

A New Blow To Transparency Stymies Due Diligence In China

China is not famous for its transparency. It was therefore always a refreshing surprise that so much corporate information was available in the overflowing archives of China's business registry, the State Administration of Industry and Commerce ("SAIC"). The open archives include the basic details of a business entity, including corporations, such as registered capital, scope of business and shareholders, while the internal archives are rich in financial and management information, such as the audit reports, share transfers, and assets ownership documents (e.g. of real estate). Whereas the open archives are a public record and have in many places been made available online, the internal archives have always been available but only to Chinese practicing lawyers or other authorized persons.

This access to corporate information has become an accepted necessity in the practice of M&A in China, as lawyers and accountants need to review a target's most up to date corporate documents and verify their provenance. It has also been a treasure trove for short-sellers and fraud investigators, who have found that the information companies file with the SAIC may be very different from what they have filed with a foreign regulator or potential business partner.

Today, the surprise to practicing lawyers and their corporate clients is that most of this valuable information is now off-limits. Starting earlier this year, in order to obtain access to the internal archives, SAIC registries dotted all over China have begun to require either a court order or an authorized request from the company and its legal representative. These restrictions are very frustrating for both lawyers and their clients who want to understand more about the history, ownership, structure and stature of a potential target company or business partner. Without a court order, which can rarely be obtained without alerting the company in question, preliminary due diligence is effectively impossible. For M&A transactions, this means first signing a letter of intent and ensuring that the target consents in writing to open its SAIC files to scrutiny. For partner due diligence, however, it means no in depth knowledge can be gained about the corporate background of a potential partner.

The tightening of the control over the access to SAIC archives does have a legal basis. Although both the *Company Law* and the *Regulations on the Administration of Company Registration* have long provided that registered corporate records be available for inspection, they allow the SAIC's discretion in practice. As a result, the *Measures on the Investigation of Registered Corporate Files*, issued by SAIC in 2003, provide for lawyers to review "paper files" only upon production of a court order of the type now being required. The recent application of the *Measures* came as a surprise, however, because up to now, internal archives were available to lawyers on a pay-for-service basis.

There is speculation that one reason for the change in practice was the exposure by short-sellers of fraud committed by Chinese public companies listed overseas, particularly many US reverse merger companies, who had used lawyers and research firms to retrieve corporate data from the SAIC archives. In this connection, there has also been a tussle between the SEC and Deloitte US, which is reported to have defended itself from SEC requests to produce documents on a Chinese company prepared in Shanghai by relying on a Chinese Securities Regulator Commission circular prohibiting the release of state secrets and information in the national interest by securities services providers. But the SAIC's most recent blow to business transparency also seems to be part of a broader trend to crack down on the circulation and trading of private information, including that of the party leadership and their family members.

The Chinese government has recently launched campaigns to crack down on the "infringement of personal information of citizens," which is protected by a variety of regulations and the Criminal Law. Newspapers have recently been replete with stories of mass arrests of people trading in "personal information" gleaned from commercial sources such as banks, insurance companies, telecom service providers and real estate brokers.

However, this campaign seems to have spilled over into the area of corporate data. In April, a lawyer in Beijing was detained on the charge of "illegally obtaining the personal information of the citizen" after he "illegally retrieved" the corporate files and the personal information of the company's legal representatives from the SAICs in his capacity as the lawyer and "illegally" sold them. Although it is still unclear on what basis the prosecutor would prove that such corporate data constitutes "personal information" as defined in the Criminal Law (and the liberal view in China suggested it would not), this incident had sounded an

alarm bell for lawyers, research firms and investors performing due diligence in China. At the same time, several well-known corporate and credit infringement services providers have suspended or closed their business in China.

It remains to be seen whether this is a temporary tightening in China's peristaltic regulation of information, as this year heralds a major leadership change and has also been subject to numerous economic challenges, or is going to be a permanent feature of doing business in China.

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