

**GREETINGS...**

Greetings and ni hao to our clients, friends, colleagues and associates in the US and China. Having just enjoyed our holidays and New Year in the US, it is time to wish our Chinese friends a Happy Chinese New Year. We hope the Year of the Boar brings many wonderful blessings to all.

Sincerely,  
Aaron Schechter and Frances Chou

**HOT TOPICS...**

**The Impact of China's New M & A Rules...**

Last September, China introduced new merger-and-acquisition rules targeting not just foreign investors but also Chinese companies incorporated overseas. The rules aim to "promote and regulate foreign investment in China". Experts believe that the rules may help to crack down on false inflows made through overseas companies that had been set up by Chinese investors to enjoy the tax benefits of a foreign company investing into China, but which also fuel inflation and are difficult for Beijing to control should the economy overheat.

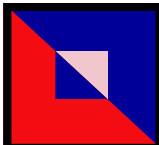


Additionally, the revised rules add additional government scrutiny to capital outflows of domestic assets when Chinese companies incorporated abroad seek to list their companies on overseas stock exchanges. Under the revised rules, when Chinese companies incorporated abroad seek to list overseas, they need to receive central government approval from the China Securities Regulatory Commission and the Ministry of Commerce in addition to the regulatory approvals from authorities in the market where they seek to go public. Other restrictions included requirements that such companies list their shares within 12 months, or return to their original share structure. In the five months since the new rules have gone into effect, there has been an effective freezing of approvals for Chinese companies who want to list their companies in overseas stock exchanges. This has created some uncertainty for foreign venture capital firms. In the past, foreign VC firms have avoided China's strict capital controls by listing Chinese companies they fund on international capital markets through offshore investment vehicles. Listing on international markets provided them an exit strategy for their investments.

Some experts feel that with the new rules the Chinese government is making an attempt to encourage more venture capital backed Chinese firms to remain in China and list their shares in the recently resurgent Chinese stock market. To date, no dollar-denominated foreign VC fund has exited an investment through a listing on the Chinese stock market. In 2006, 151 Chinese firms listed on stock exchanges with 86 of these firms listing offshore. Of the 86 that listed offshore, 29 were backed by venture capitalists. Total VC investment topped \$1.78 billion in 2006, a 51% increase to the prior year. For VC's to consider listing on mainland exchanges, they would want China to allow them the ability to repatriate returns from a Chinese mainland IPO in a timely manner. Although recently, one foreign venture capital firm commented that a VC investing in a great Chinese company, and who has a sufficiently long time frame, might consider a domestic exchange. Some experts believe that the hold up in approvals is merely the result of Chinese government bureaucracy with 6 different government agencies involved in determining the consensus to the application of the rule.

**China Stock Market Update...**

In our August 2006 newsletter, we discussed the Chinese government's efforts to reform the 16 year old stock market in mainland China and the resurgence of the Shanghai and Shenzhen stock exchanges. Since enacting government reforms after the China stock markets hit an eight year low in mid-2005, the mainland stock markets have continued to surge. The benchmark Shanghai Composite Index rose 130% in 2006, and has continued to soar in 2007. In a frenzy similar to the dotcom boom in the US in the late 1990's, individuals are opening stock-trading accounts at the rate of 90,000 per day, 35 times the rate of a year earlier. There are about 80.5 million individual investment accounts in China. The stock market capitalization of the Shanghai and Shenzhen exchanges is just over \$1 trillion, far smaller than the New York Stock Exchange \$26.5 trillion capitalization. Still, China places third in Asia behind Japan and Hong Kong. The Chinese stock market is open mainly to domestic Chinese investors. With the recent surge, some believes that the market is approaching bubble-like levels. Chinese stocks trade at a P/E ratio of about 33 times, with Hong Kong Stocks trading at 18 times earning. Still, others believe that with \$2 trillion in bank deposits and limited investing options, stocks in China will remain expensive.



