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KEY ISSUES AND CONSIDERATIONS IN CROSS-BORDER TECHNOLOGY M&A

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Morgan Lewis Coronavirus/COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

To help keep you on top of developments as they unfold, we also have launched a resource page on our website at

www.morganlewis.com/topics/coronavirus-covid-19

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to [subscribe](#) using the purple “Stay Up to Date” button.

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SECTION 01

AGENDA

Agenda

- Current deal flow and global COVID-19 pandemic
 - Cross-border deal trends from 2018 to present
- International political considerations
 - US-China trade dispute
- Deals in process
 - Closing conditions and covenants
 - Purchase price considerations
 - Virtual closings and digital tools
- China specific issues and considerations
- Deals in the pipeline
- Key considerations and takeaways

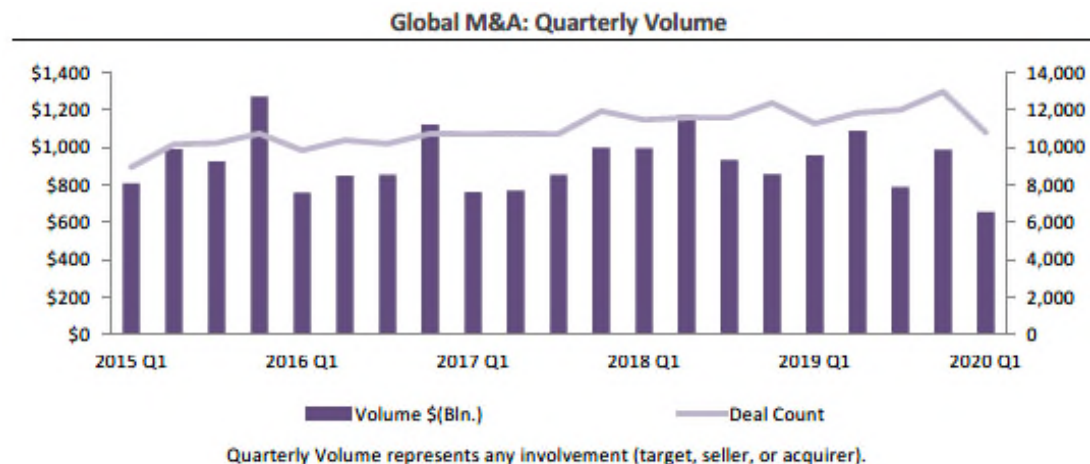
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SECTION 02

CURRENT DEAL FLOW AND GLOBAL COVID-19 PANDEMIC

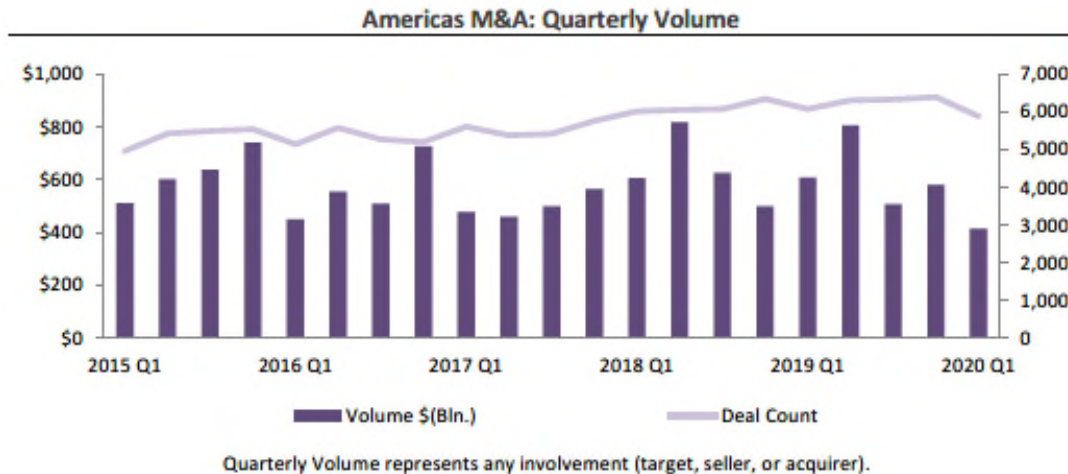
Cross-Border Deal Trends – 1Q2020

- During the first quarter of 2020, global M&A activity reached \$655.5 billion and saw a 31.5% decrease compared to the same period last year



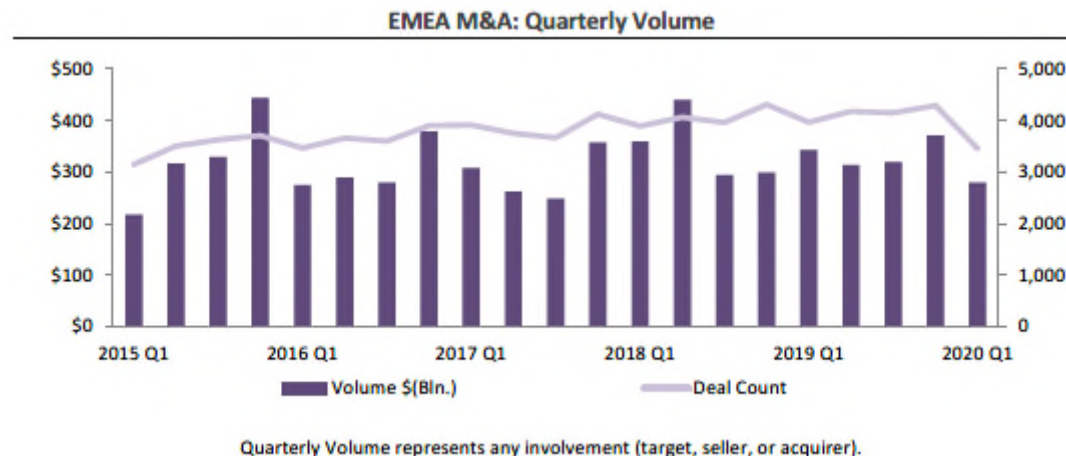
Cross-Border Deal Trends – 1Q2020

- In the Americas, \$314.1 billion in deal volume, resulting in a 38.9% decrease and lowest deal volume since 1Q2014. Most of the deals (85.7%) in the U.S. Financial sector M&A most active. (In the U.S. specifically, 51% decrease)



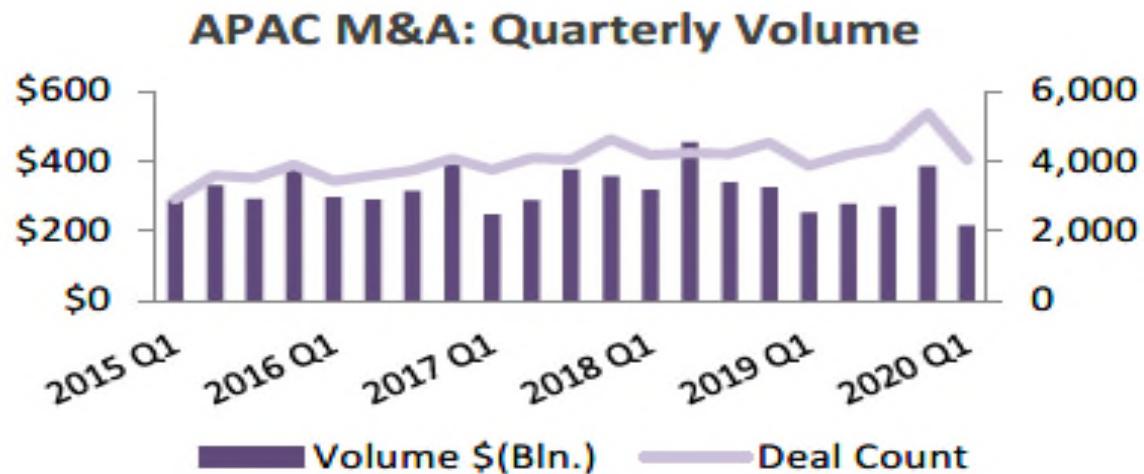
Cross-Border Deal Trends – 1Q2020

- In EMEA, \$165.1 billion in deal volume or 36.4% decrease and lowest deal volume since 2017. Germany and financial sector most active.



