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International Mergers and Acquisitions in China

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INTRODUCTION

Mergers & Acquisitions ("M&As"), a term rarely heard in China about ten years ago, is now common practice in the country. International M&As, usually referred to as foreign M&As in China, is a transaction by which foreign investors acquire the rights of domestic enterprises according to Chinese laws and regulations. More and more foreign companies are finding their M&As opportunities in China thanks to the economic development and the modification of Chinese laws and regulations. And at the same time, Chinese enterprises are showing growing interest for international M&As, after Lenovo's takeover of IBM's personal computer business,[1] home appliance giant Haier and the China National Offshore Oil Corporation are also making moves.[2] But this paper focuses on international M&As in the territory of China.

Since it became one of the official members of the World Trade Organization (WTO) on 11 December, 2001, China has begun to carry out wide range of policies to open up to the outside world. In view of the trend of global Foreign Direct Investment (FDI), the Chinese government has been issuing many new rules and provisions to regulate international M&As in China in accordance with Chinese industrial investment policy. Among them, the general rule for international M&As is the "*Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*" (hereinafter refer to "the M&As Provisions") which provides for basic aspects of international M&As but still leaves much room for improvement. And almost all of the provisions are government regulations instead of legislations, and there also exist conflicts among the provisions.

Since international M&As is new in China, few works has been written on this topic; there are only some journals articles that analyze some of its problems. This paper aims to

1 See http://tech.sina.com.cn/it/2004-12-08/. the Lenovo Group, which is China's biggest computer producer, bought off IBM's PC business for USD 1.25 billion.

2 See http://www.crienglish.com. 2005/07/06/. The latest merging activity is focused on the China National Offshore Oil Corporation, which is seeking US review of its merging proposal with Unocal. Meanwhile, China's largest home appliance maker Haier announced plans to purchase household name Maytag Corporation in the United States.

review the current Chinese M&As legal framework and the preliminary merger control system, especially the anti-monopoly problem, and offer some practical suggestions based on the study's findings.

This paper is divided into four parts. Part one introduces the trend of international M&As and China's current situation, explaining why international M&A is now catching on in China. Part two will mainly discuss China's regulatory framework for international M&As in the country, analyzing the principles and requirements in the existing laws and regulations. The third part analyzes a variety of problems attending the practice of international M&As, such as national treatment, anti-monopoly and competition, and the limitations of the existing legal system, and offers suggestions for solving these problems. And in the fourth part, a conclusion will be offered.

Although there are four different legal systems within the territory of China, namely those of the mainland China, Hong Kong, Macao and Taiwan, this thesis focuses on just the legal system on the mainland China.

§1. CURRENT SITUATION

1. General Situation of International M&As

1.1 Definition of M&As

Mergers and Acquisitions (M&As) is a term that originated from the common law system. In American law, M&As, in a broad sense, refer to the "methods by which corporations legally unify ownership of assets formerly subject to separate controls. A merge or acquisition is a combination of two companies where one corporation is completely absorbed by another corporation. The less important company loses its identity and becomes part of the more important corporation, which retains its identity."[3] Here, American law does not distinguish mergers from acquisitions.

In contrast, in China where a civil law system is in place, there is no exact equivalent to M&As in the Chinese law system. And due to the lack of a unified definition, the use of this term has been quite indiscriminate in the existing regulations. In Chinese law, M&As ("Binggou" in Chinese) has different meanings. In a narrow sense, M&As only refers to "merger" (or "Jianbing" in Chinese) in the Chinese company law and may take two forms: absorption and consolidation. Absorption is a combination of two companies where one corporation is completely absorbed by another corporation, with the surviving corporation assuming all the rights, privileges, and liabilities of the merged corporation. Consolidation, on the other hand, refers to a situation in which two corporations lose their separate identities and unite to form a completely new corporation.[4]

In a broad sense, M&As also includes "acquisition" ("Shougou" in Chinese), which usually refers to a situation in which one company gains control of another company by acquiring certain amounts of the latter's shares. In economics, acquisition, which usually includes stock acquisition and assets acquisition,[5] refers to the transfer of the control right of one company in which the former investor loses its control right. Therefore, the essence of acquisition lies in gaining the control right of a particular company.[6]

3 See the "Merger and Acquisition" entry in *West's Encyclopaedia of American Law*, vol. 7 (West Group, 1991), p. 191.
4 See art.184 Company law of PRC enforced on 1 July, 1994.
5 See JIANG Ping, *A New Course of Company Law* (Beijing: Law press, 1994), p. 84.
6 See ZHANG Yuanzhong, *M&As of Domestic Enterprises*, p. 85.

As in western countries where the idea of M&As can also be conveyed by such terms like “purchase,” “tender offer,” and “takeover,” it is not necessary in Chinese to distinguish *merger* from *acquisition*. Similarly, in this thesis, M&As refers to the broad sense definition as is used in Chinese law.

1.2 Types of M&As

There are three basic types of M&As, based on the competitive relationships between the merging parties. In a *horizontal merger*, one firm acquires another firm that produces and sells an identical or similar product in the same geographic area and thereby eliminates competition between the two firms. It is forbidden in many countries because it may destroy fair competition and lead to monopoly. In a *vertical merger*, one firm acquires either a customer or a supplier. As vertical merger concerns merging parties that are in the same chain of the production and/or sales of the same kind of products or services, it may choose to reduce the supply of certain things to its competitors when it has to protect its own supply and sales. And since that can also damage or threaten to damage the regular competition order, vertical merger is also regulated by the laws of all the countries. *Conglomerate mergers* encompass all other acquisitions, mainly including *geographic (market) extension mergers*, where the buyer makes the same product as the target firm but does so in a different geographic market; and *product extension mergers*, where a firm producing one product buys a firm which makes a different product that requires the application of similar manufacturing or marketing techniques.[7]

M&As can also be divided into *friendly M&As* and *hostile M&As* according to the attitude of target enterprise. *Friendly M&As* refers to an M&A in which the target enterprises agree with the conditions offered by the acquiring party and are willing to cooperate. It is likely to be a win-win M&A as at least it would not damage the interests of the target enterprises. On the other hand, *hostile M&As* refers to an M&A in which the target enterprise was not notified or whose consent to the M&As was not obtained. Since the 1990s, most of the important international M&As were carried out through cautious

7 See *West's Encyclopaedia of American law*, Vol. 7 (West Group, 1991), pp. 191-192.

selection and patient negotiations, that is to say, friendly M&As.

1.3 Trend of International M&As

International M&As is one of the two basic forms of Foreign Direct Investment (FDI); the other is *Greenfield investment* which is more primary in nature and often takes place in the developing countries. In contrast, M&As, which is a more developed phase of FDI usually, happens in the developed countries and some developing countries that have mature industries qualified to be M&As targets.

The late 1990s did, however, witness a surge in one form of FDI: a global wave of M&As. According to the statistics of OECD, over a trillion US dollars of corporate assets were involved in international M&As in the year 2000.[8] Many factors are said to be responsible for this global wave of M&As. Deregulation and privatization are important explanations in Europe and in many developing economies. And liberalization of FDI regimes has no doubt played an important role in facilitating overseas acquisitions of corporate assets, as has the ease with which firms were able to raise funds cheaply on stock markets in the late 1990s.[9]

2. General Situation in China

2.1 Background

Since 1979 China's use of Foreign Direct Investment has not only increased phenomenally but also undergone a change from Greenfield investment to international M&As, which, in the Chinese context, refer to instances where foreign investors invest in domestic enterprises through M&As and then change them into Foreign Investment Enterprises (FIEs).[10]

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8 See statistics of OECD international direct investment yearbook 2000, published 2001, available online at: http://www.oecd.org/document.

9 See LIN Ping, "Merger control in China," research paper available online at : http://www.ln.edu.hk/econ/staff/plin/Merger/pdf.

10 See YE Jun, M&As of Domestic Enterprises, p. 1. "Foreign Investors", in the current Chinese law system, the term should be understood in a broad sense. It refers to not only foreign companies, enterprises, other economic organizations and individuals coming from outside the territory of China, but also the foreign controlled FIEs inside the territory of China including Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures, wholly foreign-owned enterprises in the form of limited liability companies or foreign investment joint stock limited companies and foreign investment companies.

