SPECIAL REPORT

CHINESE OUTBOUND INVESTMENTS - THE REGULATORY LANDSCAPE

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McDermott
Will & Emery

SPECIAL REPORT

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CHINESE OUTBOUND INVESTMENTS – THE SELLER'S PERSPECTIVE

1. CHINESE REGULATION

1.1 The Chinese Regulations Applicable to Chinese Outbound Investments

Generally, any outbound investment by a Chinese enterprise must be approved by the competent authorities and their local-level bodies before it can be closed. Each competent authority has its own approval requirements for outbound investments, which differ according to the type of investor, the amount of investment in question and other relevant factors. The competent authorities are as follows:

1.1.1 The National Development and Reform Commission (NDRC)

The current NDRC regulatory framework for outbound investments is mainly a "record filing system" which means that a simplified consent is necessary.[1] "Approval" (granted after an in depth review)[2] is only required in exceptional cases. The approval procedure is triggered only by the investments involved in sensitive countries and regions (jurisdictions with no diplomatic relationship with China or subject to UN sanctions) or sensitive industries, such as those relating to weapons, cross-border water resources or news media. The NDRC reviews outbound investments to assess whether the investment target helps to foster the Chinese economy as laid down in the "Chinese 2025 plan" and the "belt road initiatives," for example.

The "record filing" and the "approval" are addressed under the newly issued Measures for the Administration of Overseas Investment of Enterprises.

The regulatory framework applicable to Chinese outbound investments was substantially amended by the so-called Measures for the Administration of Overseas Investment of Enterprises (the Measures), which took effect on March 1, 2018. The most relevant changes introduced by the Measures, which overall aim to encourage outbound investments, are summarised as follows.

(a) Cancelling the Requirement of Project Information Report before Submitting Any Binding Offer

Prior to the Measures, in M&A or bidding projects where the investment volume by the Chinese investor amounted to USD 300 million or more, the Chinese investor was required to submit an additional project information report to NDRC before starting any substantive work, such as signing a binding agreement or the proposal of a binding offer. Since the Measures came into effect, such requirement has become obsolete.

Under the old regime, after receiving the project information report, NDRC would issue a confirmation letter within seven days if it deemed the project to be in line with outbound investment policies. In cases where there were several Chinese investors bidding for a project valued at USD 300 million or more, only one of the investors could ultimately get the

[1] Pursuant to the record filing system, a transaction cannot be closed without obtaining a record filing notice issued by NDRC or local Development and Reform Commissions (DRCs). The issuance of such notice is conditioned on the review of the completeness and authenticity of application documents. Typically, the subject/target in the application form is not scrutinised substantially.

[2] The granting of any approval is conditioned on an in-depth review of the subject/target itself.

confirmation letter to submit a binding offer (so as to avoid a situation where several Chinese investors compete with each other, driving up the purchase price for the potential investment).

Nowadays, in auction processes with a transaction value of more than USD 300 million, Chinese investors no longer must submit a project information report to the NDRC and await pre-approval in the form of a confirmation letter to submit their binding offers.

In addition, more than one Chinese investor can submit a binding offer, giving the seller the opportunity to choose its preferred bidder amongst several (Chinese) investors—a fact that sellers will appreciate from a price competition perspective.

CHANGES IN AUCTION PROCESSES

The change in auction processes puts Chinese investors on equal footing with other international and European bidders in terms of pace to submit their binding offers; sellers no longer must consider extending deadlines for the submission of binding offers just because Chinese investors are in the process.

(b) Postponing the Requirement to Get Approval or a Filing Notice from Pre-Signing to Pre-Closing

Prior to the Measures, obtaining a record filing notice letter was a signing condition for outbound investments. A Chinese investor could not sign the sales and purchase agreement (SPA) on the outbound investment prior to filing the transaction and receiving the relevant record filing notice letter.

Under the Measures, Chinese investors no longer must obtain the record filing notice letter before signing, but only before closing. This change from a signing condition to a closing condition should speed up the process toward signing when dealing with Chinese investors. The requirement of obtaining the record filing notice from the Chinese authorities hence aligns with the standard European or German closing requirements of obtaining merger clearance and clearance for foreign investment control.

