

GETTING THE DEAL THROUGH

# Mergers & Acquisitions

in 66 jurisdictions worldwide

# 2014

Contributing editor: Alan M Klein



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**Mergers & Acquisitions 2014****Contributing editor:****Alan M Klein****Simpson Thacher & Bartlett LLP**

*Getting the Deal Through* is delighted to publish the fully revised and updated fifteenth edition of *Mergers & Acquisitions*, a volume in our series of annual reports, which provide international analysis in key areas of law and policy for corporate counsel, cross-border legal practitioners and business people.

*Mergers & Acquisitions 2014* examines the law and regulation of business combinations and addresses the most important issues for international deals.

Following the format adopted throughout the series, the same key questions are answered by leading practitioners in each of the 66 jurisdictions featured. New jurisdictions this year include Angola, Mozambique, Panama, Portugal and Spain. Global and EU overviews are also provided.

Many legal disciplines come into play in large M&A deals. In particular, advisers must take account of competition regulation. This volume contains an appendix covering merger control rules across the world. For a more detailed analysis please refer to another volume of the *Getting the Deal Through* series: *Merger Control*.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually in print. Please ensure you are referring to the latest print edition or to the online version at [www.GettingtheDealThrough.com](http://www.GettingtheDealThrough.com).

*Getting the Deal Through* gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise in this field. We would like to thank Casey Cogut of Simpson Thacher & Bartlett LLP for his stewardship of the title over the last fifteen years. We would especially like to thank and acknowledge Alan M Klein as contributing editor of this and future editions.

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Global Overview 5

**Alan M Klein**  
Simpson Thacher & Bartlett LLP

EU Overview 7

**Richard Thexton and Rós Ní Dhubháin**  
Freshfields Bruckhaus Deringer LLP

Angola 10

**António Vicente Marques**  
AVM Advogados

Argentina 15

**Pablo Trevisán, Laura Bierzychudek and Walter Beveraggi**  
Estudio Trevisán Abogados

Australia 22

**Neil Pathak, David Clew and Peter Feros**  
Gilbert + Tobin

Austria 30

**Christian Herbst**  
Schönherr

Belgium 37

**Sandrine Hirsch and Vanessa Marquette**  
Simont Braun

Bermuda 44

**Peter Martin and Andrew Martin**  
MJM Limited

Bolivia 50

**Carlos Pinto-Meyer and Cristian Bustos**  
Ferrere Abogados

Brazil 54

**Vamilson José Costa, Ivo Waisberg, Antonio Tavares Paes, Jr, Gilberto Gornati and Stefan Lourenço de Lima**  
Costa, Waisberg e Tavares Paes Sociedade de Advogados

