China

Guide to Mergers and Acquisitions

2010 edition
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INTRODUCTION

Investment Overview

Since its accession to the World Trade Organization (WTO) in 2001, the foreign investment regime of the People’s Republic of China (PRC) has evolved considerably in recent years. The developments regarding mergers and acquisitions (M&A) by foreign investors are particularly prominent. The notable ones are the Ministry of Commerce’s (MOFCOM) delegation of its authority to approve various forms of foreign investment projects to its local counterparts, the introduction of partnership as an investment vehicle for foreign investors and the tightened scrutiny of offshore transaction from the PRC tax, exchange control and merger control perspectives.

While it is probably beyond dispute that China is currently one of the most promising jurisdictions in the world for foreign investment, there remain various legal hurdles and practical difficulties for international investors to tap into the potential of the Chinese market.

Transparency and bureaucracy are continuing concerns, complicated by China’s increasing awareness to guard against foreign control or even participation in key industries or well-known brands.

Special Notes

Please note that this brochure approaches the topics covered herein primarily from a foreign purchaser’s point of view. This brochure does not seek to cover issues in relation to M&A initiated by domestic PRC companies and only touches marginally on issues that are typically to be considered and resolved by sellers.

For the purposes of this brochure, the terms PRC or China do not include Hong Kong, Macau or Taiwan.
SUMMARY OF THE PRC FOREIGN INVESTMENT REGIME

Forms of Establishment

Traditionally, foreign investors usually establish a presence in the PRC via one or more of the following legal forms:

- Representative Office (Rep Office);
- Sino-Foreign Joint Venture (JV);
- Wholly Foreign-Owned Enterprise (WFOE); and
- Foreign-Invested Joint Stock Limited Company (FISC).

The latest option, which has been available since 1 March 2010, is foreign-invested partnership (FIP). It is expected that the more flexible form of FIP may gradually phase out foreign-invested venture capital enterprise (FIVCE), a form of entity used by some international investors to acquire Chinese targets using a PRC vehicle.

Rep Offices are non-legal person extensions of their foreign investors in the PRC. Either a JV or a WFOE would take the form of a limited liability company (LLC) that does not issue shares but has “registered capital” and “total investment” (paid-up capital plus permitted borrowing) figures that are both approved by the PRC Government. FISCs, which are currently rare in China by comparison, are share-issuing companies similar in legal form to Western-style corporations. A FIP may take the form of a limited liability partnership, which is akin to their Western-style counterparts. JVs, WFOEs, FISCs, FIPs and FIVCEs are collectively known as Foreign-Invested Enterprises (FIEs) if the foreign shareholdings in these enterprises are 25 percent or greater.

The following paragraphs briefly summarise each of the common foreign investment vehicles in China.
Representative Offices

Rep Offices are a popular business vehicle in the PRC, both as a first step into the market and as a way of maintaining a presence in the country without committing any more resources than what is absolutely necessary. Given the current impossibility of setting up branches in China (as discussed below), establishing a Rep Office is currently the least capital-intensive means for foreign investment in China.

Rep Offices allow foreign companies to conduct local promotional and marketing activities for their products and to conduct local research. However, they are prohibited from engaging in “direct business operations” in the PRC. Accordingly, Rep Offices are not permitted to sell products in the PRC and Rep Office personnel are not permitted either to sign contracts in the PRC on behalf of the Rep Office’s parent company or to issue sales invoices. Unlike an FIE, a Rep Office is not a separate legal person from its head office and the head office will assume all liabilities resulting from the Rep Office’s operations in China. In this way, investors may conceptualise Rep Offices as branches with significantly restricted scopes of permissible activities.

Sino-Foreign Joint Ventures

A JV is typically a non-share-issuing, limited liability company formed between one or more non-PRC entities (including Hong Kong, Macau and Taiwan entities) with one or more Chinese entities. A JV can be set up in the form of an Equity Joint Venture (EJV) or a Cooperative Joint Venture (CJV), which are structurally similar in most respects. JVs have definite, albeit extendable, terms of operations.

JVs are popular investment vehicles either for foreign investors less familiar with investment in China that would prefer a local partner with connections to help handle local issues or for those investing in certain industries that require the participation of a Chinese partner under the current PRC legal regime.

Most investors seeking to establish JVs in China choose to set up their ventures as EJVs. Investors typically would adopt a CJV structure.
if they specifically desire to adopt a non-legal person structure, need more freedom in configuring their profit distribution ratios or prefer the ability to recover their investments early under certain circumstances (these are the main benefits of a CJV structure not available for typical EJVs).

**Wholly Foreign-Owned Enterprise**

A WFOE is a limited liability company 100 percent owned by one or more foreign entities (in other words, a JV formed between two foreign investors would also be categorised as a WFOE in China), although currently most WFOEs only have one investor. As in the case of a JV, the ownership of a WFOE is also in the form of equity interests and no shares are issued. Like JVs, WFOEs have definite, albeit extendable, terms of operations.

During the past several years, WFOEs have become popular investment vehicles especially favoured by foreign investors that are more familiar with investment in China because they are wholly owned by foreign parties. This usually means that there will be greater flexibility in terms of management and control, and less complexity arising from having to deal with Chinese partners. However, because it is wholly foreign-owned, a WFOE may be subject to more stringent investment restrictions with respect to the types of activities in which it may engage, especially in certain sensitive industries.

**Foreign-Invested Joint Stock Limited Companies**

Unlike JVs or WFOEs, the shareholding of the investors in a FISC is in the form of issued shares, similar to Western-style corporations. As such, a FISC is the only form of FIE that can be directly listed on PRC stock exchanges. Other forms of FIEs would have to be converted into an FISC before they could be listed. Unlike a JV or a WFOE, a FISC can be operated for an unlimited duration.

The formation requirements of an FISC are much more stringent than those of JVs and WFOEs. For example, the sponsors of FISCs are
subject to additional restrictions and qualification requirements and the foreign equity holding in an FISC cannot be lower than 25 percent; a FISC is required to have a minimum registered capital of Renminbi or RMB30 million; and the approval procedures for establishment of FISCs are also generally more burdensome.

**Foreign-Invested Partnership**

A FIP combines the features of JVs and WFOEs, and can be partly or wholly-owned by foreign investors, with the partners having limited and/or unlimited liability towards third parties.

The main attractiveness of using FIP is, while being a separate legal person, it is “transparent” for PRC tax purposes and offers more opportunities for tax planning. Another breakthrough is that FIPs do not require separate application to MOFCOM or its local counterpart, and can be established directly by submitting the requisite documents to the competent AICs.

**Foreign Contractors**

In specific circumstances/industries, foreign firms may also register as foreign contractors to carry out certain projects in the PRC without first establishing any formal presence in China. However, China is apparently changing its policy to gradually phase out these arrangements, e.g., regulations have been enacted to end such arrangements in the construction industry. Foreign construction firms now have to set up construction FIEs in China before they can undertake construction projects.

**No Branches**

Finally, as mentioned above, currently foreign companies may not establish branches in the PRC, as currently there are still no regulations to implement the principles laid down in the PRC Company Law. Generally, subject to a few exceptions (including financial institutions and insurance), foreign investors looking for a form of presence with minimal investment establish Rep Offices, while those
who wish to conduct more substantial business activities establish FIEs such as JVs or WFOEs.

**Business Scopes**

Under PRC law, all entities in China (whether domestic- or foreign-invested) are allowed to engage only in those activities within the “business scopes” approved by the governmental authorities and as stated on their business licences.

**The Foreign Investment Catalogue and Sector-Specific Restrictions**

The PRC authorities have published the Regulations for Guiding the Direction of Foreign Investment (the Foreign Investment Guidelines) and the Catalogue for Guiding Foreign Investment in Industries (the Foreign Investment Catalogue) to serve as general indications of the current policies governing foreign investment in various industries. These documents provide certain policy incentives or disincentives depending on whether a project is deemed “encouraged”, “permitted”, “restricted” or “prohibited”. An enterprise in the “encouraged” businesses category, for example, may be qualified for local (and generally more lenient) approval processes. An enterprise conducting “restricted” activities, on the other hand, may be subject to additional scrutiny by higher approval authorities during the establishment process and may in some cases be required to have its Chinese partner(s) control more than 50 percent of the equity holding in the company. These documents are important guidelines that affect many aspects of merger and acquisition activities outlined in this guide.

It is worth mentioning that foreign investment in various industries in the PRC is still restricted. Some restrictions, however, have been removed pursuant to China’s WTO commitments. With the implementation of WTO commitments, foreign investors have gained greater access to these and other sectors.
Closer Economic Partnership Arrangement

China entered into the Closer Economic Partnership Arrangement (CEPA) with both Hong Kong and Macau in 2003, which are designed to be permissible regional free trade agreements under the WTO rules. Additional CEPA benefits for Hong Kong and Macau companies were introduced by agreements signed between 2004 and 2009. Among other things, these arrangements provide investment and trade access to qualified Hong Kong and Macau enterprises on more favourable terms than some of the concessions stipulated in China’s WTO accession protocol. The latest round of liberalisation measures was introduced with the signing of CEPA VI between Hong Kong and China on 9 May 2009 and effective on the same date.

Although the above arrangements are designed primarily to benefit Hong Kong and Macau companies, they may also indirectly benefit multinational investors with significant subsidiaries already established in Hong Kong or Macau through their application to such subsidiaries. These ongoing arrangements may therefore provide additional options to multinational corporations planning to invest in certain restricted industries in China.

