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subject **IPO for the Foreign Invested Companies on Chinese A-Share Market**

Introduction

Since China promised in the joint statement made after China-U.S. Strategic Economic Dialogue in the end of 2007, to consider opening its domestic exchange to listings by foreign firms and what are called "red chips" — Chinese firms registered overseas and trading on the Hong Kong market, 2008 seems in the eyes of the public to become another record year for Initial Public Offering (hereinafter "IPO") for the foreign-invested enterprises (hereinafter "FIEs"). Foreign-invested firms are all eager to seize this opportunity after long time waiting.

It is has been speculated that HSBC, Coca-Cola Amatol, Siemens and some other well-performed foreign firms would have priority to become listed on the Shanghai exchange. A Chinese magazine[1] recently reported that the New York Stock Exchange (hereinafter "NYSE") may as a first foreign company list its shares on mainland A-stock markets, citing an unidentified CSRC official. But just a month earlier, Fan Fuchun, the vice chairman of the China Securities Regulatory Commission (hereinafter "CSRC") denied the likelihood of reforms in short term, at least impossible before the "red chips" coming home. Back in January 2008, Shang Fulin, chairman of the CSRC, also refused to give a timetable for when the first "red-chip" would list A-shares. But China will still encourage qualified foreign-invested companies to list on the domestic stock markets, which can be shown by the latest Guiding Opinion of the Ministry of Commerce on the 2008 National Work of Attracting the Foreign Investment.

Under such complicated circumstances, it remains to be seen whether these FIEs will be approved to go public in China very soon.

1. Legal Invironment

Since 2001 Some Opinions Relevant to Foreign Investment in Listed Companies has been promulgated by the Ministry of Foreign Trade and Economic Cooperation (hereinafter "MOFTEC") and CSRS, most of the legal obstacles for FIEs to be listed on the Chinese A-Share market look apparently to be cleared. A number of laws and regulations have been enacted to clarify the requirements in this regard, including:

1. Company Law of People's Republic of China
2. Securities Law of the People's Republic of China;
3. Some Opinions Relevant to Foreign Investment in Listed Companies;

[1] Further information please see the website of Caijing Magazine on April 21, 2008 http://www.caijing.com.cn/20080421/57800.shtml

4. Circular of the General Office of Ministry of Foreign Trade and Economic Cooperation On Relevant Issues of Foreign-funded Joint Stock Companies;
5. Special Provisions on the Contents and Formats of Prospectuses of Foreign-funded Joint Stock Companies;
6. Provisional Regulations on the Establishment of Foreign-Funded Joint Stock Companies Limited;
7. The Catalogue of Industries for Guiding Foreign Investment (hereinafter "Catalogue"); and
8. The Measures for the Administration of Initial Public Offering and Listing of Stocks

According to the aforementioned legislations, the first step for foreign investors to participate in this development is to establish a foreign-funded joint stock company (hereinafter "FFJSC") or restructure other enterprises to become a FFJSC, in any of the four ways as follows:

1.1. Transformation into FFJSC

1.1.1. Establishing a new FFJSC

Requirements:

1. Sector Access: in conformity with the Catalogue;
2. Promoters: two (2) to two hundred (200) promoters, half of whom should have domiciles in China and at least one (1) of whom is a foreign shareholder;
   For a company established through public offer: at least one promoter having a record of profit-making in the past three consecutive years.
3. Registered Capital: no less than RMB30,000,000 (higher requirements may be applicable to some special industries according to relevant laws and regulations); and
4. Equity Interest held by Foreign Investors: no less than 25% of the registered capital.

1.1.2. Transformation into FFJSC

In addition to the requirements mentioned in the aforesaid Item 1, Sino-foreign joint equity ventures, Sino-foreign joint cooperative ventures and solely foreign-funded enterprises (referred to hereinafter as FIEs), when applying to transform into FFJSC, should submit profit-making records for the past three consecutive years. This restructuring process generally takes a period of two (2) to six (6) months according to the relevant practice experience on the market.

1.1.3. Investing in an existing FFJSC

In accordance with applicable PRC laws and regulations as well as relevant practice, foreign investment in an existing FFJSC by shares transfer, subscription of new shares to be issued by the FFJSC or in any other methods are subject to central MOFCOM's approval.

