让有关事项的通知} (State-owned Assets Supervision and Administration Commission of the State Council; Ministry of Finance,Guo Zi Fa Chan Quan [2006] No.306, Dec. 31, 2006) (herein "Notice on State-Owned Asset Transfers").

which the other companies were merged maintains its original date of establishment. When a new company is created by means of a merger through new establishment, then the establishment date is determined by the date the AIC issues the new enterprise its business license.[1] Although tax preferences and exemption periods have been substantially reduced under the new Enterprise Income Tax Law, when merging companies with existing, unexpired tax holidays or preferential rates, consideration should be given as to whether the entity enjoying the preference should be the survivor of the merger.

§ 8:14 Merger of foreign invested enterprises—Capitalization rules—FIE mergers with China-owned companies

The FIE Merger Regs contain several articles that discuss how an FIE and a domestically owned company can merge. The interplay between these regulations and the Domestic Acquisition Regulations is unclear, but the most likely explanation is that both sets of regulations apply to any merger involving an FIE and a domestically owned company. Any such merger must meet the following conditions:

1. The domestically owned company to be merged must be a limited liability company or a FIJSC formed under the Company Law;
2. The investors must possess the qualifications required for the post-merger enterprise to carry-on its business in the particular industry;
3. The equity ratio of the foreign investor will not be less than 25% in the post-merger company; and
4. Each party to the merger agreement guarantees that the employees of the companies to be merged will be fully employed or properly settled.[1]

There is some question as to whether condition 3 above is still required. The Domestic Acquisition Regulations provide that a merger may lead to a foreign shareholding of less than 25% and, should that happen, any benefit given to the former FIE is withdrawn and a notation is to be made on the company's business license as to it non-FIE status.[2]

The 2001 amendment to the FIE Merger Regs added a provision to the effect that a merger between an FIE and a domestically owned company would be an FIE and the post-merger amount of total investment would be the aggregate of (a) the former total investment of the FIE and (b) the total amount of assets of the domestic enterprise as recorded by the company in its financial statements as audited. Similarly, the registered capital of the post-merger company is supposed to be the aggregate of the registered capital of the two enterprises prior to the merger.[3] Again, there is a potential contradiction with the Domestic Acquisition Regulations, which require that the parties to a merger shall price the deal based on the value of the equity proposed to be transferred, or valuations of the assets proposed to be sold, in each case as determined by an asset appraisal agency.[4] If a merger of an FIE and a domestic enterprise must have a registered capital that is the aggregate of the registered capital of the two companies prior to the merger and total investment equal to the aggregate of the FIE's total investment and the domestic enterprise's assets as shown on its financial statements, but the overall "price" must be in accord with an outside appraisal, the balance sheet of the new entity will have to be adjusted for the results of the appraisal. This may be a case that is covered by the provision in the Domestic Acquisition Regulations that those regulations will only be applicable if the other FIE Merger Regulation is silent on a matter.[5]

§ 8:15 Merger of foreign invested enterprises—Capitalization rules—50% limitation

Another provision added in 2001 was Article 19 of the Foreign Merger Regs which provides that when a domestic company merges into an FIE, it must comply with China's industrial policies relating to the utilization of investments and FIE Investment Regs. This provision raises an interesting question. The FIE Investment Regs generally permit FIEs to acquire domestic companies with only local government approval, unless the domestic entity's business line is one where investment is restricted. Nevertheless, Article 6 of the FIE Investment Regs provides that:

> The aggregate value of all investments by a foreign investment enterprise in China shall not exceed fifty percent of its own net assets. However, such total value shall not include the capital inter-

[Section 8:13]

[1]FIE Merger Regs, Art. 15.

[Section 8:14]

[1]FIE Merger Regs, Art. 17.

[2]Domestic Acquisition Regulations, Art. 9.

[3]FIE Merger Regs, Art. 18.

[4]Domestic Acquisition Regulations., Art. 14. It is clear that this requirement relates to any domestic enterprise acquired, not just those that are state-owned.

[5]Domestic Acquisition Regulations, Art. 55.

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est it owns in any Target Company attributive to capitalization of any profit distribution it has received from the same.[1]

This raises the question whether any FIE can carry-out a two stage transaction where it acquires the shares of a target company, not using more than 50% of its own net asset value, and then merge the acquired company into itself with the acquired company dissolving and the FIE surviving. Obviously this staged transaction, could be used any number of times.

§ 8:16 Merger of foreign invested enterprises—Required documentation

When an FIE merges either with another FIE, then the surviving entity in the case of a merger by absorption and both entities in the case of a merger by new establishment must act as the applicant. The documents to be submitted to the approval authority include:

1. The application to merge and the Merger Agreement signed by the legal representatives;
2. Resolutions reflecting the decision of each of the companies to be merged adopted by their highest governing authority;
3. The contracts, referring to investment contracts in the case of FIEs, and the Articles of Association of each of the companies to be merged;
4. Copies of the approval certificates and business licenses of each of the merging companies;
5. The capital verification report for each of the merging companies issued by an authorized institution;
6. Balance sheets and an inventory of assets for each merging company;
7. The prior year's audited financial statements of the merging companies;
8. The list of creditors of each merging company;
9. The proposed contract and Articles of Association of the surviving or newly established entity;
10. A list of the Board of Directors and other senior executives of the surviving or newly established entity; and
11. Such other documents as may be required by the examination and approval authority.