Bulgaria 60

**Yordan Naydenov, Angel Angelov and Nevena Dzhurova**  
Boyanov & Co

Canada 68

**Neill May and Rob Kallio**  
Goodmans LLP

Foreign Investment Review in Canada 75

**Richard Annan, Calvin S Goldman QC and Joel Schachter**  
Goodmans LLP

Cayman Islands 79

**Rob Jackson and Ramesh Maharaj**  
Walkers

China 84

**Caroline Berube and Ralf Ho**  
HJM Asia Law & Co LLC

Colombia 89

**Enrique Álvarez, Santiago Gutiérrez and Tomás Calderón-Mejía**  
Lloreda Camacho & Co

Czech Republic 98

**Rudolf Rentsch and Petra Trojanová**  
Rentsch Legal

Denmark 105

**Thomas Weisbjerg, Jakob Mosegaard Larsen and Martin Rudbæk Nielsen**  
Nielsen Nørager Law Firm LLP

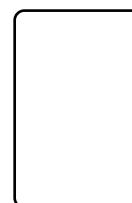
Dominican Republic 111

**Marielle Garrigó and Mariángela Pellerano**  
Pellerano & Herrera

England &amp; Wales 114

**Michael Corbett**  
Slaughter and MayPublished by  
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## CONTENTS

France	124	Kuwait	208	Romania	297
<b>Sandrine de Sousa and Yves Ardaillou</b> Bersay & Associés		<b>Ibrahim Sattout and John Cunha</b> ASAR – Al Ruwayeh & Partners		<b>Simona Mares and Lucian Danilescu</b> Mares / Danilescu / Mares	
Georgia	130	Latvia	213	Russia	304
<b>Revaz Javelidze and Eka Siradze</b> Colibri Law Firm		<b>Gints Vilgerts and Vairis Dmitrijevs</b> Magnusson		<b>Igor Akimov, Ilya Lifshits and Alim Oshnokov</b> EDAS Law Bureau	
Germany	135	Luxembourg	218	Saudi Arabia	309
<b>Gerhard Wegen and Christian Cascante</b> Gleiss Lutz		<b>Alex Schmitt, Chantal Keereman and Philipp Mössner</b> Bonn & Schmitt		<b>O Ali Anekwe and Babul Parikh</b> Baker Botts LLP	
Ghana	143	Macedonia	223	Serbia	316
<b>Kimathi Kuenyehia, Sr, Kafui Baeta, Valery Atuwo and Atsu Agbemabiase</b> Kimathi & Partners, Corporate Attorneys		<b>Emilija Kelesoska Sholjakovska and Elena Miceva</b> Debarliev, Dameski & Kelesoska Attorneys at Law		<b>Nenad Stankovic, Dusan Vukadin and Sara Pendjer</b> Stankovic & Partners	
Hong Kong	149	Malaysia	229	Singapore	323
<b>John E Lange and David M Norman</b> Paul, Weiss, Rifkind, Wharton & Garrison / David Norman & Co		<b>Wong Tat Chung</b> Wong Beh & Toh		<b>Ng Wai King and Mark Choy</b> WongPartnership LLP	
Hungary	155	Malta	235	Slovenia	331
<b>David Dederick, Pál Szabó and Eszter Katona</b> Weil, Gotshal & Manges		<b>Ian Gauci and Karl Sammut</b> GTG Advocates		<b>Nataša Pipan Nahtigal and Jera Majzelj</b> Odvetniki Šelih & partnerji, o.p., d.o.o.	
India	161	Mexico	241	South Africa	338
<b>Rabindra Jhunjunwala and Bharat Anand</b> Khaitan & Co		<b>Daniel Del Río and Jesús Colunga</b> Basham, Ringe y Correa, SC		<b>Ezra Davids and David Yuill</b> Bowman Gilfillan	
Indonesia	170	Morocco	247	Spain	344
<b>Mohamad Kadri, Johannes C Sahetapy-Engel and Almira Moronne</b> Arfidea Kadri Sahetapy-Engel Tisnadisastra (AKSET)		<b>Nadia Kettani</b> Kettani Law Firm		<b>Isidro del Saz, Gonzalo Navarro and María Grañén</b> Roca Junyent, SLP	
Italy	176	Mozambique	253	Switzerland	351
<b>Fiorella Federica Alvino</b> Ughi e Nunziantè – Studio Legale		<b>Hélder Paulo Frechaut</b> AVM Advogados		<b>Claude Lambert, Dieter Gericke, Reto Heuberger and Gerald Brei</b> Homburger	
Japan	182	Nigeria	258	Tajikistan	360
<b>Ryuji Sakai, Kayo Takigawa and Yushi Hegawa</b> Nagashima Ohno & Tsunematsu		<b>Theophilus Emuwa and Chinyerugo Ugoji</b> ÆLEX		<b>Denis Bagrov and Khujanazar Aslamshoev</b> Colibri Law Firm	
Kazakhstan	188	Norway	264	Thailand	364
<b>Azim Usmanov and Otabek Suleimanov</b> Colibri Law Firm		<b>Ole Kristian Aabø-Evensen</b> Aabø-Evensen & Co Advokatfirma		<b>Ruengrit Pooprasert, Archaree Suppakrucha and Anaknong Chaiyasri</b> ZICOlaw (Thailand) Limited	
Kenya	193	Pakistan	275	Turkey	369
<b>Michael Kontos, David Wayumba and Fahreen Alibhai Bid</b> Walker Kontos Advocates		<b>Bilal Shaukat and Shahbakht Pirzada</b> RIAALAW		<b>Tunç Lokmanhekim and Elif Çağla Yazdıç</b> ELİG Attorneys-at-Law	
Korea	199	Panama	281	Ukraine	378
<b>Gene-Oh (Gene) Kim and Joon B Kim</b> Kim & Chang		<b>Luis Chalhoub M and Jordana Fasano</b> Icaza, González-Ruiz & Alemán		<b>Galyna Zagorodniuk and Dmytro Tkachenko</b> DLA Piper Ukraine	
Kyrgyzstan	204	Peru	285	United Arab Emirates	383
<b>Zhanyi Abdrakhmanova</b> Colibri Law Firm		<b>Percy Castle and Carlos Carrasco</b> Casahierro Abogados		<b>Michael Hilton and Mohammad Tbaishat</b> Freshfields Bruckhaus Deringer	
		Portugal	291		
		<b>António Vicente Marques</b> AVM Advogados			

