Measures for Administration of the Acquisition of Listed Companies ("Measures")

- Preliminary Analysis –

The Measures were promulgated by the China Securities Regulatory Commission ("CSRC") on September 28, 2002 and will come into effect on December 1, 2002.

- The Measures represent a much-needed elaboration of the takeover provisions found at Chapter IV ("Acquisition of Listed Companies") of the 1999 PRC Securities Law ("Securities Law"), and seek to set forth certain procedural, filing, notification, disclosure and approval requirements related to the acquisition of shares of PRC companies that have listed shares. In addition, the Measures set out some of the concrete circumstances where a waiver of application of such provisions may be given by the CSRC.

Key aspects of the Measures include:

- Confirmation that the central CSRC in Beijing continues to have strong authority over any activity that might implicate the acquisition of "control" of publicly-listed PRC companies. Such authority comes at the expense of the Shanghai and Shenzhen Stock Exchanges, as well as the local offices of the CSRC. This tight control is perhaps best expressed by the power of the central CSRC to approve proposed offers for the shares of publicly-listed companies, and in some cases to cause the proposed purchaser to change price or other offer terms.

- Even though there is ample provision in the Measures for timely reports to the CSRC and the stock exchanges, and a whole host of required public disclosure and announcements (*i.e.*, intention to acquire, report on acquisition, directors and independent directors' views, professional opinions (both fairness opinions and legal opinions), etc.), the Measures express a very clear business regulation philosophy, rather than the pure disclosure model favored in other jurisdictions.

- Control of public companies may be acquired by private agreement, "public offer" (akin to a mandatory offer directed at all non-participating shareholders, with a 30-60 day offer period), private agreement that triggers a public offer, or competitive bidding triggered by a public offer.

- The key threshold indicating "control" is ownership of 30% of *all* the issued share capital of a PRC company.

- Most importantly, this 30% threshold includes *all* share capital, and not just shares that are listed and traded on Chinese or foreign stock exchanges. This is a change from Article 81 of the Securities Law, which limited the applicability of the mandatory offer provisions to purchasers whose ownership exceeded the 30% threshold through their acquisition of "securities trading on a stock exchange". Thus, for example, if a Chinese or foreign shareholder held 28% of a company's illiquid legal person shares or unlisted foreign capital shares and then sought (itself or through another entity deemed to be part of its control group) to purchase listed shares of the same company equal to 2% of the company's share capital, the

procedures and substantive review described under the Measures would be triggered, as would the requirement of a mandatory offer to all other shareholders of the company – including shareholders of unlisted and listed shares.

- The Measures provide for minimum permissible prices that may be offered in the public offer context, for both listed and unlisted shares. For listed shares, the minimum permissible price is calculated according to recent trading history; for unlisted shares, the minimum permissible price is either the highest price paid by the same purchaser within the prior six (6) months for the same kind of unlisted shares, or the most recent audited "book value" per share of the company to be acquired. The CSRC may waive these constraints upon application, but it may also require adjustments where the proposed price is "obviously unfair".

- The CSRC is fully empowered under the Measures to grant waivers of mandatory offer requirements. Some of these potential waivers arise in easily understood contexts: *i.e.*, technical impossibilities (especially as regards foreign investors holding certain kinds of Chinese shares – see the immediately following bullet), ownership adjustments arising from decrease of capital (buy-backs), underwriters' possession of shares, acquisitions arising from the implementation of court decisions, inheritance, workouts and restructurings of failing companies, etc. In addition, there is also tacit acceptance of broadly defined control groups in China, such that transfers amongst the same controlling persons will not trigger a public offer. Nor will mandatory offers apparently be triggered by acquisitions of control pursuant to government-mandated transfers and/or allocations of state-owned assets – a characteristic of China's state-owned property rights and corporate structure system.

- The Measures leave to another day the vexing problems of: (i) transfers of illiquid state-owned and legal person shares to non-state (or even foreign) actors, and (ii) the ability of foreign investors to buy listed shares they are not now permitted to purchase. For instance, under the Measures, a Chinese or foreign purchaser that goes over the 30% threshold might be obligated to make an offer for shares of a company held by the state or a legal person – not readily transferable to any person (and actually forbidden in the case of a foreign purchaser pursuant to a 1995 State Council ban). Or a foreign purchaser that goes over the 30% threshold might be obligated to make an offer for "A" shares of a PRC company, which technically may not be purchased, held or traded by foreign persons. The Measures finesse these problems by referring to special required approvals or allowing for applications to the CSRC for a waiver in these specific cases. The important implication of the Measures is that they do not completely dismiss these possibilities, and thus may be taken as an indication that allowances for certain of the mandated, but now technically impossible, transactions may be forthcoming.