Cross-Border Deal Trends – 1Q2020

- In APAC, \$178.2 billion in deal volume or a 4.2% decrease. China deals represented approx. 33% of total deal volume. Financial sector most active.



Cross-Border Deal Trends – 2019

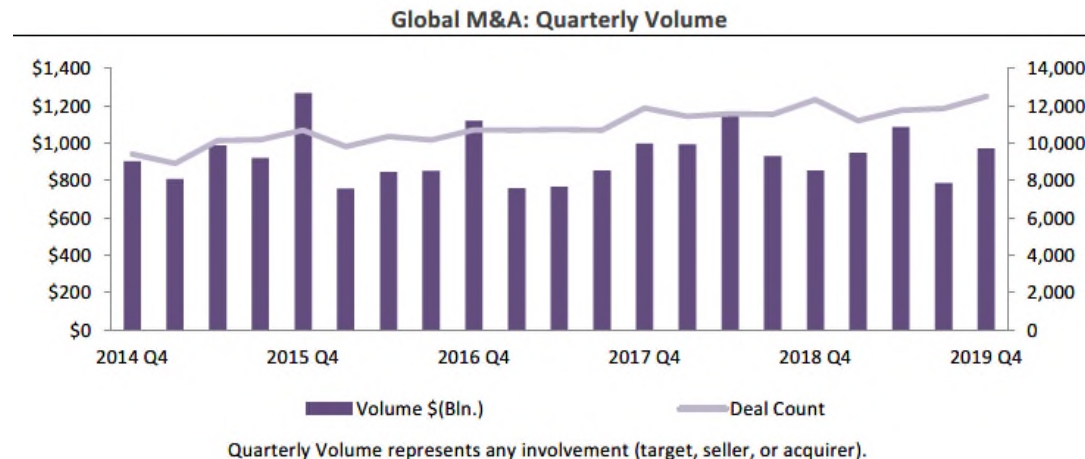
- According to another source that tracks cross-border deal activity, cross-border announced deals in 2019 declined 25% compared to 2018, slowest year since 2013
- European deals decreased 25% compared to 11-year high in 2018
- APAC deals decreased 14% from 2018 and a five-year low
- Japan saw a 40% increase and a 21-year high



2019

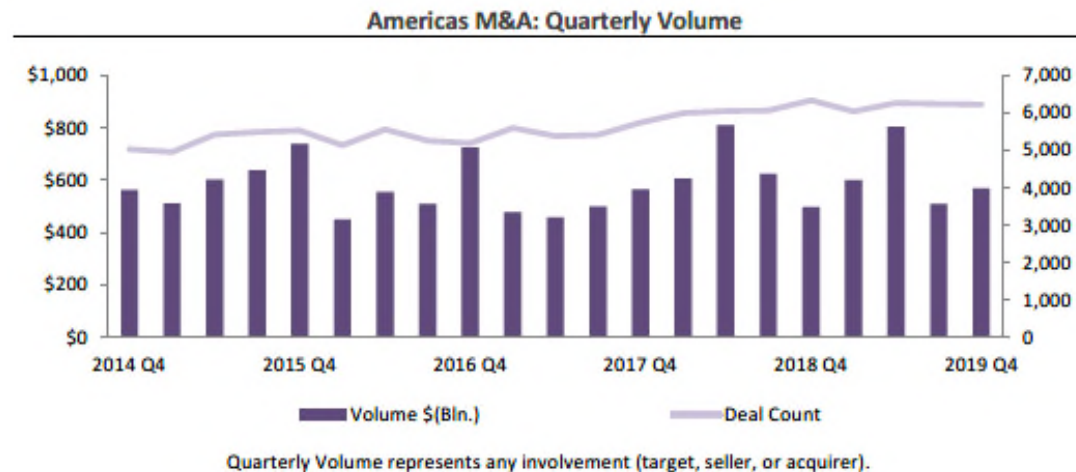
Cross-Border Deal Trends – 2019

- In 2019, global M&A activity reached \$3.8 trillion and decreased slightly by 3.7% compared to 2018



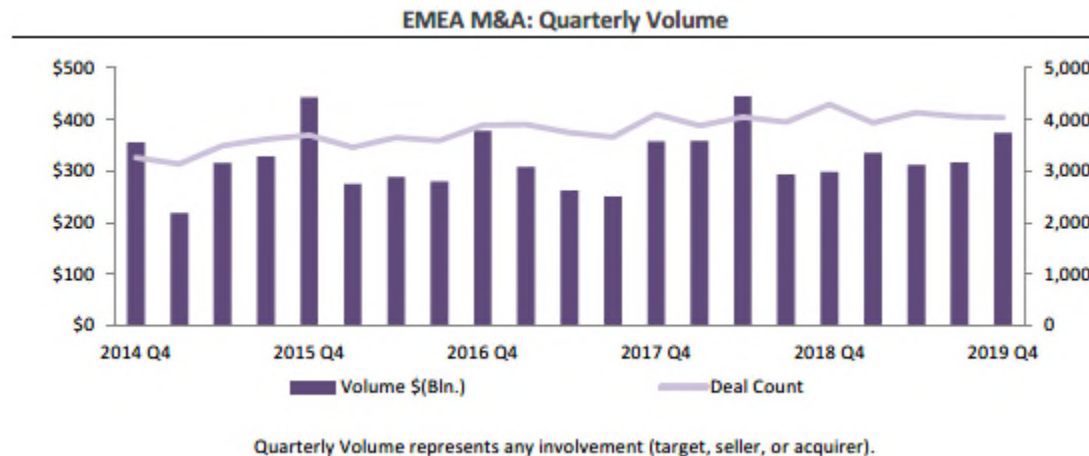
Cross-Border Deal Trends – 2019

- M&A activity in the Americas in 2019 reached \$2.1 trillion in deal volume, representing a 2.1% increase compared to 2018



Cross-Border Deal Trends – 2019

- In the EMEA, \$900 billion in deal volume or 9.1% decrease compared to 2018. U.K. deals and financial sector most active.



Cross-Border Deal Trends – 2019

- In APAC, \$845.8 billion in deal volume or 11.5% decrease from 2018. China deals represented approx. 30% of total deal volume. Financial sector most active.