FDI absorption is an important component in China's cardinal policy of opening up. Over the past 25 years since its inception of reform and opening up policy, China has made achievements in FDI utilization that has attracted worldwide attention. Since the early 1990s, China has been one of the largest recipients of FDI in the world. By 2002, China surpassed the United States as the largest FDI recipient, with a total amount of $52.74 billion in FDI that has been utilized.[11]

Apart from the quantitative change, there is also a change in the form foreign investment takes. In the past, the FDI inflow to China primarily took the forms of joint ventures or other Greenfield investments, in contrary to the global trend where international M&As account for the great majority of FDI. Foreign participation in M&As of established enterprises in China accounted for less than 5 percent of all FDI volume.[12] After China became a WTO member and revised rules and policies followed over a long period of time, foreign investment in China has entered a new phase, marked by the rapid increase of international M&As. In 2002, its first year as a WTO member, China overtook Japan to become the most active M&As market in Asia. Foreign companies spent $13.9 billion from January to November 2002 purchasing Chinese firms, up 180 percent over the $4.9 billion spent in 2001[13]. Foreign investors have been increasingly using M&As as a vehicle for strategic positioning in China's market (e.g. to gain immediate access to distribution channels, customer bases or control of domestic companies with great potential, etc).

2.2 Target Enterprises

Although there is no restriction on the kinds of enterprises that are open to foreign investors, three kinds of enterprises stand out as attractive M&As targets for foreign investors, namely state-owned enterprises (SOEs), joint ventures (JVs) and private enterprises.

State-owned enterprises are important M&As targets basically because of government encourage through favorable policies. Now China has more than 400,000 SOEs which

11 See *China's Statistical Yearbook 2002*, p. 135, Available online at : www.mofmoc.gov.cn.
12 See *Chinese Investment Report 2003*, p. 13. Available online at : www.mofmoc.gov.cn.
13 See US-China Business Council, *Foreign Investment in China*, 2003, available online at. http://uschina.org/statistics/2003foreigninvestment.html

manage about RMB 10 trillion worth of state-owned properties, representing more than 60% of the national economy.[14] Most of the SOEs have been in a difficult situation during the transition from a planned economy to a market economy.[15] In 1987, it was made clear at the 13th CPC National Congress that small SOEs could be sold to collectives and individuals. Since 2001, a series of regulations concerning the restructuring of SOEs through the introduction of foreign investment have been issued and China has opened the industries which were formerly closed off to foreign investors for a long-term, such as the retail industry, the financial sector, telecommunications, and so on. Some medium or large SOEs, which in a leading position of the industry, enjoying a good market reputation and a high profit, are deemed to be the first targets of International M&As.

Joint ventures are important M&As targets for obvious reasons. When JVs started to be established more than 20 years ago, it was because China would only allow this form of foreign investment for certain industries. Now, thanks to more relaxed government regulations which allow foreign investors in these JVs to reorganize their business structure, some foreign investors would like to win the control right through M&As. What they can do is increase capital or shares in the JVs and gradually change the JVs into wholly foreign-owned enterprise. For instance, in October 2001 Alcatel consolidated ten of its joint ventures in China and bought control stake of Shanghai Bell to create Alcatel Shanghai Bell (ASB), becoming the first telecom company in China where a foreign investor owns the majority stake.[16] Such restructuring of existing FIEs by foreign investors is taking place across most industrial sectors in China.

Foreign investors are also looking to China's private sector for the M&As targets. In recent years, with the encouragement of the Chinese government, some of private enterprises in high-tech and IT sectors have been listed on NASDAQ in the US and warmly received by many American investors.[17] Foreign investors gradually realize the importance

14 See SHI Dongming, "A win-win for international M&As of SOEs", in *Chinese Foreign Investment*, Vol.12, 2003, p. 34.

15 Statistics show that, more than 80% of SOEs are small enterprises, most of them running at loss; about 15% are medium-sized SOEs, some of them with a large scale and net property; and about 5% are big SOEs which contribute more than 60% of the total tax revenues and have 70% of all the SOEs' assets and sales.

16 *China Daily*, 24 October 2001.

17 Major Chinese dot-coms like Sina and Sohu and other emerging private IT stars attract more investors than the traditional industries. See www.sina.com.cn/news/finace/10//12/2002.

of China's private enterprises, so they decide to buy off the rivals in the Chinese market today, in order to protect their own hometown markets. In 2001 when Emerson took over Avansys, it acquired the entire electronic business of Huawei Technolo- gies, a top telecommunications supplier in China, for $750 million in cash, making it, to date, the largest M&A deal between a private Chinese company and a foreign investor.[18]

2.3 Characteristics

On the Chinese market, international M&As distinguish themselves in two ways. First, foreign investors seek to acquire many Chinese enterprises in a particular sector or geographical region, which they merge into a large-scale enterprise. For example, the Hongkong-based China Stegy Investment Co. (or "Zhongce" in Chinese) approached its M&As in China by a blanket purchasing of all the SOEs in Quanzhou city (Fujian province) in September, 1992 and establishing a JV with 101 enterprises in Dalian city (Liaoning Province) in May, 1993 in which Zhongce controlled 51% of the shares.[19]

Second, the buyers are almost all of the world's famous multinational companies. Examples include American companies like GM, HP, IBM, Dupont, Motorola; Japanese companies such as Panasonic, Toyota; German companies like Siemens, BAL and the Dutch company Philips, and so on.[20]

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18 See China Mergers and Acquisitions Yearbook, 2003, (Beijing: Post & Telecom Press), p. 211.

19 See TANG Zongkun, "Case analysis of State-owned Property Transaction," in *Reform*, Vol. 2, 1997, p. 41.

20 See WANG Yi, *Enterprises Merger and Acquisition*, (Shanghai: Finance and Economic Press), 2002, P. 63.

§2. CHINA'S REGULATORY FRAMMWORK FOR INTERNATIONAL M&As

China's strategic purpose for utilizing international M&As is to attract more FDI and to restructure its poor performed state-owned enterprises (SOEs), establish effective corporate governance for them and make them more competitive in the international market. With the emergence of market transactions of M&As, the Chinese government has recognized the need to establish a modern M&As regulatory system, which includes the following aspects.

1. Government Policy

Since the 1990s, as China's economy becomes more and more open to international competition, the Chinese central government has been persistently using M&As (not just international M&As) as a means to reform and restructure the SOEs and to enhance international competitiveness of the domestic enterprises. To that end, it has made many important policies along the way. In 1994, China started the mergers of large and medium-sized enterprises in 100 pilot cities. Later in 1997, a more ambitious project was undertaken to merge thousands of enterprises into 120 large enterprise-groups to sharpen their competitive edge. Not surprisingly, a large number of large-scale domestic M&As that took place in recent years was government managed.[21]

Recently, the Chinese government began to allow foreign investors to merge with or acquire domestic enterprises in China. The tenth five-year plan (2001-2005) of the Chinese government, which was approved on the March 15th, 2001 by the ninth session of the National People's Congress (NPC), encourages foreign investment especially multinational companies to participate in the restructuring of the SOEs by new forms of investment, such as M&As, venture investment and fund investment.[22] In 2002, a total of 653 M&As

21 For example, in a government-ordered merger in 2002, the Civil Aviation Administration of China (CAAC) pushed nine domestic airlines which were directly under the CAAC to form three super groups: Air China, China Eastern Airways, and China Southern Airways. Under the administrative transfer technique, the super groups got the assets of the regional carriers for free. See *China Mergers and Acquisition Yearbook 2003*, pp. 393-395.

