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Technology M&A 2023

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China: Trends & Developments

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Trends and Developments

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Introduction

Overall M&A activity in China remained at a relatively high level in 2022 domestically, with only a slight decrease noted in cross-border deals.

China saw only four fewer domestic deals in the first half of the year than it did during the same period in 2021 (ie, 6,173 compared with 6,177). However, the number of private equity deals and deals exceeding USD1 billion both appear to have decreased somewhat.

In terms of outbound M&A, some – though far from all – of 2021's recovery from 2020 was lost again in 2022. The announced deal value for the first half of 2022 came in at just over USD16 billion, according to a report from Ernst & Young. The decline is largely attributed to factors such as the COVID-19 pandemic, geopolitical tensions, and fluctuations in the stock market. A report by PricewaterhouseCoopers indicates that investor confidence is likely to bounce back upon the reduction of these factors.

The TMT sector, however, still has the most outbound M&A deals in China. Specifically, in the first half of 2022, it accounted for USD5.4 billion – more than twice the amount of the second-hottest sector, according to the aforementioned Ernst & Young report. M&A activity in TMT is seen as continuing more-or-less steadily in the second half of 2022 and there are no specific signs of major changes in 2023 either.

Foreign Investment

Restrictions on foreign investment

Contrary to what geopolitical trends might suggest, China continues to open its markets to foreign investors, including (if not especially) in tech sectors.

Although parts of the Chinese economy remain subject to restrictions on foreign investment (ie, limiting or prohibiting foreign participation in various industry sectors), the number and level of such restrictions continued to decrease throughout 2022. The annually updated *Special Administrative Measures (Negative List) for Access to Foreign Investment* (the "Negative List") specifies the prohibited sectors and the maximum foreign shareholding limits for these limited sectors.

On 27 December 2021, China's National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) jointly issued a 2021 Negative List, which took effect on 1 January 2022. The 2021 Negative List removed two restricted items from the previous edition (bringing the total number of such items down from 33 to 31). The prohibition on the production of ground receivers and key components for satellite television broadcasts has been removed and no shareholding limitation was even put in place. Foreign investors are therefore now free to fully participate in this high-tech sector.

Foreign capital in the technology sector is growing rapidly. According to a MOFCOM press conference, between January and September 2022 the high-tech sector's utilised foreign investment rose by 32.3% (compared with the same period in 2021) – among which high-tech manufacturing grew by 48.6% and high-tech services increased by 27.9%.

Foreign investment in telecommunications

In addition to the relatively straightforward restrictions on foreign investment, businesses from abroad have been said to face difficulties when navigating the formal procedures for obtaining relevant operating licences. However, this is another area in which China has continuously opened up to foreign investors.

A recent example of deregulation occurred on 7 April 2022, when the key regulations governing the entry and licensing of foreign telecommunications companies – the Administrative Provisions on Foreign-Invested Telecommunications Enterprises (the "FITE Provisions") – were revised in order to radically ease the market entry requirements for foreign-invested enterprises seeking to obtain PRC telecommunications operating licenses. Unsurprisingly, according to a report by the China Academy of Information and Communications Technology, the total number of foreign-invested enterprises with one type of such licences (specifically, a licence for value-added telecommunications business) increased from 829 to 1,097 from February to September 2022.

The key amendments in the FITE Provisions include the removal of the previous requirement placed on foreign-invested companies to demonstrate that their principal shareholders/parent companies have a "good track record in the telecommunications business". The telecommunications track record requirement may have precluded foreign financial investors (eg, USD-denominated funds) from taking significant stakes in Chinese companies performing internet/telecommunications activities, given that such investors could be viewed as lacking established experience in providing telecommunications services.

Previously, some strategic investors in this industry even had to adopt alternative structures to bypass the "good track record" requirement. Now, however, foreign investors seeking to obtain telecommunications operating licences in China and to become FITEs are expected to have a much easier and more straightforward experience.

Draft Company Law Revisions

On 24 December 2021, the Standing Committee of the National People's Congress released draft revisions to the Company Law of the People's Republic of China (the "Draft Company Law Revisions"). Even though they still have not been enacted, the Draft Company Law Revisions would potentially affect every type of Chinese company (including foreign-invested ones) in various ways, such as:

- corporate governance;
- potential legal liability faced by directors, supervisors, senior officers, and shareholders; and
- processes for liquidation and deregistration.