While parties may now reach signing somewhat quicker, transaction security may have decreased. Against this background, it is advisable for the seller to consult early in the process with a Chinese outbound advisor experienced in the Chinese regulatory framework to assess potential closing obstacles due to Chinese regulations.

In addition, agreeing on a breakup fee that will become due for the Chinese investor in case the required record filing letter is not obtained may be a good indication of the buyer's confidence to obtain the record filing notice letter. However, the amount and the process of securing a breakup fee is also subject to regulation.

(c) Simplification of Application Process through Option to Bypass Intermediary Review by Local DRCs

In the former regime, any application by local enterprises to NDRC was required to be submitted to local DRCs, which would then forward the application to NDRC after a preliminary review. Depending on the efficiency of the relevant local DRCs, the preliminary review process could be rather time-consuming.

The Measures stipulate that local enterprises may now choose to apply directly to the NDRC without the need to submit any application to local DRCs first.

(d) Comprehensive Online Platform to Finish All Required Applications and Filings without Having to Visit the NDRC In-Person

APPLICATION TO NDRC

The regional factor thus has become less relevant and the application process can, if so desired, be streamlined.

All outbound investment related regulatory processes can now be handled online. Chinese investors can use the established online platform to handle matters such as information exchange, approval, filing, supervision and penalty issue. The new online-based procedures should shorten approval and filing periods.

1.1.2 The Ministry of Commerce of the People's Republic of China (MOFCOM)

The MOFCOM regulatory framework for outbound investments is also mainly a "record filing" system. Specific "approval" is only required in exceptional cases, such as the establishment of overseas companies in sensitive countries/regions or sensitive industries. The purpose of any review undertaken by MOFCOM is mainly to assess if the establishment of overseas entities is carried out in compliance with applicable procedures for outbound investments. The application documents required for the record filing for NDRC and MOFCOM are basically the same. After both the NDRC and MOFCOM record filings have been accomplished, the investor must contact State Administration of Foreign Exchange (SAFE) qualified banks for foreign exchange registration and fund remittance.

1.1.3 The State Administration of Foreign Exchange (SAFE) and SAFE-Qualified Banks

The regulatory framework for outbound investments provides that SAFE-qualified banks in China deal directly with the foreign exchange registration of outbound investment transactions and process subsequent matters, such as opening capital accounts and remitting outbound funds, while SAFE indirectly supervises the foreign exchange registration of outbound investments. However, since November 2016, when the Chinese rules for capital control became stricter for transactions with overseas fund transfers in excess of USD 5 million, any foreign exchange registration and remittance requires permission from SAFE before it can be dealt with by qualified banks. In addition, the local SAFE authority now interviews the relevant Chinese investors to assess the authenticity and compliance of the outbound investment target. In summary, SAFE has moved to centre stage from its previous indirect supervision function since the capital control measures were intensified.

1.2 Supplement: State-Owned Enterprises (SOEs) and Listed Companies

Besides the aforementioned generally applicable regulatory framework, there are specific regulatory aspects that apply to SOEs and listed companies respectively, both of which are the main players in the outbound investment market.

1.2.1 The State-Owned Assets Supervision and Administration Commission of the State Council (SASAC)

Under the SASAC Rules, a central SOE[3] or its subsidiary that intends to purchase or merge with an overseas listed company or to otherwise make any major overseas investments, must report the intended transaction to the SASAC for filing or approval, as the case may be, which process must be completed before

[3] Central SOEs are SOEs that are owned by the Chinese central government, while local SOEs are separately owned by different local governments. The local rules applicable in each province or municipal city are based on the SASAC Rules.

starting the record filing or approval process with the NDRC. At the beginning of 2017, the SASAC released a list of industry categories in which SOEs are not allowed to invest. In addition, SOEs must not invest in businesses outside their sector of business activity.

1.2.2 The China Securities Regulatory Commission (CSRC) and Stock Exchanges

CSRC approval is only required for an overseas investment by a Chinese-listed company if the outbound investment constitutes a so-called "material asset restructuring"[4] of the listed company. Chinese outbound investments in Germany usually do not meet these criteria.

Cash transactions that do not constitute a material asset restructuring of listed companies account for the majority of outbound investment for Chinese-listed companies.

