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Technology M&A 2023

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China: Law & Practice
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CHINA

Law and Practice

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1. Market Trends

1.1 Technology M&A Market

The current technology M&A market in China is slowing more down than it was 12 months ago, which corresponds to a general decline in M&A markets globally.

The COVID-19 pandemic, inflationary trends, changes in the financing market, geopolitical factors (such as the war in Ukraine) and the Chinese government's continuing scrutiny of TMT giants have all affected the pace of deal activity in the past 12 months in China. The numbers and deal value of both outbound and inbound M&A deals have significantly declined as a result. Specifically, there were far fewer outbound M&A deals than in the past and most of the M&A deals occurred in domestic market, owing to the COVID-19 pandemic and geopolitical factors.

2. Establishing a New Company, Early-Stage Financing and Venture Capital Financing of a New Technology Company

2.1 Establishing a New Company

New start-up companies are typically advised to incorporate in China. However, if entrepreneurs intend to seek an overseas listing in the future, they may be advised to incorporate or restructure into an offshore holding company (principally in the Cayman Islands).

China has relaxed its incorporation requirements throughout the years, to the extent that it now usually takes:

- one or two weeks to incorporate a purely domestic company; and
- one or two months to incorporate a foreign-invested company.

Generally, there is no initial paid-in capital requirement for a company incorporation unless the company will be engaging in certain specified business activities.

2.2 Type of Entity

New start-up companies are typically advised to incorporate in China as limited liability companies. The partnership form is usually chosen for the purposes of setting up an investment fund or holding vehicle.

2.3 Early-Stage Financing

Entrepreneurs and many venture capital firms typically provide early-stage financing to a start-up company. If the funds are provided by venture capital firms, simplified investment agreements will be entered into to set forth the usual preferred rights for venture capital firms.

2.4 Venture Capital

Typical sources of venture capital in China include funds of funds, wealthy entrepreneurs, government-sponsored funds, large corporations, etc. Both local and foreign venture capital firms are active in China. Government-sponsored funds have also been quite active recently.

2.5 Venture Capital Documentation

There are well-developed standards for venture capital documentation in China, including for deal terms. Since 2017, Han Kun Law Offices has issued an annual Venture Capital/Private Equity Deal Data Analysis Report, which recaps the most common terms in venture capital/private equity deals in China each year and has become the market standard in this field.

2.6 Change of Corporate Form or Migration

Start-ups are generally advised to restructure their corporate forms from an onshore structure to an offshore structure if they intend to list overseas, and vice versa. Also, in the case of domestic listings, Chinese law provides that only joint stock companies can be publicly listed. Therefore, start-ups that intend to list in mainland China (A-share listing) or in Hong Kong (H-share listing) must change their corporate form from a limited liability company to a joint stock company.

3. Initial Public Offering (IPO) as a Liquidity Event

3.1 IPO v Sale

Start-up investors tend to look for a liquidity event after the start-up has been in operation for more than five or six years. In the past, investors preferred IPOs to a trade sale. However, they currently appear to be more flexible when it comes to exit options and, depending on the specific terms of the transaction, are open to either an IPO or a trade sale.

3.2 Choice of Listing

Chinese companies choose to list domestically rather than overseas, based on a variety of factors. Among other things, companies need to consider:

- whether the proposed exchange will give a higher valuation and provide more liquidity after listing (eg, companies in TMT industries prefer listing overseas, whereas those in traditional industries prefer domestic listings);
- whether the company fulfils the listing requirements of the proposed exchange (eg, A-share listing requirements tend to be stricter than those for overseas listing);
- whether the company needs to restructure in order to list and whether this would be prohibitive in terms of time and cost; and
- whether the company needs to go through certain procedures required by Chinese authorities in order to be listed overseas - for example, consent from the Cyberspace Administration of China (CAC) may be required if a PRC-based company intends to list on a foreign exchange if it has more than a million users' data.

3.3 Impact of the Choice of Listing on Future M&A Transactions

If the company chooses to list on an overseas exchange (ie, neither A-share nor H-share), it must conduct its business through an offshore structure. Use of an offshore structure may:

- complicate a future sale if the buyer is a purely domestic company; and
- give rise to other implications, such as cross-border tax issues, scrutiny by multiple jurisdictions, etc.

4. Sale as a Liquidity Event (Sale of a Privately Held Venture Capital-Financed Company)

4.1 Liquidity Event: Sale Process

If the sale of a company is chosen as a liquidity event, the sale process is more likely to be run as a bilateral negotiation with a chosen buyer than as an auction. An auction sale is more common if it is a cross-border deal.

