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Corporate M&A

China

Trends and Developments

Shifang Guo, Jerry Liu, Steven Zhu and Qing Ren
Global Law Office

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Contributed by:

Shifang Guo, Jerry Liu, Steven Zhu and Qing Ren
Global Law Office see p.8

Outbound M&A

Suffering from the COVID-19 crisis and increasingly rigorous foreign investment control, worldwide outbound M&A by Chinese investors in 2020 declined by 27.59% in value (USD42 billion) compared to 2019 based on disclosed deal volume, and the number of transactions (403) declined by 39.58% according to statistics released by PwC. The most popular economic sectors for Chinese outbound M&A activity by deal value were industry, hi-tech and consumer products. Driven by the “Belt and Road” initiative, Chinese investment in parts of the world including India, Latin America and the ASEAN countries is increasing year-on-year and this is likely to continue going into 2021.

Meanwhile, with the special purpose acquisition company (SPAC) booming in the USA in 2020, the SPAC has also become a popular outbound M&A choice for Chinese investors in 2020. Ucommune, United Family Healthcare and Faraday Future all chose to be listed in the USA by means of a merger with a SPAC. As SPAC deals are a fast, low-cost, low-threshold way of financing, and Asia-focused SPACs are emerging, more and more Chinese investors may seek mergers with suitable SPACs for overseas listing purposes in 2021.

In 2017 the China National Development and Reform Commission (NDRC), the Ministry of Commerce (MOFCOM) and the State Administration of Foreign Exchange intensively promulgated a series of rules and regulations attempting to streamline governmental procedures and guide Chinese investors towards rational investment. In the following years of 2018, 2019 and 2020, China outbound M&A activities displayed

a tendency towards greater rationality. Overall, there have not been material revisions or updates to the regulations governing overseas direct investment in 2020.

Inbound M&A

China inbound M&A by foreign strategic investors in 2020 (USD14.6 billion) increased by 30.81% in value over 2019 based on disclosed deal volume, though the number of transactions (181) declined by 27.02% according to statistics released by PwC. Following the implementation of the Foreign Investment Law and its implementing regulations (Foreign Investment Law) on 1 January 2020, China has been attracting more foreign investment in the past year. Figures released by MOFCOM show that China attracted CNY999.98 billion of foreign investment in 2020, reflecting a 6.2% year-on-year increase despite the fact that global cross-border investment encountered a sharp decline in the face of the COVID-19 pandemic. The number of new foreign-invested enterprises set up in China in 2020 reached 39,000, making China the world’s largest recipient of foreign investment.

One of China’s commitments upon its entrance to the WTO was the opening-up of its economy and the facilitating of foreign investments. This was the keynote of 2020 M&A policy and is also essential to China’s economic development. To further improve the environment for foreign investors in China, material revisions to the rules and regulations governing inbound M&A have been made in the past year.

The Administrative Measures for Strategic Investment in Listed Companies by Foreign Investors

On 18 June 2020, the MOFCOM promulgated the revised draft of the Administrative Measures for Strategic Investment in Listed Companies by Foreign Investors (Strategic Investment Regulation) for public comment. The Strategic Investment Regulation regulates M&A involving A-share listed companies. The 2020 draft mainly indicates the following potential revisions of the Strategic Investment Regulation.

- In light of the new information reporting mechanism under the Foreign Investment Law, replacing the ex-ante MOFCOM examination and approval of foreign strategic investment with an ex-post reporting requirement.
- Further clarifying that in stock-swap M&A transactions, except for implementing foreign strategic investment by means of a contractual transaction (as opposed to other means including tender offers), the foreign entity as a party to the swap transaction is no longer required to be a foreign listed company.
- Clarifying that the proportion of shares scheduled to be purchased in foreign strategic investment, by contractual transaction or by tender offer, shall not be less than 5% instead of 10%.
- Adding additional requirements in terms of information disclosure and expert opinion on compliance with the Strategic Investment Regulation.
- Specifying that foreign strategic investment in the companies listed on the National Equities Exchange and Quotations may be made with reference to the Strategic Investment Regulation.

Foreign investment in specific regulated industries

On 23 June 2020, the 2020 version of the List of Special Administrative Measures for Foreign Investment Access (the so-called Negative List) was promulgated and implemented.

Compared with the 2019 version, six items, which used to be subject to prohibitions or limitations, were entirely removed from the new Negative List, including the following.