Holding Companies

Finally, a Holding Company (HC) is a special-purpose limited liability company, which allows larger companies with multiple investments in the PRC to better coordinate the operations of their different investments. An HC is typically established as a WFOE, although it can also be established as a JV. HCs can take equity stakes in other WFOEs or JVs and can provide various support services for their investee companies, including centralised purchase of raw materials and equipment; provision of after-sale services; domestic and foreign distribution of investee products; certain financing, foreign exchange and loan matters; transportation and warehousing services; and consultancy services, training, and administrative support functions. An HC that qualifies as a Regional Headquarters of a Multinational will be able to, among other things, engage in logistics and distribution
services; and, upon the approval of MOFCOM, engage in operating leasing and finance leasing businesses.

Though the primary functions of the HC vehicle are to hold equity in and provide support services for investee companies, HCs have gradually been permitted to engage in a somewhat wider range of activities, including sale of imported parent company products (other than by retail sales); export of Chinese products as an agent, distributor or through establishment of an export purchasing organisation; after-sales service for products that it imports; and establishment of R&D centres.
TYPES OF TRANSACTION

Common Types of Acquisition Transactions in the PRC

A foreign investor who wishes to acquire or increase its equity interest in a PRC target company would commonly do so in one of the following ways.

• Direct acquisition, whereby the foreign investor purchases all or part of the equity interest of the PRC target company directly or by subscription to any increased capital of the target.

The direct acquisition transaction is conducted in the PRC and will be subject to full PRC approval requirements, which may be time consuming and involve government discretion, i.e., the PRC authorities may withhold approval if they perceive problems with the transaction.

• Offshore/indirect acquisition, whereby the foreign investor may acquire or increase control of the PRC target company via the offshore purchase of some or all of the shares of the PRC target company’s foreign parent(s).

This option is available only if the PRC target company has foreign investors and applies only to acquisitions of equity interests in such foreign investors. An offshore transaction is conducted in the jurisdiction of incorporation of the offshore company and is generally not subject to PRC jurisdiction and review, except in certain circumstances pursuant to the antitrust review regime in the PRC (please refer to Consents and Approvals, below, for details) and disclosures for PRC tax purposes (please refer to Specific Tax Considerations, below, for details). In addition, if the offshore company’s ultimate shareholder or shareholders are PRC nationals, certain PRC filings should have been made with the foreign exchange authorities in the PRC and should be reviewed during the due diligence process. (Please refer to the section on Exchange Control for details)
• Asset acquisition, whereby a foreign investor, using a new FIE or an existing FIE as the acquiring vehicle, purchases directly some or all of the business and assets of the PRC target company. Such transactions are subject to PRC jurisdiction and relevant PRC approval requirements.

Special Types of Acquisition

State-Owned Interests and Special Types of Acquisition

The passing of the Law of the People’s Republic of China on the State-owned Assets of Enterprises in October 2008 was a reminder of the significance of state-owned enterprises (SOEs) in the Chinese national economy. And it remains the Chinese Government’s objective to spin-off SOEs in less sensitive sectors, particularly those SOEs in poor financial shape. Since early 2003, foreign investors have been allowed to acquire domestic creditors’ rights in the target SOE and thereby qualify for the opportunity to later convert such debts into equity in the companies (similar to a convertible bond concept). The normal means of direct equity/asset acquisition applicable for regular companies outlined above will also apply, subject to certain special rules and restrictions. Furthermore, there could be additional issues involved with such acquisitions, such as state-asset valuations and employee resettlement issues, which are discussed later.

Mergers

Western-style mergers between two companies are possible but are rarely seen in the PRC. Current PRC statutory mechanisms recognise two means of mergers: a “merger by absorption” or a “merger by new establishment”. A merger by absorption involves the absorption by one company of another following which the absorbed company is dissolved and its registered capital and assets merged into the surviving entity. In a merger by new establishment, both pre-merger
companies are dissolved and a new company is established, holding an aggregate of the pre-merger companies’ assets and registered capital. Generally, the post-merger entity would be a complete successor of the pre-merger entities in that it would assume all rights and liabilities of such entities. However, creditors of the companies to be dissolved are given the option of having their claims repaid in full prior to the completion of the merger.

It should be noted that cross-border mergers are currently unavailable under PRC law, i.e., it is not possible to directly merge a foreign entity with a domestic company (including FIEs). As far as foreign investors are concerned, the only permissible forms of mergers in China are between FIEs and FIEs, or between FIEs and domestic companies. In order to effect these mergers, the FIE must be fully capitalised and have commenced operations. The merger should comply with the Foreign Investment Catalogue and, in principle, the post-merger FIE should also comply with all other aspects of the PRC legal regime governing FIEs.

**Debt Restructuring and Equity Contribution**

The concept of debt restructuring is formally recognised as one of the possible means of corporate restructuring. It is defined in a 2009 tax circular that deals with the tax treatments of corporate restructuring as “compromises made by the creditor on the debts” upon the agreement with a debt-ridden company or in “compliance with a court order”. Furthermore, since March 2009, investors are allowed to use their equity interests in other Chinese companies as in-kind capital contribution when setting up new companies.

However, due to restrictions imposed under relevant regulations governing foreign investors’ acquisitions of non-FIE targets, these potential options are only relevant to intra-group restructuring of a foreign investor’s investee companies in China.
Advantages and Disadvantages of Different Types of Acquisitions

The high-level summary below on the advantages and disadvantages of different acquisition focusses mainly on share and asset acquisitions, which are the dominant means of acquisitions by foreign investors.

<table>
<thead>
<tr>
<th>Type of Transactions</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity deals</td>
<td>• The only option available if the PRC target is a purely domestic company with no foreign parent company, i.e., not an FIE</td>
<td>• (When compared to indirect acquisitions) In general are subject to approval by the Chinese authorities, which may be time-consuming or present opportunities for PRC authorities to scrutinise, and possibly intrude on, the parties’ contractual terms</td>
</tr>
<tr>
<td>Direct acquisitions</td>
<td>• Simpler and less administratively cumbersome than asset acquisitions, because foreign investor does not need to “pick and choose” those preferred assets and businesses of the PRC target company or execute individual assignment contracts for the assets and businesses (that may be subject to different formality requirements)</td>
<td>• Various specific PRC legal requirements, such as state-owned asset appraisal, may also apply and may add further complications and variables to the process</td>
</tr>
<tr>
<td></td>
<td>(When compared to asset deals) Assume all of the existing or contingent obligations/liabilities of, and restrictions applicable to, the PRC target company, in proportion to its equity holding therein</td>
<td></td>
</tr>
<tr>
<td>Equity deals</td>
<td>Indirect/off-shore acquisitions</td>
<td></td>
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<tr>
<td>--------------</td>
<td>---------------------------------</td>
<td></td>
</tr>
<tr>
<td>• Not subject to PRC governmental approval, unless a PRC antitrust review is required; disclosure to PRC tax authorities may be required</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Subject to the terms of the relevant JV contract, may be able avoid getting consent from other partners of the PRC target company (if any) or from the board of directors of the PRC target company</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Asset deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>• May cherry-pick the preferred business and assets</td>
</tr>
<tr>
<td>• In general liabilities or restrictions will remain with the PRC target company</td>
</tr>
<tr>
<td>• Are generally not subject to PRC governmental approval, except for a few cases (depending on the type of assets that are transferred, as described in the Consents and Approval section)</td>
</tr>
<tr>
<td>• Cannot be used for acquisitions of purely domestic targets with no foreign shareholders</td>
</tr>
<tr>
<td>• (When compared to asset deals) Cannot avoid claims against the enterprise; the existing or contingent obligations/liabilities of, and restrictions applicable to, the PRC target company</td>
</tr>
<tr>
<td>• (When compared to asset deals) The assets cannot have a step-up basis in China for tax deduction purposes</td>
</tr>
<tr>
<td>• More complex than equity acquisitions, as different categories of assets and liabilities may be involved</td>
</tr>
<tr>
<td>• If a new FIE is to be established to carry out the asset acquisition, separate approval from the Chinese authorities will be required for its establishment</td>
</tr>
<tr>
<td>• Tax considerations for the parties in relation to the transfer of assets</td>
</tr>
</tbody>
</table>
Determination and Payment of Consideration

Depending on the type of transaction utilised, the foreign investor may pay consideration in various forms, including currency and certain types of assets/property rights. Regardless of the form of consideration, for all transactions subject to PRC jurisdiction, PRC statutes set forth detailed time schedules by which foreign investors need to fulfill their minimum obligations.

Most types of transactions will be subject to the requirement that the transaction price must, in principle, be an amount that is in accordance with valuation results produced by qualified appraisers. Please refer to the Asset Valuation section for further details.

Assumption of Liabilities

Generally speaking, the foreign purchaser in a share acquisition will assume all of the existing or contingent obligations/liabilities of, and restrictions applicable to, the PRC target company in proportion to its equity holding therein. In an asset transaction, any existing obligations, liabilities or restrictions of the PRC target company will generally remain the sole responsibility of the PRC target company.

However, there are a number of regulations and Supreme Court interpretations on the issue of the assumption of liabilities in an enterprise-restructuring context that vary depending on the specific type of transaction. While this guide will not discuss these rules in detail, investors should note that a final determination regarding the question of debt assumption can only be made after careful consideration of these rules.

Possible Post-Acquisition Issues

As discussed in the sections above, in an indirect equity acquisition neither the equity holding structure nor the assets of the target company are directly affected. A direct acquisition, on the other hand, will have a direct impact on the target company’s equity holding
structure. In a direct equity transaction, the PRC target company may need to be converted into an FIE depending on the final shareholding structure.

While an asset transaction would not trigger any corporate conversion by itself, i.e., the selling company will remain the same type of company after the transaction, if the target company has sold the whole or the vast majority of its business or assets to the acquiring FIE, the asset acquisition may be followed by liquidation and dissolution of the selling company.