4.2 Liquidity Event: Transaction Structure

The typical transaction structure in China is either to:

- buy the entire company; or
- buy a controlling interest (eg, where the offeror buys out the venture capital funds but requests that the management or entrepreneurs retain a portion of their shares after the sale in order to ensure a smooth transition period).

4.3 Liquidity Event: Form of Consideration

Most M&A transactions in China are conducted as a sale of the entire company for a combination of stock and cash, particularly in the TMT sector.

4.4 Liquidity Event: Certain Transaction Terms

Founders are usually expected to stand behind representations and warranties and certain liabilities after closing. Venture capital investors are generally expected to stand behind limited representations, warranties and liabilities only in respect of themselves. An escrow/holdback (ranging from 10–30% of the consideration) is customary for these purposes. Representations and warranties insurance is not customary in China.

5. Spin-Offs

5.1 Trends: Spin-Offs

Spin-offs are customary in the technology industry in China.

Key drivers for considering a spin-off include:

- the spun-off business may perform better after the spin-off;
- the spun-off business no longer fits with the parent business; and
- the spun-off business may have a better chance of raising funds and listing independently.

5.2 Tax Consequences

Chinese tax law allows spin-offs to be conducted in a tax-deferred manner – that is, the spin-off price is set at net book value instead of fair market value. Certain criteria must be met, such as:

- the shareholding structure must remain unchanged;
- the spun-off entities' business operations must remain unchanged; and
- cash payments may be no more than 15% of the total transaction consideration.

5.3 Spin-Off Followed by a Business Combination

Chinese law allows spin-offs to be immediately followed by a business combination. There are no specific requirements for this.

5.4 Timing and Tax Authority Ruling

Spin-offs typically take between several months and one or two years to complete, depending on how the spin-off is structured. There is no need to seek tax authority pre-approval for spin-off arrangements. However, in practice, it is recommended that the arrangements are discussed with a competent tax authority before the transaction is executed – particularly in the case of large-volume restructurings. Such discussions may take one or two months.

6. Acquisitions of Public (Exchange-Listed) Technology Companies

6.1 Stakebuilding

It is customary for buyers in China to acquire stakes in listed companies before making an offer to acquire; stakes are often built through negotiated transfers or by other means. Acquisitions of listed technology companies are predominantly conducted by way of transfer agreements and supplemented by a tender offer or other arrangement.

Reporting Thresholds

Buyers are obliged to report their stake in a listed company within three trading days once the stake reaches 5% of the shares of the listed company (eg, upon acquiring shares on the open market or after the execution of a transfer agreement). Buyers must thereafter report each additional 5% increase or decrease in ownership in accordance with the same three-day time limit. In addition, once the buyer acquires a 5% stake in the target listed company, the buyer must notify the target of every 1% increase or decrease in shareholding on the trading day following the occurrence of such change. The target listed company will then publicly announce the buyer's change in shareholding.

Disclosure Thresholds

Buyers are not allowed to trade shares in the listed company prior to submission of the above-mentioned reports and the making of an announcement. In addition, when making these reports, each buyer must disclose the purpose of its acquiring a stake in the target listed company and whether it intends to continue its stakebuilding within the next 12 months. If the buyer has acquired 20% or more of the shares in the target, it must also disclose its future plans for the listed company, including whether it intends to adjust the company's business, organisation and structure, personnel arrangements, and other matters. The buyer may not deviate from any disclosed plans and commitments in its subsequent actions.

Lock-Up Period

Buyers who acquire a listed company are not allowed to transfer the acquired listed company's shares within 18 months of completing the acquisition. (If the buyer is an offshore investor, the restriction period is three years.) However, transfers between different entities controlled by the same overall controller are not restricted.

6.2 Mandatory Offer

A buyer must make a tender offer to all shareholders of a listed company once its stake in the company reaches 30% if it intends to continue increasing its shareholdings, according to the provisions of the relevant administrative measures. This is also called a mandatory offer.

It is worth noting that a tender offer to acquire all the shares held must be made to all the shareholders of the company if:

- the acquisition will cause shares owned by the buyer to exceed 30% (eg, from 26% to 31%); and
- the buyer intends to acquire listed company shares other than by way of a tender offer, such as:
  - (a) acquisition by a negotiated transfer agreement from a specific seller; or
  - (b) indirect acquisition of an entity that holds certain shares of the listed company.

Exceptions exist for certain cases in which the buyer satisfies special conditions, such as:

- transfers between entities under the same control; or
- where the 30% shareholding threshold is passively exceeded as a result of the listed company's targeted share buy-backs.