[Section 8:15]

[1]FIE Investment Regs, Art. 6.

In the event that an FIE merges with a domestic company, then the FIE must submit the business license of that enterprise and any enterprise in which that company has invested.[1]

§ 8:17 Merger of foreign invested enterprises—Required documentation—Merger agreement

As mentioned above, the Company Law requires that there be a merger agreement, but does not specify its content. Mergers between FIEs and, by extension mergers between FIEs and domestic companies, must have a merger agreement and the regulations give a skeleton outline of what must be included:

1. The name, location and legal representative of each of the parties to the merger;
2. The name, location and legal representative of the successor entity;
3. The total investment amount and the registered capital of the merged company;
4. The form of merger;
5. The plan for the transfer or acceptance of the claims and debts of each party by the merged company;
6. The employee settlement plan;
7. The liabilities for breach of the agreement;
8. The means for the resolution of disputes;
9. The date and place of signing of the agreement; and
10. Any other issues that the parties desire to address in the agreement.[1]

§ 8:18 Merger of foreign invested enterprises—Required documentation—Assumption of debts

The FIE Merger Regs provide that the surviving company or the newly established company shall assume the debts and obligations, as well as the assets and claims, of the companies dissolved.[1] At the time of the initial approval of a proposed merger, the companies to be merged must give notice to their creditors within 10 days of the approval and must make a public announcement within 30 days at the provincial or higher level.[2] Creditors within 30 days of receipt of the notice or 90 days after

[Section 8:16]

[1]FIE Merger Regs, Art. 20.

[Section 8:17]

[1]FIE Merger Regs, Art. 21.

[Section 8:18]

[1]FIE Merger Regs, Art. 25.

[2]FIE Merger Regs, Art. 27.

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the publication have the right to request the company to revise its plan for the acceptance of the debt, or have the alternative of demanding that the company either pay off its debt or provide an appropriate guarantee.[3] If the creditors do not exercise this right in a timely manner within the periods stated above, they will loose the right to assert their claim.[4]

There is an apparent inconsistency between the FIE Merger Regs and the Domestic Enterprise Acquisition Regs, since the latter simply provides that in the case where an FIE acquires a domestic company through merger, the surviving entity assumes all assets and debts of the domestic company.[5] There is no system in place for the creditors to object to the merger and require that the merging entities either pay off the debt or provide an acceptable guarantee. But as both sets of regulations remain in force, it is unclear what the rights of creditors are when an FIE acquires a domestic company through merger.

§ 8:19 Merger of foreign invested enterprises—Required documentation—Payment in some mergers

One final contradiction between the FIE Merger Regs and the Domestic Enterprise Acquisition Regs relates to the time and method of payment. The FIE Merger Regs provide that when a foreign investor purchases the equity ownership rights of the shareholders of a domestic enterprise, the payment conditions of the purchase money must comply with the relevant provisions applicable to the payment of capital into equity joint ventures.[1] The Domestic Enterprise Acquisition Regs, however, provide a different timing for merger consideration. Basically where a foreign investor establishes an FIE by merging or acquiring a domestic enterprise, it shall, within three months such FIE is issued its business license, make full payment of consideration due to shareholders who have transferred equities. Under certain circumstances, the investor may request a delay such that 60% percent of the consideration is paid within six months and the balance within one year.[2]

§ 8:20 Merger of foreign invested enterprises—Resolving contradictions

According to the Domestic Enterprise Acquisition Regs, discrepancies such as those relating to capitalization, payments to creditors, and payments to shareholders should be resolved as stipulated in the FIE Merger Regs if those regulations contain specific language on the subject.[1] However, even though there is specific wording that the FIE Merger Regs are to control, this stipulation contradicts a long-held view among China practitioners that the latest law governs notwithstanding what an older statute might provide. Because these contradictions can affect material elements of the merger transaction, it is always best to confirm the approach to be taken with the examination and approval authority before entering into definitive documentation. On issues of this nature, most approval authorities are quite willing to be of assistance in clarifying the inherent ambiguities. One must bear in mind, however, that a ruling by the approval authority in a specific case is quite discretionary and, if the parties prefer one result to another, it may be advisable to simply proceed in the manner most favorable to the parties and subsequently argue with the approval authority should any questions arise.

§ 8:21 Mergers of domestic enterprises with payment in foreign shares

One of the features added by the revision to the Domestic Enterprise Acquisition Regs in 2006 was the ability for a foreign company to acquire a domestic enterprise through the use of foreign shares as a means of payment.[1] Although logically a foreign company should be able to acquire assets and pay for the same with shares, the regulations appear to restrict this type of acquisition to the purchase of equity.

§ 8:22 Mergers of domestic enterprises with payment in foreign shares—Preconditions to the use of shares

Not every company may use its overseas shares to acquire a Chinese company. The acquirer must be lawfully established in a jurisdiction with a sound legal regime and it and its management

[3]FIE Merger Regs, Art. 28.

[4]FIE Merger Regs, Art. 28.