Finally, separate formalities may be required if the new foreign investor wishes to amend the corporate details of its own PRC entity or the target company (name change, change of corporate officers) upon completion of the transactions. If any employees are transferred pursuant to the transaction, the relevant labour bureau registrations should also be amended. Please see the section on Employment Issues for details. There may also be certain governmental title registration requirements associated with specific types of assets. Please see the section on Asset Acquisitions for details.
CONSENTS AND APPROVALS

Background - Establishment Procedures for a New FIE

As further discussed below, the establishment of a new FIE generally requires project verification by the National Development and Reform Commission (NDRC) or its local counterparts, and contract approval by MOFCOM or its local counterparts, depending on the proposed total investment of the new FIE as follows:

<table>
<thead>
<tr>
<th>Encouraged or Permitted</th>
<th>If total investment of the project is:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• &lt; US$100 million – local DRC and/or COFTEC</td>
</tr>
<tr>
<td></td>
<td>• ≥ US$100 million but &lt; US$500 million – NDRC and/or MOFCOM</td>
</tr>
<tr>
<td></td>
<td>• ≥ US$500 million – NDRC and/or MOFCOM, to be submitted to State Council for verification</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Restricted</th>
<th>If total investment of the project is:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• &lt; US$50 million – local DRC and/or COFTEC</td>
</tr>
<tr>
<td></td>
<td>• ≥ US$50 million but &lt; US$100 million – NDRC and/or MOFCOM</td>
</tr>
<tr>
<td></td>
<td>• ≥ US$100 million – NDRC and/or MOFCOM, to be submitted to State Council for verification</td>
</tr>
</tbody>
</table>

For projects subject to the verification by the NDRC, MOFCOM or the State Council, the applicant should submit its project application report or to the provincial-level DRC/COFERT of the place where the project will be located. The provincial DRC will then forward the application to the NDRC/MOFCOM after preliminary verification and approval.

Project Verification System

Since July 2004, projects that do not involve government investment only require either verification and approval (核准) (which is referred to as the verification system for the remainder of this section) or recordal
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[备案], which are more like straightforward registration systems used in many Western jurisdictions.

Verification applies to those projects listed in the List of Investment Projects to Be Verified and Approved by the Government, which are considered major and restricted “fixed asset investment” projects invested in and established by enterprises without using government funding (the term “fixed asset investment” is not defined in the list). If a project is of a type on the list, it will be subject to the verification system and the applicant needs to submit an application report to the Government. Recordal, on the other hand, applies to projects not listed and can be carried out with local investment authorities, except where other regulations apply.

Most foreign-invested projects are not eligible for simple recordal. They are all subject to the verification system, unless they fall within the service trade industry and no fixed asset investment is involved. When reviewing the application report, the Government’s primary considerations will be: protection of the security of the economy; rational development and utilisation of resources; environmental protection; optimisation of major overall arrangements; safeguarding of the public interest; and the prevention of monopolies. When reviewing foreign investment projects, the Government will also take into account aspects such as market access and capital account administration.

After obtaining the verification document issued by the NDRC or its local counterparts, the project applicant shall carry out the procedures relating to land use, urban planning, quality supervision, work safety, use of resources, enterprise establishment (or amendment), administration of the capital account, importing equipment and applicable tax policies.

Approval of Establishment of an FIE

In addition to the NDRC verification discussed above, the Articles of Association and any joint venture contracts/shareholders’ agreements (as appropriate) (the Contract) of an FIE must be approved by the relevant approval authority according to the rules below.
For an FIE carrying on an Encouraged or Permitted business with a total investment equal to or greater than US$100 million or carrying on a Restricted business with a total investment equal to or greater than US$50 million, the Contract and Articles of Association of such FIE must be approved by MOFCOM.

For an FIE carrying on an Encouraged or Permitted business with a total investment less than US$100 million or carrying on a Restricted business with a total investment less than US$50 million, the Contract and Articles of Association of such FIE must be approved by provincial-level counterpart of MOFCOM.

An FIE is formally established when it has obtained its approval from the approval authority and completes the registration of such approval with and receives a Business Licence from the provincial or local counterparts of the State Administration for Industry and Commerce (SAIC).

The general approval authority rules described may, however, vary in particular cases. The Central Government has promulgated a number of individual statutes, notices and policies concerning special rules for determining and delegating the approval authority for projects and transactions in certain sectors or industries. For example, sector-specific authorities, such as the China Banking Regulatory Commission (CBRC) and the China Securities and Regulatory Commission (CSRC) may be the primary approval authority for their respective industries. Furthermore, local authorities have often published individual rules to further refine delegations of approval power within their localities.

As described above, the precise approval authority for any given project, company or transaction can only be determined after careful consultation of all of the relevant rules.

**Governmental Approval Processes for Acquisitions**

Aside from establishing a new FIE and bringing in fresh capital and equipment as described above, a foreign investor may also purchase
interests in established companies via either an equity acquisition or an asset acquisition, as explained in the section Types of Transaction. The remainder of this section summarises the relevant formalities for these means of acquisitions.

**Indirect Acquisitions**

As described previously, indirect acquisitions conducted offshore can only be equity acquisitions. As an indirect acquisition is conducted offshore, PRC authorities generally have no jurisdiction over the transaction and the transaction will, by and large, require no PRC approval, except for the antitrust review procedures summarised below.

**Antitrust Review**

In the wake of the coming into force of the Anti-Monopoly Law (the AML) in August 2008, the State Council promulgated the Regulations on the Notification Thresholds of Concentrations (Concentration Regulations) on 3 August 2008 and prescribed the thresholds that will trigger the mandatory antitrust reviews on “foreign mergers and acquisitions of domestic companies or foreign capital investments in domestic companies’ operations in other forms”. These are supplemented by a set of July 2009 regulations specifying how the thresholds for business operators in the finance sectors are to be determined.

The merger-control aspect of the AML is handled by the Anti-Monopoly Bureau of MOFCOM, which will process offshore and onshore transactions that exceed the thresholds stipulated under the Concentration Regulations. For offshore acquisitions, the foreign purchaser is required to submit the acquisition plan to MOFCOM if one of the following thresholds is fulfilled:

- The combined worldwide revenue in the preceding accounting year of all business operators participating in the concentration exceeds RMB10 billion, and each of at least two business operators has revenue in the PRC exceeding RMB400 million; or
• The combined revenue in the PRC in the preceding accounting year of all business operators participating in the concentration exceeds RMB2 billion, and each of at least two business operators has revenue in the PRC exceeding RMB400 million.

As of March 2010, MOFCOM has issued various guidelines on the procedural requirements of reporting of business operator concentrations, as well as how the “relevant market” should be defined.

Under certain circumstances where the acquisition will improve conditions for fair market competition, improve the environment, safeguard employment, enhance the enterprise’s ability to compete internationally, parties to the acquisition may apply to MOFCOM for exemption from the antitrust review. On the other hand, MOFCOM has residual discretion under the Concentration Regulations to investigate any transaction that has not met the quantitative thresholds but that may have the effect of limiting or eliminating competition in China.

**Direct Acquisitions**

Under current PRC law, transactions involving a transfer of the registered capital of an existing FIE or the conversion of a domestic LLC (or SOE) into an FIE via a direct-equity transfer would require approval and registration, similar to the situation where a new FIE is formed. MOFCOM and/or its local counterparts have the power to examine and approve transactions involving foreign investments in domestic companies and FIEs, and would, in most cases, be the relevant approval authority for this purpose (unless otherwise specified by laws or administrative regulations, or where the target companies are in certain special industries). The SAIC and its local branches (AICs) are responsible for the administration of the registration procedures once the proposed transaction has been approved by the appropriate approval authority.

**Approval Authority**

The rule in relation to the approval authority of a direct equity acquisition is similar to that of the establishment of a new FIE.
The relevant application should be filed with the original approval authority of the target FIE. If the target is currently not an FIE, then the application should be lodged with MOFCOM or the provincial Commission of Foreign Economic Relations and Trade (or equivalent) (COFERT), depending on the size of the total investment and the industry involved.

Under the Provisional Regulations on the Acquisition of Domestic Enterprises by Foreign Investors (M&A Regulations), the parties to an acquisition are required to report to MOFCOM if the target company is in a “key industry”, if there are factors that affect or might affect “national economic security”, or if there is a change of control over a “famous trademark” or “renowned Chinese brand”. Failing that, MOFCOM and other relevant government departments may request the parties to terminate the acquisition or to implement measures to eliminate the adverse impact on national economic security caused by the acquisition.

When offshore companies controlled or established by Chinese enterprises or natural persons acquire their Chinese affiliates, MOFCOM approval is required. The M&A Regulations impose a general requirement that parties to the acquisition are required to declare whether any affiliation already exists between the target, purchaser and seller.

**Asset Valuation**

In general, if the target is not an existing FIE, the parties are required to have the value of the equity appraised before transfer. Prices manifestly lower than the appraisal result are forbidden.

If the acquisition involves a transfer of state-owned equity, regardless of whether the target is an existing FIE or not, the seller must appoint an asset appraisal institution with appropriate qualifications to carry out an asset appraisal. The appraisal results must be either approved or registered by the state asset administration authorities, and the approved or registered appraisal results are to be the basis for the
transaction price. In general, the transaction price and the appraisal may not differ by more than 10 percent.

Appraisals are not generally required for transfers of equity in FIEs in practice, unless the equity being transferred is state-owned equity in the FIE held by the Chinese investor. In such cases, appraisal rules described in the preceding paragraph apply.

**Documentation Requirements**

Parties to a direct equity transfer transaction must enter into an agreement for the transfer of or subscription for the target’s registered capital. This equity transfer or subscription agreement must be governed by PRC law and will be subject to substantive review from the approval authority.

The Articles of Association (and the JV contract or shareholders’ agreement, in the case of a JV or a WFOE with multiple investors) of the target will have to be amended to reflect the changes. Where the target is converted into a JV or a WFOE with multiple investors upon completion of the transaction, a new joint venture contract or shareholders’ agreement will be necessary. Such amendments or new corporate documents would also be subject to review and approval from the approval authority at the same time of the approval of the equity transfer agreement.

