The Legal 500
Country Comparative Guides

China

MERGERS & ACQUISITIONS

Contributing firm
DaHui Lawyers

Jenny Li
Partner | jenny.li@dahuilawyers.com

Julia Dai
Partner | julia.dai@dahuilawyers.com

Dimitri Phillips
Associate | dimitri.phillips@dahuilawyers.com

This country-specific Q&A provides an overview of mergers & acquisitions laws and regulations applicable in China.

For a full list of jurisdictional Q&As visit legal500.com/guides
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;
- 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

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, the National Radio and Television Administration and the National Press and Publication Administration may promulgate rules governing M&A activity in specific industries.

2. What is the current state of the market?

According to data from PwC, the number of M&A transactions in the China market in 2020 increased by 11% compared to 2019. The total deal value in 2021 was USD 733.8 billion, the highest number since 2016, a rise of 30% from 2019, largely due to funding from state-owned investment funds and state-owned enterprises.

In terms of cross-border M&A transactions (especially for outbound investments by Chinese investors), the number of transactions significantly decreased in 2020, to the lowest point since 2015, and the total deal value dropped by 40%, which is the lowest figure since 2010. This is attributable to the COVID-19 pandemic and political reasons, as well as the fact that state-owned investors, which are the key players in Chinese outbound investments, shifted their focus to the domestic market.

3. Which market sectors have been particularly active recently?

In 2020, the Chinese M&A market was primarily driven by strategic investors (including onshore and offshore investors) and financial investors (including private equity (PE) and venture capital (VC)). The onshore strategic investment transactions were particularly active because of stimulus and funding from Chinese 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 SAMR (which replaced MOFCOM in respect to anti-trust matters in 2019).
government, including domestic industrial upgrading policies in the context of the COVID-19 outbreak and state-owned enterprises restructuring acceleration. PE and VC transactions remained active in 2020, in terms of fund-raising and investments. Investors are particularly interested in sectors such as consumer, high-tech, life science, financial services and industrial products (like new energy auto), with some notable large deals and privatization transactions announced or closed in 2020.

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

Strict antitrust merger scrutiny over M&A activities. On February 7, 2021, the Antimonopoly Commission of the State Council of the PRC promulgated the Anti-Monopoly Guidelines for Internet Platforms, which reinforces antitrust merger review for internet-platform-related M&A transactions to promote market competition, and also for the first time, expressly includes concentrations involving a VIE structure within the ambit of SAMR’s merger control review if the reporting thresholds are triggered. Furthermore, in December 2020, SAMR formally penalized three Internet companies with a VIE structure for failure to file prior notifications of implementing concentrations. Hence, starting from 2020, SAMR has been reviewing historical cases of M&A transactions with or without a VIE structure, and past failure to file prior notification of concentrations of undertaking may be investigated and penalized. We expect that greater scrutiny and attention from regulators and more frequent and rigid investigation or review by SAMR on M&A deals may have implications on the transaction process since they have to be cleared by SAMR prior to closing, as well as on the dynamics of the M&A market.

International and domestic policies against backdrop of pandemic. The decline in PRC cross-border M&A in 2020 has been partly imputed to changes in international and PRC policies. A number of countries issued stricter FDI (foreign direct investment) regulations. The trend has accelerated during the pandemic period. For example, the Committee on Foreign Investment in the United States (CFIUS) expanded its jurisdiction to new types of transactions in 2020, which has far-reaching implications for transactions involving foreign investors, including Chinese investors. Certain EU countries, such as Spain, Italy and Germany, expressly include healthcare as a sector covered by their FDI regime. On December 19, 2020, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) of China jointly issued the Measures for Security Review of Foreign Investment, effective from January 18, 2021, to provide a clearer and potentially more rigid legal regime for national security review for both direct and indirect foreign investments in China in some key sectors, such as key technology and key internet products and services. Whether cross-border M&A market activity encounters decrease in 2021, or will rebound, depends on a number of elements, including the effects of the coronavirus in China and elsewhere in the world, trade and geopolitical relations, and any changes of policies in the PRC and internationally.

PRC capital markets. A total of 388 A-share listed companies raised RMB 464.5 billion in 2020, including 141 companies listed on the Science and Technology Innovation Board and 106 companies listed on the Growth Enterprise Market. This is a significant increase over the 201 A-share listed companies raising RMB 249.1 billion in 2019. The increase in IPO activity should also stimulate M&A, especially in high-tech and healthcare sectors. There were a total of 370 exits via IPOs in 2020 – significantly more than the 227 IPO exits closed in 2019, including 127 exits on the Science and Technology Innovation Board. In addition, the amendment to the PRC Securities Law, update of private placement financing rules of listed companies and launch of the new Growth Enterprise Market of the Shenzhen Stock Exchange, a registration-based system, will further boost M&A activity in the coming years.

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

The most commonly used deal structures in the 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 on a PRC company, such as shareholding structure, corporate history, administrative penalties, on-going and concluded litigation and enforcement procedures, pledges, intellectual property registrations and filings. Public companies are also required to publicly disclose their audited financial reports and other financial information periodically, as well as material information in accordance with the
listing rules and disclosure requirements of the stock exchanges. Otherwise, a target company is not generally obliged to disclose any diligence information to a potential acquirer. It is customary, however, for an acquirer 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 or a letter of intent including confidentiality clauses).