---

<u>United States</u>	<u>390</u>	<u>Venezuela</u>	<u>406</u>	<u>Zambia</u>	<u>416</u>
<b>Alan M Klein</b> Simpson Thacher & Bartlett LLP		<b>Jorge Acedo</b> Hoet Peláez Castillo & Duque		<b>Sharon Sakuwaha</b> Corpus Legal Practitioners	
<u>United States, Delaware</u>	<u>395</u>	<u>Vietnam</u>	<u>410</u>	<u>Appendix: International Merger Control</u>	<u>422</u>
<b>Rolin P Bissell and Elena C Norman</b> Young Conaway Stargatt & Taylor, LLP		<b>Tuan Nguyen, Phong Le, Hanh Bich, Huyen Nguyen, Hai Ha and Thuy Huynh</b> bizconsult law LLC		<b>David E Vann, Jr and Ellen L Frye</b> Simpson Thacher & Bartlett LLP	
<u>Uzbekistan</u>	<u>401</u>				
<b>Artem Klimenko and Ravshan Rakhmanov</b> Colibri Law Firm					

# China

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## 1 Types of transaction

How may businesses combine?

In China, 'business combination' is a legal concept – in simple terms, it generally means bringing together two (or more) separate companies into a single business.

The combination of companies can generally be divided into two types: absorption and consolidation. Absorption and consolidation are both kinds of merger.

Absorption is where a company absorbs another company or companies. The absorbing company will continue to exist while the company or companies being absorbed will be brought to an end.

Consolidation is where a completely new company is established and the two or more companies being consolidated are brought to an end.

For both absorption and consolidation, the remaining company shall take over all the credits and debts of the original companies.

## 2 Statutes and regulations

What are the main laws and regulations governing business combinations?

The main laws and regulations governing business combinations are as follows:

- The Company Law of the People's Republic of China (PRC), effective since 1 January 2006, recently revised on 28 December 2013; amendments came into effect on 1 March 2014: this law sets out some general procedures and conditions relating to business combinations, for example, the quorum required to pass a shareholder resolution with regard to a business combination.
- The Securities Law of the PRC, effective since 1 January 2006, revised on 29 June 2013: this law governs the purchase of listed companies (one of the ways of effecting a business combination).
- The State-Owned Assets of Enterprises Law of the PRC, effective since 1 May 2009: this law sets out some general requirements for combining state-owned companies, for example, an assessment of assets may be required before combination.
- The Accounting Standards for Enterprises No. 20 – Business Combination, effective since 1 January 2007: this regulation focuses on the accounting standards for business combinations.
- Circular on the Merger and Separate Establishment of Foreign Investment Enterprises, effective since 1 November 1999, recently revised on 22 November 2001: this regulation sets out the conditions, requirements and procedures around the combination of foreign-funded businesses.
- Opinions on Standards for Limited Liability Companies, effective since 15 May 1992: this regulation sets out some general procedures and requirements of business combinations with respect to limited liability companies.
- Opinions on Standards for the Companies Limited by Shares, effective since 15 May 1992: this regulation sets out the procedure and requirements of transaction agreements for a combination of companies limited by shares.

- Notice of the Ministry of Finance and the State Administration of Taxation on Several Issues Concerning the Enterprise Income Tax Treatment on Enterprise Reorganisation, effective since 1 January 2008: this regulation stipulates the treatment of enterprise income tax in relation to enterprise reorganisations.
- Announcement No. 4 [2010] of the State Administration of Taxation – Measures for the Enterprise Income Tax Administration of Enterprise Reorganisations, effective since 1 January 2010: this regulation sets out relevant tax matters in relation to enterprise reorganisations.

## 3 Governing law

What law typically governs the transaction agreements?

In general, PRC laws govern transaction agreements with regard to business combinations in China. Only agreements where one party is foreign entitle the parties to choose governing laws other than PRC laws.

