

From Idea to IPO

Legal Considerations for Start-ups in China

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I. Fundamental Understandings of China's Legal System

- Industrial Policy
 - “Independent and self-sustainable economy”
 - Catalog Guiding Foreign Investment
 - Priority and preference



I. Fundamental Understandings of China's Legal System

- Approvals
 - Overreaching administrative power
 - Purpose of administrative approval
 - Source of corruption
 - Legal uncertainty and “grey area” practice



I. Fundamental Understandings of China's Legal System

- Operation in “bird cage”: scope of business
 - Defined in Business License
 - “Word smith” by SAIC
 - Consequence in noncompliance



I. Fundamental Understandings of China's Legal System

- Foreign Exchange Control
 - Why foreign exchange control
 - SAFE (State Administration of Foreign Exchange)
 - Capital account vs. current transaction account



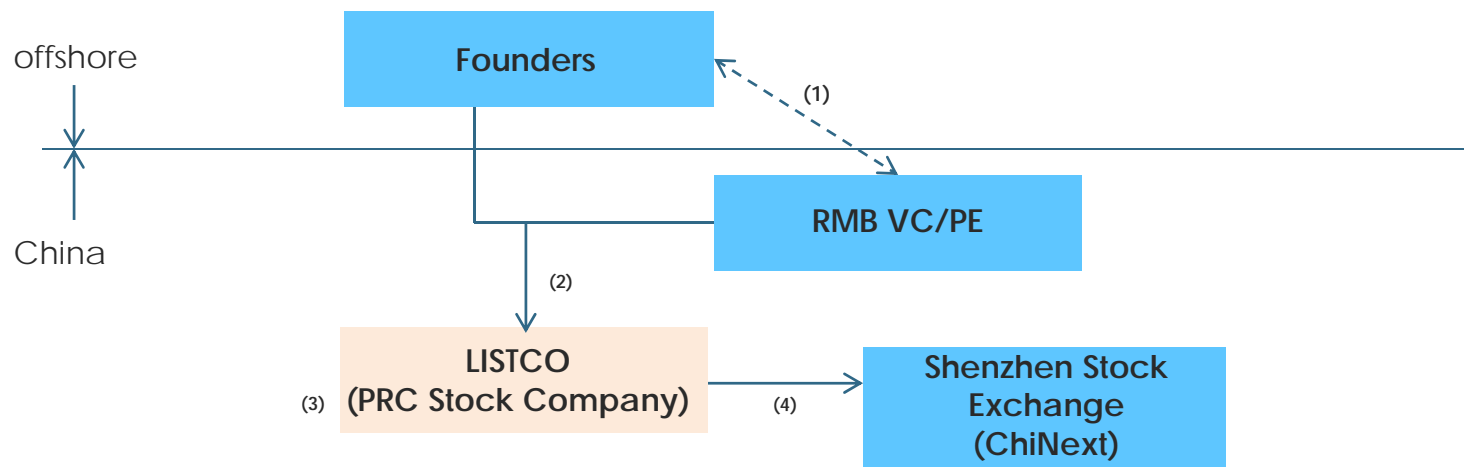
II. Pre-formation Considerations

1. Orientation and Alignment/“Returning Student”, a Grey Area
2. Source of VC/PE Funds
3. Listing Alternatives
4. Incentives and Subsidies
5. Indigenousness
6. Tax



III. Corporate Structure

1. Domestic Financing Structure



(1) Founders to submit business plan, obtain commitment and sign term sheet with VC/PE

(2) Founders to establish a Sino-Foreign joint venture company in China to be jointly invested by founders and VC/PE

(3) Upon successful operation, JV to apply to MOFCOM to convert from limited liability company into stock company and complete the same upon approval