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**S+C NEWSLETTER** Volume 1, Issue 9, February 6, 2007

**LEARN THE ROPES...**

February 21, Schechter + Chou will be speaking at the USC School of Policy, Planning and Development on the topic of "Doing business with China" for the graduate level course on International Real Estate Development Opportunities.

**RECENT DEVELOPMENTS...**

**Catch the China Wave 2007**

The UC Berkeley – Haas Alumni Network-Los Angeles Chapter, in association with the USC Marshall School of Business Alumni Association-Los Angeles Chapter, will be hosting "Catch the China Wave event 2007: Get the inside story on doing business with China" on Thursday, February 22, 2007, at the Jonathan Club in downtown Los Angeles. Aaron Schechter is the event leader and will also serve as the moderator for the panel.

"Catch the China Wave 2007" is a follow up event to our successful "Catch the China Wave 2006" event, which attracted more than 200 attendees. For this year's event, we have assembled a panel of experts with many years of experience in various industries from the movie industry, to real estate, to product development and sourcing, as well as ecommerce in China. We also have a legal expert on the panel who will discuss how we can protect ourselves in our business with China. For more information and to register for this exciting event, please visit [http://www.haasla.com/pages/022207\\_China2.html](http://www.haasla.com/pages/022207_China2.html)

**LEGALLY SPEAKING...**

The following is provided by Y.F. Chou, Prof. Corp. For questions, please contact [info@yfchou.com](mailto:info@yfchou.com).

**To Arbitrate or Not To Arbitrate, That is the Question.**

When US companies do business with China, they usually will consider whether to use arbitration or litigation to resolve any potential disputes. When considering this issue, most of them have a lot of concerns with regard to the arbitration procedures in China. For example, what kind of arbitration clause should be included in the contract to make it enforceable? How can an arbitration award be enforced in China? Also, if the arbitration award is improperly entered, how can they challenge such an award in China? The Interpretation by the Supreme People's Court on Several Issues Concerning the Application of the Arbitration Law of the People's Republic of China (the "Interpretation") issued on August 23, 2006, and effective on September 8, 2006, provides some needed guidelines in answering such questions.

The Interpretation provides that any enforceable arbitration agreement reached between the parties in writing will generally be deemed valid. If the arbitration agreement or clause simply provides that the dispute may be submitted either for arbitration or litigation, then a party may not use this agreement or clause to force the other party to arbitrate a dispute. However, if a party submits for arbitration, and the other party fails to object as provided in Article 20.2 of the Arbitration Law of the PRC (the "Arbitration Law"), then any objection to the enforceability will be deemed waived. The arbitration agency, where the arbitration will be held, has to be specified. When the identity of such an arbitration agency is not clear, the Interpretation provides various rules in order to ascertain such an agency. With regard to challenging the validity of the arbitration agreement, the Interpretation provides that the validity of such an agreement shall be determined by the arbitrator, and that the People's Court will not accept any challenge by any parties with regard to the validity of such an agreement after the arbitration award has been issued, or if the parties fail to object at the arbitration. With regard to the court that has jurisdiction over any challenges of the arbitration agreement, the Interpretation provides that the Intermediate People's Court where the arbitration agency is located shall have the jurisdiction. If no arbitration agency is selected, then the Intermediate People's Court, where the arbitration agreement was entered shall have the jurisdiction. With regard to challenging the arbitration award, the Interpretation clarifies the specific grounds that an arbitration award may be set aside. The Intermediate People's Court may order the arbitration agency to hold a new arbitration, if the evidence on which the award is based was falsified, or the other party has concealed any evidence sufficient to affect the impartiality of the award. With regard to enforcing an arbitration award, the Intermediate People's Court, at the place where the party subject to enforcement is domiciled, or where the property subject to enforcement is located, shall have the jurisdiction.

Hopefully, the Interpretation provides sufficient guidelines on arbitration procedures in China and provides more confidence in foreign companies to choose to arbitrate in China when they are doing business with China.