



The Legal 500 & The In-House Lawyer
Comparative Legal Guide
China: Mergers & Acquisitions (3rd edition)

This country-specific Q&A provides an overview to M&A laws and regulations that may occur in China.

This Q&A is part of the global guide to Mergers & Acquisitions. For a full list of jurisdictional Q&As visit <http://www.inhouselawyer.co.uk/practice-areas/mergers-acquisitions-3rd-edition/>



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The Legal 500

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1. **What are the key rules/laws relevant to M&A and who are the key regulatory authorities?**

The key rules governing M&A activity in the PRC include:

- the PRC Company Law, the PRC Contract Law and various judicial interpretations of the Supreme People's Court;
- the current foreign investment regulations, including the *Provisions for Guiding the Foreign Investment Direction*, the *Catalogue for the Guidance of Foreign Investment Industries* (2017 Revision), the *Special Administrative Measures for Access of Foreign Investment (Negative List)* (2018 Edition), and *Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones* (2018 Edition), together with their implementing rules;
- Chinese outbound investment regulations;

- PRC foreign exchange laws and regulations;
- company registration laws and implementing rules;
- the PRC Enterprise Income Tax Law and its implementing rules; and
- anti-trust-related laws, including the Anti-Monopoly Law and the *Guiding Opinions of the State Administration for Market Regulation on the Declaration of Concentration of Business Operators* (2018 Revision).

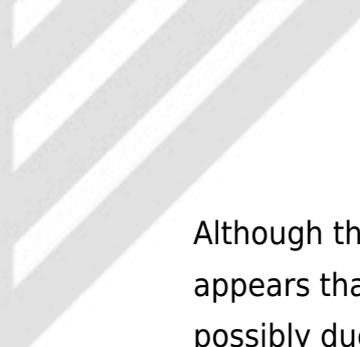
In general, the key regulatory bodies governing M&A activity in the PRC include:

- the State Administration for Market Regulation (SAMR);
- the State Administration of Taxation (SAT);
- with respect to outbound, inbound and cross-border M&A, the Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC) and the State Administration of Foreign Exchange (SAFE);
- with respect to public M&A, the China Securities Regulatory Commission (CSRC), the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE); and
- with respect to anti-trust issues, the Anti-Trust Bureau of the SAMR (which recently replaced MOFCOM in respect of anti-trust matters).

In addition, industry-specific regulators, such as the Ministry of Industry and Information Technology (MIIT) on telecoms and IT sectors, Ministry of Education, the National Medical Products Administration, and the National Radio and Television Administration, may promulgate rules governing M&A activity in specific industries.

2. **What is the current state of the market?**

According to data from China Venture, a total of 6,998 M&A transactions in the China market were announced in 2018, slightly more than the 6,870 transactions announced in 2017. The total deal value in 2018 was \$576.834 billion, which is slightly lower than the 2017 figure of \$587.781 billion.



Although the domestic Chinese M&A market continued to be active in 2018, it appears that the number of *cross-border* M&A transactions decreased. This was possibly due to China tightening its outbound investment and foreign exchange control policies in respect of some typical Chinese outbound investment destinations, such as the US, the UK, Germany and Australia. It is reported, however, that M&A deal volume between China and ‘Belt and Road countries’ continues to grow.

3. **Which market sectors have been particularly active recently?**

Traditionally, the Chinese M&A market is driven by both public and private M&A. According to data from China Venture, in 2018, private equity (PE) and venture capital (VC) transactions accounted for the greater part of the total deal volume, while public M&A transactions account for the majority of the total deal value.

In terms of cross-border transactions, the total deal value of outbound investment dropped a significant 19.7%. On the other hand, the total inbound M&A deal value in 2018 rose by 35.22%.

As for specific industries, TMT and life sciences remained M&A-active industries, while M&A in the manufacturing sector, particularly the automotive industry, appeared to grow more quickly than other sectors.

4. **What do you believe will be the three most significant factors influencing M&A activity over the next 2 years?**

- Macro-economy and fund-raising market. Financial investors are a significant driver of M&A activity in China. They contribute materially to the selection and development of investment targets and tend to lead overall investment trends in specific industries. It is widely accepted that the highly competitive PE and VC markets in China contributed to

China's record high valuations for start-up companies in 2018. However, as a result of China's deleveraging efforts, the Chinese PE/VC funds have recently experienced fund-raising difficulties. The fluctuations in the Chinese macro-economy and the ability of financial investors to raise investment funds will have a significant impact on M&A activities going forward.