However, the Contract Law of the PRC expressly provides that three types of contract shall be governed by PRC laws only: Sino-foreign equity joint venture contracts, Sino-foreign contractual joint venture contracts, and Sino-foreign cooperation contracts on developing natural resources.

However if an M&A transaction agreement has a foreign element and can be distinguished from the above three types of contract, the parties can choose any governing law other than PRC law.

## 4 Filings and fees

Which government or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other government fees in connection with completing a business combination?

### Filings

All company combinations shall be filed with the local Administration of Industry and Commerce (AIC) of the city where the company is incorporated. They shall also be filed with authorities which issue relevant company certificates (eg, tax bureaus) if the combination results in the establishment of a new company or any change on such certificates.

Prior approval is required for specific companies as follows:

- (i) Business combinations relating to solely state-owned companies shall be approved by the State-owned Assets Supervision and Administration Commission (SASAC). In addition, a business combination in relation to important solely state-owned companies must also be approved by the People's Government of the city where the company is incorporated after examination by the SASAC.
- (ii) A business combination in relation to foreign-funded companies shall be approved by the local Foreign Economic Trade Bureau (FETB).

## Fees

There are no statutory fees or taxes charged for the approval or registration of business combinations.

However, a registration fee will be charged by the AIC. In general, the registration fee for the establishment of companies is proportionate to the registered capital of the company (the rate is from 0.04 per cent up to 0.08 per cent); the registration fee for a company change is a fixed amount (usually 100 renminbi) per registration.

If the business combination is effected via share transfer, income taxes may be imposed on the seller on the income deriving from the sale of its shares.

## 5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

For ordinary companies, all the creditors shall be informed about the decision to combine within 10 days and the decision to merge shall be announced in a newspaper (usually local) within 30 days of the resolution of combination being executed.

For foreign-funded enterprises, all the creditors shall be informed about the decision to combine within 10 days and the decision shall be announced at least three times in a provincial or upper level newspaper published nationwide within 30 days of the preliminary approval being made by the competent administration. After registration of the business combination, an announcement about such registration shall also be published in a nationwide published provincial or upper level newspaper within 30 days of the company change being registered or a new business licence being issued.

## 6 Disclosure of substantial shareholdings

What are the disclosure requirements for owners of large shareholdings in a company? Are the requirements affected if the company is a party to a business combination?

There is no specific requirement for disclosure of large shareholdings in an ordinary company except the following for listed companies: Any investor owning a shareholding reaching 5 per cent of the issued shares of a listed company shall report such shareholding to the China Securities Regulatory Commission (CSRC) and the Stock Exchange, and inform the listed company and announce such shareholding via the local agency of the CSRC, within three days of such shareholding threshold being reached.

Any investor holding 5 per cent or above of the issued shares of a listed company shall report and announce its shareholding for every 5 per cent increase or decrease in the issued shares in accordance with the above-mentioned procedure.

In addition, an investor shall disclose further information as follows, if he holds more than 5 per cent but less than 20 per cent of the issued shares of a listed company while it is the first majority shareholder or actual controller of the listed company, or if he holds more than 20 per cent but less than 30 per cent of the issued shares in a listed company:

- the structure of the controlling shareholder, actual controller and the controlling relationship of the investor and his partner;
- the price of obtaining the relevant shares, the required capital amount, the source of the capital, or other payment arrangement;
- whether there is competition, continuous transaction between the business of the investor and the listed company; if any, whether the corresponding arrangement is conducted to ensure the independence of the listed company;
- the subsequent plan for the adjustment of the assets, business, personnel, organisation, or articles of association of the company in the coming 12 months;
- any important transaction between the investor and the listed company during the past 24 months; and

- evidence and documents demonstrating the good faith of the investor.

If the purchaser's shareholding reaches 30 per cent of the issued shares in a listed company and he continues to purchase shares, he shall issue an offer of purchase to all the shareholders of the listed company. However, in the event that the shareholding exceeding 30 per cent is due to the business combination being approved by the government or SASAC, such shareholder may apply to the CSRC for an exemption from the offer procedure.

## 7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

There are no specific duties of the directors, managers or controlling shareholders of an ordinary company except the following for listed companies:

### General duties

The directors and managers of a listed company shall be loyal and diligent to the company, and shall be fair and equitable to all the purchasers.

The controlling shareholder of a to-be-purchased listed company shall not harm the company or the other shareholders by abusing its shareholders' rights.

