Global Arbitration Review

The Guide to M&A Arbitration

Editor
Amy C Kläsener

Third Edition

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Publisher's Note

Global Arbitration Review is delighted to publish *The Guide to M&A Arbitration*.

For those unfamiliar with GAR, we are the online home for international arbitration specialists, telling them all they need to know about everything that matters. Most know us for our daily news and analysis service. But we also provide more in-depth content: books and reviews; conferences; and handy workflow tools, to name just a few. Visit us at www.globalarbitrationreview.com to find out more

Being at the centre of the international arbitration community, we regularly become aware of fertile ground for new books. We are therefore delighted to be publishing the third edition of this guide on mergers and acquisitions within the world of arbitration. It is a practical know-how text in two parts. Part I identifies the most salient issues in M&A arbitration, while Part II surveys substantive principles from select regional perspectives.

We are flattered to have worked with so many leading firms and individuals to produce *The Guide to M&A Arbitration*. If you find it useful, you may also like the other books in the GAR Guides series. They cover energy, construction, mining, challenging and enforcing awards and (soon) IP, in the same practical way. We also have books in the series on advocacy in international arbitration and the assessment of damages, and a citation manual (*Universal Citation in International Arbitration*). Our thanks to the Editor, Amy C Kläsener, for her vision and energy in pursuing this project and to our colleagues in production for achieving such a polished work.

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Part II

Survey of Substantive Laws

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China

Ariel Ye and Huang Tao[1]

Frequency of M&A disputes

Although there are no empirical studies or surveys as to the frequency of M&A disputes in mainland China, it is generally believed that at least 50 per cent of M&A transactions will have disputes of some form or other.

Form of dispute resolution

Based on a survey we conducted, among the 73 post-closing M&A disputes that we randomly pulled from our firm's 2016–2017 dispute resolution database, 22 (30 per cent) included arbitration agreements.

It is, however, rather uncommon to see parties choose expert determination or other forms of alternative dispute resolution to settle M&A disputes in China.

Grounds for M&A arbitrations

Among the 73 post-closing M&A disputes that we looked at for this survey, 17 concerned the price of the transaction; 14 related to earn-out; four were repurchase without earn-out disputes; two concerned breaches of misrepresentation and warranties; and two concerned failure to complete the transactions.

1 Ariel Ye and Huang Tao are partners at King & Wood Mallesons. The authors would like to thank all of their KWM colleagues who have supported and contributed to the survey. Special thanks also go to KWM partners Wang Kaiding and Song Yanyan for their advice on relevant rules for listed companies.

Generally speaking, we believe the relative frequency of grounds for M&A arbitrations in China is as follows.

Failure to complete the transaction	Frequent
Price adjustment	Very frequent
Earn-out	Frequent
Pre-contractual failure to disclose or fraud	Frequent
Misrepresentations and breaches of warranties	Frequent

Fraud

There is no special statutory regime that deals with M&A contracts in the People's Republic of China. The Contract Law[2] applies to contracts generally. Under the Contract Law, a contract shall be null and void if it is concluded through fraud or coercion, according to Article 52.[3] When a contract is concluded by fraud, under Article 54 the injured party may request the people's court or an arbitration institution to modify or cancel the contract. If the injured party requests modification, the people's court or the arbitration institution may not cancel the contract.

According to Article 55 of the Contract Law, the right to cancel a contract shall be lost if:

- a party having the right to cancel the contract fails to exercise the right within one year of the day that it knows or ought to have known the ground for cancellation; or
- a party either expressly or by conduct waives any right to cancel the contract after it knows the ground for cancellation.

Article 58 of the Contract Law provides that after a contract is found null and void or cancelled, the property acquired as a result of the contract shall be returned; where the property cannot be returned or restitution is unnecessary, compensation is due at its estimated price. The party at fault shall compensate the other party for resulting losses. If both parties are at fault, liability shall be apportioned.