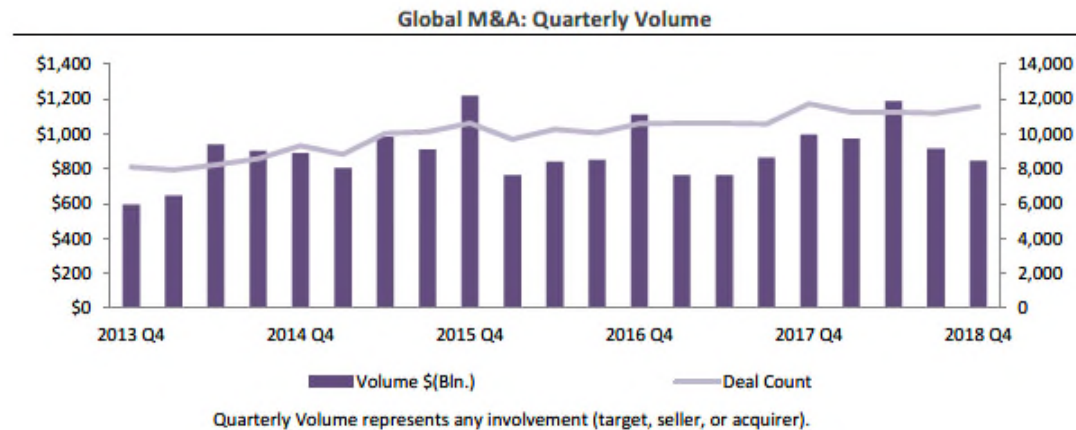
Cross-Border Deal Trends – 2018

- According to another source that tracks cross-border deal activity, cross-border announced deals in 2018 reached a 11-year high and increased 32% from 2017
- Cross-border deals accounted for 41% of overall announced global M&A deal volume in 2018
- European deals increased 32% from 2017 and a 11-year high
- China outbound deals decreased 5.3% from 2017 (peak in 2016)

2018

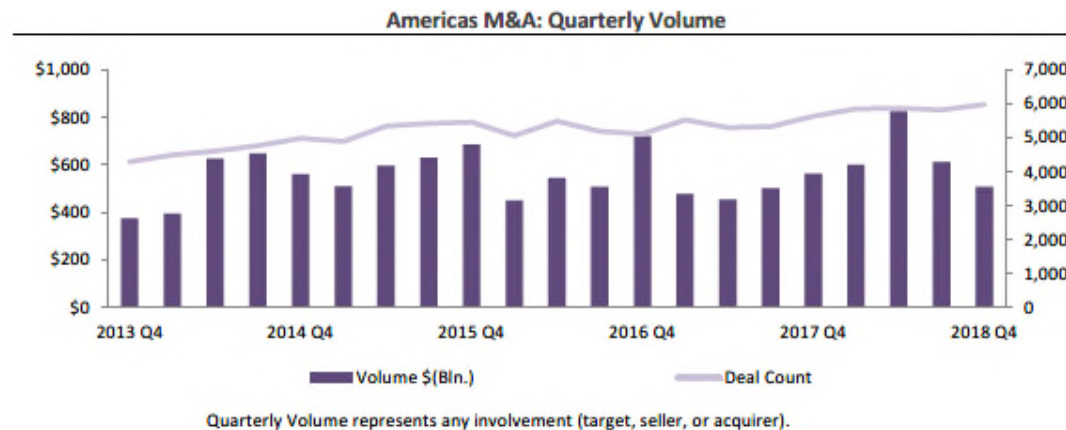
Cross-Border Deal Trends – 2018

- In 2018, global M&A activity reached \$3.9 trillion and increased 15.9% compared to 2017



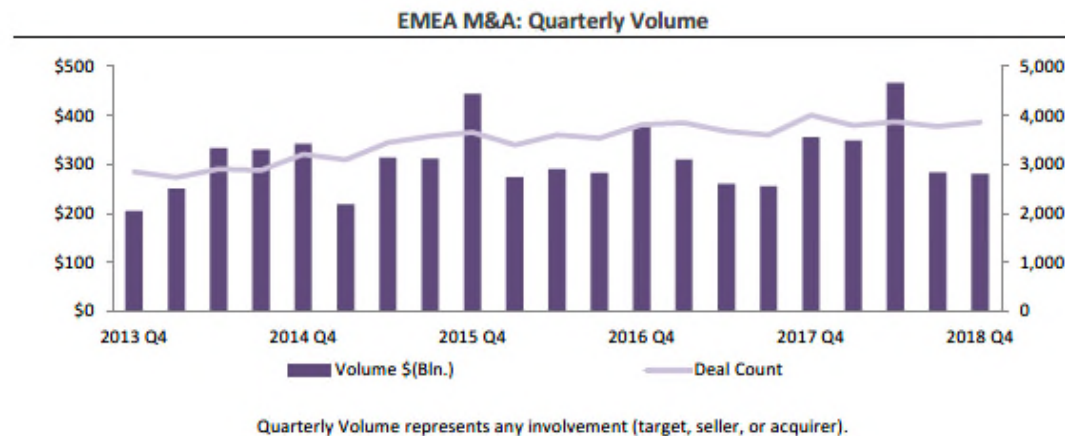
Cross-Border Deal Trends – 2018

- In 2018, M&A activity in the Americas reached \$2 trillion in deal volume, with the U.S. constituting 90% of total deal activity. Technology deals increased 169% year over year, and \$95.4 billion in venture capital financing, a record high since 2008



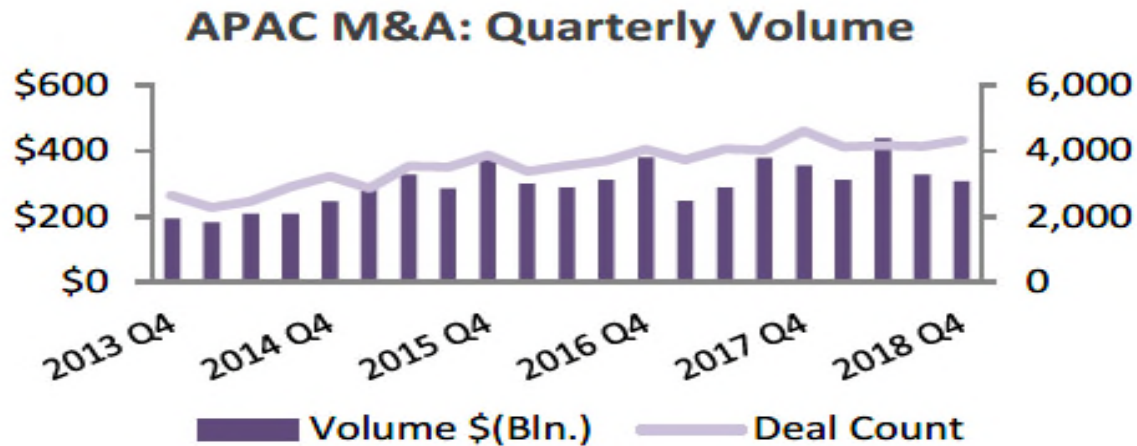
Cross-Border Deal Trends – 2018

- In the EMEA, \$983.8 billion in deal volume or 18.8% increase compared to 2018. U.K. deals and financial and consumer sectors most active.



Cross-Border Deal Trends – 2018

- In APAC, \$934.3 billion in deal volume or 8.6% decrease compared to 2018. China deals and financial sector most active.