However, pursuant to the relevant rules of the Shanghai and Shenzhen Stock Exchanges, if a listed company purchases assets that fulfil certain criteria requiring a disclosure of the transaction, either a board meeting or a shareholders' meeting (subject to the company's articles of association) must be held to review and approve the intended transaction. Further to approval, an announcement must be released in a timely manner that must briefly describe the basic conditions of the transaction with information on the deal structure, the counterparty, the target, the main terms of the transaction agreement, the purpose of the acquisition and the impact on the company. Listed companies generally do not need to suspend trading or accept exchange inquiries.

1.2.3 Transparency of State Controlled Funds

If state controlled funds are invested outbound, (this mostly occurs directly by an SOE, its subsidiaries or through a PE Fund) whose limited partner (LP) is owned directly or indirectly by an SOE. It is rather unlikely that a SOE would "disguise" as a private company or investor.

Some Chinese government-backed PE Funds are registered in the Cayman Islands or in Luxembourg and act similar to a Western-style PE fund, whereas an LP or the GP is still directly or indirectly owned by a Chinese SOE in order to implement the "One Belt One Road Initiative" of the Chinese government.[5]

2. WESTERN REGULATION: INVESTMENT REVIEW PROCESSES IN GERMANY AND THE UNITED STATES

Not only does a Chinese bidder face regulation in China. It is also subject to investment reviews in Germany, which again can be influenced by US regulations to the extent there is a US business angle.

2.1 Germany

In order to protect German public security and order, the Federal Ministry for Economic Affairs and Energy

[4] A transaction constitutes a material asset restructuring if the listed company or any of ist subsidiaries purchases an asset which is out of the scope of its daily operating business and additionally one of the following criteria are met: (i) the total value of assets purchased in the latest fiscal year accounts for more than 50 percent of that of the listed company (on a consolidated basis) for the same period; (ii) the operating income generated by the purchased assets in the latest fiscal year accounts for more than 50 percent of that of the listed company for the same period; (iii) purchased net asset value in the latest fiscal year accounts for more than 50 percent of that value of the listed company at the end of the same period and also exceeds RMB 50 million.

[5] Source: Belt and Road Portal. https://eng.yidaiyilu.gov.cn/ghsl/cjwd/2757.htm The Silk Road Economic Belt and the 21st-century Maritime Silk Road, also known as The Belt and Road (abbreviated B&R), is a development strategy and framework, proposed by Chinese President Xi Jinping that focuses on connectivity and cooperation among countries primarily between China and the rest of Eurasia, which consists of two main components, the land-based "Silk Road Economic Belt" and oceangoing "Mari-time Silk Road".

(BMWi) may review acquisitions of German targets by foreign—including Chinese—investors.

A relevant acquisition under the German Foreign Trade and Payments Act (Außenwirtschaftsgesetz, or AWG) is any direct or indirect acquisition of at least 25 percent of the voting rights in a German company by a foreign investor. Voting rights of any third parties are attributed to the investor if it holds 25 percent of the voting rights in the third party or if it has a voting agreement in place with the third party. Thus, even indirect acquisitions (through [intermediate] holding companies) may be subject to review.

CURRENTLY, THERE ARE TWO INVESTMENT REVIEW REGIMES IN PLACE:

(i) a sector-specific investment review for investments by any non-German investor investing in targets active in security sensitive areas (in particular the defence sector and crypto technology) and

(ii) a cross-sectoral investment review for investments in all other sectors by any foreign investor located outside the territory of the European Union or the European Free Trade

The following overview focuses on the cross-sectoral investment review, since it accounts for the majority of investment cases. The key criterion for the cross-sectoral investment review is whether any foreign investments could endanger public security and order in Germany.