- International and domestic policies. The decline in PRC outbound M&A in 2018 has been imputed to international and PRC policies. For example, direct outbound M&A transactions are believed to have decreased partly due to more stringent CFIUS rules issued in the US, and new FDI restrictions adopted by European countries. Simultaneously, many Chinese investors have also experienced difficulties in PRC regulatory approval procedures for outbound investments, possibly owing to China's efforts to maintain a steady foreign exchange reserve. However, we are cautiously optimistic that the optimisation of M&A policy and other policy reforms in the PRC and internationally – some of which may correlate with the loosening of trade tensions between the US and China – could help to spur market activity.
- PRC capital market. The Shanghai composite and the main Shenzhen index dropped by more than 20% and 30%, respectively, in 2018. Many PRC public companies defaulted on debt and are generally facing financial difficulties. Therefore, PRC investors (especially state-owned enterprises) have become more active in attempting to obtain control of public companies in 2018. However, not many deals were closed due to stock price fluctuations and disagreements on key deal terms. The Science and Technology Innovation Board was recently announced and is expected to be launched by the SSE soon. It will be aimed at providing an easier listing board for high-tech companies than those currently existing in the SSE and SZSE, which may also stimulate M&A activities in high-tech sectors.

5. What are the key means of effecting the acquisition of a publicly traded company?

The most commonly used deal structures for acquisition of PRC public companies include share transfers by agreement, voting trusts, block trades and tender offers. Hybrid structures employing a combination of these are common too.

6. What information relating to a target company will be publicly available and to what extent is a target company obliged to disclose diligence related information to a potential acquirer?

From publicly available sources (including websites of governmental authorities), PRC investors can easily find general information concerning a PRC company, such as shareholding structure, corporate history, administrative penalties, on-going and concluded litigation and enforcement procedures, intellectual property registrations and filings, etc. Public companies are also required to publicly disclose their audited financial reports and other financial information periodically, as well as material information per the listing rules and disclosure requirements of the stock exchanges. Other than this, a target company is not generally obliged to disclose any diligence information to a potential acquiror. It is customary, however, for an acquiror to request a target company to provide as much information as possible during due diligence (typically subject to the signing of a non-disclosure agreement with the target company).

7. To what level of detail is due diligence customarily undertaken?

Some PRC investors tend to neglect the importance of prudent due diligence and an informed decision-making process during the execution of M&A deals. Timetables can be unreasonably aggressive in a rush to close a deal and save on transaction costs. This may result in acquirors being exposed to material compliance and internal control issues as well as contingent liabilities without appropriate provisions in transaction documents. More prudent investors, on the other hand, tend to engage experienced lawyers, accountants, tax and financial advisors and other professional advisors to conduct thorough due diligence on a target company and to carefully assess relevant risks before making an investment decision. In the latter scenario, although investors may vary in terms of the level of detail in due diligence, our general observation is that parties tend to focus more on corporate history and compliance issues of a

target company, among other areas.

8. What are the key decision-making organs of a target company and what approval rights do shareholders have?

The shareholders' meeting is typically the highest decision-making organ of a PRC company, followed by the board of directors. Subject to a company's articles of association, typically simple majority approval by the shareholders' meeting is required for most material corporate actions. One exception to this structure, however, is a Sino-foreign equity joint venture (EJV), in which there is no shareholders' meeting, making the board of directors the highest decision-making organ in an EJV. As a result, shareholders technically have no approval rights in an EJV. However, PRC law requires that certain actions are unanimously approved by the board of directors, amendments to the EJV's articles of association, suspension or dissolution of the EJV, registered capital increases or decreases, and mergers or divisions. All other decisions require a simple majority of an EJV's board of directors.

9. What are the duties of the directors and controlling shareholders of a target company?

Under the PRC Company Law, a director owes duties of loyalty and diligence to a target company. In a private transaction, the directors are generally required to execute the decisions of the shareholder meeting. In an EJV, however, the directors would normally act under instructions of the shareholders who nominate them. While a controlling shareholder does not owe specific legal duties to an investor, some investors attach contractual obligations to the controlling shareholders (e.g., maintain control of the company, ensure minority shareholders receive adequate compensation) or grant other rights to protect minority shareholders (e.g., co-sale rights).



In the acquisition of a public company, the target company's directors must make decisions and take actions in the best interest of the target company and its shareholders, and treat all competing acquirors equally and fairly in accordance with their duties of loyalty and diligence. Directors cannot set unreasonable prerequisites to the acquisition, provide financial assistance to the acquiror using resources of the target company or harm the lawful interests of the target company or its shareholders. Likewise, the controlling shareholders cannot harm the lawful interests of the target company or its other shareholders.