Key Observations

- **Politicization of cross-border M&A transactions**
 - Bifurcation of global economy: U.S. vs. China
 - Protectionist tendencies
- **In-bound M&A regulatory review**
 - Most major markets around the world have foreign investment review process
 - All G7 countries are making their foreign investment review process more restrictive
 - CFIUS in the U.S. (Foreign Investment Risk Review Modernization Act)
9 voting members: Treasury Department, Justice Department, State Department, Commerce Department, Defense Department, Energy Department, Department of Homeland Security, Office of Science and Technology Policy, U.S. Trade Representative; Office of the Director of National Intelligence also has a role.
- **Business model disruption**
 - Technology: 5G, cloud, blockchain, e-commerce, social media, AI, robotics
 - Healthcare: Gene/cell therapy, digital health, MedTech
 - Financial sector: Digital payments, new players, role of banks

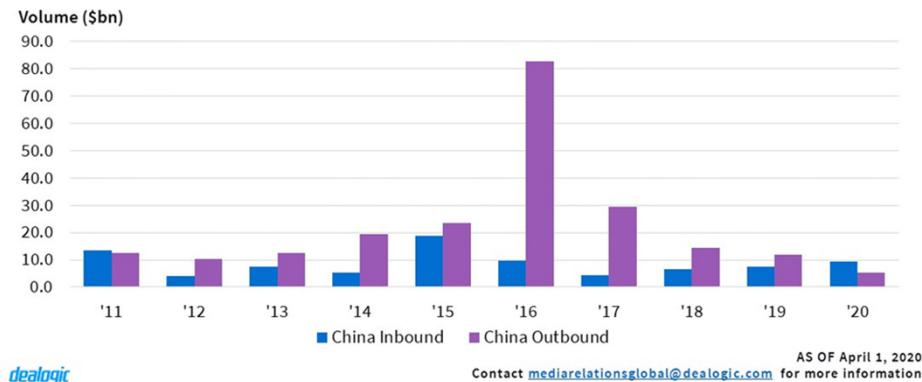
SECTION 03

**INTERNATIONAL POLITICAL
CONSIDERATIONS:
US-CHINA TRADE DISPUTE**

Cross-Border Deal Trends (China) – 1Q2020

- The Coronavirus outbreak, travel bans and quarantine policy in many cities and provinces in China and the disruptions in daily business operations have contributed to Chinese companies putting breaks on M&A activities in Q1 2020

Q1 CHINA INBOUND & OUTBOUND M&A



- China outbound M&A hit record low since 2013 for Q1 2020
- China inbound M&A saw an increase

Resource: <https://www.dealogic.com/insight/ma-highlights-first-quarter-2020/>

Global Policy Development

- **EU**

- On March 21, 2019, the EU published Regulation (EU) 2019/452, establishing a framework for the screening of FDI into the EU that may affect security or public order.

- **US**

- On August 13, 2018, Trump signed FIRRMA, expanding the jurisdiction and power of CFIUS.
- On August 13, 2018, Trump signed ECRA, enhancing export and investment controls on critical technologies.

- **Germany**

- On December 19, 2018, the German government amended the German Foreign Trade Regulation to tighten the FDI screening regime.
- German started a legislative process to change the FDI regime in the German Foreign Trade Act.

- **France**

- On December 31, 2019, the French government adopted a Decree and a Ministerial Order to expand the scope of sectors subject to foreign investment control.

Global Policy Development (con't)

- **UK**

- New UK foreign investment screening rules (effective on June 11, 2018) lower merger control thresholds;
- UK Government's White Paper (published in July 2018) propose a sea-change in the review of deals from a national security perspective.

- **Japan**

- On May 27, 2019, Japan published amended rules that aim to tighten the regulatory requirements applicable to FDI under the Foreign Exchange and Foreign Trade Act of Japan.

- **Australia**

- The Security of Critical Infrastructure Act 2018 (commenced on 11 July 2018) was designed to manage these national security risks from foreign involvement in Australia's critical infrastructure in the electricity, gas, water and ports sectors.
- The Security of Critical Infrastructure Rules 2018 specify correspondent thresholds.

US-China Trade Dispute

2018.03.22

.....

2020.02.15

Trump signed a memorandum:

- file a WTO case against China for discriminatory licensing practices
- restrict investment in key technology sectors
- impose tariffs on Chinese products (such as aerospace, information communication technology and machinery)

Additional tariffs:

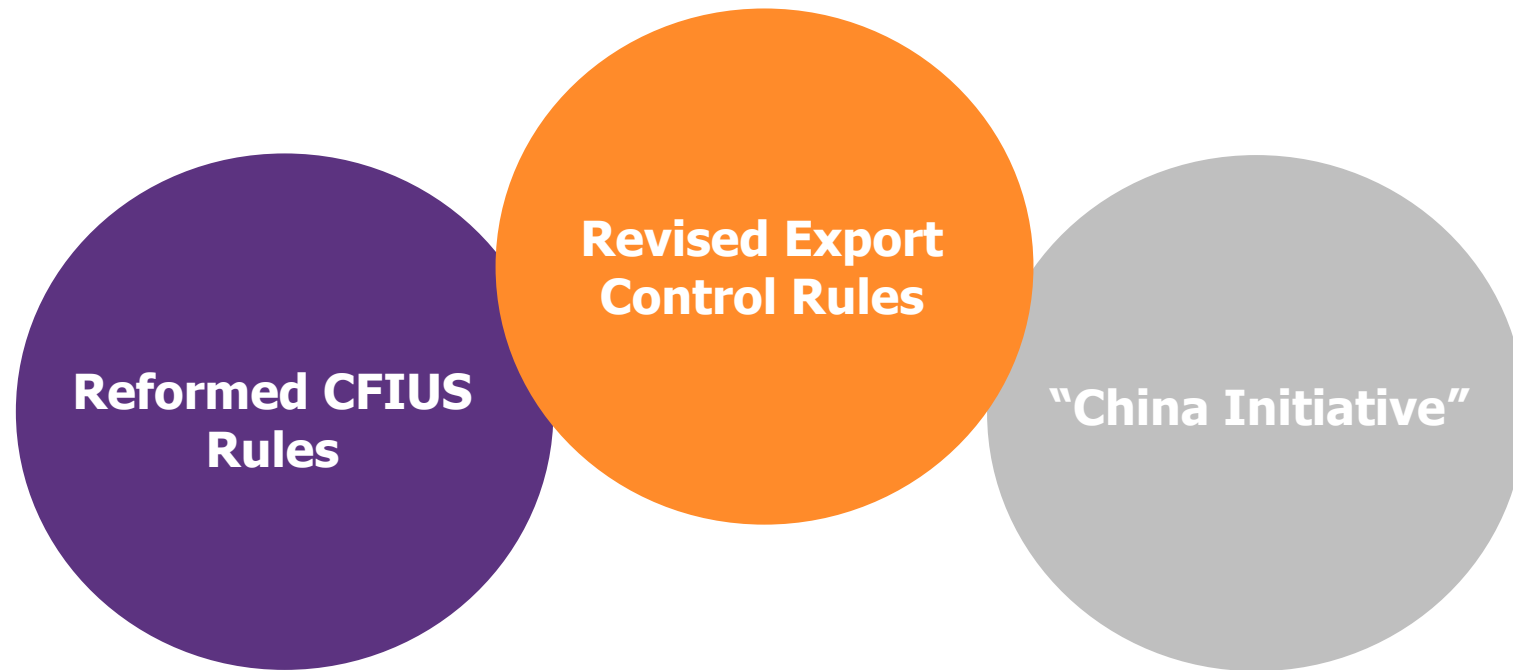
- peak at the end of 2019
- US had imposed tariffs on more than US\$360 billion worth of Chinese goods
- China had retaliated with import duties of their own worth around US\$110 billion on US products