- Various actors in public company acquisition transactions – controlling shareholders, "actual controlling persons", directors, supervisors and senior officers -- are held to a newly-described duty of care: "*chengxin yiwu*" or what we have translated as "fiduciary duty". While it seems certain that this is not meant to import wholesale "fiduciary duty" and standards of care developed under better elaborated jurisprudence in Hong Kong, the United Kingdom or the United States, this does represent the first time such a duty has been explicitly identified in a

Chinese statute, with a description as to whom precisely the duty is owed -- the company and the other shareholders. (The only previous attempt to import fiduciary duty into PRC law on corporations was in the letter from the now-defunct Commission on Restructuring of the Economic System ("CRES") to the Hong Kong Stock Exchange of June 1993 in connection with proposed Hong Kong or "H" share listings of PRC companies. In that letter, CRES assured Hong Kong regulators that a form of words in Article 62 of the now superseded "Opinion on Standards on Companies Limited by Shares" (subsequently absent in the PRC Company Law, but reinstituted for overseas issuers in the CSRC's "Overseas Listing Rules") had "… the same meaning as '*chengxin zeren* [fiduciary duty]' of Hong Kong law.")

- Notwithstanding the articulation of new duties, there is no explicit right granted to individual shareholders to bring a cause of action against breaching purchasers, officers, directors and supervisors, the company, etc. This is consistent with the Securities Law, notwithstanding the immense pressure in China from private shareholders to bring private actions against illegal behavior. By the same token, the Measures do not forbid private suits, and we may thus expect pleadings by aggrieved minority shareholders and other actors in the near future.

- Boards of directors and independent directors are under a duty to opine on the appropriateness of an offer, and mandated to retain the services of investment banks and law firms to provide the equivalent of "fairness opinions" and legal opinions respectively. The Measures do not, however, specify what consequences would follow from the issuance of a false, misleading or otherwise dishonest opinion.

- Provision is made in the Measures for the acquisition of publicly-listed shares with other securities, thus explicitly permitting share swap transactions in public deals.

- The Measures import the United Kingdom/Hong Kong corporate law prohibition against financial assistance (wherein the target may not render financial assistance to the acquirer), which is also a feature of the Mandatory Articles of Association for Overseas Listing Companies.

The Measures were previewed by release of the "Measures for Administration of the Acquisition of Listed Companies (Draft for Public Comment)" ("Draft Measures") on July 27, 2002. There are rather wholesale changes between the Draft Measures issued for public comment and the final form of the Measures, which are a good indication of aspects of concern to both the CSRC and market participants. Key differences or additions include:

- Payment in stock for an acquisition has been added, in addition to cash purchase arrangements.

- The "fiduciary duty" (*chengxin yiwu*) imposed upon acquirers, and the similar requirement that performance of their offer be in some way guaranteed or *bona fide*, is new.

- Directors and independent directors are asked to consider acquisition offers more promptly, and the role of independent directors in offering (and publishing) separate opinions with respect thereto is strengthened. In fact, provision is made for management buy-outs, and the necessary role of independent directors (to the exclusion of presumably "inside" directors) in confirming such transactions.

- Offerors are permitted to withdraw an offer (unless there is an allegation of fraudulent conduct). However, they may not re-start an offer until twelve (12) months have passed. (Offerees are always permitted to withdraw their initial acceptance of an acquisition offer, and gain the release of any shares they have deposited with intermediaries in anticipation of transfer.)

- Controlling shareholders or controlling persons who have significant loan or guaranty relationships with the target company are now forced to settle all such relationships prior to transferring control to a third party purchaser or put in place a plan to settle the same.

- New restrictions have been imposed upon the actions of a company under offer during the pendency of the offer.

- The CSRC has created for itself the power to approve or disapprove the implementation of a court decision that leads to acquisition of a public company.

- There is greater specificity as to what must be included in various reports issued to the CSRC by potential acquirers or offerors.

- Specific allusion to professionals (financial advisors and lawyers) being "qualified to practice in the securities field" has been removed.

- All participants in an acquisition are now permitted to first correct identified violations of the Measures "on their own initiative", prior to being ordered to do so by the CSRC or relevant stock exchange, or being subject to legal process.