6.3 Transaction Structures

General Acquisition Structures

As previously discussed, acquisitions of listed companies in China are principally conducted by way of transfer agreements (direct or indirect) and supplemented by other means, such as:

- by subscription to shares issued by the listed company via private placement;
- tender offers;
- purchasing shares via stock exchange trading systems;
- becoming the actual controlling party by way of an investment relationship; or
- agreement or other arrangement (eg, by accepting proxy voting rights or agreeing to carry out concerted actions with other parties).

Acquisition by Merger

Acquisitions of listed companies may also be completed by merger; however, such transactions are rare in China. Mergers in this context are uncommon because the China Securities Regulatory Commission (CSRC) and the relevant exchange must pre-approve operational matters, which usually include:

- the buyer applying for an IPO on the A-share market (where the buyer is an unlisted domestic company);
- the buyer issuing shares (where the buyer is a listed company); and
- stock-for-stock mergers.

The approval process is complicated and more restrictive, as it requires compliance with a number of laws and regulations concerning listing and restructuring.

6.4 Consideration; Minimum Price

Consideration and Payment Methods

Public company acquisitions in the technology industry tend to be structured as cash transactions, rather than stock-for-stock, a combination of cash and stock, or other legal methods. Cash is favoured in these acquisitions because securities (including stocks) used as consideration must meet certain requirements – for example, that the shares can be traded conveniently and have a reasonable valuation – and tender offers require three years of annual audit reports and a securities valuation report.

The cash option must be provided where the securities are not listed on a stock exchange. It should be noted that, in some cases, cash consideration is mandatory or may be offered. Cash consideration is mandatory if the buyer is required to issue a tender offer for all the shares either:

- in order to terminate the company's listed status; or
- due to a failure to satisfy the exemption conditions for a tender offer.

Additionally, as mentioned early, a cash option should be provided to the counterparty if the buyer can also provide a cash option in which it pays with securities other than the shares of a non-listed company as the consideration.

Minimum Price Requirements

Acquisitions and business combinations in China are subject to minimum price requirements, which vary according to how the transaction is structured.

Agreements and tender offers

The minimum pricing in an acquisition by agreement must not be lower than 80% or 90% (depending on the listed market) of the closing price of the listed company on the trading day preceding the execution of the agreement. For tender offers, the minimum price must be no less than the highest price paid by the buyer within six months prior to the date on which the tender offer is announced. In practice, this price is generally not lower than the arithmetic average of the daily weighted average price for the 30 trading days prior to the date of announcement.

Stock-for-stock mergers

The pricing of stock-for-stock merger transactions must not be lower than 90% of any of the following: the average trading price of the company's shares for the past 20, 60 or 120 trading days prior to the announcement of the listed company's board resolution concerning the merger transaction. (There is usually some premium based on the listed company's share price average for the previous 20 trading days.)

Use of contingent value rights

Buyers and sellers generally do not agree on mechanisms to adjust transaction consideration because the Chinese securities regulators impose a minimum price requirement for the acquisition of listed companies and regulate the overall arrangements for such transactions. However, in some cases, the parties will agree on performance commitments for the listed company through commercial negotiations. In such cases, the exiting controlling shareholder or the actual controlling party in the listed company may:

- attempt to achieve certain performance commitments within a certain period of time; and
- compensate the buyer accordingly if the company fails to achieve these performance commitments.

6.5 Common Conditions for a Takeover Offer/Tender Offer

In order to make mandatory offers, the buyer usually chooses to establish minimum acceptance conditions (in accordance with the provisions of the relevant administrative measures), which will be discussed in **6.7 Minimum Acceptance Conditions**. However, when a buyer makes a voluntary tender offer, it usually sets up some other conditions (related to the acquisition price and ratio) in order to acquire shares.

Generally, the buyer prefers to offer a relatively high price based on the expectations of the listed company's existing shareholders. If a voluntary tender offer is made to obtain control of a listed company, then the agreement usually sets forth a certain percentage of pre-offer shares as a condition precedent to the execution of the offer.

Chinese securities regulators implement restrictions with regard to the ratio (percentage of shares to be acquired) and price, but this is limited only to achieving minimums (rather than maximums).

Voluntary tender offers are rare in comparison with mandatory tender offers triggered by a 30% shareholding threshold (see **6.2 Mandatory Offer**). The circumstances under which voluntary tender offers occur are generally:

- where the controlling shareholder(s) of the listed company is looking to increase control;

- where "white knight" investors bail out a listed company that is in trouble or stabilise the company's share price; or
- where the voluntary tender offer supplements the acquisition of shares by other means.

6.6 Deal Documentation

It is customary in China for the parties to enter into a transaction agreement in connection with the acquisition of a listed company's control rights through a transfer agreement or merger. However, for tender offers, it is not customary to enter into an agreement with the listed company or the seller; instead, the buyer usually puts forward a tender offer that is then accepted by the original shareholders.