The key changes would impact M&A specifically in two respects.

- First, whereas the current Company Law requires a shareholder resolution in any M&A circumstances, the Draft Company Law Revisions would provide for two instances in which it would not be needed:
  - (a) when a company is being acquired by a parent holding at least 90% of the acquired company's equity (although the acquired company must notify all other

shareholders, who then have a right to have their equity purchased at a reasonable price); and

(b) when a company seeks to acquire another company through consideration that does not exceed 10% of the acquiror's net assets.

- In addition, under the current Company Law, when any shareholder proposes transferring equity to any person other than another shareholder, it is subject to the consent of a majority of the other shareholders (although where the majority disagrees, they must purchase the equity to be transferred). However, the Draft Company Law Revisions would eliminate this rule.

Of course, there are changes in the Draft Company Law Revisions that do not target M&A specifically but would nonetheless be relevant to acquirors and other investors – for example, the expansion of liability for directors and a requirement that companies with 300 or more employees have an employee-representative director.

Notably, in a second draft of the revisions to the Company Law, released on 30 December 2022, all the above points were retained.

Cyber and Data

The areas of legislation, regulation, and possibly enforcement that experienced the greatest growth in 2022 were cybersecurity and data protection. This trend has persisted in recent years, with implications across all tech activities – not least in M&A.

Cybersecurity review

The so-called cybersecurity review was introduced with the promulgation of the Cybersecurity Law in 2016 and was emphasised by the issuance of the Cybersecurity Review Measures of 2020 (CRM). However, it has only recently shown – and further grown – its teeth.

The now-infamous investigation of Didi Chuxing (China's Uber) was launched by the Cybersecurity Administration of China (CAC) shortly after the wildly successful company's US IPO in the summer of 2021 and progressed alongside revisions to the original CRM. These revisions to the CRM were issued at the very end of 2021 and came into effect in February 2022, while the CAC concluded its investigation of Didi Chuxing in July 2022 and imposed a fine of RMB8.02 billion.

Violations of the CRM were not among the final findings of the CAC, possibly because cybersecurity review was not explicitly required for overseas IPOs under the original CRM. However, a combination of the revised CRM's express mandate for cybersecurity review in such cases (as well as other additional cases) and Didi Chuxing's plight sends a relatively clear signal. It may not only be companies seeking to make an IPO overseas (including M&A with SPACs) that should heed the cybersecurity review requirements, process, and possible consequences – in fact, it may be that Chinese regulators will be eyeing major cross-border M&A for potential cybersecurity review as well.

On the other hand, according to customary legislative practices, the scope of such requirements would likely not cover Hong Kong – given that regulators instead view that region as part of the PRC and therefore not falling within the scope of CRM's wording ("outside of the country"). This dovetails with the trend of Beijing continuing to incentivise greater activity and alignment between mainland China and Hong Kong.

Cross-border data transfers

The biggest waves in China's data protection scene of 2022 were made by:

- two releases related to the so-called security assessment (a regulatory prerequisite for cross-border data transfer in some circumstances); and
- two releases related to the so-called standard contract for cross-border data transfer in certain (other) circumstances.

The broad framework set out in 2021's Personal Information Protection Law (PIPL), in which three avenues of regulatory compliance are provided for companies to choose from when transferring certain data out of China, is finally crystallising and thus likely coming into full effect. Any company acquiring or merging with a target that is itself a mainland China company (or that has substantial affiliates in mainland China) will have to pay more attention to regulatory compliance and potential effects on operations in light of the concrete cross-border data transfer framework.

The Measures on Security Assessment for Cross-Border Data Transfer (the "SA Measures"), which entered into effect on 1 September 2022, and the Guidelines on the Application of Security Assessment of Cross-Border Transfer of Data (the "SA Guidelines"), released on 31 August 2022, elaborate on the process and documentation required for the assessment – and provide templates for an applicant's reference.