In July 2017, an amendment to the German Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung, or AWV) came into effect (the New Rules), which inter alia introduced examples of targets that, if acquired, could pose an enhanced risk of threatening public order or security. The list of examples includes operators of critical infrastructure (e.g., in industries such as energy, IT and telecommunications, transportation and traffic, health care, water, finance, insurance and nutrition) as well as developers of software for critical infrastructure and certain other industries (such as cloud computing and telematics). As Chinese investors have traditionally shown a specific enthusiasm for acquiring German tech companies, and many of the listed industries are contained in the Chinese 2025 plan and the Belt Road initiative, they have certainly taken careful note of the New Rules. The New Rules follow a certain trend toward closer scrutiny of foreign (including Chinese) investments into Germany, as illustrated by cases such as KUKA, Osram, Aixtron and (most recently) 50Hertz.

Pursuant to the New Rules, any transaction in any area that qualifies as critical must be notified in writing to the BMWi. Prior to the New Rules, such notification requirement existed only for the sector-specific investment review, not for the cross-sectoral review.

In areas in which there is no notification requirement, the investor may freely choose not to notify the transaction to the BMWi. In these cases, the BMWi can open investigations within three months after it becomes aware of the acquisition and, at the latest, five years after the conclusion of the acquisition agreement. The legal uncertainty resulting from the five-year longstop date introduced by the New Rules can be avoided by notifying the transaction to the BMWi and requesting a certificate of non-objection. In fact, it may be advisable in many cases to voluntarily approach the BMWi. In terms of timing, most investors notify the transaction and apply for a certificate of non-objection between signing and closing the envisaged transaction.

However, pursuant to a contested yet prevailing view amongst legal experts, filing of the application would even be admissible before signing. In such an instance, however, the transaction documentation should be in final or close to final form to avoid further review at a later stage based on authorities' assumption that the conditions of the transaction (or, as in the case of Aixtron, the circumstances) might have changed as compared to the point in time when the pre-signing application for non-objection was made.

If the BMWi does not launch an in-depth review within two months after receipt of the notification (and the application for a certificate of non-objection, as the case may be) or grant the requested certificate, a certificate of non-objection is deemed to have been granted after expiry of the two-month period.

If the BMWi decides to launch an in-depth review within the two-month capture period, it has four months (following receipt of all documents required and requested for the in-depth review) to assess and potentially restrict or prohibit the transaction.

RECOMMENDATION

Overall, under the New Rules, a (voluntary) notification combined with an application for a non-objection certificate to the BMWi is typically recommended for the sake of transaction security, at least if the target—after a preliminary assessment—could be deemed active in any of the critical areas. A clearance or deemed clearance under the applicable AWG/AWV should be considered a closing condition.

2.2 CFIUS

2.2.1 Explaining CFIUS

The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee made up of government officials led by the US Department of Treasury and includes representa-tives from the departments of Treasury, Defense, Homeland Security, Justice, Energy, Labor and State as well as other related agencies. All transactions that potentially involve a foreign entity ac-quiring control of a US entity may be reviewed by CFIUS to determine if such transaction would af-fect US national security interests. Depending on the type of transaction, the parties to the transac-tion may be required to submit an application for CFIUS approval.

After the parties to a transaction have submitted an application to CFIUS, CFIUS will conduct a 45-day review of the transaction for risks to national security to assess whether a full investigation is necessary. If CFIUS does not approve the transaction during the review or investigation period, the parties to the transaction can withdraw from CFIUS review, modify the deal to address any poten-tial concerns, or continue to push the transaction forward. Once CFIUS has conducted its review and/or investigation, it can submit a recommendation and report on the transaction to the presi-dent, at which point the president can approve, block or restrict the transaction.

Historically, a deal is rarely blocked over national security concerns. In fact, before President Trump took office, the sitting US president has only blocked four deals that failed to receive CFIUS approv-al. Part of this is due to the fact that most parties withdraw their application and voluntary walk away from the deal or restructure the deal if CFIUS does not approve the transaction within their review period.

2.2.2 Strengthening CFIUS under the TRUMP Administration

Under the Trump administration, a policy window opened to create a stronger, well-funded CFIUS charged with reviewing a wider array of transactions. First, foreign investment through acquisition, particularly from China, in 2018 continued to stream into the United States. In fact, CFIUS reviewed more than 200 transactions in 2018, more than a 25 percent increase from the previous record year. At the same time, funding for CFIUS had not kept pace, leaving the organization too overburdened to handle its caseload. Second, the Trump administration, with its "America First" agenda, took aim at immigration flows, trade agreements and the free flow of capital. The administration sees CFIUS as a lever it can use to prevent foreign entities from taking over US industries or acquiring key intel-lectual property developed in the United States. Since President Trump took office, nine deals have fallen apart due to failure to obtain CFIUS approval.