Other documentation required generally includes a unanimous board resolution of the target enterprise, consent from existing co-investors in the target and waiver of their preemptive rights to purchase the equity transferred, or shareholders’ unanimous resolution in case of acquisition of domestic LLCs (further described in the section on Non-Governmental Consents and Approvals). The approval authority may also specifically require the parties to the transaction to submit other documents for its substantive review and scrutiny, such as bank letters evidencing the purchaser’s financial soundness, board resolutions adopted by the parties approving the equity sale, constitutional documents of the parties and/or any other contracts or documents referred to in the transaction documents.
Under applicable rules and prevailing practice, all documents submitted for review will need to be in Chinese (translations would suffice for non-essential documents). Officials can refuse to review any document that is not available in Chinese, therefore potentially delaying the approval process. Whether legalised or authenticated copies of documents or translations produced by certified translators are necessary largely depends on local practice or even the requirements of individual reviewing officials, although currently the relevant statutes and most authorities do not impose these requirements.

**Approval Process and Timing**

Upon receipt of all necessary documents, the approval authority will review the substance of the Chinese versions of the documents and may impose changes on the parties if it considers any term therein inappropriate. The parties may need to negotiate with the approval authority if they object to those changes.

A number of factors (such as the size, locality, approval level, industry, complexity and sensitivity involved in the transaction) can significantly affect the approval period for a given transaction. Depending on these factors, the time requirement for obtaining the necessary approvals can range from several weeks to more than a year, even assuming that the approval authority has raised no issues during the approval process.

**Special Procedures for State-Owned Equity**

**Unlisted Equity**

If a foreign investor is purchasing state-owned equity (other than state-owned equity in financial enterprises or listed companies) and the target is to be reorganised as an FIE, special procedures must be followed.
The seller will have to submit a reorganisation plan to the relevant government authorities for approval. The seller must also appoint a qualified institution to carry out an asset appraisal.

Subsequently, the examination and approval procedures for FIEs must be carried out with the foreign investment authorities on the strength of the approval documents for the reorganisation plan and the acquisition agreement.

Regulations issued by the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) and the Ministry of Finance that came into force on 1 February 2004 provide that any transfer of state-owned equity (other than state-owned equity in financial enterprises or listed companies) must be carried out at one of China’s property rights exchanges, unless otherwise provided by relevant laws and regulations. The purpose of this rule is to increase transparency and stem state asset losses resulting from the sale by corrupt officials of state assets at much less than their actual value.

Under the rules, sellers must make a public announcement through a property rights exchange concerning the equity they propose to sell. If more than one prospective buyer emerges during the prescribed notice period, the equity must be sold by means of an auction or tendering process. The main problem with this system is, of course, that foreign investors who have put a lot of time and resources into negotiating an acquisition may find themselves competing with other bidders in an auction or tendering situation near the end of the process.

**Listed Shares**

A set of provisional measures issued jointly by SASAC and CSRC in 2007 (Order 19) regulate the transfer of listed shares of a state-owned shareholder (other than listed shares held by state-owned financial institutions), whether it is done through the securities exchange, by agreement, allocation (without consideration) or through direct transfer. Where the transfer of listed company shares is by agreement,
Order 19 requires the state-owned shareholder to publicly solicit potential transferees through a public announcement on the securities exchange following the above mentioned initial approval by SASAC or relevant local counterpart. Exceptions are available only in limited circumstances, e.g., where there are special requirements on the transferee in the key industries or areas of national economy.

According to Order 19, depending on the total capital of the listed company, the percentage of shares being sold and whether there is a change of control, the share transfer plan will be subject to recordal or approval of SASAC or its provincial counterpart.

**Registration Process**

Following the approval of the transaction, the target company would need to file with the relevant local AIC for an amendment of any existing registration particulars that are affected by the transaction and need to be updated. Any changes to registered company particulars such as the company name, business scope, investor, amount of total investment/registered capital, and principal officers and directors would need to be updated as appropriate.

**Asset Acquisitions**

If a foreign investor wishes to acquire assets, rather than equity, it must have a registered presence in the PRC. In these circumstances, the foreign investor may have an existing FIE in China or, in some circumstance, the foreign investor may establish a new FIE for the purpose of acquiring and operating the purchased assets. Approval from the appropriate approval authority is necessary for any new entity formed.

**Possible Governmental Approvals**

Apart from approval for establishment of a new FIE, transfers of certain assets (such as those listed below) are subject to additional governmental approvals.
• When all of the assets, or the main assets, of a state-owned enterprise or company with state-owned equity are sold to a foreign investor for the establishment of an FIE, the assets must be appraised and the appraisal results approved or registered. The approved or registered appraisal results form the basis for the transaction price. Also, a reorganisation plan must be approved and the acquisition agreement must be approved (approval of the acquisition agreement may be carried out by the parent company rather than government authorities in some circumstances).

• Other transfers of state-owned assets must also be appraised in accordance with the state-owned asset appraisal regulations.

• If the transferred assets involve certain tax-exempted equipment still under customs supervision and control, approval from the customs authorities for release of the supervision (normally involving retroactive payment of taxes and duties exempted or reduced) would be required.

• If the transferred assets involve certain types of intellectual property rights, such as patents and trademarks, or involve any technology or know-how subject to the PRC technology export administrative regime, separate approvals/formalities may be required.

If the asset transfer involves certain special industries in which foreign participation is restricted, particular care should be taken. Investors should note that while the transfer of any assets may not require approval per se, the necessary licences to operate in such sectors cannot be transferred. The purchasing FIE will still need to apply for its own licence from the relevant governing authorities before it can make use of the purchased assets.

In certain asset acquisitions, foreign exchange approval and examination may be required. Please refer to relevant section on Direct Acquisitions.
Documentation Requirements

If the foreign investor does not have a registered presence in China and needs to form a new entity as the acquisition vehicle, it would need to prepare the same type of documents required in the establishment of a new entity as discussed earlier.

The parties to an asset transfer should enter into an appropriate asset transfer agreement for the primary transaction.

Depending on the nature of the transaction and the existence of any approval requirements, other documentation required could include the resolution of the seller of the assets approving the sale of assets and notification to creditors or staffing plans (further described in the Non-Governmental Consents and Approvals section). Similar to an equity acquisition, any documents submitted should be in Chinese and may need to be notarised or legalised.

Follow-Up Formalities

If any of the corporate constitutional documents or the principal company particulars of either party involved are to be changed as a result of the transaction, approvals from the respective approval authorities and registration with the SAIC of such changes may be required. In addition, there may be additional governmental title registration requirements associated with certain types of assets such as real estate or vehicles that need to be updated.

Mergers

Mergers of two or more FIEs should generally be approved by the original approval authority of the relevant FIE(s) and/or the appropriate approval authority for any FIEs to be established as a result of the merger. Where the merger involves more than one approval authority, the merger should be approved by the appropriate approval authority having jurisdiction over the post-merger FIE. Following the approval of the merger, relevant registration procedures should be carried out with the SAIC or its local counterparts.
Non-Governmental Consents and Approvals

Other than the consents and approvals from the approval authorities mentioned in the last section, certain other non-governmental consents and approvals may be required before the transaction can be completed, either because they are statutory requirements and would form part of the application documents or because they are required under applicable existing contractual obligations.

Consent of the Seller

Consent of the seller is generally evidenced by a resolution of the shareholders of the seller. This is normally a non-governmental approval but in the case of state-owned equity it sometimes involves approval of a government authority since government authorities often, in such cases, perform the role of shareholder on behalf of the state.

If the equity being transferred is state-owned equity held by a state-owned asset authority, the state-owned asset authority must, naturally enough, approve the transfer. If the transfer would cause the state to lose its controlling interest, the People’s Government at the same level as the state-owned asset authority must also approve the transfer.

If the equity being transferred is state-owned equity in a subsidiary of an enterprise, which in turn is held or partly held by a state-owned asset authority, the enterprise must approve the transfer. If the subsidiary is a major subsidiary and the transfer is a major transfer, the state-owned asset authority and finance authority at the same level must also approve the transfer.

Consents and Waivers from Other Shareholders

Under PRC law, in a direct equity transfer transaction, consents to the transaction will be required from all co-investors of an FIE (such as a CJV or an EJV). These co-investors have preemptive rights to purchase any equity interest offered for sale by the selling investor, which need to be waived before a sale can be made to a third party.
Where the target in a direct equity transfer transaction is a domestic limited liability company, the M&A Regulations require that unanimous consent from the shareholders of the target company must be obtained.

**Board Approval**

Prior to an equity or asset acquisition, normally a resolution of the boards of directors of all entities involved (including the transferor, the purchaser and the target enterprise) in favour of the transaction will be required. In an equity transaction, the resolution from the PRC target enterprise in favor of the transaction and the necessary amendments in the company’s corporate documents will need to be unanimous. However, since directors in a PRC FIE or LLC are normally appointed and controlled proportionally by the investors, once the necessary consents and waivers from the co-investors are obtained, this requirement is in most instances merely a formality.

**Approval from Employees**

Under the M&A Regulations, a labour deployment plan must be submitted to the Approval Authority in both the case of an asset acquisition and a direct equity acquisition. The deployment plan should cover issues such as how many (if any) employees might be dismissed as a result of the acquisition, how unpaid salaries, benefits and severance pay are to be settled. If a transfer of state-owned equity implicates the rights and interests of the workers, matters such as the resettlement of workers must be approved by the employee representative congress. It should be noted that in the case of an asset acquisition, a transferred employee is entitled to severance payment as a result of the termination of his or her employment with the seller. In practice, most employees are willing to waive their right to severance if the purchaser agrees to take into consideration the previous years of service of the transferred employee with the seller when calculating severance payments in connection with any subsequent termination.
Strictly speaking, in the event the company is considering restructuring or other major operational matters, it should listen to the opinion of the union, and listen to the opinion and suggestions of the employees either through an employee representative congress or other means. However, there are no penalties specified for not following this vague consultation procedure, so it is rarely followed in practice.