22 See the chapter 17, *Outline of the Tenth Five-Year Plan for Social and Economic Development (2001-2005)*. Available at: http://past.people.com.cn/GB/jinji/35/160/20030610/1013220.html.

involving publicly listed companies took place in China as a result of the government's industrial policy and its newly adopted measures to attract foreign direct investment (FDI).[23]

In early 2003, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC)[24] was established to manage state-owned property. A senior official in the Commission announced that China would make a substantial adjustment in managing state-owned property: "We welcome foreign capital and Chinese private capital to participate in the restructuring of SOEs, which will improve China's industrial and economic structure."[25]

Since the international M&As of domestic enterprises is a new form of utilizing foreign investment in China and results in the establishment of an FIE, it should be carried out according to the foreign investment policy because China still places certain restrictions on using foreign investment and the administrative approval procedure for establishing an FIE has to be followed.

2. General Laws

International M&A is, in fact, a transaction by which foreign investors acquire the rights of domestic enterprises according to Chinese laws and regulations. Since no matter what kind of form an M&A takes, it is a property transaction between foreign investors and domestic investors, it should be carried out following the rules of civil and commercial law, and the parties have the right to choose the applicable law(s) unless the law provides otherwise. That is the characteristic of M&As in private law. China has a legal framework for such transactions based on its *General Provisions of Civil Law*,[26] *Company Law*,[27] *Contract Law*,[28] *Security Law*,[29] *and* three basic laws and enforcement regulations for the

23 See LIN Ping, "Merger Control Regime in China," p. 4. Available at http://www.ln.edu.hk/econ/staff/plin/Merger/pdf.

24 For detailed information, see www.sasac.gov.cn/news 10/01/2003, "Chinese government decided to set up SASAC to manage the state –owned properties".

25 HUANG Shuhe, deputy director of SASAC, "Speech at the Advanced International Forum on M&As and Restructuring," www.sina.com/finance/news, 12/11/2003.

26 Refer to *General Principles of the Civil law of the PRC*. Adopted at the fourth Session of the NPC on April 12, 1986.

27 Refers to *Company Law of PRC* adopted by the Standing Committee of the NPC on 29/12/93. First amended decision adopted in 1999, and second amendment was made in 2004.

28 Refers to *Contract Law of PRC* issued by the Standing Committee of the NPC, effective from 01/10/1999.

29 Refers to *Securities Law of PRC* issued by the Standing Committee of the NPC 29/12/1998.

FIEs,[30] that framework defines the legal environment in which the parties of international M&As can deal with their transactions.[31] Unfortunately, the above mentioned general laws only set the basic principles on mergers; there are no specific provisions on international M&As. As general laws are silent on the specifics, the practice of international M&As has met various problems. Although the related government bodies did manage to solve some problems by making do with the provisions on *Greenfield investment,* there will be a great difficulty in keeping up with the trend of international M&As in China, if China does not have relevant legislations on international M&As.

3. Government Regulations

Although the private aspect of M&As should not be subject to government regulations and laws, its public aspect has to be regulated because an international M&A is a deal between enterprises and may affect public order and public good, such as market competition, the protection of consumers and employees, and the stability of financial order. All these make it necessary for the government to regulate these transactions.

As China does not have any specific laws on international M&As, an array of new rules governing foreign investment and M&As has been introduced during the past few years in order to regulate and control the transaction of M&As. Most of the existing regulations on M&As in China, as listed in Table 1, are adopted because the government wishes to attract and regulate FDI. The author has classified the regulations into four categories according to the type of enterprises they are designed to address. These types of enterprises which foreign investors are allowed to purchase stake under China's current laws include Chinese domestic enterprises (e.g. state-owned enterprises (SOEs), companies with state-owned interests (SOC) or collectively-owned enterprises), Chinese limited liability companies or companies limited by shares, and FIEs.

Table 1 China's regulations on FDI-related M&As

30 They refer to *Law of Sino-foreign equity joint venture of PRC*, adopted by the National People's Congress on 01/07/1979, amended first in 1990, then in 2001; *Law of Sino-foreign contractual joint venture of PRC*, adopted by the National People's Congress on 13/04/1988, and amended in 2000; and *Law of wholly foreign-owned enterprise of PRC*, adopted by the NPC on 12/04/1986 and amended in 2000.

31 YE Jun, *M&As of Domestic Enterprises by Foreign Investors*, pp. 13-15.

Title of Law	Issuing Date	Target Enterprise	Category
Interim Provisions on Asset reorganization of SOEs by Using Foreign Investment	14 Sept. 1998	SOE or SOC	
Interim Provisions on Restructuring SOEs by Using Foreign Investment	8 Nov. 2002, effective 1 Jan. 2003		
Measures on the takeover of the Listed Companies	28 Sept. 2002	Listed company	
Circular Regarding the Transfer of State-Owned Shares and Legal Person Shares of Listed Companies to Foreign Investors	4 Nov. 2002		
Several Provisions concerning Changes in Equity Interest of Investors in FIEs	28 May 1997	FIE	
Provisions on Mergers and Divisions of FIEs	1 Nov. 1999 rev. on 22 Nov. 2001		
Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors	7 Mar. 2003	Domestic Enterprises	
Catalogues for the Guidance of Foreign Investment Industries	21 Feb. 2002	All the Foreign Investment	

3.1 Category : SOE or SOC as the target enterprises

Because of the importance of the SOEs in the national economy, the Chinese government has issued many regulations to facilitate the reform of SOEs. There are two basic regulations concerning foreign investors in this regard: (1) Interim Provisions on Asset Reorganization of SOEs by Using Foreign Investment of 1998 (hereinafter "SOE Asset Reorganization Provisions"); (2) Interim Provisions on Restructuring SOEs by Using Foreign Investment of 2002 (hereinafter "SOEs Restructure Provision").

The SOEs Restructure Provision which was jointly issued by SETC MOF SAIC SAFE on 8 November 2002, effective as of 1 January 2003, was applicable to the use of foreign investment to restructure SOEs or SOCs with state-owned shares to establish FIEs. The SOE Asset Reorganization Provisions issued in 1998 which provides for three types of "asset reorganization" has been fleshed out by the 2002 document, and these two regulations have significant overlaps but it is unclear whether the 1998 regulation have

been repealed by the 2002 regulation.[32]

The SOEs Restructure Provisions list five forms of restructure, such as the sales of all or part of the state-owned interests to the foreign investors, or selling debts owned by SOEs to the foreign investors. It also sets the principles and procedures that should be followed.

3.2 Category : listed companies as target enterprises

On 28 September 2002, the CSRC issued *Measures on the Takeover of Listed Companies* to regulate the purchase of Chinese listed companies by Chinese parties only. Under current PRC law, foreign investors are still not allowed to acquire publicly traded shares via the stock exchange.

The only legal instrument that makes it possible for foreign investors to acquire a stake in a listed company in China is *Circular Regarding the Transfer of State-owned Shares and Legal Person Shares in Listed Companies to Foreign Investors* (Circular 2002),[33] which was co-issued by CSRC, MOF and the former SETC. Circular 2002 permits foreign investors to purchase non-tradable state-owned shares and legal person shares of listed Chinese companies by assignment agreement. It has been regarded as a sign of the lifting of the "95 Ban," which the State Council imposed in 1995 to forbid such transfers.[34] The Circular provides that the transfer of state-owned and legal person shares to foreign investors shall comply with the certain conditions: (1) foreign investors shall comply with the "Catalogues for the Guidance of Foreign Investment Industries" (Art. 2, Circular 2002); and (2) foreign investors are subject to a mandatory holding period of 12 months after full payment of the entire acquisition price. The status of the listed company that transferred state-owned or legal person shares to foreign investor will not change because the resultant entity is not an FIE and is ineligible for preferential treatment (Art.9, Circular 2002).

32 It is very common for Chinese legislators to indicate expressly in a new legislation whether previous legislations or regulations concerning the same subject-matter have been repealed. The SOEs Restructure Provisions 2002 does not indicate if the SOEs Asset Reorganization Provisions 1998 has been repealed.