[5]Domestic Acquisition Regs, Art. 13.

[Section 8:19]

[1]FIE Merger Regs, Art. 38. The Article specifically refers to Several Provisions on Capital Contribution by Parties to Sino-foreign Joint Ventures {中外合资经营企业合营各方出资的若干规定} (State Council, Dec. 30, 1987 and issued by MOFERT and SAIC Jan. 1, 1988) (herein "Several Provisions on Capital Contribution"). These regulations establish the basic rule that a 15% payment must be made within three months and the remainder over an agreed period, *see* Art. 4.

[2]Domestic Acquisition Regulations, Art. 16.

[Section 8:20]

[1]Domestic Acquisition Regulations, Art. 55.

[Section 8:21]

[1]Domestic Acquisition Regulations, Art. 27.

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Chapter 16

Outbound M&A Activity

§ 16:1 China's outbound investment
§ 16:2 The regulatory scheme for outbound investment
§ 16:3 The role of the NDRC
§ 16:4 —Reform of procedural impediments
§ 16:5 —Effect of Administrative Notice
§ 16:6 Legal and diplomatic approvals
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§ 16:10 —Permissible local approval
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§ 16:14 —Export credit loans
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§ 16:1 China's outbound investment

Why China buys United States Treasury bonds and not United States companies has befuddled deal-makers ever since China crossed the trillion dollar mark in foreign exchange reserves. One would expect that the world's largest economy and the world's second largest economy would each be major investors in the

other. In 2010, however, when China's foreign investment abroad jumped by 20%, the United States ranked seventh as a destination for China's investment Dollars. Admittedly the top three countries, Hong Kong, the British Virgin Islands and the Cayman Islands, may serve as a half-way point for outbound funds and so disguise the ultimate destination of the investment; however, since none of these countries has a tax treaty with the United States, it is unlikely that they serve as pass-through corporate vehicles for investment in America. And while the United States might make excuses for coming behind these three former or existing British colonies, the United States also ranked in 2010 behind Luxembourg, Australia, and Sweden, and was only slightly ahead of Canada.[1]

However, times are changing. There has been a rapid increase in the amount and rate of investment by Chinese companies in the United States in the last three years. At the end of the second quarter of 2013, the United States with cumulative investment from China of $57.8 billion ranked only behind Australia with $59.2 billion.[2] With the September 2013 closing of the Shuanghui International acquisition of pork producer, Smithfield, for $7.1 billion and several large real estate investments, the United States took the lead as the preferred destination for China investment.[3] Included within the United States numbers during the first nine months of the year is $12.2 billion invested in 55 Greenfield projects and acquisitions in the United States.[4]

[Section 16:1]

[1] US-China Business Council, China Market Intelligence: China by the Numbers: China's Investments Abroad Jump by More than 20 Percent 4 (Sept. 21, 2011).

[2] G. Guilford, Chinese Companies Investing Overseas Aren't Telling Anyone What They Are Up To, Sinoceros (Oct. 21, 2013).

[3] T. Hanemann, Rhodium Group, Chinese FDI in the United States: Q3 2013 Update (Oct. 25, 2013).

[4] T. Hanemann, Rhodium Group, Chinese FDI in the United States: Q3 2013 Update (Oct. 25, 2013).

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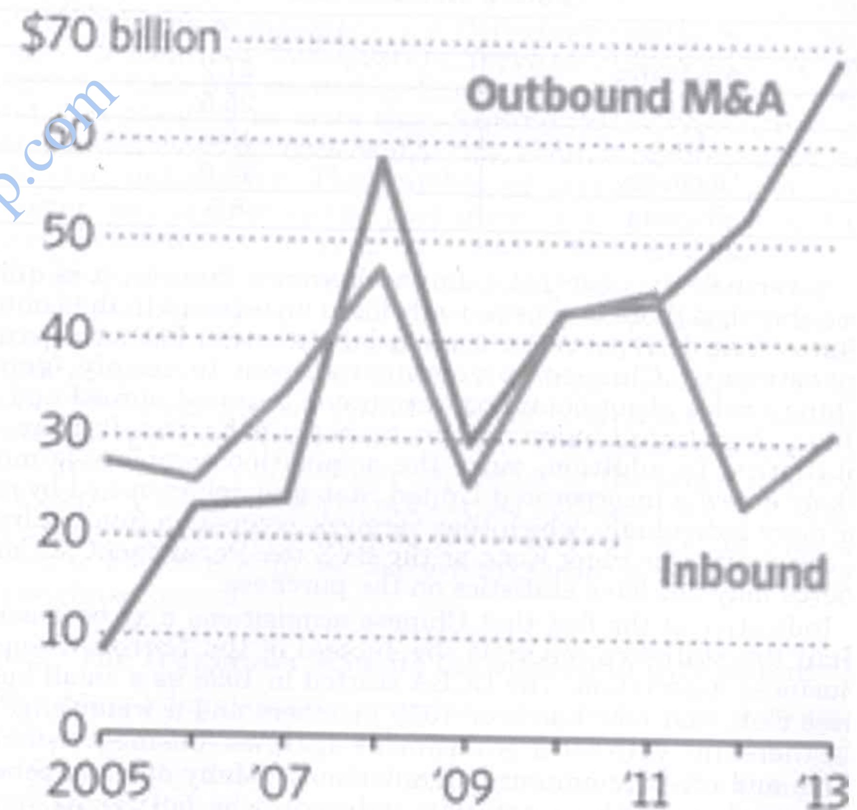
Mixed Sentiments

Chinese companies set a record for overseas deals last year, while global firms are thinking twice about acquisitions in China.



