

client alert

M&A | CHINA |

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CHINA ISSUES NEW STATE-OWNED ASSETS TRANSACTION RULES

On 24 June 2016, the State-Owned Assets Supervision and Administration Commission of the State Council ("**SASAC**") and Ministry of Finance ("**MOF**") jointly released the *Measures for the Supervision and Administration of Transactions Involving State-Owned Assets of Enterprises* (Order No. 32, "**Measures**"), which came into effect the same day. The Measures complement the *Interim Measures for the Management of Transfers of State-Owned Property Rights of Enterprises* issued by SASAC and MOF in 2003 (Order No. 3) and broaden the scope of transactions in relation to state-owned assets subject to supervision ("**SOA Transactions**"). They also further detail the rules and requirements for the transaction process.

This Client Alert highlights the main changes brought about by the Measures and their general impact on SOA Transactions.

HIGHLIGHTS

Scope of SOEs subject to the Measures

The general notion of state-owned enterprises covers various types of entities, whether corporate or not, with different forms and levels of state investment, such as full ownership of a non-corporate "enterprise" or full or partial shareholding in a company (listed or unlisted). However, so far, SASAC had remained ambiguous on the type of state-owned enterprises whose transactions would be subject to its supervision. Now, SASAC has provided a clear scope of the state-owned enterprises that will be subject to the Measures for the purpose of approving SOA Transactions (collectively "**SOEs**");

- Enterprises and companies that are solely funded by the State (including governmental departments, organs and administrative institutions), as well as enterprises and companies whose equity is 100% owned, directly or indirectly, solely or jointly, by the aforesaid enterprises and/or companies and/or the State ("**Wholly State-Owned SOEs**");
- Enterprises and companies whose equity is more than 50% owned, solely or jointly, by the State and/or Wholly State-Owned SOEs and whose biggest shareholder is the State or a Wholly State-Owned SOE ("**State-Controlled SOEs**");
- Subsidiaries whose equity is more than 50% owned by a Wholly State-Owned SOE or a State-Controlled SOE; and
- Enterprises and companies whose biggest shareholder is the State, a Wholly State-Owned SOE or a State-Controlled SOE, and whose controlling rights are vested in such shareholder, even if its shareholding is less than 50%.

Supervised SOA Transactions

The SOA Transactions subject to the Measures include equity transfers, capital increases and asset transfers.

- **Equity transfers** are transfers conducted by SOEs or an agency performing the contributor's duties (e.g. SASAC) on equity formed from capital contributions.
- **Capital increases** are those conducted by SOEs, excluding capital increases made by a State organ to an SOE.
- **Asset transfers** are transfers of major assets by SOEs.

For capital increases and asset transfers, the Measures impose the traditional supervision methods that currently apply to equity transfers, including (i) the approval of SASAC or the competent headquarters of the SOE, (ii) appraisal, and (iii) a public transaction through a trading centre. These procedures must be completed for any SOA Transaction.

Strict payment requirements

The Measures adopt a more stringent position on the payment and price adjustment scheme of an SOE equity transfer:

- The parties to the equity transfer may not adjust the terms or price of the transaction based on the target's operating profits or losses during the transaction period;
- The transaction price must be denominated in renminbi; and
- If the purchase price is to be paid in a lump sum, it must be paid within five working days after the transfer agreement goes into effect. If the purchase price is to be paid in instalments, the first instalment (at least 30% of the total price) must be paid within five working days after the transfer agreement goes into effect, while the rest must be paid within one year. Moreover, an effective guarantee and undertaking must be given until the deferred payment is made.

Exceptions

Although they make appraisal and public transaction mandatory for SOA Transactions, the Measures still identify various scenarios where an SOA Transaction may be exempt from such requirements. The table below lists such cases:

| SOA Transaction | Exemption from Appraisal | Exemption from Public Transaction |
|-----------------|---|--|
| Equity Transfer | i) Internal restructurings of an SOE, where the transferor and transferee are such SOE and the subsidiaries are directly or indirectly wholly owned by it | i) Reorganisations of any enterprise whose main business is classified as an important industry or key field in connection with national security or the national economy, where there are special requirements for the transferee and the property rights must be transferred between Wholly State-Owned SOEs and State-Controlled SOEs ii) Equity transfers arising from the internal reorganisation of an SOE, where the equity transfer is between an SOE and the enterprises held or actually controlled by it |

| SOA Transaction | Exemption from Appraisal | Exemption from Public Transaction |
|-------------------------|--|--|
| Capital Increase | i) Where the existing shareholders of an SOE make the capital increase proportionally to their shareholding ii) Where the agency performing the capital contributor's duties (e.g. SASAC) increases the capital of an SOE iii) Where an SOE increases the capital of its wholly owned subsidiary iv) Where the enterprise subject to the capital increase and the investor are both Wholly State-Owned SOEs | i) Where specific SOEs participate in a capital increase under a necessary layout or structural adjustment of State-owned capital ii) Where an investor participates in the capital increase of an SOE or its subsidiary due to a strategic partnership or community of interests between the investor and SOE iii) Where an SOE directly participates, or appoints its holding or actually controlled subsidiary to participate, in the capital increase iv) Where the creditor's rights of the enterprise are converted into equity v) Where the existing shareholders make the capital increase |
| Asset Transfer | Similar to the exemption for equity transfers | i) In internal transfers involving certain industries where a non-public transfer among the SOEs is necessary |

COMMENTS

By setting out a definitive scope of the SOEs affected and broadening the types of SOA Transactions subject to SASAC supervision, the Measures provide a clearer guideline to market players for their transactions with SOEs in China.

However, compared with previous rules, the Measures contain more restrictions, from both substantial and procedural perspectives, as set out above. These restrictions will limit the autonomy of transacting parties and may even favour the SOE party in an SOA Transaction.

The coordination of the Measures with previous SASAC rules is also an issue. The Measures do not directly abolish related rules; instead, they only provide that the Measures prevail in case of any inconsistencies with previous rules. In practice, this type of legislative method could easily create uncertainties at lower-level SASAC bureaus, thus leading to different supervision policies from place to place.

As always, Gide will continue to follow the implementation of the Measures and any developments or interpretations regarding the general supervision of SOA Transactions. Please feel free to contact us should you have any questions.

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