US and China signed a preliminary agreement:

- China pledged to boost US imports by \$200 billion above 2017 levels and strengthen Intellectual property rules
- US agreed to halve some of the new tariffs it imposed on China

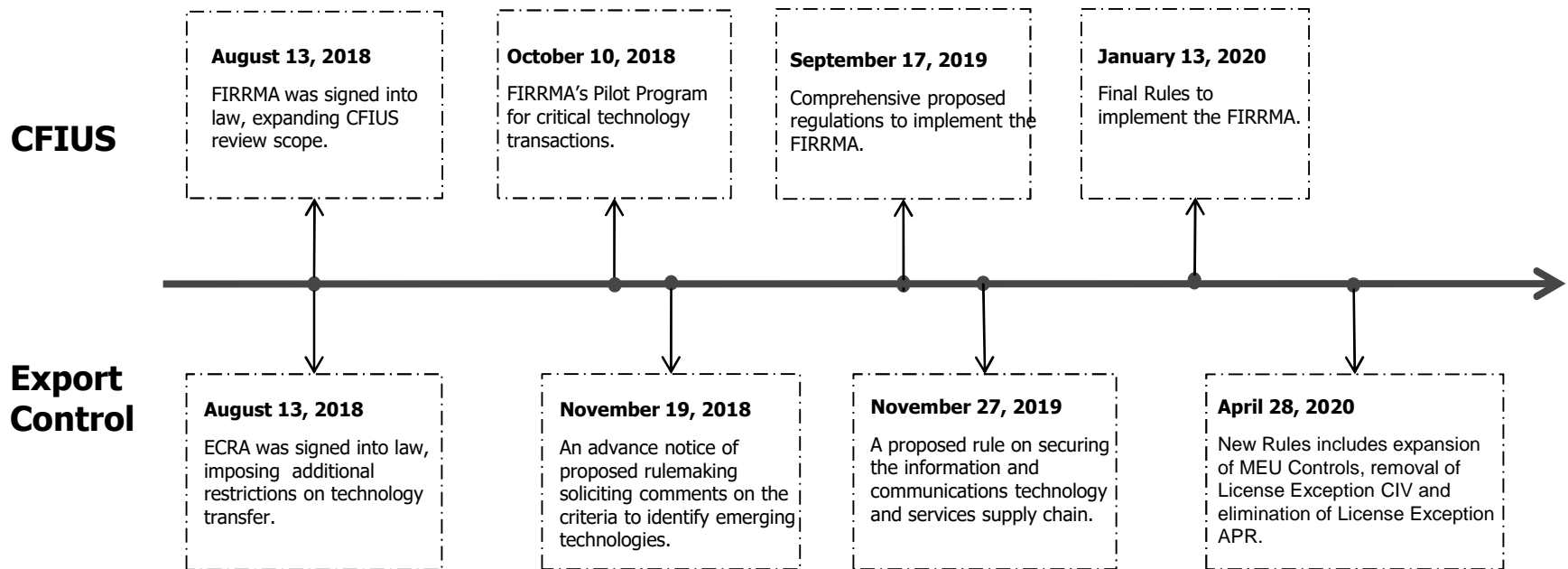
US-China Trade Dispute

- **US Measures in Trade Dispute**



US-China Trade Dispute

• Development of CFIUS and Export Control Rules



US-China Trade Dispute

• China Measures in Trade Dispute



Foreign Investment Law (FIL)

On March 15, 2019, China passed a new Foreign Investment Law (FIL), which took into effect on January 1, 2020.



Opening Up Financial Sector

On 20 July 2019, China announced Relevant Measures for Further Opening Up Financial Sector ("11 Measures").



Promoting investment Facilitation

On 23 October 2019, China issued the Circular on Further Promoting the Facilitation of Cross-border Trade and Investment.

US-China Trade Dispute

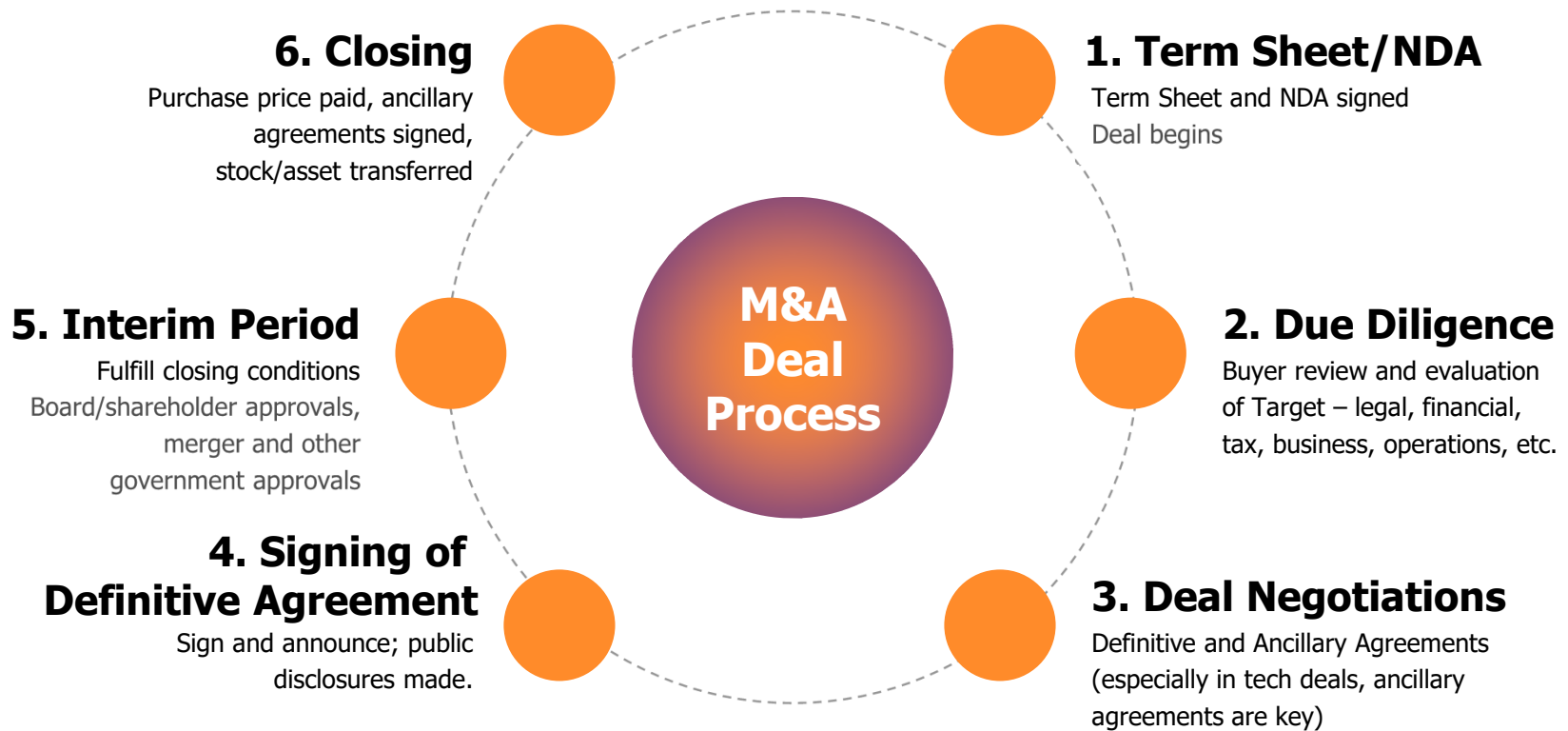
- **Impact on M&A**

- China's outbound M&As clocked their weakest year in a decade in 2019
- The preliminary agreement set the scene for a positive 2020 outlook but the COVID-19 outbreak has changed the near-term outlook and may alter the long-term picture
- Despite current tensions, the economic argument for expanding two-way investment in non-sensitive sectors between US and China remains valid
- Crises also generate buying opportunities
- China has a stronger incentive to further open up its markets