- Foreign investment in the smelting and processing of radioactive minerals and the production of nuclear fuel was prohibited.
- The construction and operation of urban water supply and drainage pipelines and networks for cities with an urban population of 500,000 or more was required to be controlled by Chinese shareholders.
- Foreign investment in air traffic control was prohibited.
- Foreign shareholders were not permitted to hold more than 51% of the shares of securities companies or securities investment fund management companies – this restriction will be eliminated in 2021.
- Foreign shareholders were not permitted to hold more than 51% of the shares of futures companies – this restriction will be eliminated in 2021.
- Foreign shareholders were not permitted not hold more than 51% of the shares of life insurance companies – this restriction will be eliminated in 2021.

Another six items were revised, among which developments in the fields of manufacturing and agriculture are of particular interest.

In the field of manufacturing, the 2020 version of Negative List cancelled the restrictions on the foreign shareholding percentage in the manufacturing of commercial vehicles.

In the field of agriculture, the requirement that the Chinese party must hold a controlling stake in the breeding of new varieties and seed production of wheat was amended to a requirement that the shareholding percentage of the Chinese party shall not be less than 34%.

In addition, the 2020 version of the List of Special Administrative Measures for Foreign Investment Access in Pilot Free Trade Zones and the Catalogue of Encouraged Foreign Investment Industries were also promulgated in 2020 to facilitate foreign investment in China, with the former removing six items from the negative list and the later adding 127 to the encouraged list.

Measures for the Security Review of Foreign Investment

On 19 December 2020, the NDRC and MOFCOM jointly promulgated the Measures for the Security Review of Foreign Investment (Security Review Regulation), which was implemented on 18 January 2021. The Security Review Regulation marks a new era of national security review in China and will have far-reaching impact on foreign M&A in China.

Under the Security Review Regulation, where an acquisition of Chinese enterprises' equity or assets by foreign investors through M&A falls within any of the following categories, the acquisition shall proactively be reported to the NDRC before closing:

- investment in the military industry, facilities supporting the military industry or other fields concerning national defence and security, as well as investment in the surrounding areas of military facilities and military industry facilities; or
- investment in important agricultural products, important energy and resources infrastructure, important equipment manufacturing, important infrastructure, important transpor-

tation services, important cultural products and services, important information technology and internet products and services, important financial services, key technologies and other important fields concerning national security, and obtaining actual control of the invested enterprise.

When it is decided that the reported inbound M&A affects national security, the foreign investor may not make the investment, and where the investment has been made, the foreign investor shall dispose of equity or assets within the prescribed time limit and take other necessary measures to restore the pre-investment state and eliminate the impact on Chinese national security.

Rules on handling complaints of foreign-invested enterprises

The Rules on Handling Complaints of Foreign-Invested Enterprises was promulgated on 18 August 2020 and came into force on 1 October 2020. Under these rules, foreign investors may apply for MOFCOM or local government co-ordination when their legitimate rights are infringed by administrative agencies, as well as reporting issues and suggestions concerning the Chinese investment environment. These new rules are expected to facilitate foreign inbound M&A in China with more practical dispute resolution choices, which is consistent with the legislative purpose of the Foreign Investment Law to promote foreign investment activities in China.

The Potential Impact of the Blocking Rules and the Unreliable Entity List Rules

The Blocking Rules and the Unreliable Entity List Rules

Against the backdrop of a rapidly changing international trade environment, and US-China relations in particular, it is worth noting two new rules recently promulgated by MOFCOM:

- the Rules on Blocking Unjustified Extraterritorial Application of Foreign Laws and Measures, effective as of 9 January 2021 (Blocking Rules); and
- the Rules on Unreliable Entity List, effective as of 19 September 2020 (Unreliable Entity List Rules).

Although these rules may be more related to trade sanctions and export control administration, it appears that parties to M&A transactions have taken these rules into account when negotiating M&A deals.

The Blocking Rules do not specify which foreign laws or measures (collectively blocked foreign laws) are subject thereto, but it could be reasonably anticipated that recent US laws and measures (eg, sanctions and export control) would be the main subjects. The Blocking Rules do not clearly state what specific circumstances are regulated either. Article 2 of the Blocking Rules only provides that they apply to circumstances where the extraterritorial application of foreign laws and measures is against international laws and basic norms of international relations and unjustifiably prohibits or restricts Chinese parties from conducting normal business activities with third-party country counterparts.