### Regarding purchase by offer

The board of directors of a listed company shall examine and investigate the identities and credit situations of the purchasers, advise the shareholders on whether to accept the offer to purchase, and hire independent financial consultants for professional advice.

The board of directors shall submit the report of the board and the professional advice of the independent financial consultant to the CSRC within 20 days of receiving the offer of purchase.

After the purchaser announces the offer and before the purchase is completed, the board of directors shall not, without the approval of the shareholders' meeting, dispose the assets of the company, or adjust the main business of the company, or provide guarantees or loans on behalf of the company, or take any other actions that may cause serious effect to the assets, debts, rights or operation of the company.

The directors of the to-be-purchased company shall not resign during the purchase period.

### Regarding purchase by agreement

The board of directors of a to-be-purchased listed company shall disclose promptly any situations that may damage the company. For example, the board of directors shall disclose if the controlling shareholder has not paid off a debt to the company, or that the guarantee provided to the company has not been released.

The controlling shareholder, who intends to transfer his shares of the listed company to the purchasers by agreement, shall investigate the identity, credit situation and offer from the purchasers and disclose information of such investigation in a report regarding the change of shareholding.

### Regarding indirect purchase

If the actual controller and the shareholder controlled by the actual controller of the listed company do not report or announce such controlling relation, the board of directors of the company shall refuse the proposal submitted by such controller or shareholder, and shall report such situation to the CSRC and the Stock Exchange.



## 8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

Shareholders have the power to approve the resolution of business combination. Specific requirements are as follows:

- for limited liability companies, the business combination shall be approved upon by at least two-thirds of all the shareholders with voting rights, whether present at the shareholders' meeting or not; and
- for companies limited by shares, the business combination shall be approved upon by at least two-thirds of all the shareholders with voting rights that are present at the meeting.

There is no specific regulation regarding the appraisal or similar rights of the shareholders in business combinations.

## 9 Hostile transactions

What are the special considerations for unsolicited transactions?

The Chinese laws and regulations do not expressly define the term 'hostile transactions' or stipulate detailed countermeasures for hostile transactions.

However, the considerations of disclosure of substantial shareholdings in question 6 cover the unsolicited transactions.

## 10 Break-up fees – frustration of additional bidders

Which types of break-up and reverse break-up fees are allowed?

What are the limitations on a company's ability to protect deals from third-party bidders?

There is no statutory 'break-up fee' stipulated by Chinese laws and regulations.

However, regarding limited liability companies, if any of the shareholders wants to transfer his shares to a third person, or the company is proposed to be combined with other companies, the other shareholders who disagree with such transfer or combination could have the following options to restrict the 'break-up' or transfer, according to PRC Company Law:

- to purchase the to-be-transferred shares at the equivalent price offered by the third person; or
- to request the company to purchase their shares at a reasonable price.

Besides the above-mentioned regulations, the 'break-up fees' could also be based on the termination and damage terms, if any, in the joint venture agreement between the shareholders. The parties of a contract could either set a fixed amount or rate of liquidated damages for the break-up or stipulate that the damages shall be subject to actual losses therefrom.

## 11 Government influence

Other than through relevant competition regulations, or in specific industries in which business combinations are regulated, may government agencies influence or restrict the completion of business combinations, including for reasons of national security?

Government agencies do influence or restrict the completion of a business combination if it relates to solely state-owned companies and/or state-owned assets. Please see (i) under 'Filings' in question 4.

Such regulations are believed to be aiming to protect the state-owned assets for the purpose of national security.

## 12 Conditional offers

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, may the financing be conditional?

In practice, there are various types of transaction that occur in China, such as leveraged buyouts, venture capital, mezzanine capital and growth capital transactions, angel investments and private investment in public equity.

Financing may be conditional in a cash acquisition.

## 13 Financing

If a buyer needs to obtain financing for a transaction, how is this dealt with in the transaction documents? What are the typical obligations of the seller to assist in the buyer's financing?

The buyer and the seller shall stipulate all the details (ie, term, conditions, period) in the transaction agreements. In China, a lot of certificates, application letters and reports shall be submitted to the relevant authority for approval. Therefore, the seller is responsible for providing the related documents to the buyer and/or the relevant authority, such as the business licence, audit report, verification report, asset assessment report, resolution of the board of directors/shareholders, tax paid proof and so on.

## 14 Minority squeeze-out

May minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

Yes, minority stockholders may be squeezed out.

