



China: Opportunities and Challenges for Foreign Automotive Suppliers in China

In cooperation with:



Overview

Part I Equity Investment in China

Part II Acquisition in China

Part III Chinese Land System

Part IV Foreign Exchange Control in China

Part V Intellectual Property Protection in China

Part VI Dispute Resolution with Chinese Parties

Part I

Equity Investment in China

Guideline Catalogue for Foreign Investment

– Guideline Catalogue of Industries for Foreign Investment (2011)

Four categories:

- Encouraged/ Permitted / Restricted /Prohibited

– China intends to revise the Guideline Catalogue

Under the draft, for production of (a) automobile electronic bus network technologies, (b) electronic controllers for electric power steering system and (c) embedded electronic integrated systems, a joint venture with the Chinese partner will no longer be required.

Legal Forms

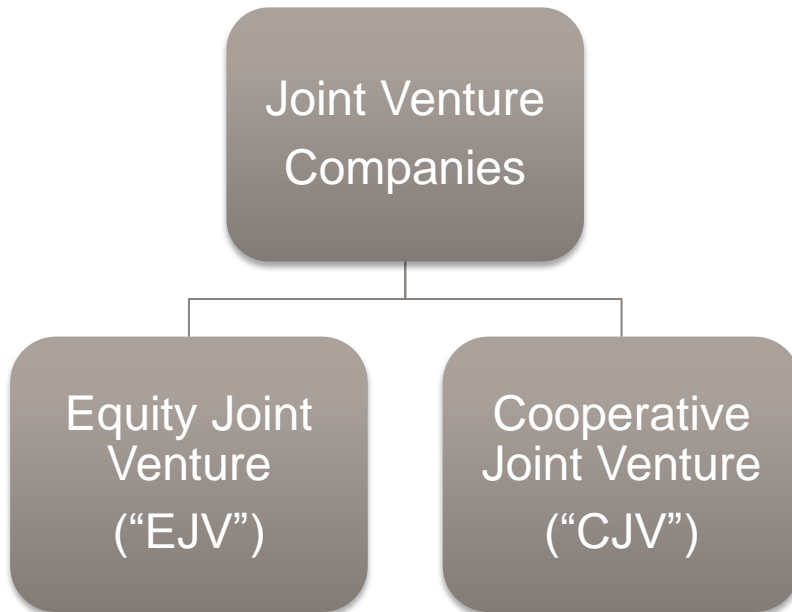
Representative Office ("Rep Office")

- No registered capital commitment
- Shorter timeframe for establishment
- No legal person status
- Permitted Activities
- Hiring of Chinese employees

Wholly Foreign- Owned Enterprise ("WFOE")

- Most popular investment vehicle
- Complete control
- Business requirements
- *✓ Permissible under the Guideline Catalogue?*

Legal Forms (cont.)



- Difference between EJV and CJV
 - Legal person status
 - More flexible arrangement between joint venture partners
 - EJV is more preferred
- Majority or minority shares?
- Statutory requirements on unanimous approval of certain matters in the JVC
- **At least 25% of capital contribution by foreign investor(s)**

Part II Acquisition in China

Due Diligence

- Comprehensive legal, financial and tax due diligence required (sometimes also environmental due diligence)

- Typical problems
 - Missing titles of lands and buildings
 - Non-payment of social security contributions for employees;
 - Cross guarantee with non-affiliates;
 - Environmental protection permits are not complete;
 - Barely insurance coverage;
 - In state-owned enterprises: number of employees exceeds the requirements of actual business volume.

Deal Structure

– *Deal Structure*

- Share Deal
Buying shares from existing shareholders
or making capital increase in the target
- Asset Deal
- Acquisition of shares tends to be more popular because
 - ✓ an asset acquisition may require third party consents
 - ✓ different tax implications on the seller

Share Deal

- Share Transfer Agreement will only become effective upon approval by the competent authority of commerce
- The transfer of shares in rem shall take place upon approval by the competent authority of commerce and registration with the competent company registration authority.
- Purchase price shall be paid within 3 months after issuance of the revised Business License of the target reflecting the acquisition (*in case the target is wholly domestically-owned enterprise*).

Exception: after approval by the authority, 60% within 6 months after issuance of the Business License, the rest within 1 year.

Asset Deal

- Approval by the Chinese government agencies is required under certain circumstance

- Transfer of contracts and account payable requires the prior consent from counterparties
 - Due to the foreign exchange control in China, cross-border AP and AR are not transferrable.

- Transfer of certain assets requires the registration with Chinese authorities
 - e.g. transfer of patents, real estate, etc.