1.1.4. Investing in an existing domestic-funded joint stock companies (hereinafter "DFJSC")

Additional requirements:

1. This DFJSC is established subject to the official State's Approval;
2. More than 25% of the FFJSC's registered capital have been purchased and held by foreign shareholders with the payment of convertible foreign currency.

1.2. Listing

The issuance of stocks in China by FFJSC (A shares) shall be in conformity with the following requirements:

1.2.1. Qualification

1. Since a joint stock limited company is established, its business operations shall last for 3 years or more, unless it is otherwise approved by the State Council. If a FFJSC is completely converted from a limited company, its operating term may be calculated from the date on which the original limited company is established;
2. The registered capital has been fully paid in;
3. having passed the joint annual inspections of foreign-invested enterprises for the recent three years;
4. the scope of business is in conformity with the requests as mentioned in the Interim Provisions on Guiding the Orientation of Foreign Investment and the Catalogue;
5. there is no alteration of the actual controller (no major change regarding an issuer's main business, directors and senior managers);
6. it has no any material illegal activities during the latest three (3) years;
7. according to applicable provisions, if a FFJSC shall be controlled (including being relatively controlled) by the Chinese investors or special requirements on the share ratio of the Chinese investors shall be satisfied, it should continue to maintain the controlling status or the share ratio of the Chinese investors after listing.

1.2.2. Company Governance

1. Complete and sound organization structure;
2. Complete and effective internal control systems.

1.2.3. Independency

1. Integrated business system and independent operation capability conducting market-based business;
2. Integrated assets; and
3. Independent personnel, finance, organization and business.

1.2.4. No Intra-trade competition

1. No competition with its controlling shareholder, actual controller or any other enterprise controlled by it; and
2. No competition after its raised funds invested in any project.

1.2.5. No Associated Transactions

1. No any apparently unfair associated transaction with its controlling shareholder, actual controller or any other enterprise under its control; and
2. No manipulation of profit through associated transactions.

1.2.6. Finance

1. Sound asset quality, reasonable structure of assets and liabilities, comparatively strong profit-making capacity and normal cash flows;
2. Positive net profits (which are calculated in accordance with the comparatively lower net profits upon deduction of non-regular profits/losses) of over RMB 30,000,000 accumulatively for the latest three (3) years prior to the issuance;
3. Net operating cash flow of over RMB 50,000,000 or business income of over RMB300,000,000 accumulatively for the latest three (3) years before issuance; Proportion of the intangible assets in the net assets at the end of the latest period being no more than 20%;
4. No uncovered deficit in the latest period; and
5. No false records in all material aspects in its financial statements within the latest three (3) years.

1.2.7 Capital Stock and Share Ratio

1. Total amount of the capital stock being no less than RMB30,000,000 prior to issuance;
2. Total amount of the capital stock being no less than RMB50,000,000 when applying for listing (required by the Shanghai and Shenzhen Stock Exchanges);
3. Shares as publicly issued being no less than 25% of the total amount of shares; and
4. The shares owned by foreign investors being no less than 10% of its total capital stock after the listing. industrial policies regarding foreign investment and the requests for the issuance of stocks by listed companies;

1.3. Procedures for Issuance

1. Transformation to a FFJSC;
2. Submission the resolution of the board of directors on the specific items of stock issuance to the shareholders' assembly for approval;
3. Approval by MOFTEC;
4. Submission of Application Documents to the CSRC (including a certificate of approval and business license of the foreign-invested stock company that has passed the joint annual inspection);
5. Decision of CSRC
6. Examination and Approval by the Issuance Verification Committee of the CSRC
7. Alteration of relevant legal documents at the MOFTEC.

2. Practice

Although there are different methods for the foreign investors to achieve the aim of listing on the mainland A-Share Market, we should admit that, the process is proved generally still to be difficult, though in the past a limited number of FIEs managed to restructure themselves into FFJSCs and subsequently gained access to the capital market.