Note: Year deals completed

Source: Dealogic

The Wall Street Journal

There have been several well-publicized success stories, such as Lenovo's acquisition of IBM's notebook business or Zhejiang Geely's acquisition in 2010 of Ford Motor Company's Volvo brand. There have been equally well-publicized failures, such as CNOOC's aborted attempt to acquire Unocal Oil Company in 2005 and Sichuan Tengzhong Heavy Industrial Machinery Co., Ltd.'s failed attempt to acquire General Motors Company's Hummer brand in 2010. It may be the case that failed outbound investment approaches the level of successful projects in some years. According to Heritage Foundation data, between 2005 and 2009, there were 40 failed investments with approximately USD 130 billion of proposed investment with the largest occurring in the following countries:[5]

Failed Investments[6]

Country	Amount, $ billions
Australia	27.2
U.S.	25.5
Iran	19.6
Germany	14.0
Nigeria	8.5

Nevertheless, notwithstanding well-known failures, it is quite possible that there is substantially more investment in the United States than is reported in the official statistics. For small scale investments, Chinese entrepreneurs seem to simply ignore China's rules about obtaining permission to invest abroad and so their investment may not be picked up by the Bureau of Statistics. In addition, since the acquisition company is most likely a newly incorporated United States company owned by one or more individuals, which then receives acquisition funding from a corporation in Hong Kong or the BVI, the Department of Commerce may not have statistics on the purchase.

Indicative of the fact that Chinese acquisitions may be greater than the statistics report is the success of the Detroit Chinese Business Association. The DCBA started in 1998 as a small business club, and now has over 1500 members and a wide range of partnerships with local government agencies, business associations and other community organizations.[7] Many of its members are suppliers to the automobile industry, who purchased small factories in the mid-West and are now allocating production between China factories and those in the United States.

[5]*See* D. SCISSORS, Chinese Outward Investment, 10 AIB Insights 10 (2010) (No. 4).

[6]Heritage Foundation Dataset, China's Outward Investment: Non-bond Transactions Over $100 Million (2005–2009).

[7]*See* Detroit Chinese Business Association at www.dcba.com.

Another indication that investment in the United States by Chinese nationals may be greater than the statistics is the number of advertisements for EB-5 visa program lawyers and consultants in Mainland Chinese newspapers. The EB-5 program, known as the "investor visa program," grants to investors that create more than 10 jobs in the United States, a permanent resident visa for each member of the investor's family. It is unlikely that the Bureau of Statistics in China would know of such investors, since the required amount of the investment is only $1 million (or $500,000 in depressed areas), well below national reporting requirements. Moreover, since each Chinese individual may outwardly remit $50,000 without government scrutiny or approval, groups of friends are formed each year to wire the full amount to Hong Kong, where it is combined into the investor's account, and then invested to obtain the visa. The following year, another friend benefits. While the Department of Homeland Security's Citizen and Immigration Services estimates that the program, which was created by Congress in 1990, as of June 30, 2011, has resulted in more than $1.5 billion in capital investments and created at least 34,000 jobs, there is no breakdown by applicant nationality. The number of investor applications, however, has doubled in the past three years and much of this increased interest in the program seems to be from China.[8]

While many such investments may slip beneath the radar of national statisticians, it is still the case that large scale deals are infrequent. The reason that the world's largest holder of foreign exchange reserves seems incapable of making significant foreign acquisitions largely stems from China's own system of regulating foreign merger and acquisition activity. While some unsuccessful cases are the result of political opposition in the target country, such as the Huawei proposed acquisition of 3-Com, both the scarcity of acquisition attempts and the limited number of success stories is due largely to the domestic throttle being held tightly in the closed position.

§ 16:2 The regulatory scheme for outbound investment

The major administrative procedures required for an outbound investment to be made by a PRC company include:

- approval by the National Development and Reform Commission (NDRC);
- approval by the Ministry of Commerce (MOFCOM);
- inspection by and registration with the State Administration of Foreign Exchange (SAFE); and

[8]*See* U.S. Citizenship and Immigration Services, EB-5 Immigrant Investor Program Stakeholder Meeting, (Sept. 15, 2011), available at http://www.uscis.gov/USCIS/Outreach/Upcoming%20National%20Engagements/National%20Engagement%20Pages/2011%20Events/Sept.%202011/September%20EB-5%20pr.

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- approvals or registrations with other relevant authorities.

In exercising their powers, the above authorities have authorized their local branches to review certain applications and in February 2011 the authorized amount for local approval was increased dramatically.