**Contractual Obligations**

There may be other contractual obligations assumed by the transferor, the purchaser or the target company that would require third-party approval for either equity or asset sale. For example, bank loans or security agreements may contain provisions mandating lender’s prior approval in the event of any change of control of the borrower as a result of the relevant transaction.

**Public Announcements and Creditor Notifications**

A domestic company selling its assets to a purchaser should notify its creditors and make a public announcement in a newspaper at the provincial level, or at a higher level, that is circulated nationally within 15 days from the date the application for the asset sale is submitted to the approval authority.

The seller of assets generally should remain responsible for its debts and liabilities. However, the seller may enter into an agreement with the purchaser and other creditors regarding the disposal of debts, provided that such agreement will not harm third-party rights. The debt disposal agreement should be submitted to the approval authority as part of the application documents.

**Acquisitions Involving Overseas Investment by PRC Individuals and Enterprises**

The focus of our discussion in the preceding sections is on approvals and consents required for acquisitions inside China. It is worth noting
that any investment in an overseas company by a PRC individual or enterprise is subject to registrations with and approvals from the NDRC and/or MOFCOM in the case of a PRC enterprise and the State Administration of Foreign Exchange (SAFE) and may be time-consuming. The feasibility of such registrations/approvals may also impact on the acquisition structure. In the event a direct or indirect acquisition by a foreign investor involves any overseas investment by the PRC seller or target, these approval requirements would need to be taken into consideration.
EXCHANGE CONTROL

Background

China imposes strict control over all types of foreign exchange transactions across its borders and its official currency is not freely convertible in the international foreign exchange market. SAFE, the authority in charge of foreign exchange control in China, regulates the following four types of transactions involving the movement or conversion of foreign exchange:

- Inward remittance of foreign exchange, i.e., the remittance of foreign exchange into China from an overseas party;
- Settlement of foreign exchange, i.e., the conversion of foreign exchange into RMB;
- Sale of foreign exchange, i.e., the conversion of RMB into foreign exchange; and
- Outward remittance of foreign exchange to an overseas party.

Current Account and Capital Account Items

In its administration of the foreign exchange control regime, China distinguishes between “current account items” (generally, funds for the daily operations of a company, such as revenue from export or provision of services, payment for imported goods) and “capital account items” (generally, items of a non-trade, nonrecurring nature, such as investment in China, real estate purchases, repayment of the principal of foreign currency loans and contributions to registered capital).

Current Account Items

China’s foreign exchange control regime permits the so-called “current account convertibility of the RMB”. In essence, PRC companies are allowed to effect current account foreign exchange transactions free of any prior approval of SAFE. Instead, PRC
companies are only required to submit the documents of the underlying transaction to the PRC-designated foreign exchange bank for verification.

**Capital Account Items**

Foreign exchange transactions involving capital account items, on the other hand, are currently more heavily regulated, although the PRC Government has announced a policy of gradually moving towards full capital account-convertibility of the RMB. For certain cross-border capital account foreign exchange transactions, such as receipt of purchase price under a direct equity acquisition or capital injection to an FIE by a foreign investor, prior approval from SAFE or its local counterpart would be necessary.

**Supervision and Approval for Foreign Exchange Transactions**

There are detailed rules specifying the precise extent of approval authority that local banks and local branches of SAFE have over each type of foreign exchange transaction. Such rules are changed periodically but, generally, the trend appears to be that SAFE is delegating more authority to approve foreign exchange transactions to local banks.

**Remittance Issues**

While PRC statutes allow multiple forms of payment for a merger and acquisition transaction, some foreign purchasers may opt to pay the purchase price for the relevant interest or assets transferred, utilising foreign currency funds currently held outside of China. This means that, in M&A involving foreign investors acquiring targets in China, generally, the “inward remittance” and “settlement” aspects of foreign exchange control are more relevant.

**Payment to a Foreign Seller Outside of the PRC**

In the case where the seller in either an indirect acquisition or a direct acquisition is a foreign company and has a bank account outside
of China, the purchase price is typically paid completely offshore by the foreign purchaser to the foreign seller. To the extent that such payments do not cross the PRC border, SAFE would not have jurisdiction over the transaction.

On 21 October 2005, SAFE issued the Notice on Foreign Exchange Control Issues Relating to Financing and Round Trip Investment by Domestic Residents through Offshore Special Purpose Vehicles (SAFE Notice 75) and sought to clarify the procedures for offshore investments by PRC residents. A new notice was issued by SAFE on 29 May 2007 (SAFE Notice 106) that provides further details of the registration requirements for offshore fundraising and round trip investment activities.

**Requirements Under SAFE Notice 75**

SAFE Notice 75 applies to PRC residents, which includes both legal entities and natural persons. PRC residents who wish to establish or gain control of an offshore SPV for the purpose of engaging in offshore financing or reverse investment are required to carry out registration with the local SAFE. SAFE Notice 106 has further specified that offshore financing or round trip investment, includes activities such as initial public offerings, private placement and borrowing of bridge loans offshore, or capital contribution offshore, such as stock-swap transactions. Under SAFE Notice 75, PRC residents with existing offshore structures were required to effect retroactive registration with SAFE by 31 March 2006.

After the PRC resident injects domestic assets or equity interests into a special purpose vehicles (SPV), or after the SPV carries out equity financing following such injection, the PRC resident should apply to the local SAFE to amend its registration to reflect the net assets or equity it holds in the SPV. After the SPV completes its offshore financing, the funds raised by the SPV may be repatriated into China in accordance with the business plan that was submitted to the local SAFE for registration. Any foreign exchange proceeds received by a
PRC resident from the SPV must be repatriated and settled within 180 days from receipt.

If the SPV undergoes a material change in capital other than a reverse investment, such as a capital increase or reduction, the PRC resident is required to report the change to the local SAFE for the record within 30 days of its occurrence.

**Payment to a Seller in the PRC**

**Equity Acquisitions**

If the transaction involves a seller who must be paid in China, the foreign purchaser will have to remit the purchase price into the PRC. In this situation, the purchase price will typically be remitted to a special account that the seller establishes, upon SAFE approval, for the specific purpose of receiving funds of such nature. The PRC seller will then have to submit supporting documents to the bank for converting the foreign exchange in, and remitting the Renminbi funds out of, the special account. The foreign investor will have to carry out special foreign exchange registration for the foreign exchange paid to the seller (or the foreign investor may authorise the seller of the equity to carry out the registration). A registration certificate will be issued. The certificate is proof that the foreign investor has made the payment(s) and is also important for the foreign exchange registration procedures to be carried out by the target enterprise. It is at this point that any overseas investments by PRC residents into SPVs must be disclosed, as discussed above.

Under the M&A Regulations, a foreign buyer may also, upon local SAFE approval, pay the purchase price with RMB profits that it lawfully obtains, or upon MOFCOM approval, with listed shares of a foreign company or shares of an offshore company in a pre-IPO context. In the case of a share swap, the foreign shares in question must fulfill certain conditions and comply with the relevant approval procedures set forth in the M&A Regulations.
Asset Acquisitions

In an asset purchase involving the formation of a new FIE as the acquisition vehicle, the new FIE will first need to be funded, where a capital account will be established to receive such capital contribution funds.

The PRC foreign exchange regime mandates that all transactions in China are to be priced and settled in RMB. Consequently, the purchasing FIE will need to use RMB to purchase any assets from a domestic company. Such RMB may come from conversion of part of its initial capital contributions or from its operational income.

In any event, in such a transaction, the payment to the seller itself will typically not trigger specific foreign exchange issues.
TAXATION ISSUES

Most of the information discussed below is primarily applicable to sellers, however, such information may also have an impact on purchasers, due to potential withholding requirements and due to the fact that in practice, sellers may opt to build part of the tax burden into the price of the acquisition.

Jurisdictional Taxes - Enterprise Income Tax

Registered Capital Transfer

If a foreign investor sells its interest in the registered capital of an FIE at a gain (meaning that the selling price exceeds the original value of its capital contribution for the corresponding equity interests) such gain will be subject to Enterprise Income Tax (EIT) at the rate of 10 percent, unless reduced or exempted by an applicable tax treaty. If the purchaser is a PRC entity or a PRC individual, the purchaser is required to withhold tax on the capital gain earned by the foreign seller. However, according to a tax notice in 2009, if both the seller and the purchaser are foreign investors and the transaction takes place outside of China, the purchaser does not have the withholding obligations. Instead, the seller will be responsible for the tax filings and payment. Besides, the target FIE whose equity interest has been transferred should file the equity transfer contract with the tax authorities and assist the tax authorities in collecting the taxes.

Assets Transfer

Gains or losses on the disposal of assets by an FIE must be included in or deducted from the taxable income of the FIE for enterprise income tax purposes.
Transactional Taxes

Stamp Tax/Stamp Duties

Generally, this tax is levied on each copy of the official document to be stamped. The rates of stamp duties vary depending on the type of transaction. For equity acquisitions, the stamp duties would generally be 0.05 percent of the transfer price. For asset acquisitions, property transfers are subject to stamp tax only when the law explicitly lists the class of transferred assets as stamp-dutiable properties (e.g., inventory, real estate, automobile, copyright, trademark, patent, know-how). Transfers of other properties, such as accounts receivable, contractual rights, are not subject to stamp tax. Therefore, to minimise stamp tax liability, the value of each transferred item should be separately listed in the assets transfer agreement. If there is no separate value listed for the assets transferred, the total transfer price is subject to stamp tax.