SECTION 04

DEALS IN PROCESS

M&A Deal Process



Deals in Process – Closing Conditions

- Interim period between signing and closing
- More time to get to closing – “Drop Dead Date” or “Long Stop Date”
- Government filings and approvals
 - Foreign investment approvals (e.g. CFIUS/FIRRMA)
 - China governmental approvals
 - Filings under the Foreign Trade and Foreign Exchange Act in Japan
- Labor union consultation, especially in Europe
- Merger approvals
- Board and shareholder approvals
- Third party approvals

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Deals in Process – MAC

- Material Adverse Change (MAC) - parties need not close if MAC occurs between signing and closing
- Sample language:
“**Material Adverse Change**” means any event, change, circumstance, occurrence or state of affairs that, individually or together with any other event, change, circumstance, occurrence or state of affairs, would or would reasonably likely to have a material adverse effect on the business, financial condition or results of operations of the Target or the ability of the Seller or the Target to perform its obligations under this Agreement; provided, that no event, change, circumstance, occurrence or state of affairs resulting from, arising out of or relating to any of the following shall be deemed to constitute or shall be taken into account in determining whether a Material Adverse Change has occurred or would reasonably be expected to occur..

Deals in Process – MAC

- Action is in the exceptions to this MAC definition:
 - (i) Any epidemic, pandemic or disease outbreak (**including COVID-19**) or other health crisis or public health event, or the worsening of any of the foregoing;
 - (ii) Any changes generally affecting the global economy, financial or securities markets;
 - (iii) Any natural or man-made disaster, climate change, earthquake, flood, fire, tsunami or other severe weather;
 - (iv) Any acts of terrorism, sabotage, military action, war, escalation or worsening thereof, any national or international calamity or crisis;
 - (v) Any changes or developments in any of the businesses and industries in which the Target operates;
 - (vi) Any changes in applicable law or generally accepted accounting principles [**in the People's Republic of China**] or the interpretation or enforcement thereof;
 - (vii) Any breach of this Agreement by the Purchaser

Deals in Process – MAC

- Disproportionate impact exception to the MAC exception:
provided, further, that, with respect to (i) (pandemics), (ii) (changes in global economy), (iii) (natural or man-made disaster), (iv) (terrorism, war, etc.), (v) (industry change), (vi) (change in law or accounting principles), except in each case to the extent that such event, change, circumstance, occurrence or state of affairs has a disproportionate effect on the Target as compared to other participants in the industries **or geographies [in the People’s Republic of China, Japan, Taiwan, Hong Kong, Singapore or South Korea]** in which the Target conducts its business.
- Seller may insist on yet another carve out:
(in which case only the incremental material and disproportionate impact may be taken into account in determining whether there would be or would reasonably be expected to be a Material Adverse Change)

Deals in Process – MAC

- Risk allocation between the parties if extreme, unexpected, exogenous events occur between signing and closing
- Buyer's perspective – does the COVID-19 pandemic have a disproportionate impact on the Target relative to other players in the industry or geographic market? May provide an escape hatch to get out of the deal.
- Seller's perspective – the COVID-19 exception from MAC to ensure that closing occurs, and no disproportionate impact on Target because all companies are suffering from the pandemic.
- Delaware law requirement – “unknown events” that “substantially threaten the overall earnings potential of the target” in a “durationally significant manner”
- Negotiating leverage/buyer's market
 - MAC closing condition and other financial milestones/requirements
 - Termination for MAC
 - Continued operation of business “in the ordinary course”

Deals in Process – Interim Operational Covenants

- Covenant for the Seller to cause the Target to “conduct its business in the ordinary course of business”
- What is “ordinary course of business” in light of the COVID-19 pandemic
 - Other similarly situated companies in the same industry
 - But other companies may not experience the same impact
- Qualifications:
 - “in a manner consistent with past practice” – focus on Target’s historical operations
 - “in material respects” – does not need to be substantially the same
 - “commercially reasonable efforts” – even if unable to follow historical practice, just need to use reasonable efforts to conduct the business consistent with past practice
- Buyer may consent to certain business and operational adjustments, but need clear and frequent communication with the Seller and Target

Deals in Process – Purchase Price Considerations

- In cross-border deals, negotiation of which currency to use for purchase price
 - FX fluctuation risk
 - Bank account opening/KYC compliance
 - US dollar trading at its lowest level in more than three years after 10% drop in 2017
- Use of local currency where the Target is headquartered
- Post-closing working capital adjustments
- Use of financial metrics in closing conditions or interim covenants
- COVID-19 and effects on valuation
- Business decline and effects on cash flow

Deals in Process – Virtual Closings

- Virtual closings
 - Electronic signatures
 - Originals exchanged later
 - No stock certificates
- Digital tools
 - Some apps not universally accepted (e.g. DocuSign, WeChat, Line, etc.)
 - Video conferencing
 - Interpretation/translation tools
- Tech deals
 - Deal makers in tech space are comfortable with digital tools and virtual meetings
 - WeChat platform ubiquitous in Chinese speaking countries

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SECTION 05

**CHINA SPECIFIC CONSIDERATIONS &
ISSUES**

China Specific Issues - Outbound

- China generally adopts a governmental approval-oriented regulatory system for outbound investment
- Chinese government closely supervised RMB outflow, and all outbound investments in China are subject to relevant approval or filing requirements under Chinese laws
- Outbound Direct Investment Regulators in China
 - National Development and Reform Commission (NDRC)
 - Ministry of Commerce (MOFCOM)
 - State Administration of Foreign Exchange (SAFE)
 - State-owned Assets Supervision and Administration Commission of the State Council (SASAC)
 - China Securities Regulatory Commission (CSRC)

China Specific Issues - Outbound

- **NDRC Approval/Filing Requirements**

	Projects of Central Enterprises	Projects of Local Enterprises
Filing at provincial level	N/A	<ul style="list-style-type: none"> • Not sensitive • Investment amount by the Chinese party(ies) < US\$300 million
Filing at central level	Not sensitive	<ul style="list-style-type: none"> • Not sensitive • Investment amount by the Chinese party(ies) ≥ US\$300 million
Approval at central level	Sensitive	Sensitive