In addition to the relevant provisions under the Contract Law, as outlined above, the General Provisions of the Civil Law also address fraud issues. In particular, Article 148 provides that where a civil act is performed by a party against his or her true intention as a result of fraud by the other party, the defrauded party may request the people's court or an arbitral institution to cancel the civil act. Furthermore, Article 149 provides that where a civil act is performed by a party against his or her true intention as a result of fraud by a third party, the defrauded party may request the people's court or an arbitral institution to cancel the act if the other party knows or should have known of the fraud.

2 The Civil Code of the People's Republic of China (the Civil Code) shall come into force on 1 January 2021, upon which the Contract Law of the People's Republic of China (the Contract Law) will be repealed. Unless otherwise stated, the relevant provisions of the Contract Law as cited below are not substantially amended in the Civil Code.

3 Once the Civil Code comes into force, the stipulation in Article 52 of the Contract Law will be replaced by the relevant provisions in the Civil Code. For example, subsection 1 of Article 52 of the Contract Law (i.e., 'a contract is entered into by fraud or coercion by one party, and thus damages the interest of the state') will no longer act as a statutory ground for rendering a contract null and void.

Failure to disclose

It is arguable that parties are under a duty of good faith and fair dealing under the Contract Law to fulfil certain pre-contractual disclosure obligations in M&A transactions. It is, however, advisable that parties provide for such obligations explicitly in their contract to enhance certainty and predictability.

The principles of good faith and fair dealing are enshrined in the Contract Law. Article 5 provides that the parties shall adhere to the principle of fairness in exercising their rights and performing their obligations. Article 6 stipulates that the parties shall observe the principle of honesty and good faith in exercising their rights and performing their obligations.

Burden of proof

Civil Procedure Law (2017 Amendments)

Article 64 of the amended Civil Procedure Law provides that a party bears the burden to provide evidence for its claims. Therefore, the party alleging fraud must prove it.

Article 64 further provides that the people's court must investigate and collect evidence that a party and its litigation representative are unable to collect for objective reasons, for example in the case of fraud, that the people's court deems necessary for deciding the case. Article 64 also provides that the people's court shall, under statutory procedures, verify evidence comprehensively and objectively.

Article 65 further provides that a party shall produce evidence for its claims in a timely manner; and that the people's court shall, according to the claims of a party and the circumstances of the trial, determine the evidence to be provided by a party and the time limit for provision of evidence. According to Article 65, where it is difficult for a party to produce evidence within the time limit, the party may apply to the people's court for an extension. Where a party provides any evidence beyond the time limit, the people's court shall order the party to provide an explanation; and if the party refuses to explain or the party's explanation is not acceptable, the people's court may, according to the circumstances, deem the evidence inadmissible or adopt the evidence but reprimand or fine that party.

Standard of proof – Interpretation of the Supreme People's Court on the Application of the Civil Procedure Law

Article 109 of this Interpretation provides that for proof of facts concerning fraud, where the people's court is convinced that the possibility for the existence of fraud to be investigated is beyond reasonable doubt, it shall be deemed that fraud has been established.

Knowledge sharing

We have found no statutory rules on pooling of knowledge of sellers with management or other representatives of the target.

Remedies

All the remedies available under the Contract Law are available to a successful claimant in an M&A arbitration in China.

Article 107 of the Contract Law stipulates that if a party fails to perform its obligations under a contract, or its performance fails to satisfy the terms of the contract, it shall bear the liabilities for breach, including liability to specifically perform its obligations, to take remedial measures and to compensate for loss.

Article 111 stipulates that where the quality of the performance is unsatisfactory, the parties shall be liable in accordance with the agreement. Where there is no clear agreement in the contract on the remedies available, and it cannot be determined in accordance with the provisions of Article 61 (which covers supplementary agreements for indeterminate terms), the aggrieved party may, in light of the nature of the subject matter and the degree of loss, reasonably choose to request the other party to repair, substitute or redo the work, return the goods, or reduce the price or remuneration.

Measure of damages

Under the Contract Law, damages are awarded mainly on a compensatory basis.