§ 16:3 The role of the NDRC

The fact that the principal approval authority for outbound investment is the NDRC, which is the former State Planning Commission, indicates that China's mental attitude toward foreign investment is that it must serve the nation's needs, rather than solely the profit motive.[1] The NDRC is a national, cabinet level advisory organization controlling prices and generally coordinating national economic policy either directly or by advising the State Council; the State Council is the functional equivalent of the Cabinet of the United States. The original regulations governing investment abroad were incredibly restrictive,[2] since any investment abroad above $10 million required national level approval. In February 2011, this most restrictive roadblock to foreign investment was lifted and the new rules now permit investments of $300 million in resource projects and $100 million in non-resource projects to be approved by the provincial development and reform authorities.[3] Nevertheless, it is important to remember that few substantial acquisitions cost less than $100 million and that anything above that number must be approved by the NDRC.

§ 16:4 The role of the NDRC—Reform of procedural impediments

The 2004 NDRC Overseas Investment Measures also created a system that was bureaucratically inefficient and incompatible with the normal procedures used to acquire businesses outside of China. The procedure required information to be provided on the target that would be unavailable to a potential buyer and a final approval by the NDRC or the State Council after the transaction

[Section 16:3]

[1]*See* T. LUEDI China's track record in M&A (The McKinsey Quarterly (2008 No. 3), p. 78.

[2]Interim Measures for the Administration of Verification and Approval of Overseas Investment Projects {境外投资项目核准暂行管理办法} (NDRC, Decree No. 21, Oct. 9, 2004) (herein "NDRC Overseas Investment Measures").

[3]Notice of the National Development and Reform Commission on Delegating Powers on Approval of Overseas Investment Projects to Authorities at Lower Levels {国家发展改革委关于做好境外投资项目下放核准权限工作的通知} (NDRC, Fa Gai Wai Zi [2011] No. 235, Feb. 14, 2011) (herein "NDRC Delegation of Approval Powers for Overseas Investment").

terms were negotiated, making sellers wary of dealing with Chinese bidders.

The NDRC revamped the outbound investment program and its procedure in the middle of 2009 by the issuance of an administrative notice.[1] Although labeled as only improving administration of the NDRC Overseas Investment Measures, the notice substantially changed the direction of the "Go Abroad" program and broadened its scope. While not clearly stated in the NDRC Overseas Investment Measures, there was a preference for projects that were conducive to the development of strategic resources required for developing the Chinese national economy, adjusting the industrial structure, promoting the export of fairly competitive technologies, products, equipment and labor services, and absorbing foreign advanced technologies. For this reason, China's foreign investment tended to be directed to resource countries like Australia, Indonesia and Africa.

The Administrative Notice broadened, albeit with no fanfare, the type of acquisitions that may be done by PRC enterprises by stating that the following types of projects were to be verified and approved by the NDRC or the NDRC and the State Council:

(1) Overseas acquisition projects, i.e., projects, in which domestic enterprises directly, or through their overseas subsidiaries or holding companies, acquire all or a part of equity capital, assets or other rights and interests of overseas enterprises by means of agreement or offer.

(2) Overseas bidding projects, i.e., projects, in which domestic enterprises either directly, or through their overseas subsidiaries or holding companies, participate in overseas competitive bid invitation, in a public or private manner, with a view to obtaining all or a part of equity, assets or other rights and interests of overseas enterprises.[2]

Effectively this centralizes the approval power for overseas M&A activity in the NDRC at the national level if the investment amount exceeds the new cap of $100 million for provincial approval.

A second change made by the Administrative Notice was to specify that a new form had to be completed for the NDRC's preliminary approval. Called the "Overseas Acquisition or Bidding Project Information Report," the report is available at the NDRC

[Section 16:4]

[1]Notice of the National Development and Reform Commission on Issues Concerning Improvement of the Administration of Overseas Investment Projects {国家发展改革委关于完善境外投资项目管理有关问题的通知} (NDRC, Fa Gai Wai Zi [2009] No. 1479, June 8, 2009) (herein the "NDRC Administrative Notice on Overseas Investment").

[2]NDRC Administrative Notice on Overseas Investment, Art. 1.

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website (http://www.ndrc.gov.cn) listed under the category "utilization of foreign investment."[3] The information report is more extensive that what was previously required, since it includes information on the target, background information on the project, objectives of the acquisition or bid, summary of work and due diligence on the investment, and the basic plan for the acquisition.[4]

Centrally administered enterprises file their information reports directly with the NDRC, while local enterprises submit the reports through the provincial development and reform department, which may approve them if below the investment cap. The information report must also go to the relevant industrial ministry or regulatory body of the investor in the PRC governmental structure, as well as to the NDRC, to permit the ministry or regulator to comment on the proposal.[5]

The advantage of the new system is that within seven days of receiving the information report, the NDRC will issue a Confirmation Letter permitting the applicant to proceed with the acquisition or bid. If there are negative aspects to the project, these will be listed by the NDRC thereby permitting the investor to negotiate solutions acceptable to the NDRC when formulating the definitive agreements.

It should be noted that in August 2012, the NDRC issued Administrative Measures for the Examination and Approval of Overseas Investment Projects (Draft for Comment) that, if enacted, would substantially consolidate the 2004 Measures and the 2009 Notice. As of June 2013, those Measures had not been issued in final form.