When acquiring a listed company by agreement, the parties may agree in the transaction agreement on certain obligations that the listed company is to undertake. These obligations usually include:

- relevant representations and warranties undertaken by the listed company with regard to its production and operating status;
- setting the completion of certain tasks by the listed company as a condition precedent in closing or post-closing requirements;
- requiring that the listed company operates in its ordinary course of business during the transition period; and
- requiring co-operation from the listed company with regard to the closing and the buyer's arrangements for its future production and operation, corporate governance, employment and personnel, etc.

6.7 Minimum Acceptance Conditions

The minimum acquisition threshold for acquiring a listed company by tender offer is based on a combination of factors, such as the concentration of the shareholding structure of the listed company, the buyer's purpose in making the acquisition, the capital status of the buyer, and the cost of the acquisition. However, regardless of these factors, the following minimum requirements must be satisfied.

- The percentage of acquired shares must be no less than 5% (no less than 10% if the buyer is a foreign investor). If the buyer intends to assume actual control of the listed company, the buyer will usually end up being the largest shareholder and the buyer's voting share will be significantly larger (usually over 10% more) than that of the second-largest shareholder.
- The price of acquired shares must be no less than the minimum price according to the provisions of the relevant administrative measures (see **6.4 Consideration; Minimum Price**).
- There is no mortgage, pledge, freezing, judicial seizure or any other form of encumbrance of rights in respect of the shares and the shares are not in the lock-up period.

The period of a tender offer may be no less than 30 days and no more than 60 days. The buyer is not allowed to modify the offer within the 15 days preceding the expiry of the offer period nor allowed to revoke the offer during the offer period. Apart from this, there are usually no strict requirements about the time limitation for other takeover offers.

6.8 Squeeze-Out Mechanisms

Chinese law does not provide for squeeze-out mechanisms or ownership thresholds whereby, following a successful tender offer, a buyer can buy out the shareholders who have not tendered. Upon completion of the tender offer, the remaining shareholders who refused to tender their shares are entitled to continue as shareholders of the company.

6.9 Requirement to Have Certain Funds/Financing to Launch a Takeover Offer

When acquiring a listed company, if the buyer intends to make the acquisition in cash, "certain funds" are required to launch the offer in China. If the buyer has sufficient funds to implement the bid, the buyer also needs to disclose the source of its funds and submit relevant documents to prove that the funds are sufficient and legitimate. The Chinese securities regulators will usually focus on the buyer's ability to perform contractual obligations and the source of its funds. Generally, the buyer's funds must not stem from the listed company, the seller or its affiliates. In any case, the buyer itself should make the offer.

Buyers are also permitted to use bank loans or borrowings; however, the procurement of such bank loans or borrowings cannot be a prerequisite for the acquisition. Additionally, if there is a possibility that the buyer will not be able to obtain the corresponding loans or borrowings, it is required to propose a plan to replenish or secure the funds.

6.10 Types of Deal Protection Measures

When acquiring a listed company, the buyer and the target company (or its selling shareholders) may negotiate certain deal protection measures. These measures include:

- break-up fees;
- exclusivity clauses;
- co-operation with the due diligence to be conducted by the buyer to its satisfaction; and
- an advance pledge of partial shares to the buyer.

In an acquisition via transfer agreement, the selling shareholders usually assume the corresponding obligations. The target company usually assumes these obligations in a merger transaction, however.

6.11 Additional Governance Rights

A successful bidder that obtains less than full ownership of a public target company may find it difficult to obtain additional governance rights. The circumstances differ depending upon whether the target company remains publicly listed or becomes private.

Company Remains Public

Target companies that remain public are subject to A-share regulatory independence requirements and buyers are often unable to obtain additional rights beyond those entitled to them by their shareholdings. To enhance control, buyers may negotiate with other shareholders of the target company in order to agree on certain governance arrangements.

Company Becomes Private

If a target company becomes private, the buyers may negotiate with other shareholders of the target company to agree on certain governance arrangements (such as profit-sharing). Subject to the provisions on joint stock companies, however, the same shares have the same rights; therefore, the buyer may be unable to obtain more voting rights than the number of shares they hold. In such cases, the target company could be restructured into a limited liability company after it becomes private in order to obtain additional rights; however, this may also require consent from the other shareholders that hold two-thirds or more of the voting rights.

6.12 Irrevocable Commitments

In order to reduce uncertainty, it is customary in China for buyers to seek to obtain irrevocable commitments from the principal shareholders of the target company to tender or support the transaction. The parties usually execute a term sheet in order to reach consensus on essential terms. The principal shareholder is usually required to perform certain co-operative obligations and may not transfer or negotiate with another third party (eg, a competitor) with regard to the transfer of shares in a specified period. Principal shareholders who agree to the term sheet generally comply with the commitments, unless they are willing to assume liability for breach of contract.