33 Available online at: http://policy.mofcom.gov.cn/lawinenglish.htm.

34 For the detailed information, see ZHANG Yuanzhi, *M&A of Domestic Enterprises*, p. 3. The so-called "95 Ban " grew out of the well-known "Beilv Event". Bejing Light Bus Co Ltd. is a listed company in Shanghai stock market. In July 1995, Isuzu Co and Itocho Corp., two Japanese companies acquired 40.42 million legal person shares (25% of the total shares) and promised not to sell it within 8 years but sold it soon after and made the state-owned property suffer a great loss. So in September 1995, the State Council issued a regulation to forbid listed companies to transfer state-owned shares and legal person shares to the foreign investor.

3.3 Category : FIEs as target enterprises

In the field of FIEs, there are two basic provisions for international M&As. One is *Several Provisions Concerning the Changes of Equity Interest of Investors in FIEs*[35] issued on 28 May, 1997, and the other is *Provisions on the Merge and Division of FIEs*[36] co-issued on 22 November, 2001 by the former MOFTEC and SICB.

3.3.1 ***Several Provisions Concerning the Changes of Equity Interest of Investors in FIEs*** (hereinafter FIE Equity Change Provisions)

Prior to Several Provisions Concerning the Changes of Equity Interest of Investors in FIEs (1997), the foreign partners of FIEs are not able to assign their registered capital to a third party or dissolve the JV without the unanimous consent of the Chinese parties. Therefore this provision was much welcomed by foreign investors in China. Under the provision, "changes in equity interests of investors in FIEs" refer to two types of situations (Art. 2, FIE Equity Change Provisions): (1) changes that occur in the investors of an FIE; and (2) changes that occur in the shares of capital contributions of the investors in an FIE.

The FIE Equity Change Provisions also stimulate that any changes in equity interest of the investors of an FIE require the approval of the original examination and approval authority. The documents that must be submitted to the approving authority are as follows:

(1) the application for change in the equity interest;

(2) the original JV contract and articles of association;

(3) the approval certificate and business license;

(4) the resolution of the board of directors approving the change;

(5) the list of members on the new board of directors; and

(6) the equity interest assignment agreement.[37]

If the equity interest involving state-owned assets is changed, an asset appraisal report by an authorized agency and a confirmation of the valuation by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) or its local

35 Available online at: http://policy.mofcom.gov.cn/lawinenglish.htm.
36 Ibid.
37 Art. 9, FIE Equity Change Provisions.

counterparts are required.[38] According to the FIE Equity Change Provisions, foreign investors considering the purchase of equity interest in an FIE or looking to buy all or part of the equity interests of the Chinese partner have to pay attention to a few things. Firstly, article 4 provides that the acquisition shall not violate the *Catalogues for the Guidance of Foreign Investment Industries*; thus, a foreign investor may not buy the entire equity interest of an FIE where the Catalogue provides that a Wholly-Foreign-Owned Enterprise is not allowed in that sector. (However, where the FIE falls within an industry where a Wholly-Foreign-Owned Enterprise is restricted, a foreign investor may purchase the entire equity interest subject to MOFTEC approval.)(Art.7, FIE Equity Change Provisions). Secondly where the state is required to hold a controlling interest or dominant position, a foreign investor may not purchase such interest in an FIE as it will give the foreign investor controlling position (Art.4, FIE Equity Change Provisions). Thirdly, Article 5 provides that the foreign partner must retain at least 25% of the interest (the minimum requirement for a JV) unless it sells out all its interest and convert the FIE into a wholly domestic-owned enterprise, the FIE Equity Change Provisions sanction such a conversion.

3.3.2 *Provisions on Mergers and Divisions of FIEs*

The *Provisions on Mergers and Divisions of FIEs*, adopted in 1999 to guide the mergers and division between the FIEs, was revised in 2001 and now applies to the following types of transactions:

(1) A merger or division of a JV with legal person status, wholly foreign-owned Enterprise and a joint stock company with foreign investment; and

(2) A merger between FIEs and certain China's domestic companies.

The term "merger" means either "merger by absorption" or "merger by new establishment." The term "division" means either "division by continuation" or "division by termination." The merger and division of companies shall conform to the relevant laws and to the principles of voluntarism, equality and fair competition and shall not harm the public interest or the lawful rights and interests of the creditors.

38 Art. 8, FIE Equity Change Provisions.

A merger and division of an FIE shall comply with the *Catalogues for the Guidance of Foreign Investment Industries*. A merger with a Chinese domestic enterprise in a restricted industry will not be allowed if foreign investment is prohibited in that industry. Examples of such industries are the broadcasting and power grid industries. The foreign partner shall hold at least 25% equity interest in the resultant merged company, thus the merged or divided FIE may continue to enjoy the preferential treatment as FIEs. The approval of the original examination and approval authority is needed in a merger by absorption of an FIE. In a merger by new establishment, the approval from the authority at the location of the new company must be obtained. If the merger or division involves a listed company, the approval of the CSRC is required. Approvals from the relevant authorities are needed when the merger or division leads to a change in industry or business scope of the resultant entity.

3.4 Category : domestic enterprises as target enterprises

The Interim Provisions on M&As of Domestic Enterprises by Foreign Investors (hereinafter "the M&A Provisions"), which was co-issued by MOFTEC, SAT, SAIC, and SAFE, on March 7, 2003, effective as of 12 April, 2003, provide for the basic issues concerning the international M&As and are applicable to all the forms of domestic enterprises in the territory of China. In other words, it applies to the direct acquisition by foreign investors of SOEs, companies with state shareholdings, collective and private enterprises as well as the acquisition of China's listed and unlisted companies.

3.4.1 Two types of international M&As

Althought *the M&A Provisions* doesn't give a specific definition for international M&As, it specifies two basic types of international M&As: equity M&As and asset M&As.

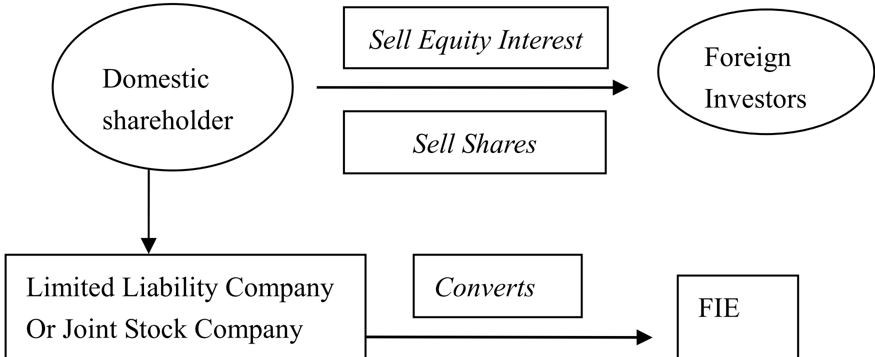
3.4.1.1 Equity M&As

Equity M&As mean that "foreign investors, by agreement, purchase equity interest from shareholders of a domestic enterprise with no foreign investment or subscribe to the increase in the registered capital of the Domestic Company with the result that such

Domestic Company changes into a foreign investment enterprise."[39] The Equity M&A requires that the target enterprise should have an equity structure[40] and no foreign investment. This type of M&A comes in two forms:

1) *Equity Acquisition*. Foreign investors purchase equity interest from shareholders of a domestic enterprise with no foreign investment and convert it into an FIE. Because there are two forms of Chinese company, "Limited Liability Company" and "Joint Stock Company" (also called "Company Limited by Shares"), the requirements of M&As are different:

Diagram 1. The Equity-Acquisition M&A



(a) If the target enterprise is a "limited liability company," it may, under PRC Company Law, have between two to fifty shareholders. Theoretically the transaction requires a simple majority vote from the other shareholders when some of the shareholders decide to sell their shares to a foreign investor (Those who oppose the assignment will have to purchase the equity interest to be assigned; otherwise, the assignment shall be deemed to have been agreed to.)[41] But in practice, the assignment has to get the unanimous consent of all the shareholders in the target company, because the result of international M&As is the establishment of an FIE, which, according to current Chinese FIE laws and executive regulations, requires the signing of a joint venture contract and articles of association by all the parties to the JV. If the other shareholders of company the target company neither agree to assign equity interest to foreign investors nor agree to purchase that equity interest,

39 See item 1.in art.2 of the M&A Provisions.

40 That is to say established or transformed into company according to PRC Company Law, all the target enterprises without equity structure should transform before Equity M&A or acquired by Asset M&A.