10. **Do employees/other stakeholders have any specific approval, consultation or other rights?**

Employees of a company generally have no approval right for an M&A transaction. Technically, the PRC Company Law provides that a target company should *consult* its labor union (if applicable) and obtain opinions and suggestions from its employees when making decisions on restructuring and major issues concerning its business operations or formulating major rules, regulations and policies. However, a target company is under no obligation to accept the opinions of the labor union or any employee. The consultation process is therefore usually only a formality.

11. **To what degree is conditionality an accepted market feature on acquisitions?**

The majority of M&A deals in the PRC are two-step transactions and it is generally accepted in the PRC market that certain conditions will need to be fulfilled or waived before the closing of an M&A transaction.

12. What steps can an acquirer of a target company take to secure deal exclusivity?

The acquiror can enter into an exclusivity agreement, or letter of intent/MOU that includes a legally binding exclusivity clause with the target company and its shareholders. The definitive transaction documents often also include exclusivity clauses covering the period from signing to closing.

13. What other deal protection and costs coverage mechanisms are most frequently used by acquirers?

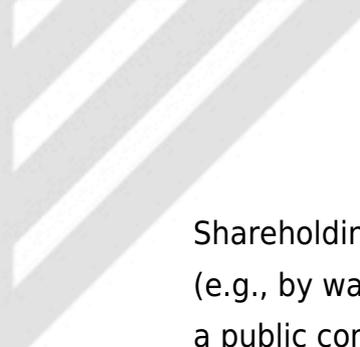
Usually if an up-front deposit is paid to the target company, acquirors request reverse break fees, payable by the target company and/or the sellers if the deal does not close.

14. Which forms of consideration are most commonly used?

Cash is the most commonly used consideration. An issuance of new shares of the acquiror is also frequently used, especially if the acquiror is a public company.

15. At what ownership levels by an acquiror is public disclosure required (whether acquiring a target company as a whole or a minority stake)?

There are generally no disclosure requirements in private M&A transactions. If an investor only acquires a minority stake in a public company, then the investor is required to publicly disclose through a Simplified Report on



Shareholding Change (Simplified Report) if the acquiror directly or indirectly (e.g., by way of persons acting in concert) acquires 5% to 20% of the shares in a public company and such shareholding will not result in a change of control of the target company. The Simplified Report typically includes the identity of the acquiror and all Persons Acting in Concert, their current shareholding in the company, their history of trading the shares in the past 6 months, the purpose of their acquisition, and whether the acquiror intends to further increase its shareholding in the target company in the next 12 months.

When acquiring a controlling stake in a public company, the acquiror is generally required to publicly disclose a Detailed Report on Shareholding Change (Detailed Report). In addition to the disclosures required in a Simplified Report, a Detailed Report should include the shareholding structure of the acquiror, all persons acting in concert with the acquiror on a see-through basis, their financials from the past three years, source of funding, and their future plans to reorganize the target company. These disclosures are intended to identify the ultimate beneficial owner of the acquiror and demonstrate that the acquirer or its ultimate beneficial owner (if the acquirer is a SPV) has the economic capacity to acquire the target company without using certain types of leverage (other than bank and shareholder loans).

16. **At what stage of negotiation is public disclosure required or customary?**

There are generally no disclosure requirements in private M&A transactions. In a public M&A transaction, the public company is required to disclose the potential transaction via the applicable stock exchange promptly upon the signing of any written agreement (even a non-binding document, such as a letter of intent).

17. Is there any maximum time period for negotiations or due diligence?

There is generally no time limit. However, if a public company is engaged in a transaction that it wishes to use to suspend trading of its shares, the public company may not suspend trading for more than three months without consent from the applicable stock exchange.

18. Are there any circumstances where a minimum price may be set for the shares in a target company?

In a direct share transfer agreement or block trade for shares in a public company, the share transfer price cannot be lower than a percentage (typically 90%) of the company's closing share trading price on the last trade day prior to the signing of relevant agreements. For indirect share transfers (e.g., acquiring shares of a shareholder of a public company), there is no strict minimum price requirement. However, for any transaction involving state-owned shares, the transfer price should be no less than the price determined by the appraisal results of the state-owned assets.

19. Is it possible for target companies to provide financial assistance?

In a private M&A transaction, there is generally no prohibition of such financial assistance. However, in a public acquisition, the target company is not allowed to provide financial assistance.