6.13 Securities Regulator's or Stock Exchange Process

Takeover and tender offers may be subject to approval, depending on how the proposed transaction is structured.

Acquisitions by Merger

The CSRC and the stock exchange must pre-approve acquisitions by merger, as discussed in **6.3 Transaction Structures**. Under current policy, this review period is no less than six months. Additionally, the Ministry of Commerce (MOFCOM)'s approval is required if the buyer in a stock-for-stock acquisition is a foreign investor (although this is extremely difficult to arrange in practice).

Acquisitions by Tender Offer

In an acquisition of a listed company by way of tender offer or transfer by agreement, pre-approval from the Chinese securities regulators or the stock exchanges is not required. However, the relevant agreements and announcements will be disclosed and may be reviewed and scrutinised by the stock exchanges during the transaction. Pre-approval from MOFCOM will be required if the buyer is a foreign investor, whatever the method of acquisition.

Approval of Offer Terms

The CSRC and the stock exchange do not usually pre-review other offer terms (eg, timing and price), provided that the offer is in compliance with the relevant Chinese laws and regulations concerning the acquisition of listed companies, which are outlined in **6.5 Common Conditions for a Takeover Offer/Tender Offer**.

Timeline

The buyer is entitled to establish the timeline for the offer free from regulatory supervision, provided that the offer is valid for no less than 30 days and no more than 60 days. The offer period can be extended by more than 15 days if a competitive offer is announced and the buyer modifies the offer less than 15 days before the expiry of the original offer period. However, the offer period may not be extended later than the expiry of the other competitive offer.

6.14 Timing of the Takeover Offer

As previously discussed, the acquisition period for a tender offer:

- must be no less than 30 days and no more than 60 days; and
- may be extended (but not reduced) after the offer is made.

Such extensions do not generally exceed 60 days unless there is a competitive offer. There are usually no strict requirements concerning the time limitation for the other takeover offer.

As discussed before, pre-approval from the Chinese securities regulators or the stock exchanges is not required in a tender offer or transfer by agreement. If additional pre-approval from the State-Owned Assets Supervision and Administration of China, the State Administration for Market Regulation (SAMR) and (if the buyer is a foreign investor) MOFCOM is necessary for an acquisition, this is usually set as a condition precedent to the offer and its closing where the M&A transaction of a listed company requires such. Regulatory approvals should be obtained following the announcement of the offer and before the offer is officially made or the agreement becomes effective. Therefore, the offer period is not affected by regulatory pre-approvals.

7. Overview of Regulatory Requirements

7.1 Regulations Applicable to a Technology Company

Setting up a new company in certain sectors of the technology industry in China is subject to specific regulations. Value-added telecommunications operators must obtain a value-added telecommunications business licence from the authorised telecommunications administration bureau, for example, which may take several months depending on the specific scope of the licence. Online game operators must obtain an online publishing permit from the competent publication authority, which may also take several months in practice.

7.2 Primary Securities Market Regulators

The CSRC and the relevant PRC stock exchanges are the primary regulators for M&A transactions in China's public securities markets.

7.3 Restrictions on Foreign Investments

Foreign investment is generally welcome and permitted in China. Foreign direct investment filings, which are mandatory under Chinese law, are straightforward and easy to complete.

Additional requirements or restrictions may apply if the foreign investment is to be made in certain industries. These are set forth in the *Special Administrative Measures for Foreign Investment Access (Negative List)*, which is amended from time to time.

7.4 National Security Review/Export Control

National Security Review

China's new national security review process, which was reformed by the Measures for Security Review of Foreign Investment, came into effect on 18 January 2021. The measures provide for a systematic review process for foreign investment from a national security perspective.

Forms and scope

All forms of foreign investment are covered, including:

- Sino-foreign equity joint ventures established through M&A;
- newly established wholly foreign-owned enterprises or projects; and
- other forms of investment (including foreign-to-foreign transactions in which the target has Chinese subsidiaries).

The scope of national security is also expanded to cover industries involving the military and military support, important agricultural products, important energy and resources, major equipment manufacturing, important infrastructure, important transportation services, important cultural products and services, important IT and internet products and services, important financial services, critical technologies and other important sectors related to national security.

Export Control

China's Export Control Law, which unified the framework for China's export control regime, took effect on 1 December 2020.

Controlled items

The Export Control Law applies to the export of "controlled items", which are defined as "dual-use (both civil use and military use) products, military products, nuclear materials and other products, technologies and services relating to the protection of national security, national interest or the fulfilment of anti-proliferation and other international obligations".