China Specific Issues - Outbound

- **MOFCOM Approval/Filing Requirements**

	Projects of Central Enterprises	Projects of Local Enterprises
Filing at provincial level	N/A	Not sensitive
Filing at central level	Not sensitive	N/A
Approval at central level	Sensitive	Sensitive

China Specific Issues - Outbound

- **Sensitive Countries and Regions**

NDRC Rules	MOFCOM Rules
<ul style="list-style-type: none"> • no diplomatic relation; • sanctioned according to international treaties or agreements; • war or civil commotion; or • other sensitive countries/regions 	<ul style="list-style-type: none"> • no diplomatic relation; • sanctioned by the United Nations; or • other sensitive countries/regions

- **Sensitive Industries**

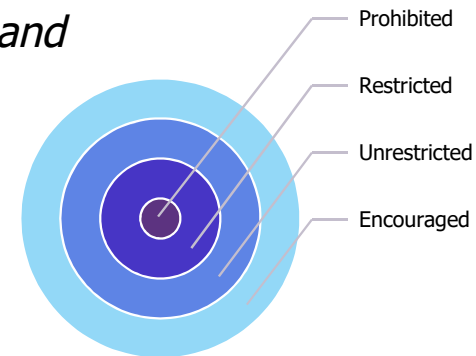
NDRC Rules	MOFCOM Rules
<ul style="list-style-type: none"> • involve development, production and maintenance of weapon equipment; • involve cross-border development and use of water resources; • news media; or • for which outbound investments by enterprises shall be restricted according to PRC laws, regulations and related regulatory policies 	<ul style="list-style-type: none"> • involve products or technologies restricted by the Chinese government from being exported; or • have impact on the interest of more than one country or region

China Specific Issues – Inbound

- Despite the COVID-19 pandemic crisis, China has strived to deepen reforms and adopt policies in further opening-up and supporting FDI in China:
 - lower entry barriers for foreign investment
 - expedited digitalization
 - increased efficiency
- Foreign Investment Law (FIL)
- Major Regulators:
 - National Development and Reform Commission (NDRC)
 - Ministry of Commerce (MOFCOM)
 - State Administration for Market Regulation (SAMR)
 - State-owned Assets Supervision and Administration Commission of the State Council (SASAC)
 - Other specific industry regulators (e.g. Ministry of Industry and Information Technology (MIIT))

China Specific Issues – Inbound

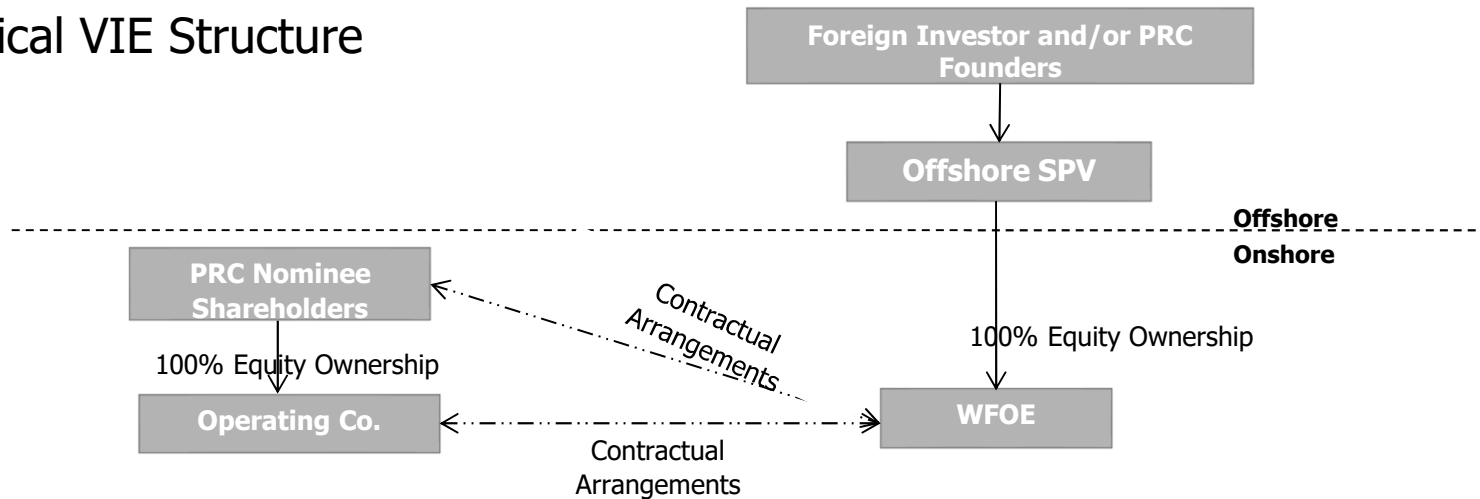
- Establishment of a nationwide “**pre-establishment national treatment and negative list**” regulation system
- Foreign investment in different sectors are therefore catalogued as Prohibited, Restricted, Unrestricted, and Encouraged, and subject to different regulatory treatment.
- **Encouraged Catalogue** mainly focus on **high-tech manufacturing sectors**
 - *E.g. 5G components, equipment for cloud computing and IC etching equipment, e-commerce, AI*



China Specific Issues – Inbound

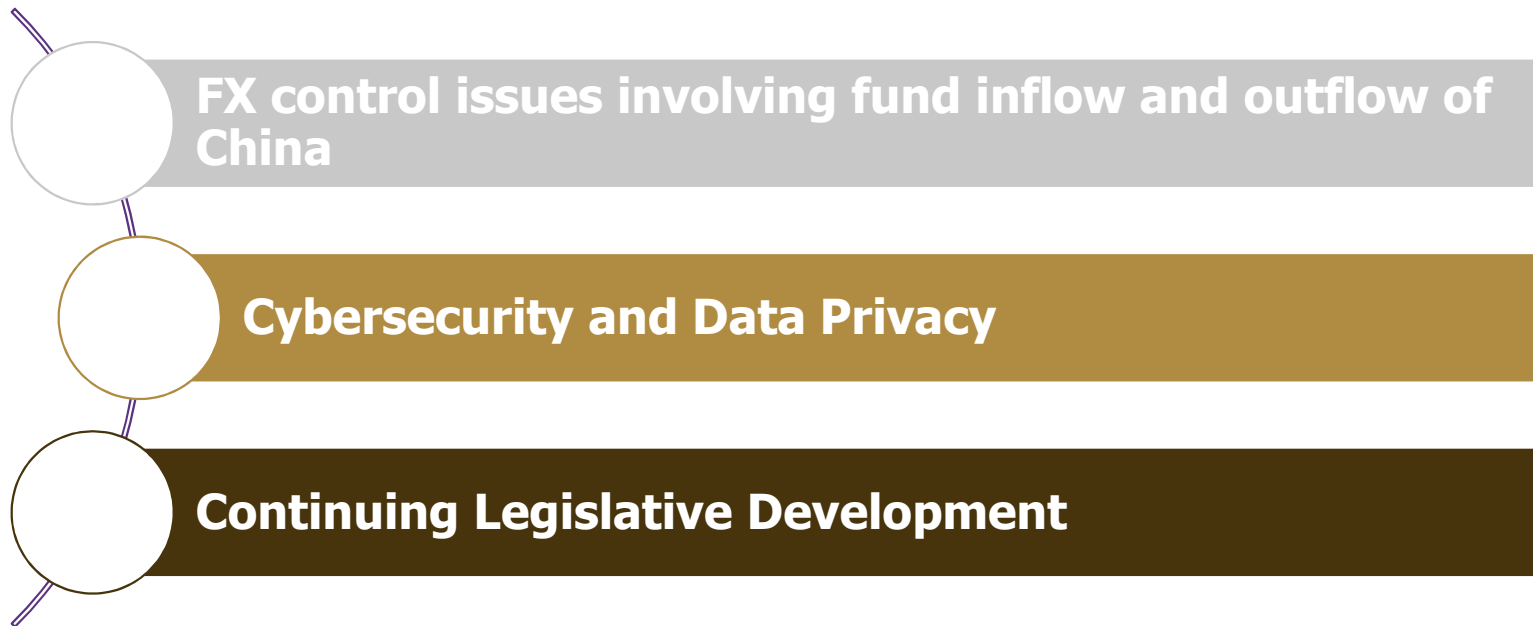
- Variable Interest Entity (VIE) Structure:
 - commonly used by foreign investors to invest in foreign prohibited or restricted industry sectors, and also used as means for Chinese domestic companies to achieve an offshore financing or listing
 - *samples: BAT, Wolters Kluwer, LexisNexis to adopt VIE structure to hold the Internet Content Provider (ICP) license*