41 See Art. 35, PRC Company Law.

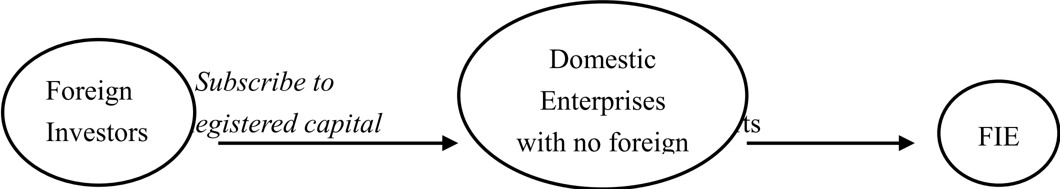
the foreign investors may not sign the JV contract and articles of association and could not establish an FIE. While according to the basic legal principle, the special rule is superior to the common rule. Therefore, foreign investment activities shall comply with the Chinese FIE laws, not only the PRC Company Law which is binding to the domestic companies. So when foreign investors purchase the equity interest, they should not only sign an agreement with shareholders who assign the equity interest, but also get the consent of all other shareholders of the target company.

(b) If the target is a domestic joint stock company, under the PRC Company Law, the minimum number of sponsors is five, and the shareholders must have held the shares for at least three years before they can transfer them. The foreign investors must buy at least 25% of all the issued shares, in order for the resultant entity to qualify as an FIC (Foreign Investment Company limited by shares) and be entitled to all the preferential treatments that an FIE enjoys. However according to the article 5 of M&A Provisions, the foreign investment proportion could be lower than 25% if permitted by the authority, but the resultant entity could not be entitled the FIC status and could not enjoy the preferential treatments that an FIE enjoys.

2) Capital Increase. A foreign investor may also convert a domestic company into an FIE by subscribing to the increase in registered capital of the target enterprises. This subscription is a transaction between the foreign investor and the domestic company. Under the PRC Company Law, the foreign investor should first negotiate with the domestic company and reach an agreement to increase registered capital, and then the general shareholder meeting and the board of director issue the relevant decisions. Generally, as long as the foreign investor can obtain the agreement of the big shareholder/s that control the general shareholder meeting and board of director, it would succeed in the M&As transaction. But actually, the foreign investor has to negotiate with all the shareholders of the domestic company and has to get consent of all of them. The reason lies in that the other shareholders of the target company have the priority in subscribing the increase registered capital under PRC Company Law, unless the other shareholders withdraw their priorities, the M&As transaction that the foreign investor's subscription to the increase registered capital might fail in vain. What's more, the result for M&As of a domestic company is also

establish an FIE, the foreign investor has to obtain the consent of all the shareholders to sign a joint venture contract according to the same requirement of establishing an FIE.

Diagram 2. M&As through Capital Increase

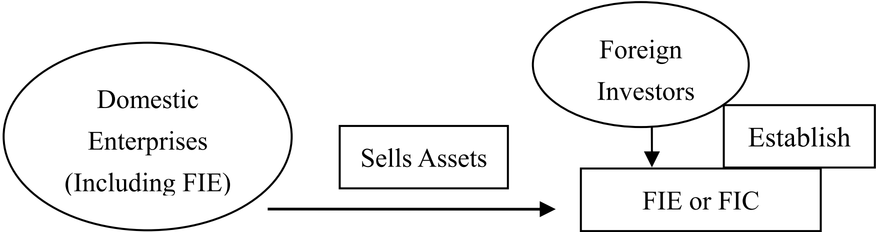


3.4.1.2 Asset M&As

Asset M&As refer to a process in which "foreign investors establish a foreign investment enterprise and then, through such enterprise, purchase the assets of a domestic enterprise by agreement and operate such assets, or the foreign investors purchase the assets of a domestic enterprise by agreement and use such assets as investment to establish a foreign investment enterprise to operate such assets."[42] In this type, the target enterprises do not have to be domestic enterprises without any foreign investment at all and may include FIEs. Asset M&A also includes two basic forms:

1) Asset Purchase by FIEs. When foreign investors establish an FIE or FIC and use it as a vehicle for purchasing the assets of a domestic enterprise, the FIE or FIC may choose not to assume the debts of the domestic enterprises. When the target is an SOE, the relevant provisions of the "SOE Asset Reorganization" and the "SOE Restructure" and the "M&A Provisions" will apply.

Diagram 3. Asset Purchase by FIEs

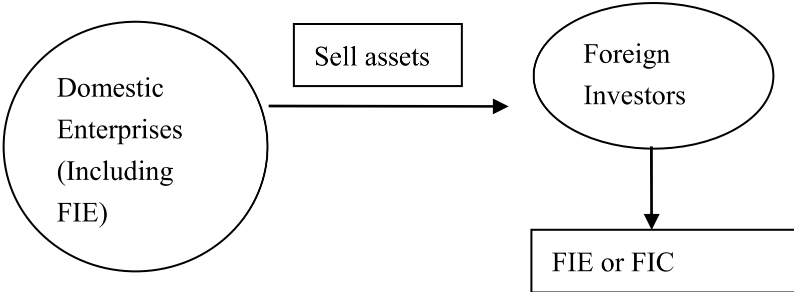


2) *Asset Purchase by Foreign Investors.* In this model, foreign investors purchase

42 See art.2.item2 of the M&A Provisions.

the assets of a domestic enterprise by agreement and use such assets as capital contribution to establish an FIE to operate such assets. If the domestic enterprise is an SOE and state assets are involved in the sale, an evaluation from the SASAC is required, and the SOEs Restructure Provisions and the M&A Provisions will also apply. If the domestic enterprise is an FIE, the transaction is governed by the Several Provisions Concerning Changes in Equity Interest of Investors in FIEs as well as the M&A Provisions. In this case, the approval of the Chinese government must be secured. In addition, the consent of the other partners of the JV and the FIE board of directors are also required.

Diagram 4. Asset Purchase by *Foreign Investors*



3.4.2 Requirements for international M&As

According to the M&A Provisions, the international M&As of domestic enterprises shall have to meet the following three requirements. First, international M&As will have to comply with all the applicable laws and regulations of the PRC. Second, they should not damage competition through "excessive concentration" and harm public interest.[43] Third, it has to strictly comply with the "Catalogues for the Guidance of Foreign Investment Industries," which stipulates the industrial sectors where foreign investors are either encourage or prohibited.

And normally for the foreign investors who engaging in the transaction of international M&As shall satisfy the requirements stimulated in the relevant provisions. For example, the SOEs Restructure Provision stimulates the standards for the foreign investors in the restructuring of SOEs (SOEs Restructure Provision) [44]: (1) with the operating ability and technical level that meets the requirements of the restructure; (2) with good credit in

43 See art.3.item 1 the M&A Provisions.
44 See Article 5 in the Interim Provisions on Restructuring SOEs by Using Foreign Investment of 2002.

business and proficiency in management; (3) with a sound financial and economic foundation. All these requirements for SOEs restructure the may be set for the special purpose of the country's economic strategy and international situation; so the state-owned properties may be required to sell to the qualified foreign investors only. And the restructure party is also requires to undertake the responsibility to examine the qualified foreign investors. Actually, the restructure party is required to select the qualified foreign competitors to participate in the SOE restructure according to the above mentioned standards.

But generally, the requirements for the qualified foreign investors participating in the international M&As are too principle to be carried out, we should improve the provisions in setting standards with specific quantity or quality indications, increasing applicability in practice.

§3. PROBLEMS AND SOLUTIONS OF INTERNATIONAL M&As IN CHINA

It is a big step forward for China to set up, in recent years, an M&As regulatory system. Yet, although these laws and regulations do have some provisions for fair competition, they mainly aim at regulating FDI.[45]

1. Problems in the Applicability of China's M&As Regulations

The most serious problem with the applicability of M&As regulations in China is that it is unclear how the M&A Provisions, which is intended as the general regulation on M&As, will interface with the rules and regulations discussed in section 3 on government regulations in Chapter 2. The problem is that the M&A Provisions only apply to M&As by foreign investors and do not provide for M&As transactions among domestic enterprises or their acquisitions by foreign investors. Also the M&As Provisions is silent on under what circumstances prior rules and regulations that govern M&As transactions of all types, FDI related or otherwise, shall apply.