2.2.3 Implementing FIRRMA

With such a policy window open, lawmakers quickly mobilized legislation – the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) – enhance CFIUS's capabilities, and on August 13, 2018, President Trump signed into FIRRMA into law. The new law made substantial changes to the current CFIUS regime. First, FIRRMA gave CFIUS authority to review a greater scope of transactions, including those involving infrastructure, critical technologies and sensitive personal data. Second, FIRRMA requires parties of certain transactions to file a CFIUS review (prior to FIRRMA, all CFIUS filings were voluntary). These transactions include those in which one of the parties is related to a foreign government, and in which the transaction involves critical infrastructure, technology or sen-sitive personal data. Third, FIRMMA gives CFIUS 90 days to review transaction: (1) a 45 day applica-tion review and (2) a 45 day investigation. In addition, FIRRMA provides for short-form declarations, in which parties to a transaction can file a 5-page application that CFIUS will review within 30 days. Lastly, FIRMMA imposes a mandatory filing fee: 1 percent of the value of the transaction or USD 300,000, whichever is less. These fees will inject much needed funding into CFIUS so that it will have the necessary staff to conduct timely reviews and investigations. US sellers to foreign entities and international investors should carefully review and consider contingencies to ensure that their transactions are not unnecessarily hindered by a stronger, more emboldened CFIUS.

2.2.4 Fallout of Reform

Such legislation has a clear goal: limiting China's ability to take control of key industries in the United States. Enacting such legislation to accomplish this goal, however, could have significant collateral damage. The legislation could potentially transform CFIUS into a bureaucratic monster, stalling much-needed foreign investment. In such a situation, foreign capital might find alternative jurisdic-tions in which to invest, putting US industries at a significant disadvantage. Not only could this in-crease the price of financing for US companies, but it could also impact current US investors, partic-ularly hedge funds, that tend to invest alongside foreign investors and governments. Through early 2020, CFIUS is conducting several pilot programs to best implement FIRRMA's mandates and, hope-fully, avoid or any severe consequences from the legislation.

3. UNDERSTANDING THE MOTIVATION/STRATEGIC RATIONALE OF CHINESE INVESTORS

If a Seller wants to comprehend the rationale of a Chinese investor for a particular investment and build confidence and trust based on a mutual understanding, it is important for the Seller to understand the deal logic of the Chinese investor and his perspective. The following aspects can be relevant:

- Chinese stock market logic (valuation arbitrage from stock market, deal logic for listed companies)
- Chinese 2025 Plan/One Belt One Road Initiative political logic (infrastructure and energy sector to comply with political endeavors, deal logic for SOEs or relevant government backed PE funds)
- Industrial logic (enhancing and updating the existing product portfolio, acquiring a well established distribution channel or expanding the potential market development in China, deal logic for any kind of Chinese companies)
- Future key industry logic (AI, chips, robotics, automation, clean energy, fully supported by government for any kind of Chinese companies)

The Chinese 2025 Plan[6], coupled with the One Belt One Road Initiative is the main (political) framework for current Chinese outbound investments. The outbound investments meeting the criteria of the One Belt One Road Initiative are well reflected in the following "Guidance" issued in August 2017[7], aiming to encourage the industry to engage in this respect, with the Chinese government providing supporting services regarding approval, tax, foreign exchange, insurance, customs and other services.

4. GUIDANCE ON THE OUTBOUND INVESTMENTS FROM CHINA'S STATE COUNCIL

4.1 Encouraged Industries: (convenient practice)

1. Construction under the Belt and Road Initiative and other related infrastructure construction
2. Outbound investment in relation to the exports of advantageous capacity, equipment and technology
3. Outbound investment that could enhance the cooperation with foreign hi-tech or advanced manufacturing entities. It is also encouraged to set up foreign R&D centers
4. On a prudential basis, the exploration and development of foreign energy sources including oil, gas and minerals
5. Cooperation in relation to the agricultural, fishery, forestry and animal husbandry industries; and
6. On an orderly basis, cooperation in relation to trade, culture, logistics and other services. Qualified financial institutions are also allowed to set up foreign branches or networks outside China.