In a limited liability company, stock can be transferred among stockholders. However, if the stockholder wishes to transfer to any non-stockholder, he shall be subject to the approval of more than half of the other stockholders. The stockholder shall notify the other stockholders in written form about the transfer of stock for their approval. If any of the other stockholders fails to give a reply within 30 days after the receipt of the written notice, it shall be deemed to have agreed to the transfer. If half or more of the other stockholders disagree with the transfer, the stockholders who disagree with the transfer shall purchase the stock to be transferred. If they refuse to purchase these stock, they shall be deemed to have agreed to the transfer. Under the same conditions, the other stockholders have a pre-emptive right to purchase the stock rights to be transferred upon their approval.

In a joint-stock limited company, stock shall be transferred to anyone in a lawfully established stock exchange or by any other means as prescribed by the State Council. In addition, the stock held by the initiators shall not be transferred for a period of one year starting on the day of incorporation of the company.

## 15 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Apart from the foreign investment restrictions, China adopts a strict foreign exchange control policy which brings complexity and difficulties to cross-border transactions if the target company is a Chinese public company. The foreign acquiring party must apply for approval to open a bank account in foreign currency in order to receive capital for the transaction with the local Administration of Foreign Exchange where the listed company is located within 15 days upon its receipt of the official approval from the Ministry of Commerce. All transactions must generally be completed within 180 days upon receipt of the official approval. If the foreign acquiring party fails to complete the whole transaction within the above time limit, the official approval will become invalid automatically.

The foreign acquiring party shall, upon the approval of the Chinese Administration of Foreign Exchange, purchase foreign currency and remit the capital abroad.

Specific laws and regulations apply to cross-border transactions:

- Interim Provisions on Restructuring State-owned Enterprises with Foreign Investment which took effect on 1 January 2003.
- Ministry of Commerce on Promulgation of the Provisions on M&A of a Domestic Enterprise by Foreign Investors which took effect on 22 June 2009.
- Provisions for the Alteration of Investors' Equities in Foreignfunded Enterprises which took effect on 28 May 1997.

#### 16 Waiting or notification periods

Other than as set forth in the competition laws, what are the relevant waiting or notification periods for completing business combinations?

As mentioned in question 15, the foreign acquiring party must apply for approval to open a bank account in foreign currency in order to receive capital for the transaction with the local Administration of Foreign Exchange where the listed company is located within 15 days upon its receipt of the official approval from the Ministry of Commerce. All transactions must generally be completed within 180 days upon receipt of the official approval.

In addition, the foreign investor shall, when merging a domestic enterprise to establish a foreign investment enterprise, within three months as of the day the foreign investment enterprise is issued its business licence, pay all the consideration to the shareholders who transfer the equities or to the domestic enterprise which sells the assets. In case of any particular circumstance under which the period needs to be extended, the foreign investor shall, approved by the approval authority, pay 60 per cent or more of the consideration within six months as of the day when the foreign-funded enterprise is issued its business licence, and pay all the consideration within one year, and the proceeds shall be distributed according to the proportion of investments it has actually contributed.

#### 17 Sector-specific rules

Are companies in specific industries subject to additional regulations and statutes?

One of the most important industry-specific regulatory schemes in China is the Catalogue for Guidance for Foreign Investment (CGFI), which indicates the Chinese government's attitudes in controlling foreign investment. Industries have been classified into four different categories: allowed, encouraged, restricted and prohibited.

These categories reflect the extent to which foreign participation is allowed when investing in China. For example, foreign shareholdings in a life insurance company shall not exceed 50 per cent, and those in a securities company shall not exceed one-third of the total shares, and the Chinese shareholder shall be the majority shareholder of a jointventure security company (both industries, however, fall under the restricted category) (articles 7.2 and 7.3 of the Restricted Industries section of the CGFI). These are the limits on potential targets and may have an implication on investment strategies, as exit strategies are more difficult to implement when one is not the majority shareholder.

#### 18 Tax issues

What are the basic tax issues involved in business combinations?

Stamp duty shall be charged to the buyer and seller at a rate of 0.05 per cent of the consideration for the transfer of shares. The shareholders of the target company (both individual and corporate) shall also be subject to income tax, whether individual (article 2 of the Individual Income Tax Law) or enterprise (article 3 of the Enterprise Income Law), based on the purchase price of the transaction;

however, none of the parties shall pay any business tax (article 1 and 2 of the Circular Caishui (2002) No. 191).