Value Added Tax (VAT)

Transfers of assets in the PRC are subject to VAT while equity transfers are not. VAT will be levied on the transfer price of the inventory generally at the rate of 17 percent. Generally speaking, under the new VAT regime, the VAT treatment of the sale of used fixed assets varies depending on whether the assets are purchased before or after 1 January 2009. If the assets are purchased on or after 1 January 2009, standard VAT rate (normally 17 percent) will apply. Otherwise, 4 percent will apply and half of the VAT can be exempted.

Customs Duties

Certain FIEs may, in some circumstances, import machinery and equipment free of any custom duties and import VAT. However, such machinery and equipment (bonded equipment) would be subject to the supervision and control of the customs authorities for a period of five years. During this supervision period, if the bonded equipment were to be sold, consent from the customs authorities would be required, and
custom duties and import VAT would be levied retroactively according to the depreciated value of the bonded equipment.

**Land Appreciation Tax**

Land appreciation tax will be levied when land use rights or buildings are sold at a gain. The tax rates range from 30 percent to 60 percent on the gain, although certain items may first be deducted from the gain. However, in practice this tax historically has not been consistently enforced in certain localities. Nonetheless, it is evident that local governments recently have strengthened enforcement to collect this tax as a result of the central Government’s efforts to combat property speculation and to stabilise property prices.

**Business Tax**

Business tax at the rate of 5 percent may be levied on the transfer price of intangible assets such as copyrights, trademarks, patents, know-how and goodwill. However, transfers of technology may be exempt from business tax. Business tax is also applicable on the transfer of land use rights and building ownership rights.

**Deed Tax**

Deed tax may be imposed on the buyer of land use rights or building ownership rights. The tax rate varies from 3 percent to 5 percent of the transfer price, depending on the location.

**Specific Tax Considerations**

**Equity Acquisition**

*Indirect acquisition* - An indirect acquisition can take place wholly offshore. Under the tax regime, as this does not involve the transfer of pre-1 January 2008 equity interest in PRC companies or any other transaction within China, the acquisition and disposition of such equity stake should not trigger any PRC tax liabilities. However, a tax notice
issued in early 2010 with retroactive effect from 1 January 2008 has significantly changed the situation.

Briefly, capital gains derived from the transfer of equity interests of PRC resident enterprises by foreign entities are subject to a 10 percent tax (this may be reduced by an applicable tax treaty, although such treaties with China are quite few). The new notice requires foreign entities to disclose indirect transfers of PRC resident enterprises to the PRC tax authorities when the offshore holding company through which such transfers are made is located in a low tax jurisdiction or such jurisdiction exempts income tax on foreign-sourced income. After reporting, the PRC tax authorities will then determine whether the offshore holding company is a shell company and potentially deem the indirect transfer as a direct transfer of the Chinese resident enterprise [such that the capital gain associated with the offshore transaction would be subject to PRC tax].

**Direct acquisition** - For share acquisitions completed prior to 16 March 2007, if the target company was originally not an FIE but upon the acquisition the foreign investor held not less than a 25 percent interest in that company, the target company (upon conversion) could start enjoying preferential tax policies available to an FIE under the previous income tax regime. Similarly, an FIE established before 16 March 2007 as the acquisition vehicle for an asset deal could also enjoy the preferential tax policies available under the previous regime. However, the new Enterprise Income Tax Law (EIT Law) removes all EIT incentives for FIEs established after 16 March 2007, such as the previous lower EIT rates, tax holidays and other EIT incentives. Turnover tax incentives, e.g., importation of equipment free from customs duty¹ will continue to be available to qualified FIEs.

If the seller is an enterprise in China, its capital gains derived from the sale of shares to a foreign purchaser will be treated as part of that enterprise’s taxable income for EIT purposes. EIT is generally levied at ¹

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¹ China has recently implemented VAT reform. From 1 January 2009, VAT incurred on purchasing of fixed assets becomes creditable against output VAT and the VAT exemption policy for FIEs has been repealed.
the rate of 25 percent on an enterprise’s net income. If the seller is a foreign company, its capital gains will be subject to withholding tax at the rate of 10 percent unless exempted or reduced by an applicable tax treaty.

The sale of an equity interest will not be subject to turnover taxes except stamp tax. Generally, stamp tax of 0.05 percent will be imposed on the share transfer price for both the buyer and seller. However, if the company is a joint stock limited company listed on a PRC stock exchange, transfer of the listed shares will be subject to 0.1 percent stamp tax, and only applicable to the seller.

**Asset Acquisition**

As mentioned before, assets transfers are subject to a variety of PRC taxes.

Further, under the old EIT regime, many FIEs enjoyed tax holidays, provided that they remained in operation for at least 10 years. If an FIE sells its assets and liquidates before it has operated for 10 years, it will be required to pay the taxes that were previously exempted or reduced during the tax holiday. Although the EIT Law does not provide for tax holidays of this kind, the clawback issue will remain alive for FIEs formed before 16 March 2007 (the date of adoption of the EIT Law) until they have operated for 10 years.

Moreover, FIEs established before 16 March 2007 that were eligible for reduced tax rates and tax holidays under the old EIT regime will continue to enjoy these incentives during a transition period of up to five years. The tax incentives of the seller FIE cannot be transferred to the buyer FIE under an asset acquisition.

**Merger**

Under the past EIT regime in effect until the end of 2007, a merger of two FIEs could be done on a tax-free basis. The old rules were effectively repealed as of 1 January 2008, when the new EIT Law took effect in China.
Under the new rules, the merger of two FIEs in China may not qualify for tax-free treatment due to the strict requirements on tax-free cross-border reorganisations. Further clarification from the tax authorities is yet to be issued.

For a merger that is subject to normal tax treatment, gain or loss needs to be recognised as under a liquidation or asset transfer. Accumulated losses and other tax attributes cannot be utilised by the post-merger entities.

The new rules also clarify the treatment of pre-merger/de-merger tax incentives after a merger/de-merger. This will be of particular interest to Chinese subsidiaries of foreign investors that continue to enjoy transitional tax holidays under the pre-2008 income tax regime.

- In a merger by absorption, the surviving enterprise can continue to enjoy its unutilised tax incentives.
- In a de-merger, the surviving enterprise can continue to enjoy its unutilised tax incentives. The tax incentives of the non-surviving enterprise cannot be utilised by the surviving enterprise.
- If the surviving enterprise is at a loss position in the year immediately prior the merger/de-merger takes place, the tax incentives to be utilised by the surviving enterprise would be zero.

However, the new rules do not clarify whether there will be a clawback of the tax incentives enjoyed by the non-surviving enterprise upon the merger.

Although it is still unclear whether a merger of two FIEs can enjoy tax-free treatment from EIT perspective, most of the turnover taxes, such as VAT and business tax that apply to asset transfers can be avoided in a merger. Therefore, a merger could still be more tax efficient than an asset transfer, depending on the type of assets to be transferred.
EMPLOYMENT ISSUES

Rules regarding employee transfer and their ramifications vary depending on whether the relevant transaction is a merger or an acquisition, and also depend on the target entity.

FIEs and domestically owned (non-FIE) companies may directly hire Chinese and expatriate staff. In contrast, Rep Offices cannot directly hire PRC citizens (expatriates are generally hired by the overseas head office and then registered as a chief representative or ordinary representative of the Rep Office). Instead, Rep Offices must contract a local labour service company (most commonly Foreign Enterprise Service Company, FESCO) to have FESCO’s employees seconded to the Rep Office. Rep Offices and their employees may, however, and commonly do, enter into direct agreements to supplement the terms of the standard FESCO labour service contracts.

The terms of all employment relationships in China are required to be set out in written employment contracts. Chinese law does not permit transfer or assignment of rights and obligations under an employment contract directly from one employer to another. Under the Labour Law of the PRC, the Labour Contract Law of the PRC, and relevant regulations, an employment relationship can only be terminated under certain statutory circumstances.

Transfer of Employees

Equity Acquisitions

From a PRC legal point of view, equity acquisitions do not trigger the need to transfer employees, as there are no changes to the target company’s (the employer’s) structure. In practice, however, many acquisitions are followed by further corporate restructurings, which may lead to employee transfers or terminations, as discussed below.

Any employers attempting to terminate employment contracts in a restructuring situation should, if circumstances permit, cite a legitimate statutory ground for termination such as “a major change
in the objective circumstances on which the employment contract was based” or one of the statutory grounds for collective dismissals. However, courts generally will not view a simple equity transfer as a sufficient change in objective circumstances such that the employment contract can be terminated. Employers must generally conduct some other restructuring, such as a shut down of a business division or introduction of a new production method or major new technology, before a termination can be carried out on these grounds. Local rules and practice should be consulted in this regard with respect to the likelihood of a successful termination. Employment contract terminations may trigger a statutory and/or contractual requirement to make severance payments.

As discussed in the section on Consents and Approvals above, a special rule in relation to SOEs provides that if a foreign investor gains a controlling interest in a SOE during a reorganisation, a plan for resettlement of the staff and workers must be approved by the employee representative congress.

**Asset Acquisitions**

Based on the current legal framework, a transfer of assets will not carry with it the obligation to transfer any employees but see the discussion below of special rules that apply in SOE acquisitions.

If the parties to an asset acquisition do wish to transfer relevant employees to the purchaser, then the current employment relationship must first be terminated (either by employee resignation or mutual termination contract) and then the employee must sign a new employment contract with the purchaser. In other words, there is no automatic or direct transfer of employees between two separate entities and employees may only be “transferred” through termination and rehire.

**SOE Acquisitions**

Special rules apply to SOE equity and asset acquisitions. When a foreign investor acquires the controlling interest in an SOE and the
SOE is reorganised as an FIE, or the foreign investor acquires the main business assets of an SOE and uses the assets to establish an FIE, a resettlement plan must be prepared and approved by the SOE’s employee representative congress. The resettlement plan must be submitted to the approval authorities and must also be included in the transfer agreement.