Take the Provisions on Mergers & Divisions of the FIEs for instance. Issued in 1999, the Provisions which were initially adopted for the mergers and division between the FIEs was revised in 2001 to facilitate international M&As of Chinese enterprises, allowing the mergers between FIEs and domestic invested enterprises. The result is that the revised Provisions on Mergers & Divisions of FIEs has been warmly welcomed by foreign investors and effectively applied in the practice. That is why when the M&A Provisions was adopted in 2003, it only regulates "acquisitions" but not "mergers." If an FIE merges a domestic enterprise, what regulation should apply to then? What the M&As Provisions intends is that the Provisions on Mergers & Divisions of FIEs will apply, but unfortunately, as the general rule of the international M&As, the M&A Provisions does not expressly so stipulate.

In order to solve this problem, it will be necessary for the M&A Provisions to address

45 In fact, the competition provisions in the M&A laws are only a part of the laws; the major part deal with non-competition aspects of mergers and acquisitions such as procedures for notifying creditors, measures to avoid division of state owned assets (in SOEs),provisions regarding means of payment, setting maximum investment levels for equity mergers or acquisitions, etc.

the interface problem. A practical approach is that the issuing departments can make supplementary provisions that expressly stipulate that the Provisions on the Mergers & Divisions of FIEs apply to foreign investors using their FIEs to merge domestic enterprises; Matters not covered therein shall be governed by *the M&A Provisions*.

2. National Treatment

"National Treatment," which is an important part of the WTO regime, means that foreign investors are entitled to the same rights as the domestic investors in the host country; although there is no 100% "same" treatment with the national since every country has its own restrictions on foreigners. After China joined the WTO, all the foreign investors are also entitled to this treatment in China.

But the fact is that from the 1980s up to its accession to the WTO in 2001, China had provided two kinds of treatments to foreign investors which Chinese scholar have described as "super national treatment" and "inferior national treatment."[46]

The *super national treatment* was provided primarily to attract foreign investment. China has provided super national (preferential) treatments to FIEs in many fields, such as taxation, the use of land, payment for registered capital, approval procedures, and so on. For example, FIEs enjoy a preferential treatment in income tax[47] and the payment of the registered capital.[48] Although these treatments have played an important role in attracting foreign investment, they have created unfair competition between FIEs and China's domestic enterprises.

The *inferior national treatment* was to protect the national industry and public interest. Like almost all the countries, where there are restrictions on foreign investors' access to

46 For a discussion of the terms, see, for example,GAO Ershen, *International Economic Law* (Beijing: Law Press) 1998, pp. 18-32.

47 See Income Tax Law of FIE, revised in 2000. For example, "two exemption and three half", that means from the year that the FIEs begin to get profit, the first two years, exempt the income tax; and the following three years, pay half of the tax they should pay." According to statistics, the nominal enterprise income tax rate for both domestic and foreign investors is 33%, but actually, 1n 2004, the average tax rate for domestic enterprises is about 25%, and for FIEs is about 12-13%, only half of that of domestic enterprises. See combine income tax of domestic enterprises and FIEs. *Beijing Youth Daily*, 02/02/2005.

48 See art. 25 of the Company Law of the PRC which stipulates that "shareholder should pay all the registered capital which is agreed in the company statute"; but the JV law stipulates that the capital contribution shall be paid by instalments; the investors' first instalment shall not be less than 15% of their respective capital subscription. That is to say if foreign investors want to get the control right of the JV by occupying 51% shares of the JV, he only need to pay 7.58% of the total registered capital, so foreign investors enjoy the flexible advantage in financing.

some of the home industries, China has also restricted or prohibited foreign investments from entering certain industries.[49]For instance, the M&A Provisions makes it clear that in M&As of domestic enterprises, foreign investors shall comply with the Catalogues for the Guidance of Foreign Investment Industries, which sets restrictions on foreign investor's access to certain industries. Article 4 also stipulates that "in the case of industries where operation by foreign investors is prohibited, no foreign investors may merge with or acquire any enterprise engaging in such industries."[50]

Providing *national treatment* to foreign investors in China means reducing or removing those preferential treatments (super national treatment) and as well widening industrial access for foreign investors. Since 2004 the Chinese government has begun to discuss the unification of the two income tax systems so that all the enterprises will enjoy the same income tax rate;[51] and China intends to establish one unified company law system in the near future. At the same time, the Catalogues for Guidance of Foreign Investment Industries, which was revised in 2004, has widened the range of access for foreign investors, expanding the industrial sectors where foreign investment is encouraged, reducing the sectors where foreign investment is prohibited.

3. Asset Evaluation Problem

In China, the state-owned shares and legal person shares in the listed company, which are not allowed to trade on the stock market, make up 2/3 of the total assets of the listed

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49 See www.mofcom.org.cn/policy. Catalogue for the Guidance of Foreign Investment Industries was newly revised in 2004, and come into effect on January, 2005. In which all the industries are divided into four catalogues: encouraged, restricted, prohibited catalogue and those excluded in the above three catalogues belong to permitted catalogue.

50 Art. 4 item.2, the M&A Provisions. "In the case of industries where no wholly foreign ownership is allowed under the Guidance Catalog of Foreign Investment Industries, any merger or acquisition of a domestic enterprise engaging in the industry shall not lead to the foreign investors' wholly ownership of all equity interest in the acquired enterprise. In the case of industries which require the Chinese party to be controlling or relatively controlling, the Chinese party shall remain to be in the controlling or relatively controlling position in the acquired enterprise after any merger or acquisition of the domestic enterprise engaging in such industries. In the case of industries where operation by foreign investors is prohibited, no foreign investors may merge with or acquire any enterprise engaging in such industries."

51 See "Experts on Income Tax Reform," www.sina.com.cn/news/finance 22/01/2005. The proposed enterprises income tax rate for enterprises will be 25%, but considering the opposition of the 54 famous multinational companies which wrote their complaints to the State Council; and newly promulgated American local investment law for attracting its oversees companies to invest back into America, in which the income tax rate will drop from 35% to 5.25%;and also Chinese policy of utilizing foreign investment, the outcome of tax reform draft will be postponed.

companies.[52]Also, foreign investors are not allowed to purchase publicly negotiable shares on the Chinese stock market. Therefore, the best way for foreign investors to secure the M&A of a listed company is to acquire non-tradable shares by agreement.

How to determine the transfer price of those non-tradable state-owned shares is a difficult issue. There are three main methods in determining the price of M&As in the world: (1) the net assets method; (2) the market value method; (3) the cash float discount method.[53] While the market value is often taken as the basis for determining the price in the international market, in China the net assets method is most commonly adopted in assets evaluation because of the special structure of the stock market. When a Chinese enterprise is selected to be an M&As target by foreign investors, there may be disputes over how to ascertain its net assets. The Chinese party would like to choose a Chinese evaluation institute while the foreign investors prefer to choose one of the four biggest international accounting firms[54] to re-evaluate it. In practice, the difference is that the results are not the same; the value as determined by an international firm is usually lower than the evaluation by the Chinese evaluation organization. This often leads to disputes over pricing as the Chinese government cannot allow state-owned assets to be undervalued while foreign investors could not accept a price higher than that of the international market.

Although the M&As Provisions stipulates that the transaction price should not be lower than the net value of the assets, and that an asset evaluation must be conducted, Art. 8 of the M&A Provisions is not specific enough to satisfy the M&As parties because it only provides that the parties of the M&As may chose an asset evaluation institution established within the territory of China which shall conduct asset evaluation by adopting internationally recognized evaluation methods.[55]

Since China would like to use foreign investment to restructure its SOEs, it should set up an evaluating system for state-owned assets, strengthen the evaluation institutions, and establish a set of evaluation standards suitable for the market economy, and adopt

52 In China, negotiable shares can be negotiated in the stock market; the non-negotiable shares can only be acquired by agreement outside of the stock market. The price of negotiable shares is much higher than that of non-negotiable shares, sometimes more than 10 times.