- Transfer of employees

Additional Regulations to State-owned Assets

- Transfer of state-owned assets is subject to the approval of the competent State-owned Assets Administration
- Assessment of the shares and assets by specially licensed Chinese asset evaluation firm is required and the assessment result shall be registered
- Handling of the transaction has to be carried out by the government Equity Exchange Center and public tendered.
Exception: relevant approval of State-owned Assets Administration at the provincial level

Security Review

- Since 3 February 2011, security review through the Joint Security Committee is required in the following cases:
 - Acquisition of companies in the military sector; companies that are located near military facilities; companies relating to national security issues;
 - Acquisition of companies in the areas of important agricultural products, important energies or commodities, important infrastructure, important shipping companies, key technology and production of key equipment (foreign investor may acquire a controlling interest).
- The Ministry of Commerce (“MOFCOM”) will decide whether the transaction is subject to security review and notify the foreign investors.

Merger Control Review

- Competent authority: the Anti-Monopoly Bureau of the MOFCOM

- Cases of the relevant concentration
 - Merger with undertakings;
 - Acquiring control of other undertaking by way of share acquisition or asset acquisition; or
 - Acquiring control of other undertaking or becoming able to exercise decisive influence over other undertaking by virtue of agreement or other means.

If two or more undertakings have common control of a newly established joint venture, such joint venture project will also qualify as a “concentration”.

Merger Control Review (cont.)

Turnover thresholds

	Aggregate annual turnover of all the undertakings in the preceding fiscal year	Individual annual turnover in the preceding fiscal year (at least two undertakings)
Threshold 1	Worldwide: RMB 10 billion	From China: RMB 400 million
Threshold 2	From China: RMB 2 billion	From China: RMB 400 million

Merger Control Review (cont.)

- Timeframe: From 30 days to 180 days

- A concentration can only be implemented after the merger control clearance
 - No approval process in China shall commence before obtaining the clearance.**

- Legal consequence
 - order the cease of the implementation
 - order a disposal of the relevant shares or assets or assignment of the concerned business within a prescribed time limit
 - order to take any other measures to reinstate the pre-concentration status
 - a fine of up to RMB 500,000 (in addition)

Closing for Acquisition

- Closing Date cannot be a specific date included in the acquisition agreement.
- Closing Date occurs upon fulfilment of certain conditions precedent, usually governmental approvals

In case of a share deal:

- Verification/recordal by the Development and Reform Commission
- Approval by the Authority of Commerce
- Registration with the company registration authority, i.e. the Administration for Industry and Commerce
- Merger control review / security review

Part III

Chinese Land System

Chinese Land System

- All land in the PRC is either state-owned or collectively owned.
- Companies are permitted to hold, lease and develop land for which they are granted land use rights.
- Lands are granted through public bidding process.
- Chinese joint venture partner contributes or leases the allocated land to the Joint Venture?

Part IV

Foreign Exchange Control in China

Foreign Exchange Control in China

- Renminbi is convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions.
- Conversion of Renminbi for capital account items, such as direct investment, loans, investment for securities and repatriation of investment, however, is still subject to the approval of the State Administration of Foreign Exchange (“**SAFE**”) or its local counterparts.
- Restriction on the registered capital of foreign invested enterprises (“FIEs”) - *Recent Changes in Certain Areas*

Part V

Intellectual Property Protection in China

Intellectual Proprety Protection in China

- Types of IP rights: patents, trademarks, copyrights, trade secrets and know-how etc.

Patents: inventions / utility models / industrial designs

- Registration authority : State Intellectual Property Office, Beijing
- Patent right is established upon registration

Trademarks: words, logos, letters, numerals, 3D signs, combination of colors and sounds

- First-to-file principle
- Registration authority: State Trademark Office, Beijing

Intellectual Property Protection in China

Remedies against Infringement of a patent/ a trademark:

Administrative actions

- fast and less costly
- order cessation
- confiscate products and tools
- fines
- cannot award damages

Court proceedings

- more time and cost-consuming
- order cessation
- confiscate products and tools
- fines
- award damages

Part VI

Dispute Resolution with Chinese Parties


Litigation or arbitration?

- China: not yet acceded to the *Hague Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Criminal Matters*; no reciprocity exists between China and most foreign countries
- Foreign contract parties: no trust in local courts in China
- Arbitration – to be agreed between the parties in advance
China is a member state to New York Convention

Arbitration in Asia

10 years ago: mainly foreign arbitration institutions, e.g. Stockholm, Zürich

Now: if foreign arbitration institution: SIAC or HKIAC and mostly: Chinese arbitration institutions



CIETAC 中国国际经济贸易仲裁委员会
CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION

HKIAC 香港國際仲裁中心
Hong Kong International Arbitration Centre

SIAC Singapore International Arbitration Centre

CIETAC	2009	2010	2011	2012
Foreign-related	560	418	470	331
Domestic	922	934	965	729
HKIAC	2009	2010	2011	2012
International	309	175	179	199
Domestic	120	116	96	94
SIAC	2009	2010	2011	2012
	160	198	188	235

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