§ 16:5 The role of the NDRC—Effect of Administrative Notice

The Administrative Notice appears to have substantially improved and redirected China's foreign investment program. The acquisition of the Volvo car business from the Ford Motor Company for $ 1.8 billion in August 2010 and the sale of Nexteer Automotive by General Motors Corporation for $ 450 million in December 2010 to Chinese buyers, the Geely Holding Group and Pacific Century Automotive, respectively, supports the view that China's system for approving outbound investment has passed through its initial trial and error stage.

General Motors earlier attempt to sell the Hummer brand to Tengzhong Heavy Industrial Machinery Co., Ltd., which collapsed finally in February 2009, after months of in-China lobbying to

[3] NDRC Administrative Notice on Overseas Investment, Art. 3.

[4] NDRC Administrative Notice on Overseas Investment, Art. 4.

[5] NDRC Administrative Notice on Overseas Investment, Art. 5.

receive final government approval stands in stark contrast to the other two automotive business deals. Tengzhong, a supplier of heavy equipment with close ties to the military, did not follow the required NDRC procedure. The final explanation given for Tengzhong's failure to receive approval was that the relevant government bodies never received a "complete purchase plan as required, which usually should include plans regarding enterprise structure, investment modes and a fund-raising program."[1] The alleged failure of Tengzhong to deliver a completed formal application report was either due to the NDRC's refusal to accept what was submitted, thereby avoiding having to say no officially, or Tengzhong bending to pressure from above instructing it not to submit the application report. In either case, there was miscommunication within China that led to Tengzhong's negotiation of a complete Sale and Purchase Agreement using foreign lawyers only to eventually learn that the deal would not be approved in China.

The new Confirmation Letter system established by the Administrative Notice should reduce such cases of miscommunication.

It also appears that the type of projects that may be approved by the NDRC has changed. At the same time the Volvo and Nexteer deals were proceeding successfully, Sinochem's (China National Chemical Corporation) proposed bid for Potash Corporation of Saskatchewan, a resource acquisition to supply the domestic Chinese economy, failed to win support in either China or Canada. In particular, the Chinese government failed to authorize export credit financing for the acquisition. Other examples of non-resource related deals are the purchase by Chinese companies of stakes in consumer companies like L'Occitane International SA, a French skin care company, for $ 50 million and Japan's Honma Golf for an undisclosed amount.[2]

If China has now resolved the teething problems of its "Go Abroad" program, so that both government planners and Chinese acquirers can act swiftly and confidently when bidding for foreign companies, and the types of companies that may be acquired has now broadened beyond natural resource suppliers, then 2015 may be the year of the Dragon in American M&A activity. One of the striking features of the recent increase in China acquisitions in the United States is that private or semi-private, Chinese

[Section 16:5]

[1] Chinese company confirms end of plan to buy U.S. Hummer (Xinhua News Agency, Feb. 26, 2010), available at http://news.xinhuanet.com/english 2010/china/2010-02/26/c_13188289.htm.

[2] A. Turner, Overseas M&A Strategy Turns to Consumer Firms (WSJ, Nov. 29, 2010) C6.

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companies are leading the way, while large State-owned Enterprises are no longer the principal investors. The Shuanghui-Smithfield acquisition makes private firms the largest investors in 2013. Last year, private firms for the first time accounted for more than half of the total deal value, largely due to Wanda's acquisition of AMC theaters. According to a study by the Rhodium Group, during the first nine months of 2013, private firms were the acquirers in 84% of the deals and the total investment of such private deals was 74% of the total.

§ 16:6 Legal and diplomatic approvals

Operating in parallel to the NDRC approval system, a Chinese buyer must also file an application with the relevant commercial authorities: MOFCOM at the national level or the committee on foreign economic relations and trade (COFERT) at the provincial level.[1]

§ 16:7 Legal and diplomatic approvals—MOFCOM diplomatic approval

MOFCOM takes a secondary position to the NDRC in the Go Abroad program. The role of the NDRC was stated explicitly at roughly the same time the NDRC Overseas Investment Measures were announced:

> the development and reform commissions at all levels are responsible for the administration of investment projects and the departments of commerce are responsible for the administration of enterprises' contracts and articles of association.[1]

In other words, the Ministry of Commerce (MOFCOM) is permitted to look at the paperwork, but the planning authorities are to make the yes and no decisions. The NDRC performs the "state planners" function, examining the proposed outbound investment for feasibility and compliance with China's long-term economic goals. MOFCOM, on the other hand, is both the lawyer and the diplomat. As lawyer, MOFCOM is supposed to check whether the proposed transaction is properly documented and accords with

[Section 16:6]

[1]Measures for the Administration of Overseas Investment {境外投资管理办法} (MOFCOM, Decree No.5 [2009], Mar. 16, 2009, eff. May 1, 2009) (herein "MOFCOM ODI Measures").

[Section 16:7]

[1]Reply of the General Office of the National Development and Reform Commission on Related Issues Concerning Verification and Approval of Foreign Investment Projects and Overseas Investment Projects {国家发展改革委办公厅关于外商投资项目和境外投资项目核准有关问题的复函} (General Office of NDRC, Fa Gai Ban Wai Zi [2004] No. 1673, Sept. 21, 2004) (herein "NDRC Authority over Investment").