According to a press conference held by MOFCOM shortly after the release of the Blocking Rules, a typical scenario contemplated under the Blocking Rules is where a Chinese company is prohibited under the US laws from engaging in an M&A transaction with its counterparts in a third-party country (eg, countries within the Belt and Road initiative), subject to sanctions by the Office of Foreign Assets Control of the US Department of the Treasury (OFAC).

What seems to be relatively clear is the scope of the entities and individuals subject to the Blocking Rules. The Blocking Rules mainly

apply to Chinese entities and individuals (including foreign-invested companies in China), and it prohibits, through injunctions imposed by the MOFCOM, Chinese entities and individuals from complying with the blocked foreign laws. Foreign companies are generally not subject to the Blocking Rules, but they may be required to compensate their Chinese counterparts under the judicial remedies available to Chinese parties under the Blocking Rules if such foreign companies benefit from foreign judgments or awards against their Chinese counterparts based on the blocked foreign laws.

With respect to the Unreliable Entity List Rules, a typical unreliable entity contemplated thereunder would be a foreign company ceasing its supply of goods or services to its Chinese counterparts blacklisted by the OFAC or the Bureau of Industry and Security of the Department of Commerce (BIS). In which case, that foreign company's business and trade with China could be substantially affected.

The authors' observations

As of the date of this article, there have been no unreliable entities publicly identified by Chinese government authorities, nor have any cases involving the blocked foreign laws been publicly released. Given the low legislative level of these two sets of rules (both were formulated by MOFCOM as departmental rules), the absence of a detailed implementation mechanism, and unclear enforcement practices by Chinese government authorities up till now, it remains to be seen how and to what extent the Blocking Rules and the Unreliable Entity List Rules will impact M&A transactions involving Chinese parties. Nevertheless, the following might reasonably be anticipated.

Deal certainty

These rules may affect deal certainty in various ways. First, as we have seen in some transac-

tions, parties have put in place stricter deal protection mechanisms. For example, the buyer may require the seller and targets to provide representations and warranties and a corresponding indemnity mechanism with respect to trade sanctions and export control, as well as requesting clear exit mechanisms (either through termination for convenience or by requiring the seller to repurchase the purchased equity or assets). Second, in deals where buyers have financing needs, such financing might be denied by financial institutions because of the blocked foreign laws.

Vertical M&A

Given the changing landscape of US-China relations, it may be reasonably anticipated that, in response to the US sanctions and export controls, Chinese companies may pay more attention to vertical M&A deals in order to secure safe supply chains.

Dilemma

Concerns have been raised as to whether these rules would put Chinese and foreign parties to transactions into an awkward dilemma (ie, either they observe the blocked foreign laws or follow the injunctions imposed by the Blocking Rules). Although the Blocking Rules stipulate, in principle, that injunctions may be suspended, revoked or exempted under certain circumstances, detailed implementation of these mechanisms remains unclear. In other words, this may essentially force foreign companies (including their Chinese subsidiaries) to take sides with either the USA or China, which could have a serious impact on future M&A transactions.

Merger Control and National Security Review

China promulgated its Anti-monopoly Law in 2007 and, since March 2018, the PRC State Administration for Market Regulation (SAMR) has been the authority administering all anti-monopoly enforcement matters, including merger con-

trol. Within the Anti-monopoly Bureau of the SAMR, three divisions are tasked with reviewing merger control filings while another division is responsible for investigating illegally conducted concentrations of business operators.

In October 2020, the SAMR issued Interim Provisions on Review of Concentration of Business Operators (Interim Provisions), consolidating and also replacing six regulations and normative documents previously issued by MOFCOM, then the authority in charge of merger control administration. The Interim Provisions, with 7 Chapters and 65 Articles in total, provide comprehensive rules regulating the filing and review of concentration of business operators, the determination and implementation of restrictive conditions (also called merger remedies), and the investigation of illegally conducted concentrations of business operators.

In 2020, the SAMR, in total, initiated reviews over 481 merger control filings and concluded reviews over 473 filings. Among the 473 concluded filings, no case was prohibited, four cases were approved with restrictive conditions, while all the remaining 469 cases were approved without conditions (accounting for 99.2%). All the four cases approved with restrictive conditions are concentrations between US companies or between US companies and European companies. In 2020, the SAMR rendered punishment decisions in 13 cases where concentrations of business operators were illegally conducted. Notably, three of these cases involved the variable interest entity (VIE) structure that has been used in industries where foreign investment is prohibited or restricted, which demonstrates the determination of the SAMR that concentrations of business operators with VIE structures be equally subject to the merger control rules.