[6] On May 19, 2015, China's State Council unveiled a 10-year national plan, "Made in China 2025" (hereinafter "the plan"), focusing on promoting China's manufacturing industries to be globally competitive. The plan emphasized the priorities of Chinese manufacturing industries shall be trans-formed from made in China to made by China, from speed to quality and from products to brands. We will be introducing the highlights of the plan in the following report.

[7] On August 18, 2017, China's State Council issued a new set of guidelines on overseas investment.

In general, investments in infrastructure, energy, high-tech manufacturing, automation, key software and hardware, logistic targets comply with the Chinese 2025 Plan and One Belt One Road Initiative.

Sometimes, the deal logic Chinese investors are driven by is different from what the Seller would expect. For example, the Seller might think that the existing European distribution channel of a target and the potential expansion in the Chinese market of the target's product (i.e., the long-term development factors) are the main considerations for the Chinese buyers. In reality, however, the main motivation of the Chinese buyer might well be the valuation arbitrage (valuation difference between Chinese and German Market). Therefore, under the valuation arbitrage logic, the Chinese investor will seek a majority purchase in order to consolidate and benefit from the higher valuation multiple in China (calculated on a net profit per share basis).

It is advisable to initiate certain background checks including reviewing the historic past transaction record of a Chinese bidder, its reputation in the market and its shareholding structure.

4.1.1 Origin of Financing

Besides the funds at hand of a Chinese investor, the remainder of the purchase price and transaction costs will funded by debt or additional equity. The sourcing will depend on the nature of the investor.

(a) SOEs

SOEs have better access to debt finance in China and in Hong Kong than other companies. Moreover, for SOEs it is relatively easier for privately owned companies to be granted a loan from Chinese Banks, which in most cases are also state owned. Some SOEs further have a strong position to be granted offshore loans in Hong Kong.

(b) Listed Companies

Listed companies have access to equity finance in the Chinese stock market, combined with the access to debt finance from Chinese or international banks. That availability, however, will fluctuate with the stock market valuation.

Since most listed companies are already highly leveraged, great portions of financing for Chinese listed companies finally result from a private placement on the stock market. There are certain regulatory requirements from the CSRC to be observed for private placements. Since the approval process for a private placement is too slow to meet the requirements of a normal bidding process in Europe, a listed company has to make use of transitional financing arrangements to purchase the target (for example through an interim M&A fund) before the financing from the private placement can be used. It often occurs that the listed company as the strategic investor founds an M&A fund with financial investors (investment funds in China), acting as LPs to provide much of the funds to purchase the target on such interim basis. After the approval of a private placement is granted by CSRC, the target is acquired by the listed company against cash or share consideration.

In addition, the extra debt finance to purchase the target could be secured through the support of a controlling shareholder, which provides the Chinese banks with more collateral by pledging their shares in the listed companies.

(c) Private Unlisted Companies

Regarding financing, private unlisted companies are in a disadvantageous position compared to SOEs, as they have access neither to capital markets nor to banks.

Basically they have to finance acquisitions with equity. Consequently, transaction volumes of unlisted companies tend to be smaller.

(d) Generally: Offshore Funds

SOEs, some Chinese companies listed in Hong Kong as well as offshore PE Funds have offshore funds, potentially also through previous overseas business operations, IPO or bond issues in Hong Kong, which are not subject to the regulatory framework in mainland China. The availability of such offshore funds will certainly accelerate the process and can ensure a swift closing.

4.1.2 Decision Making and Negotiation Processes

(a) Understanding of Decision Making

Generally, senior management of the Chinese Buyer, such as the Chairman, the CEO, or the shareholders themselves, is the driving and final decision maker, leaving the mid-level management (such as the managing director of an overseas investment department or of a strategic department) in charge of driving the transaction deal on an execution level. The senior management or shareholders will (i) decide whether to engage on the transaction in the first place after digesting the report from such executive level, (ii) determine the final offer price and (iii) whether to accept terms that initially were categorized unnegotiable. Combined with the fact that senior management and shareholders are not regularly familiar with European M&A practices, this decision-making mechanism is one of main causes for the relatively slow response from a Chinese bidder. First, it takes time for the middle level management to digest the information and prepare a good quality report for senior management team to make informed decisions and secondly, it takes further time for senior management or shareholders to make the final decision, since technically they are not equipped with sufficient expertise.