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

Some PRC investors 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 deals and save on transaction costs. This is particularly common in some early-stage investments by non-sophisticated investors, resulting 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 target companies 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 and specific industries, our general observation is that parties tend to focus more on corporate history, compliance issues and licensing of a target company, among other areas. In addition, information privacy and intellectual property issues are becoming key focuses for transactions in the TMT and life science sectors.

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 or super 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) established before January 1, 2020, in which there is no shareholders’ meeting, making the board of directors the highest decision-making organ. As a result, shareholders technically have no approval rights in an EJV. Further, the EJV-related laws require that certain actions be unanimously approved by the board of directors, including amendments to the EJV’s articles of association and suspension or dissolution of the EJV. All other decisions require a simple majority of an EJV’s board of directors.

However, the PRC Foreign Investment Law and its implementation rules, which became effective on January 1, 2020, replaced the laws and regulations on EJV and other foreign-funded enterprises, except that they provide a five-year transition period for existing EJVs to change the highest authority from the board of directors to the shareholders’ meeting, and change the voting mechanism accordingly pursuant to the PRC Company Law.

As to investors holding a certain percentage of preferred shares, they typically request veto rights (in single or shared form) over some material actions of the target companies which may materially affect their interests, such as changes of share capital, dissolution and liquidation, mergers and changes of principal business.

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 shareholders’ meeting. In an EJV, however, the directors would normally act under instructions of the shareholders who nominate them. A controlling shareholder owes duties of not impairing interests of the company and other shareholders by connected party transactions or by abuse of rights under the PRC Company Law. Also, some investors attach contractual obligations to the controlling shareholders (e.g., maintain control of the company, ensure minority shareholders receive adequate compensation or provide indemnity to investors) 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 acquirers 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 acquirer 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 generally is under no obligation to accept the opinions of the labor union or any employee and the consultation process is therefore usually only a formality, except for some transactions involving employees of state-owned enterprises or share incentive programs of public companies.

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 acquirer can enter into an exclusivity agreement, or a 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, acquirers 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 acquirer in exchange for the equity interests of the target, i.e., share swap, or a hybrid structure of combination of cash and share swap, are also frequently used, especially if the acquirer is a public company.

15. At what ownership levels by an acquirer 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 acquirer 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 acquirer 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 acquirer 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 acquirer 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 acquirer, all persons acting in concert with the acquirer 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 acquirer and demonstrate that the acquirer or its ultimate beneficial owner (if the acquirer is an 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 acquirer is required to inform the target and disclose the potential transaction if the acquisition stake triggers the threshold as discussed in question 15 above via the applicable stock exchange on which the target is listed promptly upon the signing of any written agreement (even a non-binding document, such as a letter of intent). Also, even before any execution of a written
agreement, in the event that the share price of the listed company fluctuates abnormally, the listed company is required to clarify whether such price fluctuation was caused by any non-disclosed material transaction, and if so, to disclose relevant information of such transaction. Thus, keeping the negotiation strictly confidential is significant for a public M&A.

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 material restructuring or acquisition transaction that is subject to the requirement on suspension of 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. Also, for any connected transactions of a public company (such as a public company acquiring assets or shares from its connected party), the price should be determined at arm’s length and be not less than the base valuation determined by an appraisal firm.

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, subject to approval of the general meeting and board of the target company according to the PRC Company Law and articles of association of the target, as such financial assistance may constitute a related-party transaction. 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 party, the key transaction documents such as 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 other cross-border M&A deals, such as outbound transactions, parties may be able to choose the laws of another jurisdiction to govern the transaction documents, subject to the PRC 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 Doctrine of the Most Significant Relationship, and the qualifications of their legal counsel.

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 acquirer’s compliance with applicable PRC laws, and on the legality of each procedure of the transaction. Inquiry letters or comment letters issued by applicable stock exchanges on the acquisition along with responses to the letters by the target, the acquirer, the financial advisor and legal counsel will be disclosed as well.

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, with the applicable local branches of SAMR and the tax authority, shareholder changes and other corporate changes of the target company (e.g., legal representative and director changes). If a foreign investor is involved, typically a filing with local SAFE or its authorized banks is required as well. If any seller is an individual, the acquirer will be required to withhold and pay to the local tax authority Individual Income Tax levied on the capital gains of the 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?

Directors can invite a competing bidder to compete against the hostile acquirer. 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 acquirer 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 acquirer is required to make a tender offer to all other shareholders of the target company.

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

If the target company is a private entity, the minority shareholders may have veto rights over decisions of the controlling shareholder at a shareholders’ meeting or over board resolutions pursuant to the target company’s shareholders agreement and/or articles of association. 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.

However, a minority shareholder of a public company is not entitled to veto rights over shareholders’ meetings or board resolutions due to the one-share-one-vote rule. In addition, the Science and Technology Innovation Board of the Shanghai Stock Exchange (STAR Market) permits dual-class voting, which is commonly used in other capital markets, subject to certain market cap and revenue thresholds.

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

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

In a public acquisition, if an acquirer has obtained a controlling stake in a listed company resulting in the public float of the listed company being below 25% (or 10%, if the total number of shares is 400 million or more), then, upon consent of the applicable stock exchange, the acquirer is required to acquire the remaining minority shares and delist the target company.
Contributors

**Jenny Li**  
Partner  
jenny.li@dahuilawyers.com

**Julia Dai**  
Partner  
julia.dai@dahuilawyers.com

**Dimitri Phillips**  
Associate  
dimitri.phillips@dahuilawyers.com