Legal Gaps Deter Acquisitions

—— Grant Chen

The *Notice on Several Issues Relating to Registrations of investment Companies* (Notice), promulgated by the State Administration for Industry and Commerce (SAIC) on April 25 1997, gives a definition of an investment company. The Notice provides that a domestic investment company may invest in any area other than those prohibited by laws and regulations, and may simultaneously engage directly in other non-investment related business. Domestic companies hoping to register as investment companies will find that establishment and shareholders' qualifications requirements are not overly burdensome.

Regulating foreign investors

On June 10 2003, the PRC's Ministry of Commerce promulgated the *Establishment of Companies with an Investment Nature by Foreign Investors Provisions* (New Provisions). The four regulations that had previously governed foreign-invested investment companies in China have been repealed by Article 29 of the New Provisions, although relevant clauses from this earlier legislation have been incorporated into the new law.

However, although the New Provisions detail establishment procedures, business scope and other related requirements concerning foreign-invested investment companies, there are gaps. Most notably, the new legislation is silent on establishing a foreign-invested investment company by way of taking over an existing domestic investment company.

Acquisitions by foreign investors

According to the *Acquisition of Domestic Enterprises by Foreign Investors Tentative Provisions* (Tentative Provisions), promulgated on March 7 2003, a foreign investor that obtains the necessary approvals may acquire a domestic enterprise. Assuming a foreign investor complies with the requirements of PRC legislation governing investor qualifications and industrial policy, it may purchase a shareholding in an enterprise other than a foreign-invested enterprise (i.e. a domestic company) or subscribe to a domestic company's increased capital. Both these methods will result in the domestic company being converted into a foreign-invested enterprise.

However, the Tentative Provisions do not provide any guidance on the feasibility or process for the acquisition of a domestic investment company by a foreign investor. There are several grey areas that need to be addressed in order to clarify the PRC's policy on this kind of acquisition.

Qualifications of investors

According to the New Provisions, a foreign investor who intends to set up an investment company in the PRC must meet certain requirements Among other things, the foreign investor must have set up more than 10 foreign-invested production or infrastructure construction enterprises in the PRC that are engaged in production or infrastructure construction, and have injected a total registered capital of over US$30 million into these enterprises.

If a Sino-foreign joint venture is to be set up, the Chinese investor's total assets in the year before it submits its establishment application must have been at least RMB100 million.

The requirements that shareholders of a domestic investment company need to meet are not as strict as those for shareholders in a foreign-invested investment company. The question of whether the requirements in the New Provisions also apply to a foreign investor and/or a Chinese investor when converting a domestic investment company into a foreign-invested investment company is not addressed in the existing legislation.

This is not the only difficulty. As mentioned above, domestic investment companies are permitted to engage in business activities other than investment. The New Provisions, however, state that foreign-invested investment companies are prohibited from engaging directly in production. Where a foreign investor plans to acquire a domestic investment company, it is unclear whether the business scope of the investment company should be amended to satisfy the requirements of the New Provisions.

These legislative gaps will likely prove a major deterrent to any foreign investor that is examining the possibility of acquiring a domestic investment company and will need to be addressed in order to promote such transactions.

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