Under Chinese tax law, share acquisition is more tax-effective than assets acquisition. For example, when purchasing tangible assets, value added tax (VAT) shall apply to the purchasing party according to the tax rate applicable to each type of assets (article 1 of the Interim Regulations of the PRC on VAT). When transferring ownership of real estate or intangible assets, the target company shall be subject to a 5 per cent business tax (article 1 and the Schedule of the Interim Regulations of the PRC on Business Tax) and the buyer shall pay a deed tax varying between 3 per cent to 5 per cent if the assets involve land-use rights or property titles (articles 1 and 3 of the Interim Regulations of the PRC on Deed Tax).

The payment method further influences the tax payable in a transaction. In the event that the acquirer pays by cash, the cash received by the shareholder of the target company shall be subject to income tax. If the acquirer pays with unconvertible bonds, the interest earned on the bonds received by the shareholder shall also be subject to income tax, but the interest paid by the acquirer shall be deducted prior to taxation. If the acquirer pays with convertible bonds, the acquirer can defer the process of converting the bonds to shares. By doing so, the interest paid by the acquirer shall be deducted from the taxable amount and the tax on capital gains from the conversion shall be deferred, too, which is beneficial to the acquirer.

Finally, if the transaction was carried out through the swapping of shares, it shall be exempted from income tax, as no actual monetary income was earned as a result of the transaction.

#### 19 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

Mergers and acquisitions of a company will not influence the current employment relationship between the acquired company and its employees. If the new shareholder wishes to terminate the employment relationship with the employees, severance pay shall be given in accordance with the related labour laws and regulations (articles 47 and 87 of the Employment Contract Law of the PRC). Employment issues, especially the compensation of senior managers of the target company or the compensation to settle the laid-off employees in a state-owned enterprise are important issues to be addressed in the purchase agreement and may sometimes influence the costs of the entire transaction.

#### 20 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

According to the Company Law of the PRC, all the debts of the acquired company shall be borne by the acquiring company or the new company after combination. Therefore, a due diligence report issued by a law firm, a verification report issued by an accounting firm and other relevant documents (ie, asset certificate of the acquired company) are necessary and taken into account.

#### 21 Anti-corruption and sanctions

What are the anti-corruption, anti-bribery and economic sanctions considerations in connection with business combinations?

There are no specific rules relating to anti-corruption, anti-bribery and economic sanctions considerations in connection with business combinations, but the general rules of the Criminal Law on corruption, bribery and economic sanctions apply to business combinations.



**Update and trends**

As a result of the amendment to the Company Law of the People's Republic took effect on 1 March 2014, there are three factors that may affect the trends in M&A:

- capital verification reports are no longer required to be submitted to the authorities for verification. This will speed up M&A transactions and reduce costs for the parties;
- capital contribution shall not longer be at least 30 per cent of the total registered capital is. Capital is no longer essential and required and technology and other property (ie, tangible or intangible asset) can be used as capital contribution by the parties when acquiring shares. This will impact M&A transactions; and
- there is no longer minimum registered capital required for a limited liability company or a joint-stock company. Stockholders can also stipulate in the articles of association the time frame for the payment of their capital contribution.

In view of the above three factors, the approval process from the authorities will be faster and the process of M&A transactions will be shortened and simplified. As the government will not step into the process, parties should investigate more carefully the background and credit of a stockholder.

As to the corruption, it is only applicable to any state functionary, and any person authorised by state organs, state-owned companies/enterprises/institutions or people's organisations to administer and manage state-owned property who, by taking advantage of his office, appropriates, steals, swindles public money or property or by other means illegally take it into his own possession. The threshold of the crime is 5,000 renminbi or above, or the amount is less than 5,000 renminbi but the circumstances are relatively serious.

As to the bribery, it is applicable to any individual or legal entity who offers money or property to any state functionary, any person authorised by state organs, state-owned companies/enterprises/

institutions or people's organisations to administer and manage state-owned property, and any state organs, state-owned companies/enterprises/institutions or people's organisations for the purpose of gaining illegal benefits. Bribery is defined as illegal benefits obtained by blackmailing.

In addition, both corruption and bribery are subject to financial sanctions. Any person who takes into his own possession illegal gains derived from bribery shall be convicted and punished in accordance with the Criminal Law.



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