Licences

Those who wish to export controlled items are required to obtain a licence from the enforcement authority. Moreover, a licence may be required for the export of goods that fall outside the list of controlled items but nonetheless could:

- endanger national security or national interest;
- be used to design, develop, manufacture or facilitate weapons of mass destruction or their vehicles; or
- be used for terrorist purposes.

End users and end use

Exporters must provide certificates for the end user and end use of controlled items. The certificates must be issued by the end user or the government authorities in the country or region where the end user is located. The end user must promise not to:

- change the end use of the controlled items; or
- transfer them to any third party.

Those importers and end userswill be put on a blacklist and prohibited from dealing with Chinese exporters if they:

- breach these requirements;
- endanger national security or national interest; or
- use controlled items for terrorist purposes.

In addition, China also recently enacted other laws and departmental rules that play an important role in establishing China's export control and international trade regime, including the Law on Countering Foreign Sanctions, the Provisions on Unreliable Entities List, and the Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures.

7.5 Antitrust Regulations

M&A and business combinations are subject to antitrust filing obligations according to China's Anti-Monopoly Law (AML). If a transaction leads to a concentration of undertakings that reaches specific thresholds, it must be notified to the SAMR for antitrust review.

China's new AML came into effect on 1 August 2022. It raises the maximum fine applicable to gun-jumping to:

- no more than 10% of the turnover of the filing obligor(s) in the preceding fiscal year if the concentration has or may eliminate or restrict competition; and
- no more than RMB5 million if the concentration does not have such effect.

Concentrations of Undertakings

The AML defines "concentration of undertakings" as:

- a merger of undertakings;
- an undertaking acquiring control of another undertaking by means of equity or asset acquisition; or
- an undertaking acquiring control of another undertaking – or being able to exercise decisive influence over another undertaking – by means of contracts or other arrangements.

The establishment of a joint venture (in which two or more shareholders have joint control) is deemed a concentration of the controlling shareholders.

Monetary Thresholds
The thresholds that trigger the obligation to notify mainly focus on the turnover of undertakings participating in the concentration. In particular, concentrations that reach the following thresholds must be notified:

- the aggregate global turnover achieved by all the undertakings to the proposed concentration exceeded RMB10 billion and each of at least two of the undertakings to the concentration has had a turnover of more than RMB400 million within mainland China in the previous financial year; or
- the aggregate turnover in mainland China achieved by all the undertakings to the proposed concentration exceeded RMB2 billion and each of at least two of the undertakings to the concentration has had a turnover of more than RMB400 million within mainland China in the previous financial year.

The Draft Amendments to the Rules of the State Council on the Notification Thresholds for Concentrations of Undertakings (the "Draft Amendments"), which was published on 27 June 2022, propose to increase the individual turnover threshold of each of at least two undertakings participating in the concentration to RMB800 million within China – thereby doubling the original figure. In addition, the draft amendments also increase the combined turnover thresholds by RMB2 billion to RMB12 billion globally and RMB4 billion within China respectively.

The Draft Amendments also introduce a new provision on filing thresholds proposing to capture "killer acquisitions" initiated by large-scale enterprises that meet the following criteria:

- during the previous fiscal year, the turnover of one of the undertakings to the concentration (normally the buyer or investor) exceeds RMB100 billion within China; and
- he market value or valuation of the other undertaking(s) to the concentration (normally the target) is no less than RMB800 million and its Chinese turnover accounts for more than a third of its worldwide turnover during the previous fiscal year.

As of 15 October 2022, the proposed amendments have not officially come into effect and the thresholds may be subject to further amendments.

7.6 Labour Law Regulations

The primary labour law regulations in China concerning M&A transactions include the PRC Labour Contract Law, the Social Security Law and other employment-related legislation, administrative regulations, departmental rules, local regulations and judicial interpretations.

Employers are required to consult with trade unions concerning many aspects of M&A transactions, including the formulation and amendment of certain policies, retrenchments, unilateral termination of employment contracts, or extension of working hours.

Provisions of the PRC Labour Contract Law apply in an M&A transaction where the employer decides to retrench 20 or more employees or fewer than 20 employees but more than 10% of the employer's workforce. In such cases, the employer must:

- notify the trade union or all employees 30 days in advance of the retrenchment;
- solicit opinions from the trade union or the employees; and
- report the retrenchment scheme to the labour administrative authorities.

The trade union's opinion is not binding on the employer, as it is merely a procedural requirement. It is not required that such retrenchment should be approved by the board, according to Article 41 of the PRC Labour Contract Law.

