金杜律师事务所
KING&WOOD
MALLESONS

**HOT SECTORS:
TRENDS AND ISSUES**
Today's UK investment environment

GETTING STARTED IN THE UK
Starting up and buying UK businesses

**UK MERGERS AND ACQUISITIONS:
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Planning and executing a successful bid

DOING BUSINESS IN THE UK

Doing business in the UK

As the number one destination for inward investment into Europe, the UK offers a gateway for Chinese outbound investment into Europe and the rest of the world, particularly with its historical links to Europe, the Commonwealth, Africa and the Middle East. A further significant factor that facilitates significant input from English qualified lawyers is the almost universal acceptance of English law as being the governing law of choice between parties on international transactions due to investors' confidence in the English legal system and the certainty of English law and its institutions.

As the global M&A market continues to grow and UK businesses continue to seek access to foreign capital, Chinese investment into the UK continues to develop at a steady pace. As the London office of King Wood & Mallesons, a premier international law firm with the largest Chinese presence in the UK, we not only have extensive experience of assisting and supporting Chinese companies as they shift their focus offshore from China but we also possess an unrivalled view of what assets are of prime interest to Chinese investors, what issues raise concerns and what their requirements are. Equally, we have significant experience in advising UK businesses in their interactions with Chinese companies in the UK and also in the Chinese market.

Regulatory reform and the successive easing of Chinese outbound investment rules have given Chinese investors the necessary latitude and flexibility to compete in the fast-paced UK investment environment. The growing trend for Chinese investment into the UK is leading to a deeper understanding by investors and their counterparts of their respective regulatory environments and business cultures. This understanding is key to managing execution risk on all investment transactions.

In this Guide we analyse the investment opportunities for Chinese investors seeking to transact and invest in the UK including:

- the investment environment and target sectors for investment;
- current trends in UK mergers and acquisitions (including Brexit); and
- the key themes and legal issues that are shaping today's market.

Our global team of lawyers offer long-established experience of both UK and Chinese business together with the broader Asian market, and as such are perfectly and uniquely placed to understand your needs and to help you unlock new investment opportunities in the UK.

A key differentiator for King & Wood Mallesons is our unique insight and expertise in one of the world's fastest growing economies. To succeed in the Asian Century and the new global marketplace, you first have to understand Asia.

AQ, or Asia Intelligence, is our approach to unlocking opportunities for international clients doing business with Asia and connecting Asian clients with the rest of the world. It sits at the core of our offering for clients and underpins the way we approach their business, every day.

In a rapidly evolving global market, doing business across borders has become increasingly complex. Having an international perspective with deep local understanding is crucial for long term success.

In particular, we are uniquely positioned to assist:

- Chinese clients as they navigate China's "go global" initiative and invest into Asia, Europe, the Middle East, Africa and beyond; and
- International companies who want to attract Chinese investment and develop successful partnerships with Chinese entities.

We bring genuine cultural fluency that allows us to navigate local regulatory, commercial and cultural complexities to deliver successful business outcomes for clients. Put simply, we minimise the uncertainty which clients typically face and the barriers to getting deals done in new markets, and make connections that lead to prosperous east-west business relationships.

As Asia's first and only global law firm, we are connecting Asia to the world and the world to Asia with more than 2,000 lawyers globally across Mainland China, and the world's key financial centres and growth capitals, including Australia, UK, Europe, US, Middle East, Tokyo and Singapore.

Our mission is to connect you to future success - shaping a new world for your business, and for your people.

Please contact any of our partners listed at the back of this publication if you have any questions about the contents of this Guide or any other aspect of doing business in the UK.

We welcome your feedback and the opportunity to discuss any of the topics covered in this edition.

The big picture

A wealth of opportunities, an accessible and favourable investment environment and a current government policy agenda focused on co-operation with China make the UK a particularly attractive target for Chinese inward investment.

As China's economic reforms open the doors to more outbound investment, the UK has positioned itself as a key target for Chinese capital. The UK has a highly competitive business tax regime which remains a key factor in maintaining its position as one of the most open economies in the world. The UK's corporate tax rate is only 19% (as of April 2017) and will reduce further to 17% in 2020 which is the lowest rate in the G20. The UK government is keen to encourage investment in the UK, making it easier for businesses to raise finance and unburden the UK from EU regulations and perceived bureaucracy in order to enhance UK business growth.