(4) JV to submit registration application to CSRC for listing



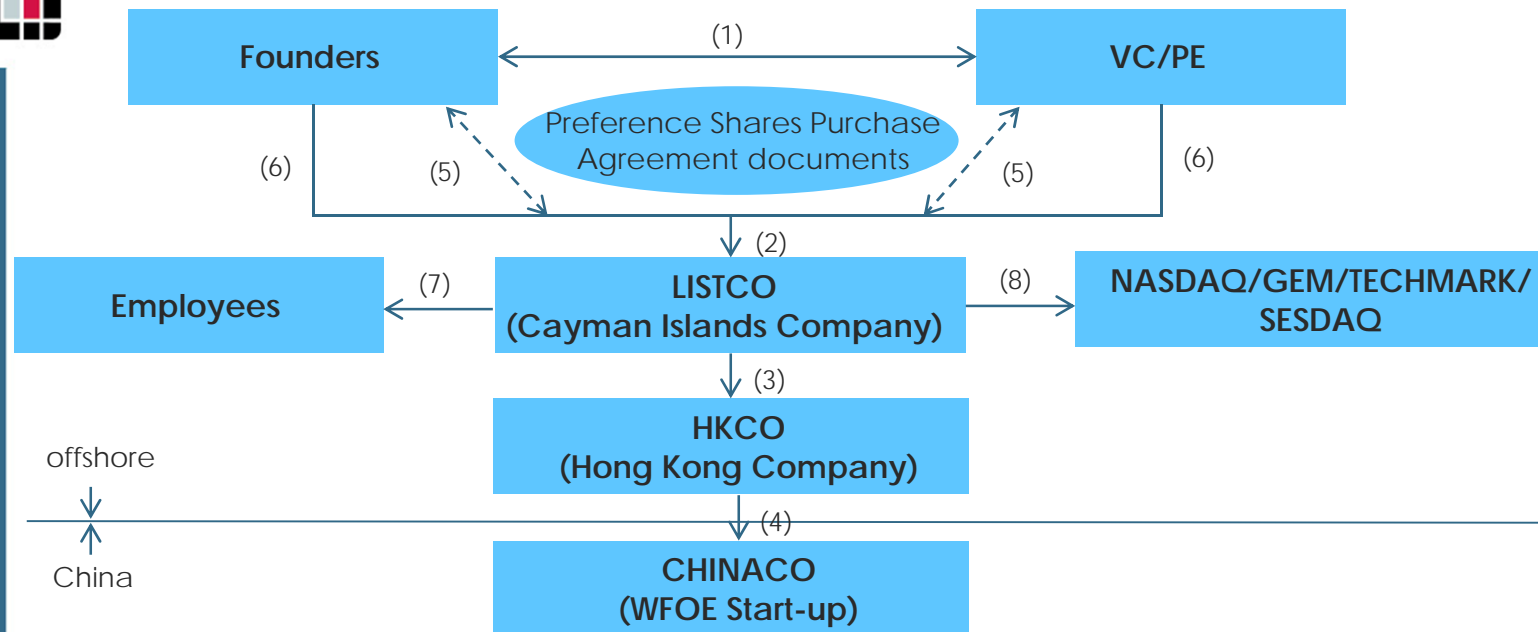
III. Corporate Structure

Comments (Domestic Financing Structure)

- Limited “exit” for investor
- Legal system uncertain and untested
- Need for converting EJV to joint stock company

III. Corporate Structure

2. "Red-chip" Model (Two-ends Outside "两头在外")



(1) Founders to submit business plan, obtain commitment and sign term sheet with **foreign** VC/PE

(2) Founders to incorporate LISTCO (as offshore company in Cayman Islands or BVI), which is to become the entity for listing

(3) Founders to establish and register a company in Hong Kong to which LISTCO would be 100% shareholder

(4) Founders to further establish a wholly foreign owned company in China as operating entity for R&D, application and mass production (to which HKCO is to become 100% shareholder)

(5) In the meantime, Founders to negotiate and finalize the Preference Share Purchase Agreement and other equity financing documents including MoA, AoA, Members Agreement, Right of First Refusal and Co-sale Agreement and Voting Agreement ("Financing Documents")