Article 113 provides that where a party fails to perform its obligations under the contract or its performance fails to conform to the agreement and this causes loss to the other party, the amount of compensation shall be equal to that caused by the breach of contract, including the profits receivable upon satisfactory performance of the contract, provided it does not exceed the amount that was foreseen or ought to have been foreseen at the time of conclusion of the contract.

Article 114 provides that the parties may agree that if one party breaches the contract, it shall pay liquidated damages to the other party in light of the circumstances of the breach, and the parties may also agree on a calculation method for the amount. Where the liquidated damages are lower than the damage actually incurred, a party may apply to the people's court or an arbitration institution to make an increase adjustment; where the liquidated damages are significantly higher than the damage actually incurred, a party may apply to the people's court or an arbitration institution to make an appropriate reduction. Where the parties agree on liquidated damages for delay in performance, the party in breach shall still perform the obligations after paying the liquidated damages.

Article 115 stipulates that the parties may agree that a party pay a deposit to the other as a guarantee for its performance in accordance with the Guaranty Law. Upon the performance of the obligor's duties, the deposit shall be offset against the price or refunded to the obligor. If the party paying the deposit fails to perform its obligations under the contract, that party has no right to demand the return of the deposit; where the party accepting the deposit fails to perform its obligations under the contract, such party shall refund twice the value of the deposit.

Article 116 provides that if the parties agree on both liquidated damages and a deposit, and one party is in breach, the other party may choose to apply the provisions either for liquidated damages or for the deposit.

Article 119 stipulates that where a party breached the contract, the other party shall take the appropriate measures to mitigate its losses; where the other party's failure to take appropriate measures results in additional losses, these cannot be recovered. Any reasonable expense incurred by the mitigating party shall be borne by the breaching party.

Article 120 provides that if both parties breach the contract, each party shall bear its own respective liabilities under the contract.

Special substantive issues

There are many special substantive issues concerning employees, transfer of liabilities and transfer of land and competition law issues, as well as relevant issues under the Company Law.

According to Article 173 of the Company Law, when companies merge, the parties shall enter into a merger agreement and prepare balance sheets and schedules of assets. From the date on which the merger resolution is passed, the companies shall notify their creditors within 10 days and make newspaper announcements of the merger within 30 days. Creditors may, within 30 days of the date of receipt of the written notification, or within 45 days of the date of the announcement if they have not received the written notification, claim full repayment or require the provision of a corresponding guarantee from the company concerned.

Article 174 provides that when companies merge, the surviving company or the newly established company shall succeed to the claims and debts of each party to the merger.

In addition to the Company Law, for transactions involving a listed company in the PRC, major rules include:

- Measures for the Administration of Takeovers of Listed Companies;[4]
- Administrative Measures for Significant Asset Restructuring of Listed Companies;[5]
- Administrative Measures for Strategic Investment in Listed Companies by Foreign Investors;[6]
- Listed Companies Corporate Governance Code;[7]
- Guidelines of the Shenzhen Stock Exchange for the Standard Operation of Listed Companies;[8]
- Guidelines of the Shenzhen Stock Exchange for the Standard Operation of Listed Companies on the ChiNext (2020 Revision);
- Rules Governing the Listing of Stocks on Shenzhen Stock Exchange (2019 Revision);
- Rules Governing the Listing of Stocks on the ChiNext of Shenzhen Stock Exchange (2020 Revision);
- Rules Governing the Listing of Stocks on Shanghai Stock Exchange (2019 Revision); and
- Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange (2019 Revision).[9]

Special procedural issues

Companies have a statutory obligation to give notice to creditors about their M&A transactions under the Company Law.

4 Issued on 20 March 2020 by Order No. 166 of the China Securities Regulatory Commission.

5 id.

6 Issued on 28 October 2015 by the Decision of the Ministry of Commerce on Amending Some Rules and Regulatory Documents by Order No. 2 [2015] of the Ministry of Commerce.