UK inward investment is unrestricted except in certain sensitive areas of national security and the tax regime is designed to attract foreign capital. As the internationalisation of China's currency continues, the UK is working to position itself as a hub for renminbi business, and the London Stock Exchange continues to work with the Shanghai Stock Exchange to implement a "stock connect". We anticipate that Chinese companies will seek listings of their shares and of global depositary receipts (GDRs) on the London Stock Exchange as a result of the "stock connect" once its fully implemented in 2019. We are actively engaged with the London Stock Exchange, financial institutions and other market participants on this initiative. As part of the Shanghai "stock connect" initiative, London premium listed companies are seeking to list Chinese depositary receipts ("CDRs") on the Shanghai Stock Exchange to raise their profile in China, to create greater liquidity in their shares and to create market entry opportunities.

Target sectors in the UK for Chinese investment have widened in recent years. Energy continues to be a key target sector, with investment in energy and infrastructure (including real estate) expected to reach over £100 billion by 2025. Other important sectors include financial services, education manufacturing and automation, battery storage, fintech and life sciences (including pharma and medical devices). The last few years have also seen Chinese investors acquiring luxury and leisure brands with a view to tapping into China's growing consumer market and rising middle class.

This report sets out further detail of the UK investment environment, key sectors for investment, the current M&A landscape and key themes for consideration when doing business in the UK.

The reception China gets

Focus on co-operation

Steps are being taken to promote strong UK-China co-operation on bilateral investment, as evidenced by various UK Ministers' trade delegations to China since 2013 and the launch of the "UK Investment Guide for Chinese Investors" in March 2014, which was produced by the National Development and Reform Commission ("NDRC") in China with the support of the British Embassy in Beijing. More recently, UK Prime Minister Theresa May led a high profile British trade delegation on her inaugural visit to China in February 2018 and this visit has served to further strengthen UK relations with China.

Various other past and present senior UK Ministers have made clear the government's ambition to make London one of the biggest renminbi trading hubs. In June 2014, China Construction Bank was appointed to provide renminbi clearing services in London, and the UK authorities granted the first wholesale branch licence to a Chinese bank in September 2014. This was followed in October 2014 with the UK issuing the first government RMB bond to market. Chinese financial institutions have made significant progress in entering the London market since then. More recently, KWM advised on the issue by ICBC London Branch of a triple tranche US$1.58 billion equivalent green bond listed on the London Stock Exchange. This was the largest ever green bond listed on the London Stock Exchange and the first Chinese issuance on the International Securities Market (a market regulated by the London Stock Exchange). The London-Shanghai Stock Connect initiative continues to gather momentum and the market is looking forward to large Chinese companies listing GDRs on the London Stock Exchange.

Accessible investment environment

In recent years the UK government has created a favourable environment both for direct overseas investment into the UK and as a jurisdiction in which to establish a holding company for investment into Europe and elsewhere. There are other tax and compliance advantages available to investors too. For example, UK companies (i) are not taxed on dividend income received from subsidiaries; (ii) are potentially not subject to tax on disposals of trading subsidiaries; (iii) do not have to withhold tax when paying dividends; and (iv) benefit from a wide range of double tax treaties (the double tax agreement between the UK and China came into force on 13 December 2013).

Non-tax related advantages to investing in the UK include the fact that, generally speaking, apart from national security interests, there are no restrictions on foreign investment in, or ownership of, UK companies. Inevitably, however, authorisation is required for investment in certain sensitive industries relating to national securities, such as financial services, energy, media and defence. A further advantage of using an English vehicle for investment purposes stems from the fact that investments made by English incorporated companies into foreign jurisdictions also often benefit from bilateral investment treaties that have been entered into between the UK and other countries. This provides an added layer of protection for investors.

Challenges

Despite this atmosphere of co-operation, investment into the UK can still present challenges for Chinese investors. These include the need for regulatory approvals in China and the speed and competition involved in the sale of UK companies and assets, particularly those sale processes led by UK investment banks (e.g. auction processes). However, as the tide of inward investment from China continues to gather pace, investors and regulators in both countries are becoming increasingly familiar with each other's requirements and better equipped to mitigate or respond to any inherent risks.