(6) Pursuant to Financing Documents, VC/PE to contribute the subscribed capital to LISTCO and become controlling shareholder(s), and the Founders to be appointed to or become part of the management team

(7) LISTCO to grant stock options to the management team and key employees

(8) Upon successful operation, and satisfying listing requirements, LISTCO to seek registration and listing at desired stock exchange



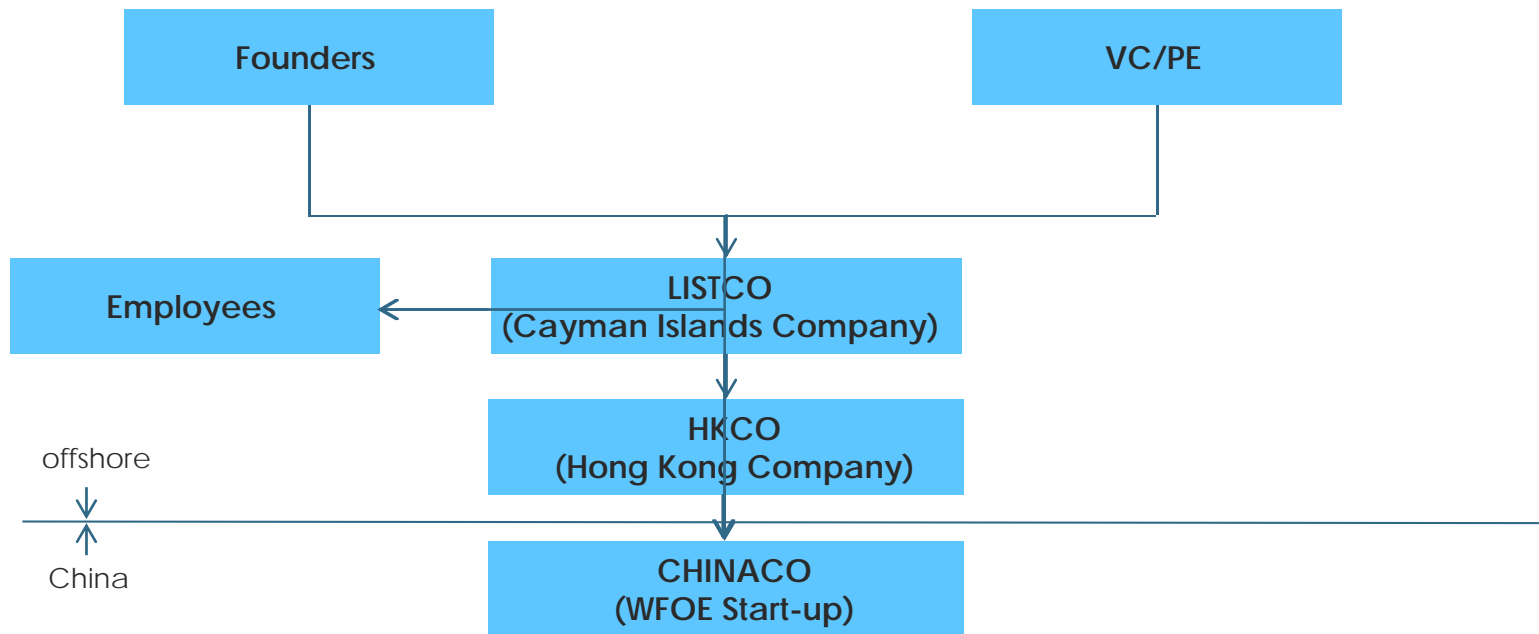
III. Corporate Structure

Comments (“Red-chip” Model (Two-ends Outside “两头在外”)

- More alternates for exit
- Multi-class share structure
- Listing selectivity
- Ease in restructure/reorganization