53 See TANG Zongkun and HANG Chaohua, "Analysis of Property Transaction of SOE," in *Magazine of Reform,* Vol. 2 1997, p. 47.

54 Refers to Pricewater House Coopers, Deloitte & Touche, Ernst &Young, and KPMG.

55 See Art.8 of the M&A Provisions.

internationally recognized evaluation methods. And China should also leave all the property transactions to an open and fair property market that is regulated by the laws and provisions so as to prevent the loss of state-owned assets through illegal or unfair transactions.

4. Anti-Monopoly and Competition Problem

With the emergence of market transactions of M&As, the Chinese government has recognized the need to establish a modern merger control and anti-trust system. China has yet to enact a comprehensive anti-monopoly law to regulate M&As. Most of the existing M&As regulations in China, as discussed above, are based on the government desire to attract and regulate FDI. Of these laws, three contain competition provisions.

4.1 Provisions on Mergers and Divisions of the FIEs

The Provisions on Mergers and Divisions of the FIEs, which was promulgated in November 1999 and revised in November 2001, provides that mergers and divisions of FIEs "must follow the principles of voluntary and equal transaction and fair competition, and shall not jeopardize public interest and the lawful interests of the creditors."[56]

Every merger between FIEs must obtain the approval from MOFTEC (which in 2003 became the Ministry of Commerce, i.e. MOC) or the original approval authority of the FIEs. After receiving an application for merger, the approval authority shall issue a preliminary written opinion within 45 days either permitting or rejecting the proposed merger. If the proposed merger might cause monopolization of the industry or that the merged company might control the market for a particular good or service and thus obstruct fair competition, MOFTEC may convene a hearing of relevant authorities and organizations to hear evidence from the companies to be merged, and to investigate the companies and the market concerned. In this case, the time limit for approval may be extended from 45 days to 180 days (Article 26). However, the *Provisions on Mergers and Divisions of FIEs* does not spell out the basis on which MOFTEC could decide on the proposed mergers.

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56 See Art.5 Provisions on Mergers and Divisions of FIEs.

4.2 Interim Provisions on Restructuring State Owned Enterprises by Utilizing Foreign Investment (2002)

Promote fair competition and prohibit monopolization is one of the basic purposes of the Interim Provisions on Restructuring State Owned Enterprises by Utilizing Foreign Investment (Article 6). In addition, Article 9 provides that in the case of restructurings that result in monopolies or hinder fair competition, hearings shall be conducted before the examination and approval by the State Economic and Trade Commission. However the Interim Provisions just remain in principle without any specific provisions on the anti-monopoly issue.

4.3 Interim Provisions on the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (2003)

The M&A Provisions is the most comprehensive regulations on M&As control in China to date. It is stipulates that, as a general rule, M&As "shall not create excessive concentration, eliminate or hinder competition, disturb social and economic order or harm public interests."[57] The rules specify two distinctive sets of thresholds that may trigger anti-monopoly filing requirements and scrutiny, depending on whether the transaction is onshore or offshore.

4.3.1 Onshore M&As Transactions

A merger or acquisition may be subject to review and approval by MOFTEC and SAIC under the following three situations. First, if any of the following thresholds is met (Article 19): (1) A party to the M&A in Chinese market obtain a revenue for the current year exceeds RMB 1.5 billion; (2) within one year, the foreign investors have aggregately merged with or acquired more than 10 domestic enterprises in the related businesses; (3) A party to the merger or acquisition in the domestic market has reached 20% of the market share; or (4) A result of the deal of M&A is that the market share of a party to the merger or

57 See Art.3 The M&A Provisions.

acquisition in the domestic market will reach 25%.[58]Second, even without any of the above occurrences, a merger or acquisition may still be subject to review if a competing domestic enterprise, relevant government agency or industrial association so request. Third, if MOFTEC and SAIC find that such transaction involves substantial market shares, or has severely affected market competition, national well being, or national economic security. If MOFTEC and SAIC believe that a merger or acquisition "might lead to over-concentration, impair fair competition, or damage consumer interests", they shall hold a hearing within 90 days upon receiving the notification and decide whether to approve the application.(Art.20, the M&A Provisions)

4.3.2 Offshore M&As Transactions

The M&A Provisions extend the reporting requirements to offshore M&As as well. If an offshore M&A meets any of the conditions,[59] a notification must be submitted to MOFTEC and SAIC prior to its public announcement of the plan for the M&A or at the same time an application has been submitted to the regulatory authorities of the country where it is located.[60] In deciding whether to approve the plan, MOFTEC and SAIC shall examine whether the merger or acquisition might cause over-concentration or impair fair competition in the domestic market, or damage the domestic consumers' interests. The rules do not appear to contemplate a hearing for offshore mergers.

4.3.3 Exemptions

Certain types of transactions are exempted from the reporting requirements after meeting the specified thresholds. These pragmatically set exemptions cover transactions that may enhance competition, restructure enterprises running at loss and ensure

58 See Art.19 The M&A Provisions.

59 See art.21. item.1 the M&A Provisions. The conditions are as following:(1) the assets owned by a party to the offshore merger and acquisition within China exceeds RMB 3 billion; (2) the sales of a party to the offshore merger or acquisition in the domestic market for the current year have exceeded RMB 1.5 billion; (3) the aggregate market share in the domestic market by a party to the offshore merger or acquisition and its affiliated enterprises has reached 20%; (4) the aggregate market share in the domestic market by a party to the offshore merger or acquisition and all of its affiliated enterprises in the domestic market will reach 25% as a result of the offshore merger or acquisition; or (5) as a result of the offshore merger or acquisition, a party to the offshore merger or acquisition will hold, directly or indirectly, equity of more than 15 foreign investment enterprises engaging in the related businesses within China.

60 See Art.21 item 2 The M&A Provisions.

employment, introduce advanced technologies and management expertise and enhance the international competitiveness of the domestic enterprise or improve environmental conditions.[61]

4.4 New Draft of Anti-Monopoly Law

China does not yet have an anti-monopoly law. Its existing competition laws, i.e., the 1993 Anti-Unfair Competition Law and the 1998 Price Law, do not cover M&As. China has been working on an anti-monopoly law since early 1990s. Chapter 4 of the most recent draft (dated 26 February 2002) of the anti-monopoly law stipulates that:

- When entering into a combination (consolidation) agreement, businesses shall apply to the anti-monopoly authority under the State Council for approval if their annual sales volume exceeds the threshold level set by the Competition Authority (Article 26).
- The anti-monopoly authority shall make its decisions within 90 working days after receiving the application (Article 28).
- It shall not grant its approval if the combination would (Article 29): (1) create or strengthen the market domination status of an operator; (2) remove or restrict competition; (3) obstruct the healthy development of the national economy; or (4) jeopardize public interests.

The anti-monopoly authority may impose conditions when granting approval of an application. The draft anti-monopoly law also spells out penalties for non-compliance: "the anti-monopoly authority may prohibit such combination (consolidation), order the restoration of the original status within a prescribed time period, or impose a fine between RMB100, 000 and RMB10, 000,000." (Article 46)

Although revised many times during the past decade, the draft anti-monopoly law has yet to become a law. There has been some resistance to enacting a general anti-monopoly law in China. One view is that China is still at the early stage of economic development and enterprises are in general of small size and thus there is no need to establish an anti-monopoly law. Also, some are concerned that an anti-monopoly law might negatively

61 See art.22 The M&A Provisions.

affect the SOEs in terms of price setting and restructuring, and so on.