The target SOE will have to use its existing assets to pay outstanding wages, non-refunded pooled contributions and unpaid social insurance premiums.

The SOE must also pay severance payments to employees who are not retained, and for employees who are transferred to the local social insurance authority to take care of, lump-sum payments of the required social insurance premiums must be made. The funds for such payments are to be deducted from the net assets of the SOE or on a priority basis from the proceeds derived from the sale.

**Mergers**

FIEs - In the event of a merger, unless there are agreements between the pre-merger entities and their employees that provide otherwise, the employment contracts of all employees will automatically be transferred to the post-merger entity. So long as the employees continue to work for the post-merger entity, the merger would not trigger a severance payment liability.

In general, if employment contracts were to be amended or renewed pursuant to a merger, employee consent would be required. However, under certain circumstances, the post-merger entity may be able to unilaterally terminate certain redundant employees following a merger. Under these circumstances, the post-merger entity will have to make severance payments.

Rep Offices - Rep Offices are not legal persons and therefore cannot merge with one another in the PRC. If a foreign company that has one or more Rep Offices in China is merged offshore with another entity, it would be necessary for the Rep Offices to amend the relevant FESCO
service contracts and relevant supplementary agreements, primarily because the name of their parent company will have changed (though in some cities, the authorities may order the shutdown of the Rep Office as a result of the offshore merger if they cannot be convinced that the original overseas head office of the Rep Office still exists). Aside from this, there would be no termination or severance requirements in relation to the employees unless the Rep Office is ordered to shutdown, in which case a new Rep Office would need to be established, and a new labour service contract would need to be signed by the new Rep Office.

Other Considerations

Payments of Taxes, Social Insurance Contributions

A purchaser should make sure that individual income taxes, social insurance contributions and, as applicable, severance payments in regard to employees are paid to the employees by the seller or as agreed by the parties.

Expatriates

If the employees to be transferred are expatriates (including Hong Kong, Macau and Taiwan residents), who are required to maintain valid employment visas and employment/residency permits, there might have to be documentary amendments. Expatriates may also have “golden parachute” arrangements that a potential purchaser should be aware of.

Transfer of Benefits, Location

For Chinese and expatriate employees alike, the purchaser should consider the benefits currently granted to employees. If the transfer requires movement to a new location, the purchaser itself (or through service providers in the new location) must make necessary arrangements so that the employees have proper work and residency documents as well as benefit accounts at the new location.
Non-Competition Restrictions and Confidentiality Obligations

The purchaser should also consider whether the existing employment contracts contain non-competition and confidentiality obligations that would give rise to liability on the part of the employees or even the purchaser. Under the Labour Contract Law, the maximum term of the non-competition restriction is two years after the end of the employment relationship, and the compensation will need to be paid in monthly instalments following the end of the employment relationship. Local regulations may specify a minimum amount that must be paid to the employee. Given that the purchaser is in effect the new employer, a waiver should ideally be sought to cover this issue.

Dispute Resolution - Labour Arbitrations

Under applicable regulations, disputes between an employer and an employee arising from an employment relationship (or the formation or termination thereof) are subject to labour arbitration procedures. This means that should there be any disputes arising due to employee arrangements following the merger or acquisition, the parties would generally have to go to labour arbitration, the quality of which can vary, although these labour arbitration decisions generally can be appealed to a People’s Court if either party is dissatisfied with the arbitration decision. However, in certain types of disputes, the right of an employer to appeal an arbitration decision is greatly restricted.
DOCUMENTATION AND DUE DILIGENCE

Preliminary/Framework Agreement

There is no strict PRC legal requirement for a preliminary/framework agreement between the parties, such as a letter of intent (LOI) or memorandum of understanding (MOU), for merger and acquisition transactions. Nevertheless, an LOI or MOU is an important tool that can be used to reach agreement at an early stage on the principles, basic terms and contemplated procedures of a proposed transaction, and is usually prepared in major transactions. It should be noted that although LOIs and MOUs are generally stated to be non-binding in nature, the Chinese parties usually expect that all the terms contained in the LOI/MOU will eventually be replicated in the formal agreements should the transaction proceed.

Due Diligence

Due diligence investigations remain an essential tool for assessing and reducing the risks inherent in a merger/acquisition transaction in China. In the absence of complete knowledge of the operations, the scope of the assets and the extent of the liabilities of the target company, due diligence investigations afford the prospective purchaser an opportunity to assess the legal and financial state of affairs of the target company. They also facilitate consideration of structuring issues in the proposed transaction based on the results of the pre-acquisition review. Accordingly, due diligence is vital in most M&As in China.

However, the concept of due diligence is relatively new to many target companies in the PRC. Many PRC companies do not keep proper corporate or accounting books and records, and the Chinese parties are used to concluding transactions in the absence of any pre-acquisition documentary review of target companies. As a consequence, foreign purchasers may still find some Chinese parties quite reluctant to fully disclose information concerning the target company. There have also been reports that lawyers, accountants and
other business professionals have been accused of violating China’s vague state secrets regime because they were closely inspecting certain financial and management records of some Chinese SOEs. Document forgery can also be an issue when dealing with some Chinese parties. Generally, foreign investors and their advisers need a high level of patience, experience and diplomacy to carry out proper due diligence investigations that are up to international standards.

**Due Diligence Process**

Typically, the due diligence process will begin with the purchaser and its advisers determining the nature and scope of the due diligence investigations. A written questionnaire or checklist that identifies the essential matters to be investigated would then be prepared and sent to the target company. Upon receipt of the questionnaire, the seller/target company or its advisers will formally answer the questions raised therein, providing copies of the relevant requested documents as required. The purchaser and its advisers will generally also carry out site visits at the site of the target company and conduct interviews with its management and staff members in order to obtain complete information on the matters to be covered. While the purchaser and its advisers typically need to drive the due diligence process in the PRC, China is in the process of converging with international practices, as more sophisticated sellers do hire advisers and prepare organised data rooms.

**Main Areas Covered in Due Diligence**

Generally, the following areas will be examined in a comprehensive due diligence investigation.

**Constitutional Documents, Government Approvals and Operating Licences**

The incorporation documents of the target company must be carefully examined to ascertain that the target company was duly established and is carrying out its business operations in accordance with PRC
laws, relevant constituent documents, and its operational approvals, permits and licences. Depending on the form of establishment of the target company, such incorporation documents may include the Articles of Association, shareholders’ agreements (if applicable), business licence and establishment approvals.

If the target company is in an industry that requires special licences or permits in order to operate, the purchaser should check whether the target company has obtained all of the required operating licences and permits needed for the legal conduct of its business.

Company Structure

The purchaser should examine the corporate structure and the relationship between the target company and any related companies. This should include any historical changes to the company structure, shareholdings, etc., to ensure that all of the previous transfers have been legally effected and that the current equity holders have legally valid ownership of their equity interests. For SOEs that have undergone restructuring in the past, it is not uncommon for such restructuring to be completed without proper and complete legal documentation and approvals, and purchasers are often required to enter into further discussions with the purchaser as well as relevant government authorities (state asset administration authority) to ascertain a clearer picture of past restructurings and disposition of assets in relation to such restructurings.

Assets

The purchaser should ascertain whether the target company has acquired title to all of its assets and to what extent such assets are subject to charges, mortgages, liens or other third-party rights and interests.

Accounting

Accounting practices in China are not necessarily identical to international accounting practices. In this respect, it is advisable for
the purchaser to retain its own accountants to simultaneously conduct a financial due diligence of the target company.

**Loans and Guarantees, Creditors and Debtors**

To protect its interests, the purchaser needs to be aware of any loans of the target company (whether as lender or borrower) and/or any guarantees provided by the target company, as they may have a potential impact on the valuation of the target company. For SOEs, purchasers should look for cross-guarantee arrangements (with other SOEs), which are not uncommon.

**Taxation**

The purchaser should request documents demonstrating the payment of taxes (such as EIT or business tax) of the target company and withholding of individual income taxes of its employees. The purchaser should also ascertain whether the target company has committed any tax or customs duties violations, or whether it has any outstanding tax disputes or liabilities. In addition, it is also important that the purchaser ascertains whether the target company is entitled to any preferential tax treatment (such as income tax holidays, reduction of the income tax rate, exemption of customs duties, fiscal subsidies or tax rebates) granted by the PRC Government.

**Land and Buildings**

Ownership of real property is one of the most complex and potentially problematic issues in M&A transactions in China. The purchaser’s legal advisers should carefully review the purchase/title documents of land and buildings, such as contracts for the grant of land use rights, land use rights ownership certificates, building/factory ownership certificates, land transfer contracts and lease agreements. In this respect, it is important to ascertain whether the target company has carried out all of its obligations in connection with the land-related contracts (such as payment and development obligations). It is also advisable for the purchaser to retain local PRC agents to
conduct searches in the public registry and to investigate whether there are any outstanding mortgages, third-party rights/claims or encumbrances registered against any real properties (as not all encumbrances show up on title documents as they should). Independent appraisals also may need to be carried out to ascertain the value of the primary properties.

Material Contracts

Material contracts should be examined to determine their potential impact on the valuation of the target company and if there have been/may be any breaches. Some examples of such contracts are major supply agreements, contracts with key customers, or purchase contracts for expensive or vital equipment.

Labour and Social Insurance-Related Matters

Generally, the purchaser should ascertain whether the target company’s labour practices are in line with PRC statutory requirements. For example, many PRC manufacturers require their employees to carry out overtime work but do not properly pay them for overtime, and some hire child labour. The purchaser should also ascertain whether all statutory labour benefits/social insurance contributions have been properly handled, as the target company may be held liable for making up any past due pension and social insurance contributions. Labour contracts signed between the target company and its key employees should also be reviewed to ascertain what additional arrangements or benefits have been promised. In addition, the purchaser should also ascertain whether there are any retired employees who are still on the payroll of the PRC target company, as such liabilities may be significant in some cases.