Under the SA Measures, a data handler must carry out a security assessment before making a cross-border data transfer if the data handler:

- is a critical information infrastructure operator (CIIO) seeking to transfer personal information (PI) offshore;
- seeks to transfer "important data" offshore;
- processes PI of more than a million data subjects and seeks to transfer any PI offshore;
- transfers offshore, on a cumulative basis, PI of more than 100,000 data subjects within a period commencing 1 January of the preceding year; or
- transfers offshore, on a cumulative basis, the "sensitive personal information" of more than 10,000 data subjects within a period commencing 1 January of the preceding year.

As a result of the above-mentioned and other rules in these measures and guidelines, restrictions and the possible need for a security assessment should be factored into the consideration and conduct of any cross-border M&A – even in the early stages (eg, due diligence) – especially given that merely accessing PRC data from abroad may be deemed "cross-border data transfer". Any merger or acquisition of technology companies (even domestic) runs the risk of compounding data processing volumes and thus triggering the security assessment requirement. Moreover, if a company has already carried out a security assessment and is transferring data based thereon, formal amendments to that security assessment are likely to be required upon completion of a merger or acquisition involving that company.

On the other hand, there will be many cases in which the security assessment thresholds are not triggered; however, cross-border transfers still need to satisfy the PIPL's requirement for the transferring parties to enter into a standard contract. On 30 June 2022, the CAC released the following draft pieces of regulation in order to specify detailed requirements for this process:

- the Standard Contract Provisions for the Exit of Personal Information (the "Draft Provisions"); and
- the Personal Information Export Standard Contract (the "Draft Standard Contract").

The Draft Provisions and Draft Standard Contract not only crystallise the requirements of the former approach to legally exporting PI out of China but also provide that the exporter must conduct a "data protection impact assessment". This should address a number of issues, mainly concerning the legality, legitimacy, and associated risks of proposed transfers of PI, as well as the adequacy of proposed security measures to protect the same.

Similarly, a data exporter must not only execute a contract that substantially resembles the Draft Standard Contract but also file it and the "data protection impact assessment" to the local provincial branch of the CAC within ten days. These are less stringent and burdensome requirements than those required by a security assessment. However, they call for a similar level of attention to that outlined earlier for potential security assessments in M&A activities.

There were also some releases related to the third way that a domestic PRC party may legally transfer certain sensitive data overseas in some circumstances – namely, undergoing a so-called "PI protection certification" by a professional institution in accordance with CAC requirements. However, this framework does not appear to have advanced enough to be relied upon. Therefore, in the meantime, parties involved in M&A activities connected with China should carefully consider the requirements for either carrying out a security assessment or executing a standard contract (and carrying out a data protection impact assessment) in many, if not most, mergers and acquisitions – at least in the tech space.

Anti-Monopoly Law

Continuing a trend from 2021 and arguably earlier, China seeks to bring within regulatory purview – although not necessarily place under scrutiny – more M&A deals, particularly in the platform economy and related industries. One key legislative development – the passing of the amendments to the Anti-Monopoly Law (AML) – is an excellent example of that objective and the typical strategy to achieve it. The amendments include a new "safe harbour" and other exemption-like rules, on the one hand, yet substantially increase fines for violating various provisions of the AML on the other.

In many respects, the developments are in line with international standards or trends in this area of law (and policy). According to the new "safe harbour" rule, for example, if a business operator can prove that its market share in the relevant market is lower than the standard set by the State Council's AML enforcement authority – and also meets other conditions – the operator's vertical monopoly agreement will not be prohibited or penalised. At the same time, for violations relevant to the concentration of undertakings, the fine is raised from RMB500,000 to as much as 10% of the sales from the preceding year if the concentration eliminates or restricts competition. (Even without such an effect, the fine could still reach RMB5 million.) Third-party liability is also expanded and appears to apply upstream and downstream, among competitors, and among parties to hub-and-spoke agreements. This demonstrates that the trend towards greater regulatory oversight is thus also clear in the anti-monopoly space.

DaHui Lawyers combines in-depth knowledge of China's legal and business landscape with extensive international experience. It has particular strength in new economy industries as well as complex cross-border transactions. DaHui has become a go-to firm for multinational companies in the Chinese technology, media and internet/telecommunications sectors. The firm's expertise in these highly regulated sectors has led to it becoming a key adviser and strategist to clients of all types and sizes in China's emerging but challenging market, providing highly effective and solution-oriented services tailored to clients' diversified business needs.

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