China's various rules relating to foreign investment. As the diplomat, MOFCOM is supposed to check whether a proposed acquisition will ignite a firestorm of opposition in the host country and thereby damage China's diplomatic relations.

Similar to MOFCOM's role in the domestic direct investment sphere, the ministry is required to set up an Overseas Investment Administration System, which will include the issuance of Enterprise Overseas Investment Certificates, each of which shall have a distinctive number to be issued in a unified manner.[2]

§ 16:8 Legal and diplomatic approvals—MOFCOM fair trade approval

Another area in which MOFCOM regulates outbound investment is the requirement that outbound investment be conducted in accordance with market principles and fair, open competition. Acts of unfair competition in international investment include obtaining business opportunities through commercial bribery, unfair price competition, engaging in bid-rigging, defaming competitors, or falsely promoting one's business performance.[1] The new rules are enforced in the overseas mergers and acquisition area by requiring that an enterprise contemplating such an acquisition must submit a Preliminary Report Form on Overseas Merger and Acquisition to MOFCOM.[2]

§ 16:9 Approval levels and applicable procedures—Mandatory national approval

There are five instances where the application must be submitted to MOFCOM at the national level for final approval:

- Investment in countries which do not have diplomatic relations with China;
- Investment in any one of a list of specific countries to be prepared by MOFCOM and the Ministry of Foreign Affairs;
- The investment amount is USD 100 million or more;
- The investment involves more than one country; or

[2]MOFCOM ODI Measures, Art. 5.

[Section 16:8]

[1]Provisions on Regulating Competition in the Field of Outbound Investment Cooperation {范对外投资合作领域竞争行为的规定} (Ministry of Commerce, Mar. 18, 2013, eff. April 18, 2013) (herein "Outbound Investment Competition Rules"), Art. 5.

[2]Outbound Investment Competition Rules, Art. 6(4). The required form has been in existence since 2005, when MOFCOM and SAFE issued the Rules for the Preliminary Report on Matters Related to Enterprises' Overseas Merger and Acquisition {企业境外并购事项前期报告制度} (Ministry of Commerce; State Administration of Foreign Exchange, Shang He Fa [2006] No. 21, Mar. 31, 2005, eff. May 1, 2005) (herein "Preliminary Report on Overseas M&A").

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- The investor is establishing an overseas company for a special purpose.[1]

If the enterprise is a central government enterprise, it files the required application form directly with MOFCOM; but if the enterprise is a local enterprise, it initially files with the provincial department of commerce, which reviews and forwards the application to MOFCOM for final approval.

For local enterprises, the provincial department of commerce has 10 working days to conduct a preliminary examination of the application to determine its truthfulness and absence of any prohibited factors.[2] This 10 days does not include any time that must be spent consulting with the commercial attaches and diplomats in the Chinese embassy or consulate in the host country for the investment. The provincial department after completion of its investigation submits the application and materials to the Ministry of Commerce.

The Ministry of Commerce then has five days to decide whether the documents submitted with the application are adequate. At the end of this period, MOFCOM must either accept the application or return it noting any discrepancies. If the application is accepted, then MOFCOM has a further 15 days to determine whether it will approve or disapprove of the application. If the application is from a central enterprise, then there is the five day period to determine whether the application is complete, and 15 days to investigate the application. Again, time spent in consulting with foreign embassies or consulates is not included in this tight timeframe.[3]

§ 16:10 Approval levels and applicable procedures—Permissible local approval

If the applicant is a local enterprise and the acquisition price is between USD 10 million and USD 100 million and the Intended Acquisition does not involve investment in the energy or mining

[Section 16:9]

[1]MOFCOM ODI Measures, Art. 6.

[2]MOFCOM ODI Measures, Art. 13. The prohibited factors are listed in Article 9 as circumstances that may (1) endanger the sovereignty, security and social public interest of the State, or violate the laws and regulations of China; (2) impairs China's relationship with other countries; (3) violates international treaties to which China belongs; and (4) involves technology or commodities as to which export is prohibited.

[3]MOFCOM ODI Measures, Art. 13.

sectors or requires additional domestic investment, the project will be subject to the provincial COFERT approval.[1]

§ 16:11 Foreign exchange approval

As anyone familiar with investing in China is aware, the State Administration of Foreign Exchange ("SAFE") plays a major role in the enforcement of national economic policy, since capital is not freely convertible in China. In order to take money out of the country, an investor needs to pass beneath the watchful eyes of SAFE or the banks whose foreign exchange dealing SAFE regulates.

SAFE has amended its regulations to make outbound investment somewhat simpler,[1] since the new system merely requires that the outbound investor register the proposed outbound investment with SAFE by presenting the appropriate national or local planning commission approval. SAFE does not have to approve the investment in addition to the approvals of the NDRC and MOFCOM. Domestic institutions are permitted to use their own foreign exchange funds, domestic loans in foreign currencies, foreign exchange purchased with RMB, and contributions in kind. The earnings of domestic institutions from their foreign subsidiaries may be deposited in overseas banks and used for overseas direct investment. And, unlike the rule governing investment into China, the domestic investor going abroad may use foreign exchange funds held in its current account, capital account (even if a foreign invested enterprise) and any other account owned by the investor.[2]

In order to register with SAFE, the investor needs to submit an "Application Form for Foreign Exchange Registration for Overseas Direct Investment," state the source of the investor's foreign exchange funds, present a valid business license, and the NDRC and MOFCOM approvals (or provincial equivalents).[3] If the documents are found to be in order, SAFE will register the proposed project and provide the investor with a foreign exchange registration certificate for overseas direct investment. This certificate al-

[Section 16:10]

[1]MOFCOM ODI Measures, Art. 5.