Environmental Matters

The purchaser should examine all environmental audit reports, environmental assessments and discharge permits to determine the target company’s compliance with the relevant PRC environmental
protection laws and regulations. Quite a number of Chinese companies consider the penalties of environmental violations cheaper than the clean-up costs. Also, some local authorities might not enforce environmental rules stringently for targets that are local Chinese companies but enforcement can suddenly increase as a result of the conversion of the local Chinese company into an FIE. The purchaser is therefore highly advised to appoint professional advisers to conduct a complete environmental audit of the target company at an early stage of the due diligence process.

Intellectual Property Matters

The intellectual property rights of a target company (for example, trade names, trademarks, patents, copyrights, technologies, know-how) can be valuable assets of the target and in some transactions may be the purchaser’s primary target. The purchaser should inspect the target company’s ownership of its intellectual property rights and ascertain whether any of these intellectual property rights are subject to encumbrances or third-party rights or interests. In addition, if the target company’s business depends on the use of certain intellectual property rights owned by third parties, the purchaser should review any relevant licence contracts to ensure that the target’s continued use of such intellectual property will not be problematic.

Disputes/Litigation/Arbitration

The purchaser should determine whether there is any outstanding or threatened arbitration or litigation against the target company, or whether there are any other claims or disputes.

Documentation and Agreements Required

Should the prospective purchaser decide to continue with the acquisition after completion of the due diligence investigations, then definitive legal documentation will have to be prepared. The exact documentation required under PRC law will depend on the nature of the target company and the structure of the transaction involved.
Please refer to the Consents and Approvals section earlier for the general documentation requirements for filing purposes.

**Checklist for Provisions in the Acquisition Documents**

Aside from the essential clauses setting forth the equity interest purchased, the consideration and the payment mechanism, the provisions required for an acquisition document in an M&A transaction in China can vary greatly, depending on the nature of the transaction and the type of assets involved. A tailor-made checklist should therefore be prepared for each transaction.

**Protective Clauses for the Purchaser**

Regardless of the type of transaction adopted and the precise documents needed, the purchaser should ensure that the acquisition documents include appropriate conditions precedent, as well as a set of comprehensive and appropriate representations, warranties and undertakings. Though the purpose of due diligence is to ensure that there are no unexpected liabilities and that the business and assets of the target company are in the condition represented, it is advisable for the acquisition documents to contain full and comprehensive representations and warranties with specific compensation provisions to cover any issues that may not have been disclosed and/or discovered in the due diligence.

Foreign investors should note that many target companies and local JV partners in China may resist such clauses, sometimes not because they have something to hide but simply because they are not used to a lengthy Western-style list of representations and warranties.

The purchaser’s own expectations as to what constitutes an appropriate amount of representations and warranties will also impact the negotiations of these clauses, as purchasers from common law jurisdictions typically demand very comprehensive and explicit representations and warranties, while purchasers from civil law jurisdictions may rely more on statutory protections provided under PRC law and demand fewer explicit representations and warranties.
Closing

The completion or closing requirements will depend on the nature and structure of the transaction involved. For example, in a direct equity acquisition, transfer of the registered capital of the target company is legally completed only following the issuance of formal approval by the relevant approval authorities and will require due registration with the local AIC. However, this requirement would not be applicable in an indirect equity acquisition or asset acquisition. In the case of state-owned equity transfers, the transaction will have to be completed at a property rights exchange as discussed in the Governmental Approval Processes for Acquisitions section above.

Subject to any applicable legal restrictions (e.g., full payment of purchase price within certain true periods under the M&A Regulations), the parties are generally free to decide the appropriate milestone for closing or completion of the transaction.
ADDITIONAL ISSUES FOR LISTED COMPANIES

Joint Stock Limited Companies and Listed Shares

All listed companies in China (which may include FISCs) are in the form of joint stock limited companies. The CSRC is generally in charge of regulation of listed company. PRC companies typically issue several types of listed shares.

- Domestic-listed shares (i.e. shares listed in one of the PRC stock exchanges):
  - “A shares” are listed shares denominated in RMB that may be subscribed for and traded by Chinese entities, Chinese citizens, Qualified Foreign Institutional Investors (QFII) and foreign strategic investors; and
  - “B shares” are listed shares denominated in RMB that may be subscribed for and traded in a foreign currency by foreign entities, foreign individuals and Chinese citizens.

- Overseas listed shares, which are shares listed on another major stock exchange outside of the PRC, such as “H shares” listed in Hong Kong, or shares listed on international stock exchanges such as New York or London.

Investments by Foreign Entities

Purchase of A Shares by Foreign Strategic Investors

Qualified foreign strategic investors are permitted to purchase A shares of listed companies.

In order to be qualified as a foreign strategic investor, a foreign company (or its parent company) must own at least US$100 million worth of overseas assets or manage at least US$500 million worth of overseas assets. From 1 July 2006, foreign-invested HCs also qualify as foreign strategic investors.
Foreign strategic investors may acquire A shares through a sale by agreement or issuance of new shares. The initial investment by the foreign investor should be at least 10 percent of the total issued shares of the listed company and the foreign investor will not be allowed to sell any of its purchased shares within three years.

**Purchase of A shares by QFIIs**

Foreign entities may also invest in A shares of listed companies through a QFII scheme. A QFII may invest in shares listed on domestic stock exchanges (only A shares), debt securities and other financial instruments, subject to the investment quota granted to it. Some of the relevant restrictions are that a single QFII cannot hold more than 10 percent of all the shares in a listed company and QFIIs together may not hold more than 20 percent of all the shares of a listed company.

**Investments by FIEs**

FIEs are also allowed to invest in PRC-listed companies if it has excess cash. It is possible for an FIE, including FISCs, to purchase A shares and non-traded shares of a domestic-listed company, subject to certain requirements and procedures. It is unclear whether there is a holding period requirement with respect to the A shares purchased by an FIE. However, if the FIE buys and sells A shares on a frequent basis, it may be deemed to engage in securities trading business and thus may exceed its permitted scope of business, which, in most cases, is unlikely to include trading of securities.

**Insider Trading**

Insider trading of securities is prohibited under the Securities Law. In a merger and acquisition transaction involving a domestic listed company, a number of individuals will knowingly be in possession of inside information and the prohibition of insider trading is relevant to those individuals. Any person with inside information on securities trading is prohibited from:
• Purchasing or selling shares of the target company;

• Disclosing such information to another person; or

• Recommending another person to purchase or sell shares of the target company.

Certain classes of individuals/entities (such as directors, supervisors, shareholders holding 5 percent or above of the shares in the relevant listed companies) are deemed under the Securities Law to possess inside information. The Securities Law also provides further definition on what constitutes inside information (e.g., plans concerning the takeover of listed companies and other major events). In any event, the CSRC is empowered to specify any additional class of persons as insiders and/or any additional class of information as inside information.

**Acquisition of Listed Shares by Significant Investors**

Pursuant to the Securities Law, an investor whose shareholding reaches 5 percent or more of the shares issued by a listed company through trading at a stock exchange must, within three days after the acquisition of such shareholding, submit a written report to the CSRC and the stock exchange, notify the listed company, and make a public announcement. During this period, such an investor is prohibited from continuing to purchase or sell shares in the listed company. The investor must follow similar procedures to report and make an announcement for each 5 percent increase or decrease in the shares it holds in the listed company through trading at a stock exchange.

Under the Measures for the Administration of the Takeover of Listed Companies revised as of 1 September 2006, an investor can take over a listed company by means of agreement, offer or centralised trading at competing prices on a stock exchange. The takeover consideration can be cash, legally negotiable securities or other payment methods permitted by laws and regulations. The acquiring party is required to make a general offer to all the shareholders of the target company if it intends to hold or control (whether individually or acting in concert
with other parties) more than 30 percent of the outstanding shares of the target company, unless this requirement is waived by the CSRC. Except in limited circumstances, the investor may elect to make a total offer or a partial offer, provided that the shares expected to be acquired pursuant to the partial offer represent not less than 5 percent of the company’s shares in issue.

The minimum offer price is the highest price paid by the investor for shares of that class during the period of six months before the takeover notice date.

Takeovers of domestic-listed companies by foreign investors are also subject to the stipulations under the Foreign Investment Catalogue (discussed in Summary of Foreign Investment Regime in the PRC above) in terms of the extent to which foreign participation in the underlying business is permitted.
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<td>Administration for Industry and Commerce</td>
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<td>China Banking Regulatory Commission</td>
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<td>CJV</td>
<td>Sino-Foreign Cooperative Joint Venture</td>
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<td>COFERT</td>
<td>Commission of Foreign Economic Relations and Trade</td>
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<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
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<td>FESCO</td>
<td>Foreign Enterprises Services Company</td>
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<td>EJV</td>
<td>Sino-Foreign Equity Joint Venture</td>
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<td>FIE</td>
<td>Foreign-Invested Enterprise</td>
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<td>FIP</td>
<td>Foreign-Invested Partnership</td>
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<td>Foreign-Invested Joint Stock Limited Company</td>
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<td>Holding Company</td>
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<td>Limited Liability Company</td>
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<td>MOU</td>
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<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>PRC</td>
<td>People’s Republic of China</td>
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<td>Abbreviation</td>
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<td>QFII</td>
<td>Qualified Foreign Institutional Investor</td>
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<td>Rep Office</td>
<td>Representative Office</td>
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<td>RMB</td>
<td>Renminbi, the official currency of China</td>
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<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
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<td>SAIC</td>
<td>State Administration for Industry and Commerce</td>
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<td>State-Owned Enterprises</td>
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<td>Special Purpose Vehicle</td>
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<td>Wholly Foreign-Owned Enterprise</td>
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