7 Issued on 30 September 2018 by Announcement No. 29 [2018] of the China Securities Regulatory Commission.

8 Issued on 28 February 2020 by Sheng Zheng Shang [2020] No. 125.

9 Issued on 30 April 2019 by Order No. 53 [2019] of the Shanghai Stock Exchange.

Article 204 provides that where any company fails to notify its creditors by notice or by public announcement in the process of merger, split, reducing its registered capital or liquidation, the company shall be ordered by the company registration authority to make a rectification, and may be fined not less than 10,000 yuan but not more than 100,000 yuan.

Although the Arbitration Law does not provide any specific power of arbitral institutions or tribunals for joinder or consolidation, some arbitration commissions' rules may allow such procedures.

For example, Article 18 of the China International Economic and Trade Arbitration Commission Arbitration Rules (2015) deals with joinder, and Article 19 deals with consolidation. Similarly, the Beijing Arbitration Commission's Arbitration Rules (2008) deal with consolidation at Article 27.

There is evidence that the people's courts tend to adopt a conservative approach to the extension of the arbitration clause to non-signatories.[10]

10 See, e.g., Yang Fan, *Foreign-Related Arbitration in China: Commentary and Cases*, Cambridge University Press (2016), Section 3.8.

Appendix 1

The Contributing Authors

Ariel Ye
King & Wood Mallesons

Ariel Ye is a partner at King & Wood Mallesons. She has over 30 years' extensive experience in the field of cross-border commercial dispute resolution. In her career, she has successfully handled a great number of complex foreign-related commercial disputes of major importance, especially those involving international arbitration. She has long been recognised as a leading expert in PRC-related dispute resolution in the Asia-Pacific region, as well as being one of the most highly respected Chinese lawyers in the field of international arbitration.

Ariel Ye also acts as committee or board member of several international arbitration institutions, and is perennially invited to speak at large professional conferences of the international arbitration community. Further, she is among the drafting experts of the 2010 IBA Rules on the Taking of Evidence in International Arbitration.

Ariel Ye has been frequently recognised as a leading lawyer by prestigious legal publications, including *Chambers China* and *Asian Legal Business*. In 2012, Ariel Ye was ranked as one of the 'Top 15 Women Lawyers in China' and one of the 'Top 75 Lawyers by Client Choice' in the Asia-Pacific region by *ALB*. She was selected as one of the outstanding commercial litigation lawyers in the 2013 edition of *Who's Who Legal*. She has represented domestic and foreign clients at China's CIETAC, and Chinese clients before the SCC, HKIAC, AAA and ICC. She is also listed on the panel of arbitrators of the AAA, CIETAC, HKIAC and SIAC. Clients especially appreciate Ariel's 'rich local knowledge with world-class excellence', 'easy communication' and 'high efficiency and accurate grasp of problems'.

Huang Tao
King & Wood Mallesons

Huang Tao is the managing partner of the dispute resolution department of King & Wood Mallesons. He has more than 20 years' experience in international commercial and maritime litigation and arbitration. He has represented numerous clients in hundreds of commercial

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Huang Tao is also a leading Chinese lawyer in the field of commodity arbitrations. Since 2005, he has represented clients in dozens of proceedings at the Federation of Oils, Seeds and Fats Associations Ltd, and the Grain and Feed Trade Association.

Huang Tao was repeatedly ranked as a 'Leading Individual' in China by *The Legal 500: Asia Pacific* in the field of dispute resolution from 2015 to 2018. He was also recognised as one of 'China's Top 15 Litigators' in 2017 by *Asian Legal Business* for his excellent performance and wide recognition by clients.

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M&A disputes can be unique in their hostility and complexity. *The Guide to M&A Arbitration* – published by Global Arbitration Review – is a practical guide on what merger parties should think about when it comes to disputes. It pools the wisdom of specialists on how to prevent these disputes arising and how best to resolve them when it is too late. The guide is structured in two sections. Part I consists of eight chapters on planning and procedural issues, covering everything from drafting clauses to how to structure contracts to minimise the potential for disputes. Part II offers a geographical survey of important differences in national laws that may affect the outcome of a dispute. It is written by 38 specialists from a variety of backgrounds and takes a practical approach throughout.

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