The decision makers hardly show up for negotiations, if at all, only in very important occasions. The mid-level managers will be responsible for the implementation, such as the involvement in the bidding process, the coordination of the advisors and negotiations in Germany.

From a Seller's perspective, a good communication line should be developed with mid-level management. However, direct access—ideally in face-to-face meetings—to the final decision makers should be established at the beginning of the process in order to convey a sense of seriousness of the buyer. The ability to reach out to the decision makers will also improve the efficiency of communication if mid-level management lacks the understanding of a European M&A process.

Decision making in China might be associated with personal liability for wrong decision in particular for the senior management member from SOEs. Some decision makers need to be provided with adequate information before any decision can reliably be made. In addition, due to the lack of proper information and understanding, decision makers are generally reluctant to make a decision at an early stage and keep things open until a final stage in order to make a more informed decision (so-called "walk and look approach").

Behavior may differ from bidder type to bidder type and might be summarized as follows.

(i) State-owned Enterprises

- Normally the Chairman has the final say. It is advisable, in case of a large cap transaction, to reach out to a representative on the highest possible level in the hierarchy in order to assure deal certainty. Sometimes, the Chairman of an SOE needs to consult with his superiors from the relevant local or central SASAC for large transactions, depending on whether the SOE is locally or centrally owned.

- Slow in decision making
- Cautious in every step of investment
- Arduous paperwork needed
- Need extra approval from SASAC
- SOEs generally do not compete with each other

(ii) Listed Companies

- Unlike the situation in a German listed company, the largest shareholder with the other concerted shareholders or the majority shareholder in a Chinese listed company will make the final decisions by influencing the board of directors. The board members assigned to the board by the controlling shareholder are—to a very large extent—representing the interests of the controlling shareholder
- Slow in decision making
- Need to go through shareholders' meeting
- Require controlling stake to consolidate target's financials
- Listed companies may not look for targets in the same sector
- Many of them already have outbound investment experience and are familiar with auction processes

(iii) Private Unlisted Companies

- The owner has the final say; owners normally take care of any money related topics themselves or assign the task to their most trusted managers
- Quick in decision making
- Very local culture
- Non-standard practices and need more education to get familiar with European market standard
- Lack of competent M&A and in-house deal team

(iv) International Players (e.g., HNA, Fosun, CIC, Baidu, Tencent)

- Well equipped with in-house M&A team, composed of the former staffs from various prestigious international investment banking firms
- Many well-known large-cap transaction records in the world
- International standard practices

(b) Chinese Negotiation Processes

Generally, Chinese investors absorb the relevant information in a rather slow manner due to various factors, such as the lack of cross border transaction experience, the language barrier or the unavailability of direct communication with the decision makers. In addition, significant differences in negotiation style and culture exist between China and Europe. Negotiation in China is seen as an ongoing, dynamic process that takes into account practical matters and additional information acquired from the negotiation process itself. With the further development of further findings during the negotiation process, a Chinese party might want to adjust their previous opinions.

If the seller wants to include a Chinese buyer in the bidding process in order to achieve a higher offer, the seller should take into account the possible extra efforts caused by a less structured approach from Chinese bidder. Generally speaking, the goal of outbound investments is relatively clear for Chinese investors, since the demand for outbound investment to address their bottleneck in China is real and concrete after knowing what they need from overseas, such as technology, market access, diversification to an existing product portfolio or financial contribution from the target.

The western tradition of abiding by oral agreements does not necessarily apply to China. For cultural reasons, Chinese communication often includes—in order to make the current conversation more impressive—making statements without necessarily taking into consideration feasibility. There is still a learning curve ahead of both Chinese investors and German sellers about how to better manage expectations of the counterparty, in order to eliminate any discrepancies in understanding.