Where the requirements of retrenchment under Article 41 are not satisfied or the employer prefers not to apply Article 41 to terminate employment with employees, the employer may choose to reach a mutual termination agreement with each employee or transfer employees to the other entity designated in an M&A transaction (if applicable).

In addition, the employer may also choose to unilaterally terminate the employment contract with the employees for applicable causes under the PRC Labour Contract Law – for example, "major change of objective circumstances" under Article 40.3 – on a case-by-case basis. Where the unilateral termination applies, the employer is obligated to report to the trade union.

During an M&A transaction, if the employer formulates or amends policies that affect employees (eg, policies related to remuneration, working hours, labour safety and health, and labour discipline, etc), the employer is required to:

- disclose and discuss the amends with the employee representative congress or all the employees in the first instance; and
- subsequently negotiate them with the trade union or employee representatives.

The trade union has the right to raise its concerns regarding any issues with the employer and such issues should be addressed through negotiation. The employer will disclose this formulation and amendment of certain policies with all its employees.

7.7 Currency Control/Central Bank Approval

China has currency control regulations that limit the convertibility of the country's official currency, the renminbi, into foreign currencies (and vice versa). In China, foreign exchange in connection with an M&A deal is permissible as long as the necessary filing procedures have been completed with the competent foreign exchange authority or its designated commercial banks.

8. Recent Legal Developments

8.1 Significant Court Decisions or Legal Developments

In recent years, the SAMR has stepped up administrative investigations and enforcement actions in connection with historical merger notification filing compliance in the TMT sector. This has had a significant impact on M&A deals in China's TMT sector and parties to these deals now regard antitrust clearance as being more important than ever before.

9. Due Diligence/Data Privacy

9.1 Technology Company Due Diligence

A public company is allowed to provide due diligence information to bidders with regard to its operations and other relevant matters. Certain information may not be provided, such as confidential information not yet publicly disclosed or information pertaining to state secrets. If it is a public bid, the public company will generally provide the same information to all bidders. The company may allow for a reasonable level of technology due diligence, which will vary on a case-by-case basis, depending on the specific requirements of the bidders and the negotiations between the parties.

9.2 Data Privacy

The recently adopted Data Security Law (DSL) and the Personal Information Protection Law (PIPL) are the major PRC data laws that set certain limitations on the due diligence of a technological company.

The DSL and Its Implications

On 10 June 2021, the 29th meeting of the Standing Committee of the 13th National People's Congress formally adopted the DSL, which took effect on 1 September 2021. The DSL is the first dedicated and comprehensive Chinese law on data security.

Enhanced protection obligations for important data and core data

The DSL lays down the framework for data classification and multi-level data protection requirements. Certain data crucial to national security and public interests must be categorised as important data requiring enhanced protection. As well as data classification, graded protection and important data catalogues, the DSL requires a more stringent administrative system for national core data, which is created by the DSL and vaguely defined as data related to:

- national security;
- the lifeline of the national economy;
- people's livelihoods in important areas; and
- significant public interests.

In light of this, enhanced data protection requirements will apply where:

- a technology company subject to due diligence may be deemed as a critical information infrastructure operator (CIIO); or
- the due diligence involves important data or core data.

Limitations on cross-border data transfers under the DSL

Relevant restrictions under the DSL apply where due diligence data comprises important data and to the export of such data, including transferring a copy abroad or allowing remote access from another jurisdiction outside mainland China.

The DSL requires the competent authorities to conduct a security assessment before important data collected and generated by CIIOs can be transferred cross-border. The DSL further stipulates that the cross-border transfer of important data pertaining to non-CIIOs is subject to security assessment or restrictions issued by the CAC and other relevant departments.

Based on the DSL, the *Security Assessment Measures for Outbound Data Transfers* (the "Security Assessment Measures"), which was published by CAC and took effect on September 1, 2022, requires data processors who provide important data abroad to apply to the CAC for security assessment. It also specifies the application procedures and materials to be submitted, along with other requirements. CAC also published the *Guidelines for Application of Security Assessment for Data to Be Transferred Abroad (First Edition)* to provide guidance on the application of security assessment.

The PIPL and Its Implications

On 20 August 2021, the 30th Meeting of the Standing Committee of the 13th National People's Congress formally adopted the PIPL, which came into effect on 1 November 2021. The PIPL is the first dedicated and comprehensive PRC law on personal information protection and is considered the Chinese counterpart to the EU General Data Protection Regulation (GDPR).

Advisability of obtaining consent from relevant individuals

Similar to the GDPR, personal information under Chinese law refers to any information that is related to identified or identifiable natural persons and has been recorded (electronically or otherwise). Anonymised information, which does not identify particular subjects, is not considered to be personal information.