[Section 16:11]

[1]Provisions on Foreign Exchange Administration for Overseas Direct Investment of Domestic Institutions {境内机构境外直接投资外汇管理规定} (SAFE, Hui Fa [2009] No. 30, July 13, 2009, eff. Aug. 1, 2009, as amended June 11, 2012) (herein "SAFE Outbound Provisions").

[2]SAFE Outbound Provisions, Art. 4.

[3]SAFE Outbound Provisions, Art. 7.

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lows the investor to carry-out the required money transfers at his local bank.[4]

Most recently, SAFE has notified each of its local branches of the NDRC's change in approval level requirements, so that the local branches of SAFE do not ask to see a higher level approval than is required.[5]

§ 16:12 Catalogue on recommended investments

China's Go Abroad program maintains its state policy connection through its various Country-Specific Industry Guidance Catalogues for Outbound Investment. These catalogues were issued in July 2004, October 2005 and most recently January 2007. The Country-Specific Industry Guidance Catalogue for Outbound Investment (III) encourages Chinese enterprises to make the certain types of investments in various African, Middle Eastern, Asian and European countries.[1] For example, the Catalogue lists Libya as a good country to invest in petroleum and natural resources or to manufacture bicycles.

§ 16:13 Encouragement for NDRC approved projects

While the process of obtaining NDRC preliminary and final approval may seem daunting, there are considerable benefits that go along with the process.

§ 16:14 Encouragement for NDRC approved projects—Export credit loans

Immediately after the adoption of the NDRC Overseas Investment Measures, a prior system to support export credits for State preferred projects was amended to permit approved projects to obtain export credit loans to finance the NDRC supported

[4]SAFE Outbound Provisions, Art. 8.

[5]Notice of the Capital Account Management Department under the State Administration of Foreign Exchange Regarding Issues Related to Carrying Out the Work on Foreign Exchange Registration for Outbound Investments Properly {国家外汇管理局资本项目管理司关于做好境外投资项目外汇登记工作有关问题的通知} (Capital Account Management Department of SAFE, Hui Zi Han [2011] No. 9, April 7, 2011) (herein "SAFE Capital Account Notification").

[Section 16:12]

[1]Notice of the Ministry of Commerce, the Ministry of Foreign Affairs and the National Development and Reform Commission on Promulgating the Country-Specific Industry Guidance Catalogue for Outbound Investment (III) {商务部、外交部、国家发展改革委关于公布《对外投资国别产业导向目录（三）》的通知} (MOFCOM; Ministry of Foreign Affairs; NDRC, Shang He Fa [2007] No. 29. Jan. 31, 2007) (herein "MOFCOM Catalogue on Outbound Investment").

acquisition.[1] The amendment provides that a portion of annual export credit funds should be set aside to encourage overseas acquisitions and that the following types of projects would be the likely beneficiaries:

(1) Overseas resource development projects which can make up for the relative insufficiency of domestic resources;

(2) Overseas production projects and infrastructure projects which can give impetus to the export of domestic technologies, products, equipment, and labor services, etc.;

(3) Overseas research and development center projects which may utilize internationally advanced technologies, managerial experiences, and professional talents; and

(4) Overseas enterprise acquisition and merger projects which can improve the international competitiveness of enterprises, and accelerate the international market development.[2]

According to the system established by the Export Credit Notice, the investor in the Intended Acquisition submits a loan application to The Export-Import Bank of China at the same time that it files the application report with the NDRC and also provides the bank with a copy of the NDRC application. The Export-Import Bank will then issue a letter stating its opinion as to the use of a special loan for overseas investment, which will be used by the NDRC or its provincial counterpart in their review of the application report.[3]

§ 16:15 Encouragement for NDRC approved projects—Investment guarantees

Another mechanism to encourage overseas investment is the ability of an Intended Acquisition investor to receive a Sinosure guarantee of investment risks, similar to the type of guarantee offered by the Overseas Private Investment Corporation (OPIC) of the United States. Sinosure or the China Export & Credit Insurance Corporation is a State agency to promote exports and, af-

[Section 16:14]

[1]Notice of the National Development and Reform Commission and the Export-Import Bank of China on the Policies of Giving Credit Loan Support to the Key Overseas Investment Projects Encouraged by the State {国家发展和改革委员会、中国进出口银行关于对国家鼓励的境外投资重点项目给予信贷支持政策的通知} (NDRC; Export-Import Bank of China, Fa Gai Wai Zi [2004] No.2345, Oct. 27, 2004) (herein "NDRC Export Credit Notice").

[2]NDRC Export Credit Notice, Art. 1 and 2.

[3]NDRC Export Credit Notice, Art. 4.

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