COVID-19 and merger review

In responding to the outbreak of COVID-19, the SAMR introduced off-site review of filings in February 2020. In particular, notifying parties may send electronic copies of notification materials as well as replies to the SAMR's requests for further information (RFI), and the SAMR may also send notices and decisions to the notifying parties via email or fax. The SAMR also established a green channel to expedite the review process for transactions facilitating the prevention and control of the epidemic (eg, pharmaceutical manufacturing, medical instruments, equipment and device manufacturing) and the resumption of work and production. By taking these measures, the SAMR has ensured that the efficiency of its merger control work has not been impacted by the epidemic. According to the SAMR's statistics, the average time periods for initiating a review and for completing a review have been reduced by 27% and 14.5%, respectively. Specifically, a larger number of simple cases are approved within a very short period (eg, less than 15 days) after the initiation of the review.

Global Law Office has more than 460 lawyers practising in its Beijing, Shanghai, Shenzhen and Chengdu offices and is one of China's leading law firms. GLO's corporate M&A practice covers a wide range of transaction types and the entire process of transactions, including unlisted/listed companies' mergers and acquisitions, and transactions from initial investment to equity exit, with special expertise in handling cross-border transactions and state-owned assets-related transactions and restructuring matters. The firm provides comprehensive ser-

vices to align industry sectors' needs, which include financial services, manufacturing, trade, energy and mining, automotive, real estate and construction, transportation, life sciences and healthcare, food and beverage, entertainment and sports, and TMT. The firm's experience and capabilities allow for the provision of one-stop services on complex M&A transactions covering foreign investment access, industry compliance, state-owned asset governance, taxation, foreign exchange regulatory, intellectual property, labour and national security review.

AUTHORS



Shifang Guo is a partner of Global Law Office based in Shenzhen and Beijing. Her practice covers cross-border M&A, capital markets and investment funds. Shifang has

led the completion of numerous domestic investment and acquisition projects around the world. This has included major asset restructuring of A-share listed companies to acquire overseas companies, and domestic companies' acquisition of international listed companies. Shifang also assists foreign investors in investing in and acquiring domestic companies – including foreign strategic investment in, and tender offers to acquire, A-share listed companies. She also has expertise in international capital market business, and has assisted clients in completing US and Hong Kong-listed projects and numerous overseas debt issuance projects.



Jerry Liu is a partner of Global Law Office based in Shanghai. He has extensive experience in the areas of M&A, PE/VC, investment, compliance/anti-corruption, data protection and

privacy and dispute resolution. Jerry provides the aforementioned legal services to many Fortune 500 multinationals and Chinese companies. His clients include firms in the manufacturing, automobile, aerospace, insurance, energy, pharmaceutical, agriculture, retail, TMT, and consulting sectors.



Steven Zhu is a partner of Global Law Office based in Beijing. His practice focuses on cross-border M&A, compliance and regulatory, and media and entertainment. Steven has

extensive experience in assisting a variety of multinationals and major Chinese companies in structuring and negotiating cross-border transactions, such as foreign direct investment (both inbound and outbound), joint ventures and VC/PE investment. Steven routinely advises on a variety of compliance and regulatory matters, including anti-corruption (eg, the FCPA and PRC anti-bribery laws). He also has significant experience in assisting Hollywood and Chinese studios in structuring and negotiating commercial, corporate and partnering transactions, such as film financing, co-production and distribution.



Qing Ren is a partner of Global Law office based in Beijing. He specialises in antitrust, dispute resolution and international trade. Qing has represented international and Chinese

companies in dozens of merger control filing cases, across various sectors, such as minerals, chemicals, healthcare and pharmaceuticals, machinery, automotive, electrical, ICT, food, retail, catering, shipping and logistics. He also represents or advises clients on antitrust investigations, litigation and compliance. Qing is an arbitrator of leading Chinese arbitration institutions, including CIETAC, CMAC, BAC, SHIAC, SCIA and CQAC. He also practises commercial and investment arbitration as counsel. Qing is a trade law expert proficient in export control, economic sanctions, and WTO/FTA matters.

Global Law Office

15&20/F Tower 1, China Central Place
No.81 Jianguo Road
Chaoyang District
Beijing 100025
China

Tel: +86 10 6584 6688
Fax: +86 10 6584 6666
Email: global@glo.com.cn
Web: www.glo.com.cn