Where personal information is used in the due diligence of a technology company, it is advisable to obtain the relevant individuals' consent for processing the personal information – despite the availability of other legal bases for processing, such as the performance of contracts. If the personal information is indirectly obtained from third-party vendors for such due diligence work, the contract with such vendors should include representations and warranties that the vendors will ensure the lawful collection and sharing of the personal information.

Cross-border data transfer limitations under the PIPL

The PIPL requires separate consent from individuals whose data will be transferred outside mainland China. Furthermore, the PIPL requires that CIIOs and certain high-volume personal information handlers pass a security assessment by the CAC before making such cross-border transfers.

The aforementioned high-volume personal information handlers are further defined in the Security Assessment Measures as those who process the personal information of more than a million individuals. Personal information handlers who have accumulatively exported personal information of no less than 100,000 individuals or sensitive personal information of no less than 10,000 individuals since January 1 of the previous year must also apply for the security assessment by CAC, pursuant to the Security Assessment Measures.

10. Disclosure

10.1 Making a Bid Public

Information related to a bid (including its pricing) is required to be made public promptly, in accordance with relevant PRC laws and regulations. During the acquisition of a listed company, public disclosure of a bid is generally required either:

- upon the execution of a term sheet or an official agreement by and between the parties; or
- after a relevant resolution has been adopted by the company's board of directors or board of supervisors.

10.2 Prospectus Requirements

Prospectus Requirements

A prospectus is required for the issuance of shares in a stock-for-stock takeover offer or business combination involving a listed company in certain circumstances. These include where the buyer is an unlisted domestic company (including foreign-invested enterprises) and the acquisition causes the buyer to have more than 200 shareholders.

The buyer may avoid the prospectus requirement by choosing to implement the stock-for-stock takeover as a major asset reorganisation of the target listed company. After obtaining CSRC approval, the buyer may directly apply to list its publicly issued shares on a stock exchange. In this way, the buyer is not required to prepare a prospectus – although it remains subject to the relevant IPO rules and requirements.

Exchange Listing Requirements

The buyer in a stock-for-stock takeover transaction of a listed target company must itself be exchange-listed or otherwise apply to list its shares. If the buyer is a foreign investor, for example, then it is required to be listed on an offshore exchange. Where the buyer is a domestic unlisted company, the buyer is required to apply to list all its shares on a domestic stock exchange in China.

10.3 Producing Financial Statements

Bidders are required to prepare and submit audited financial statements if their post-acquisition shareholding in a listed target company will reach or exceed 20% (whether the acquisition was in cash or stock-for-stock). In addition, if a buyer acquires shares in the target company in a private placement as part of a stock-for-stock acquisition, the buyer is required to submit relevant audited financial statements or a valuation report for the shares paid as consideration. These financial statements and reports must be prepared in accordance with either Chinese accounting standards or international accounting standards.

10.4 Disclosure of Transaction Documents

Transaction documents executed by the parties in order to complete a listed company acquisition must be filed with the stock exchange and/or the CSRC.

11. Duties of Directors

11.1 Principal Directors' Duties

All the directors, as well as the supervisors and management, of a company must have the obligations of loyalty and diligence to the company under the PRC Company Law. This is similar to the concept of fiduciary duty under common law and is owed to the company.

11.2 Special or Ad Hoc Committees

It is not common for the board of directors to establish any committees in business combinations.

11.3 Board's Role

The board of directors of a company tends to play a limited role in Chinese M&A deals. The founders or controlling shareholders are usually more actively involved in negotiations than the board. Minority shareholders may be involved in the negotiations in a limited way, to the extent that the deal affects their own rights and interests (eg, in terms of consideration, escrow or tax withholding). The board's decision to recommend an M&A deal is rarely challenged by shareholder litigation.

11.4 Independent Outside Advice

Financial advisers are commonly used to provide financial services and advice to the controlling shareholders or the founders of a company with regard to an M&A deal – especially in terms of valuation and deal structure. There have been limited cases in which a financial adviser was hired to provide a formal fairness opinion; however, this is not very common in domestic deals.

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Han Kun Law Offices has been widely recognised throughout the years as a leader in complex cross-border and domestic transactions. The firm's main practice areas include private equity and venture capital, M&A, international and domestic capital markets, investment funds, asset management, antitrust/competition, banking and finance, aviation finance, foreign direct investment, compliance, private client/wealth management, IP and dispute resolution. Han Kun has more than 700 professionals located in the six offices in Beijing, Shanghai, Shenzhen, Haikou Wuhan and Hong Kong. All the lawyers are graduates of top universities and have extensive experience in complex cross-border transactions and dispute resolution as counsel to both Chinese and foreign clients.

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