Since 1993, such examples have occurred continuously. Lianhua Heqian, the first sino-foreign joint venture as the reform pilot in Shanghai, has transferred into the Lianhua Heqian limited stock company in 1992. The foreign investors Jiayun Group Hongkong, which controls 17.08% of the shares after its listing, became the first major shareholder. The another example is the Fujian Haosheng (now named Lijia Stock), 44% of shares held by Haosheng Shilin (Hong Kong) limited company, which is restructured from a sino-foreign joint venture operated by three parties. Similar cases are North Stock, Xindu Hotel, etc. With the promulgation of the Some Opinions Relevant to Foreign Investment in Listed Companies in 2001, Special Provisions on the Contents and Formats of Prospectuses of Foreign-funded Joint Stock Companies in the following 2002, the future seems more and more attractive to the foreign investors. In the following few years, Huoxiang Stock, Ningbo Dongmu, and Hefei Sanyo have realized its listing one after another. But from 2004 till now, there is no move any more.

Worth mentioning, so far only one wholly foreign-owned enterprise (hereinafter "WFOE"), Min Can Kun B, has succeed in listing its shares in the B-Stock market through directly transformation into FFJSC, which benefited from the relative loose policy to the FIEs at that time. There was no such restriction of 25% Share Ratio ("the proportion of non-listed foreign shares of the foreign-funded joint stock company after its shares have been listed shall not be lower than 25% of the total share capital") as provided for in the Circular of the General Office of Ministry of Foreign Trade and Economic Cooperation On Relevant Issues of Foreign-funded Joint Stock Companies.

But over the years only a minority of the FIEs has made substantial progress in the A-share IPO. And they will continue to face challenges when seeking permission for any listing-related business in China. Nevertheless, the newly released policies have strengthened the possession of foreign investors in the Chinese capital Market. Optimists even speculate that the end of 2008 would witness the listing of the first few foreign firms in China's stock market.

In fact, industry observers argue that the 2008 regulatory changes have been minor -- really nothing more than a mirror of the 2001 regulations, but with more complex limitations and lacking feasibility. Such as the requirements mentioned in the Special Provisions on the Contents and Formats of Prospectuses of Foreign-funded Joint Stock Companies, the Issuer shall disclose in detail affiliated transactions with its shareholders, including any restrictions on its use of trademarks, patents or proprietary technology.

The move will be not as fast as expected. In accordance with China's commitment upon the entry of the WTO, China will push forward the opening of domestic and foreign trade to the outside world, but the opening will be step by step. According to a CSRC spokesman, consensus has been reached as to the new regulation allowing foreign investors access to the domestic A-share market will be concerned until the "red chips" return.

3. Conclusion and Solution

It is almost for certain that a direct ticket for entering China's stock market by way of an IPO would not become a main-stream solution for most foreign firms and their Chinese subsidiaries in the near future. This is because, although many of the legal obstacles have been cleared thanks to the legislations in the past few years, the success of an FIE's IPO remains dependent on whether and when the Chinese authorities would become confident in their ability to tackle many of the remaining technical issues such the related party transactions (which are not rare in transnational companies), evaluation of overseas assets, taxation, industrial policies, etc.

In this context, we are of the opinions that foreign investors should rather manage to gain the access to China's stock market by resorting to alternative solutions and that acquisition of shares in some existing Chinese listed company obviously represents one of the realistic solutions. It is worth mentioning that the Chinese authorities enacted the regulation for strategic investment by foreign investors in Chinese listed companies in the year of 2007 and such new regulation is believed to have far-reaching implications for the opening of China's stock market for foreign firms. The new regulation offers the possibility for a foreign investor to acquire A-shares (which used to be unavailable for foreign investors) of a Chinese listed company by subscribing to a private placement and thereafter the foreign investor may well integrate the target company as its subsidiary by raising the shareholding to more than 50% provided the industrial policy in China pose no objection and CSRC agrees to exempt the foreign investor from making a tender offer to all the other shareholders. Many foreign firms have realized the bright future and have been implementing their acquisitions in Chinese market by following this path. And we as a foreign law firm with sound presence in China have had the benefit of advising a reputable international industrial leader in successfully completing their strategic investment and acquisition in China.

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