- Typical VIE Structure



China Specific Issues

- **Other Considerations**



SECTION 06

DEALS IN THE PIPELINE

Deals in the Pipeline

- Legally non-binding
- Longer exclusivity period
- Due diligence process taking longer and all virtual (e.g. virtual data rooms, virtual management meetings, virtual interviews)
- Valuations on the decrease (trending to buyer's market?)
- More regulatory scrutiny
- Political uncertainty and global pandemic rattling markets

Examples of Contractual Provisions to Address Regulatory Risks



Buyer Friendly

- No obligation to divest
- Buyer to use “commercially reasonable best efforts” to address mitigation orders



Compromise

- Whether mitigation order constitutes a MAC
- If divestiture results in certain amount of lost revenue or other material financial impact
- Identify specific business units or subsidiaries that hold assets that may raise national security concerns



Seller Friendly

- Must close no matter what
- Reverse break-up fee paid by Buyer if no closing

Deals in the Pipeline

Threshold Issues to Consider:

- Language of deal documents
- Governing law
- Venue for international dispute resolution
- Availability of international mediation/arbitration
- Who pays for interpreters
- New digital tools to enhance deal efficiency and ensure a smooth closing

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SECTION 07

KEY CONSIDERATIONS AND TAKEAWAYS

Key Considerations and Takeaways

1. Impact of global pandemic
2. Political and economic volatility
3. Ability to negotiate and do deals virtually (digital tools)
4. Language for negotiations, deal documents and international dispute resolution
5. Travel ban and quarantine
6. Plan ahead for FX control issues
7. Pay close attention to the legislative and policy developments

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Biography



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Nancy Yamaguchi advises technology companies across the world on cross-border mergers and acquisitions, strategic and venture capital investments, joint ventures, strategic alliances, and technology transactions. Her clients include companies in the semiconductor, automotive, banking, IT, AI and software industries. She also advises clients on operations of technology businesses and technology assets around the world, including in intellectual property, labor/employment and litigation matters, collaborating with specialists in these areas. Prior to Morgan Lewis, Nancy served as Chief Legal Officer of a semiconductor company based in California and Germany and also as Director of Mergers & Acquisitions for a public company headquartered in Silicon Valley. Nancy is admitted to practice law in California and Illinois, and is a registered foreign qualified lawyer in England and Wales.

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Biography



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Alex Wang counsels clients on a broad range of corporate transactions, with a focus on private equity, mergers and acquisitions, real estate, and telecommunications, media & technology. Over 15 years of practicing in greater China, Alex has represented multinational corporations, investment banks, financial institutions, and private equity and hedge funds in a variety of complex and often innovative cross-border and offshore transactions within China. In addition, Alex has experience in advising Chinese investors, including sovereign wealth funds, state-owned enterprises, and public companies on outbound transactions, including joint ventures, mergers and acquisitions, real estate development, and financing. Alex is admitted to practice in New York.

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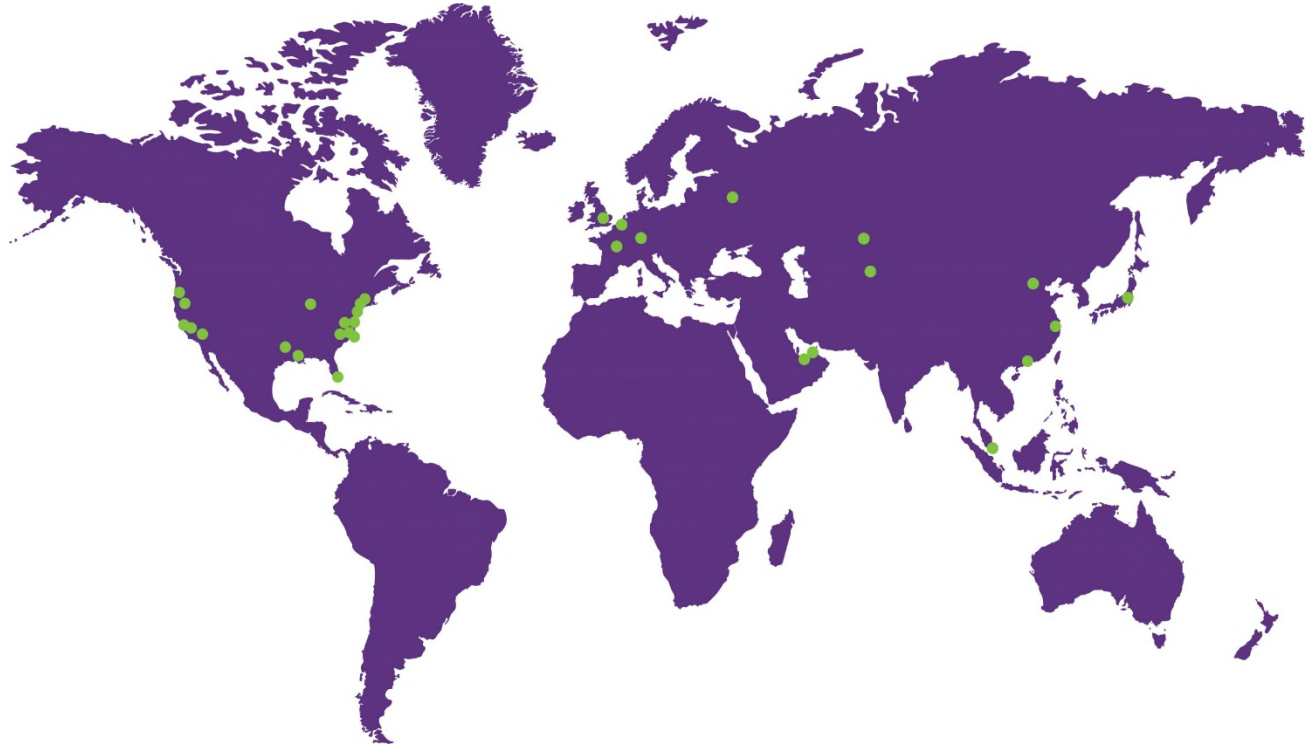
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