20. **Which governing law is customarily used on acquisitions?**

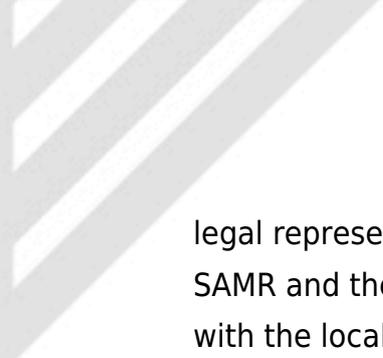
Where a purely domestic company is being purchased or invested in by a foreign buyer, the key transaction documents such as the share purchase agreement (SPA), the equity joint venture contract (not applicable in a full takeover) and the articles of association of the target company must be governed by PRC law. For cross-border M&A deals, parties may be able to choose the laws of another jurisdiction to govern the transaction documents, subject to the *Law on the Laws Applicable to Foreign-related Civil Relations*. The selection of the laws of a given jurisdiction to govern a share/equity purchase agreement will be determined based on several factors, including the deal structure, the nationality of the purchasing entity, the qualification of their legal counsel, etc.

21. **What public-facing documentation must a buyer produce in connection with the acquisition of a listed company?**

The buyer will need to engage a qualified financial advisor (usually a PRC investment bank) to produce a series of reports, including a Simplified Report on Shareholding Change, a Detailed Report on Shareholding Change, and an Independent Financial Advisor Report. The buyer is also required to engage PRC legal counsel to issue a number of legal opinions on the acquiror's compliance with applicable PRC laws, and on the legality of each procedure of the transaction.

22. **What formalities are required in order to document a transfer of shares, including any local transfer taxes or duties?**

In a private M&A transaction, the parties will register the shareholder change as well other corporate changes of the target company (e.g., the change of the



legal representative and directors) wish the applicable local branches of the SAMR and the tax authority. If a foreign investor is involved, typically a filing with the local MOFCOM is required as well. If any seller is an individual, the acquiror will be required to withhold and pay to the local tax authority Individual Income Tax levied on the capital gain of such transfer on behalf of the individual seller. The parties will also be required to pay a stamp duty.

In a public M&A transaction, the parties should register the transfer of shares of the target company at the applicable branch of the China Securities Depository and Clearing Corporation Limited (CSDC).

23. **Are hostile acquisitions a common feature?**

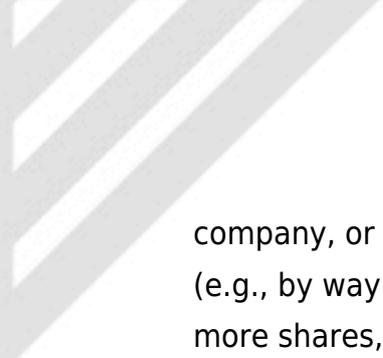
No. Competitive or hostile takeovers are relatively rare in the PRC market.

24. **What protections do directors of a target company have against a hostile approach?**

The directors can typically invite a competing bidder to compete against the hostile acquiror. As directors are required to conduct independent investigations on the qualifications, credibility and intention of a hostile acquirer and analyze the tender offer terms, they may also issue a negative opinion on the offer to facilitate its rejection by shareholders.

25. **Are there circumstances where a buyer may have to make a mandatory or compulsory offer for a target company?**

If an acquiror intends to acquire more than 30% of the shares of a public



company, or if it already holds 30% or more of the shares of a public company (e.g., by way of transfer by agreement or block trade) and intends to acquire more shares, the acquiror is required to make a tender offer to all other shareholders of the target company if the acquiror intends to acquire such target shares.

26. If an acquirer does not obtain full control of a target company, what rights do minority shareholders enjoy?

The minority shareholders may have veto rights over decisions of the controlling shareholder at a shareholders' meeting or over board resolutions at a board meeting under the shareholders agreement and/or articles of association of the target company. In addition, the PRC Company Law provides that the following decisions may only be adopted upon an affirmative vote of two-thirds of the total number of shareholder votes:

- amending the articles of association;
- increasing or decreasing registered capital;
- merging, diverging or dissolving the company; and
- changing the corporate form of the company.

27. Is a mechanism available to compulsorily acquire minority stakes?

If a company's shareholder meeting has adopted a resolution to merge or divide the company, a dissenting minority shareholder may require the company to repurchase all the shares held by the dissenting minority shareholder.

In a public acquisition, if an acquiror has obtained over 90% of the shares of the target company, then, barring a waiver from the CSRC, the acquiror is required



to acquire the remaining minority shares and delist the target company.