The time the final decision maker may take to arrive at a decision is generally hard to predict. More open, less strict timelines can help alleviate the uncertainty. In addition, the Chinese team engaged with the outbound investment might also simultaneously be highly engaged with domestic cases, as multitasking is quite popular in China. It is more important to have close contact with decision makers.

While notably accomplished in political life or domestic business, many decision makers in China have little knowledge or experience in outbound investment. Thus, when it comes to cross border transactions, they often rely mainly on their mid-level overseas managers for the implementation of the transaction. Such managers are generally fluent in English and have certain experience in outbound investment, but often lack systematic training or previous working experience in the international market. Consequently, if the mid-level managers misunderstand any information or process steps, this can reverberate into broader misunderstanding at the level of the decision makers and may result in the failure of the deal.

Further, trust is an important basis for a Chinese investor, especially considering investments in a foreign country of which it has little knowledge. Trust with a Chinese investor can be built most effectively through personal relationships in addition to meetings—in particular lunches and dinners—rather than normal business meetings that remain on a factual level.

The best way to address the risk of misunderstandings is to rely on advisors well acquainted with both sides and able to contribute to a better and more accurate education of the Chinese side as well as to give the German side a transparent picture of what the considerations and concerns are from a Chinese perspective.

OUR CHINA DESK

We have several Chinese lawyers who are part of the McDermott team and speak Chinese Mandarin fluently. In Paris, Shurong Qu leads our European China Desk. Moreover, we have German lawyers who speak Chinese Mandarin. Due to our strong collaboration with the MWE China Law Offices in Shanghai, we can also involve our Chinese colleagues at any time.

Other than that, most of our European lawyers have already participated in various cross border transactions and matters, involving in particular Chinese parties/clients, and are therefore familiar with Chinese legal and cultural aspects. It is also noteworthy that one of our German corporate partners has recently served as a foreign counsel at MWE China Law Offices in Shanghai.

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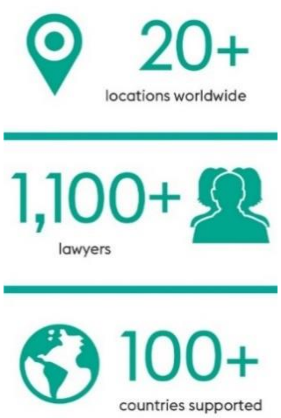
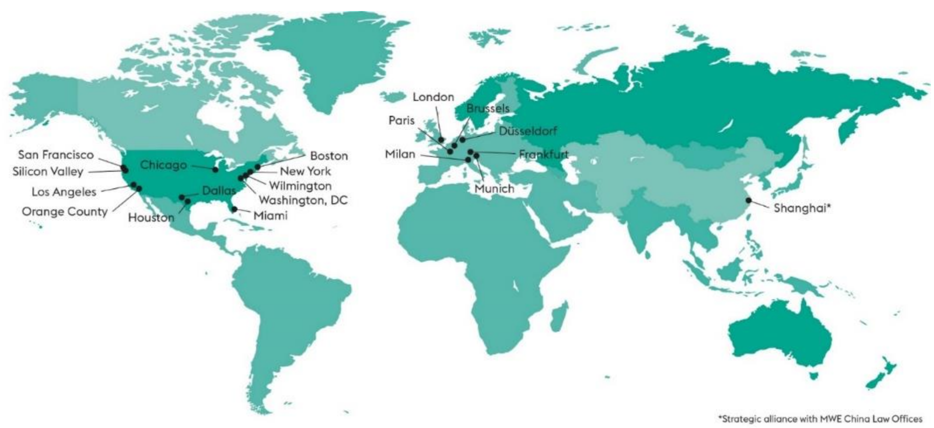
ABOUT MCDERMOTT

McDermott Will & Emery partners with leaders around the world to fuel missions, knock down barriers and shape markets. With 20 locations on three continents, our team works seamlessly across practices, industries and geographies to deliver highly effective—and often unexpected—solutions that propel success. More than 1,100 lawyers strong, we bring our personal passion and legal prowess to bear in every matter for our clients and the people they serve.

Our understanding of delivering highest quality of advice is shown by a culture of hands-on working partners, focus on adding value and avoiding hierarchies as well as lean and efficient project management.





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