LLINKS Law Offices
通力律师事务所

Shanghai
21F, South Tower
Shanghai Stock Exchange Bldg.
528 Pudong Road South
Shanghai 200120 P.R.China
Tel: (86 21) 6881 8100
Fax: (86 21) 6881 6880

上海
上海市浦东南路528号
上海证券大厦南塔21楼
邮政编码: 200120
电话: (86 21) 6881 8100
传真: (86 21) 6881 6880

www.llinkslaw.com

Beijing
Units 902-903
Winland International Finance Centre
No.7 Finance Street, Xicheng District
Beijing 100034 P.R.China
Tel: (86 10) 6655 5050
Fax: (86 10) 6655 5060

北京
北京市西城区金融大街7号
英蓝国际金融中心9楼02-03单元
邮政编码: 100034
电话: (86 10) 6655 5050
传真: (86 10) 6655 5060

master@llinkslaw.com

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New Guidelines on FDI in China and the Impact on M&A

By Grant Chen and Nicholas Lou

On 6 March 2007, China's Ministry of Commerce (**MOFCOM**) issued the Guiding Opinions *of the General Office of the MOC of the People's Republic of China, on the Work of Absorbing Foreign Investment Nationwide in 2007*(**the Guiding Opinions**), which explained the general goals of government policy toward foreign investment and further provided several guidelines on some detailed aspects of foreign investment in China.

The Guiding Opinions acknowledged that in 2007, most investment by multinational corporations will continue to be conducted through M&A activity. Accordingly, they emphasize that the administration of foreign investment in China should be strengthened and that foreign investor's M&A of domestic enterprises should also be guided and regulated. The authorities intend, through the Guiding Opinions, to encourage fair competition and prevent monopolistic or malicious M&A activities. This will preserve domestic control over critical industries and key sectors.

Obviously, the Guiding Opinions' major effect on foreign investors' M&A of domestic enterprises is the strict regulation of monopolistic and malicious M&A. Under the Guiding Opinions, authorities may strengthen the approval process and restrict the approval of any M&A projects which are found to be monopolistic or malicious. These approval authorities include but are not limited to MOFCOM and the National Development and Reform Commission (**NDRC**), and their local branches.

Monopolistic M&A

Although the Guiding Opinions did not define monopolistic M&A, the *Interim Provisions on the Takeover of Domestic Enterprises by Foreign Investors,* published in 2006, established procedures for antitrust review of foreign investors' M&A of domestic enterprises. In particular, the *Interim Provisions* established criteria for when a foreign investor must report its M&A activities to MOFCOM and the State Administration of Industry and Commerce (**SAIC**) and when an anti-trust review is required.

如果您需要本出版物的中文本，请与下列人员联系：

韩东红: (86 21) 6881 8100 - 6609
Publication@llinkslaw.com

If you would like other Llinks publications, please contact:

Lily Han: (86 21) 6881 8100 - 6609
Publication@llinkslaw.com

Llinks Law Offices
www.llinkslaw.com

Malicious M&A

Unlike monopolistic M&A, neither the Guiding Opinions nor any current regulations expressly define or provide criteria for malicious M&A. Government approval authorities will therefore have the power to judge, at their own discretion, whether M&A transactions are malicious.

One example of malicious M&A might be a hostile takeover resulting in the loss of major Chinese brands or companies, or loss of domestic control over the companies, even though the purchase price may be considerable. Hostile takeovers whose goal is merely to sell off the target's assets or shares after taking over the domestic target, without adding value or without bringing benefits to the domestic industries might also be considered malicious. Under the Guiding Opinions, such takeovers might then be rejected by the approval authorities.

Malicious M&A will not necessarily be hostile takeovers. Another possible example might be a foreign investor taking advantage of a domestic enterprise's business difficulties or cash flow problems to acquire the target at an unreasonably low price. Even if the foreign investor contributes to the management and development of the enterprise, and does not merely sell out its shares at a higher price, such M&A without a considerable price might also be deemed to be malicious and might not receive government approval. These situations may occur more often if a deal involves state-owned assets, which might also result in more strict examination and approval process.

The Guiding Opinions did not provide any detailed mechanism for preventing malicious M&A. The government is therefore likely to issue more detailed regulations or implementing rules on this topic soon. In particular, there may be new restrictions on foreign investment in certain industries as well as new procedural policies or practices in the approval process of foreign investment in China including M&A transactions.

Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual Llinks contact.

Shanghai	Beijing
David Yu Tel: (86 21) 6881 8100 - 6635 David.Yu@llinkslaw.com	**Wayne Chen** Tel: (86 10) 6655 5050 - 1022 Way.Chen@llinkslaw.com
Grant Chen Tel: (86 21) 6881 8100 - 6613 Grant.Chen@llinkslaw.com	

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