4.5 Analysis of anti-monopoly and competition laws concerning M&As

As mentioned above, it is a great progress for China to have set up these M&As regulations which contain competition provisions. However, these laws mainly aim at regulating FDI and the protection of domestic industries and enterprises, which remains a top priority of the government. For instance, the M&A provisions make it clear that in M&As of domestic enterprises, foreign investors shall comply with requirements under China's industrial policies as stipulated in the Catalogues for the Guidance of Foreign Investment Industries.[62] The competition provisions (i.e., Article 19 and 20 in particular) in the M&A provisions are just an additional set of constraints to M&As, within the industrial policy framework. It is fair to say that these competition provisions are subordinate to the industrial policies in China.

Though the M&A Provisions has regulated some issues in international M&As, such as the reporting and hearing system, offshore M&As and exemption system, etc., regulating the international M&As is a new issue in China; there are still certain problems and unresolved issues hindering the effectiveness of the existing legal framework of M&As and anti-monopoly and competition.

On the technical side, the M&A provisions does not provide enough details as to how MOFTEC and SAIC would go about examining a merger application. And they fall short in providing a definition of relevant market, and leave many other questions unanswered. How are market shares to be calculated? What are other main factors (e.g., economies of scale) that the government would consider in examining a merger case? How will a hearing be conducted? And so on. Furthermore, The M&A Provisions also fails to include a list of items to be reported or documents to be produced, and does not spell out whether the government would consider imposing conditions on a proposed merger or acquisition, nor does it specify penalties for noncompliance with the reporting or approval requirements.

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62 Art. 4 of the M&A Provisions.

While countries with mature anti-trust laws and regulations, such as the US and the EU,[63] have precious experience in controlling anti-monopoly practices arising from large-scale M&As, the newly launched counterpart the M&A provisions in China are still lagging behind. Drawing on the successful experiences elsewhere, China can introduce many vital measures and provisions into its anti-monopoly legal system, among which some have already appeared in the latest draft of the Chinese anti-monopoly law. (Penalties for non-compliance, art. 46)

To solve the problems in china's anti-monopoly legal system, I think, China should limit the role of administrative agencies and strengthen that of the courts. In view of the problems like how to define the relevant market or how to determine the exemption from anti-monopoly review, most of these criteria are relatively vague and thus are in fact subject to the sole discretion of MOC and SAIC. These administrative agencies have egregious discretion over the determining of many vital facts while the courts have very limited authority over competition practices and anti-monopoly matters. So it is necessary to make specific criteria in the laws or regulations for the administrative authority to follow, in order to reduce its discretion and to gain the transparency and fairness of the law. How to strengthen the power of courts? Private litigation is the key to solve the problem, but now the administrative authorities remain the gate-keepers for complaints by private parties about anti-competitive behaviors. The existing competition provisions or the future anti-monopoly law should be open to the private anti-monopoly actions and make the court take the place of the government to be the protagonists of the campaign.[64]

It appears that once an anti-monopoly law is enacted, China will set up an anti-monopoly authority directly under the State Council. The Chinese government has recognized that this anti-monopoly authority must be powerful enough; for one thing it must be capable of combating administrative monopolies on the part of government ministries. It remains to be seen exactly how this anti-monopoly authority is to be set up and what procedures it will use for M&As scrutiny and how to share the powers with the courts in

63 Anti-trust Law may has different names in different countries, in American, it is called anti-trust law, in EU, competition law, in China, anti-monopoly law.

64 See LI Shoushuang, "International M&As and Government Regulation" availble at www.chinalawinfo.com 05/06/04.

regulating anti-monopoly activities.

5. Legislation Problems

5.1 Lack of systematic

Legislation on the international M&As is a systemic project, but in China, it has not been systemically approached. The existing regulations and provisions are made according to the pragmatic principle “make one when one is needed,” without any plan and foresight. Since 2001, quite a number of regulations and provisions on M&As have been promulgated, but most of the legislators are administrators in different government administrations who pay much attention to the administrative and supervision rights of their own departments. So many of the regulations and provisions in the international M&As are lacking in coordination, overlap or conflict with each other, and it is not easy for the parties of the M&As or even other relevant departments to understand and carry out these regulations.

5.2 Lack of authority

Until now, all Chinese regulations on international M&As belong to departmental regulations and most of them are named as “circulation” and “interim provisions,” which are lacking in authority and continuity and the inferior status of these regulations will make them difficult to enforce. Although the M&A Provisions was designed to serve as the general rule of international M&As of domestic enterprises, its status is just that of a administrative regulation, which adds to its difficulty in guiding all other relevant regulations. What’s more, the M&A Provisions has been titled as “interim”, which will harm its authority and cause hesitation and doubts on the part of foreign investors because of the risks its “provisional nature” may entail.

So the M&A Provisions can only serve as a transitional regulation in a short term; in order to greatly improve the foreign investment environment, China should make a unified foreign investment law, which should, with respect to international M&As, specify the definition, the parties and the forms of the M&As; the treatment to which foreign investors are entitled, an examination and reporting system, rights and responsibilities of the parties,

and the catalogues of guidance of industries. What's more, it should specify which law /regulations should apply in the case of large-scale M&As if and when an anti-monopoly law is passed.

§4. CONCLUSION

Although China has established a relatively complete legal framework on international M&As, it still has yet to have a general law governing international M&As. The existing M&As regulations, which were enacted during the past few years aiming at regulating FDI, are still in a very preliminary level and even the governing bodies are not very clear of their powers and responsibilities. Therefore much is left unresolved for the parties and authorities concerned.

Although China has also made some progress in modifying its competition rules, which is a great improvement on its M&As legal system, its anti-monopoly regime with respect to M&As is still at an embryonic stage and while its draft anti-monopoly law is still waiting to become a law in the future. Moreover, as competition provisions in M&As regulations are designed to safeguard competition within the specified industrial policy framework, M&As that will enhance competition but do not meet the industrial policy requirements are not allowed.

As the M&A Provisions, designed as the general regulation for international M&As for the time being, just regulates M&As by foreign investors, not including activities of M&As between domestic investors, and as the M&As control provisions as contained in the new draft anti-monopoly law does not cover foreign investors, some foreign companies are concerned that the proposed anti-monopoly authorities might treat foreign and national investors differently.[65] Whether the draft anti-monopoly law will be implemented in a non-discriminatory manner is a challenge for the Chinese government.

In view of the problems existing in the international M&As, China should promulgate a general law on M&As that should be applicable to all the activities of M&As in China and should regulate all the problems concerning international M&As specifically; and the draft anti-monopoly law should be revised so that it becomes applicable to mergers on the part of foreign investors.

Nevertheless, the establishment of the M&As regulatory system represents a big step

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[65] *China Daily*, 13 January 2004.

forward that China has taken in developing a modern M&As control system. Valuable lessons will be accumulated as existing regulations are implemented. One hopes that the general M&As law and China's antimonopoly law, as well as their implementations, will be more in line with international standard and practices. In any event, it must be noted that since it was only in 1992 that China decided to transform its planned economy into a market economy, many concepts, procedures and practices that other countries are so used to in M&As and anti-monopoly are completely new to China. It takes time for China to establish a modern M&As and anti-monopoly legal system that can effectively deal with M&As related issues and meets international standards at the same time.

ABBREVIATIONS

art.	Article
CBRC	China Banking Regulatory Commission
CSRC	China Securities Regulatory Commission
FDI	Foreign Direct Investment
FIE	Foreign invested Enterprises
FIC	Foreign Investment Company limited by shares
JV	Joint Venture
M&As	Mergers and Acquisitions
MOC	Ministry of Commerce
MOF	Ministry of Finance
MOTEC	the Ministry of Foreign Trade and Economic cooperation
NPC	National People's Congress
OECD	Organization of Economic and Co-operation Development
p.	Page
pp.	Pages
PBC	The People's Bank of China
PRC	People's Republic of China
RMB	Ren Min Bi (Chinese currency)
SAFE	the State Administration of Foreign Exchange
SAIC	the State Administration for Industry and Commerce
SAT	the State Administration of Taxation,
SASAC	State-owned Assets Supervision and Administration Commission of the State Council
SETC	State Economic and Trade Commission
SOC	State-owned Companies
SOE	State-owned Enterprises
UNCTAD	the United Nations Conference on Trade and Development
Vol.	Volume

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