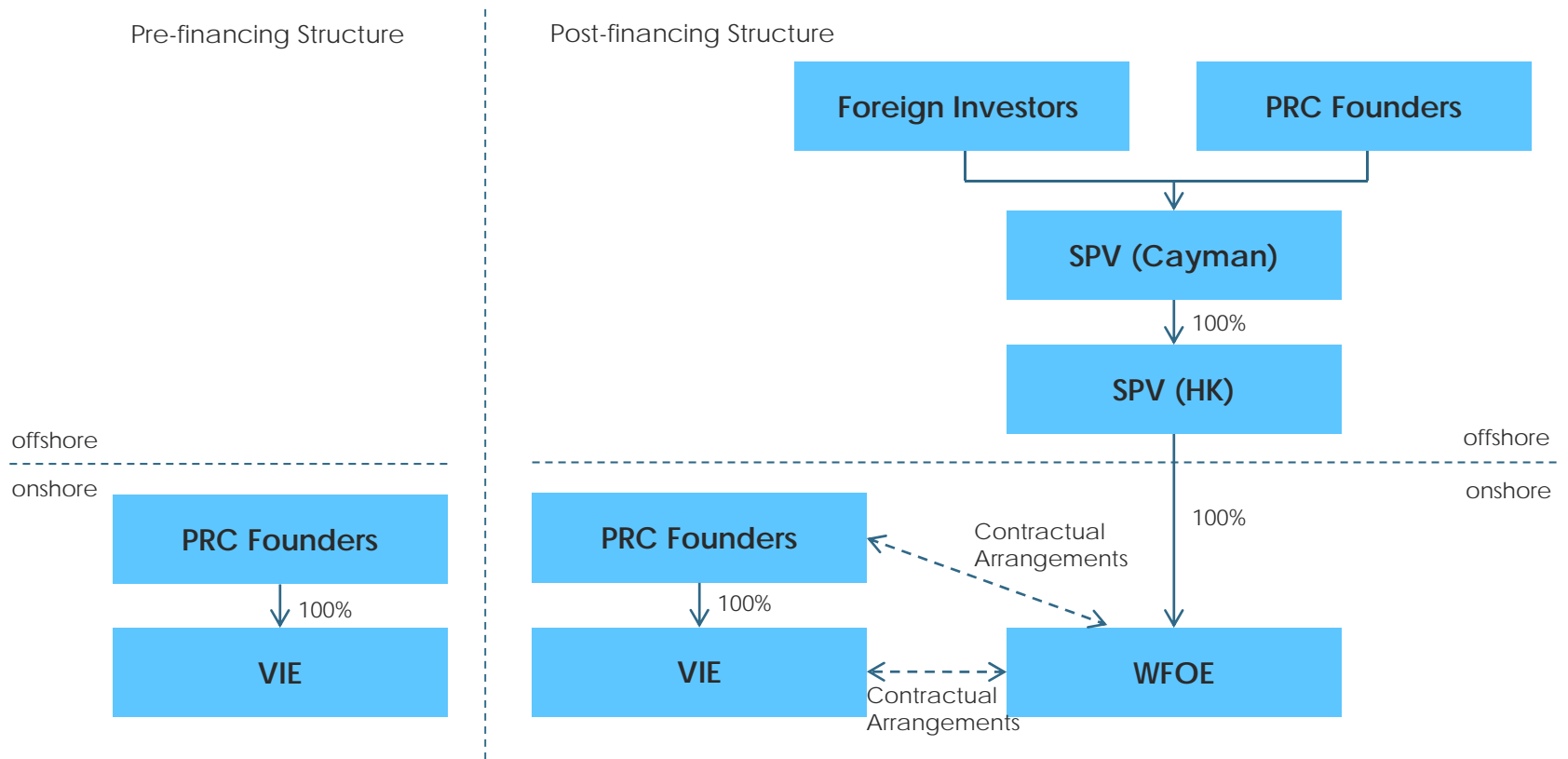
III. Corporate Structure





III. Corporate Structure

3. “Sina” Model (VIE Model)





THANK YOU!

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