THE MAYOR OF LONDON SADIQ KHAN SAID: "LONDON IS THE UNDISPUTED TECH CAPITAL OF EUROPE AND TODAY'S FIGURES OFFER FURTHER PROOF THAT LONDON REMAINS A LEADING GLOBAL TECH HUB FOR INVESTORS. WITH WORLD-CLASS UNIVERSITIES AND A DIVERSE INTERNATIONAL TALENT POOL, LONDON IS A CENTRE FOR CREATIVE ENERGY AND INNOVATION."

LONDON AND PARTNERS, JUNE 2018

Hot sectors: trends and issues

Brexit

In June 2016, the UK held a referendum which indicated that the majority of those who voted wanted the UK to leave the European Union. This was a significant shock to the UK markets and the pound sterling. In March 2017, the UK Prime Minister, Theresa May formally invoked Article 50 of the Lisbon Treaty signifying the UK's intention to withdraw from the European Union by March 2019. During this period, the UK and the European Union need to agree on the terms of the UK's exit as well as agree on the terms of future trade. This is widely regarded as being a very tight timetable given the complexity of the arrangements, including those relating to financial services. At the time of writing there is as yet no certainty as to whether or not a trade deal will be adequately negotiated on or before the upcoming deadline at the end of March 2019 (a "no deal" Brexit). There is, however, agreement in principle from both the UK and the EU that there will be a transitional period lasting until December 2020 where the current law and rules governing international trade between the UK and the EU will largely be maintained in its present state.

In the aftermath of these historical events, despite the uncertainty created (and perhaps because of the uncertainty), we have seen a considerable increase in interest in UK assets especially from China and the wider Asian region. This is in large part due to the depreciation of the pound which makes asset values particularly attractive to investors together with the view that the UK will remain a long term investment safe haven. Brexit may have, for an short interim period, persuaded some investors to adopt a more conservative "wait and see" approach and by so doing this may have temporarily eased competition for key assets (although we have not seen competition reduce materially). However, with sterling depreciating against the US Dollar and other currencies, we have seen considerable interest from overseas investors (including from China and the rest of Asia) who have been attracted by interesting investment opportunities at competitive prices.

We see Brexit as being particularly favourable to Chinese investors given the need for British businesses to increasingly align themselves with business partners outside the European Union, as well as the rise in the number of key/attractive assets that are available in the market. The current uncertainty brought about by Brexit presents a valuable opportunity for Chinese enterprises to acquire stable assets in the UK that will assist them to not only gain a strong foothold in the UK economy but also provide them with a springboard opportunity to create synergies with a larger market place in Asia.

Financial services

Financial services is one of the most dynamic sectors in the UK economy and a key area of opportunity for Chinese investment not least due to the UK government's ambition to make London a centre for renminbi business, as the internationalisation of the renminbi progresses.

The ability for Chinese banks to operate branches, as opposed to subsidiaries, in the UK, gives them a regulatory advantage that enables them to scale up their UK activities while remaining largely under the supervision of their home jurisdiction regulatory authority and to leverage their head office's capital pool. That said, such banks should expect scrutiny of their resolution and recovery arrangements and they will need to provide the UK banking regulator, the Prudential Regulatory Authority ("PRA"), with sufficient comfort that such arrangements are robust enough to minimise the impact of the branch's insolvency on the UK financial system and its UK customers. They will also need to ensure that they are prepared to comply with the Senior Managers and Certification Regime, the new regulatory framework for individuals within banks, which has applied to branches in the UK as well as subsidiaries since March 2016.

Fintech is also booming in the UK. In 2017 London & Partners confirmed that London is regarded as the world's number one fintech centre by investment value, with many investment opportunities being generated by exciting innovations and

a regulatory environment that nurtures the origination and development of innovative fintech products. There has been significant growth of businesses focussing on payment systems and structures and hence the UK has a number of opportunities for investors as companies in this sector often seek additional funding or are interested in collaborating with partners who add value. The UK is renowned as a fintech innovation hub, with many exciting start-ups thanks to government, regulatory and private initiatives designed to incubate talent.

We say…

"Financial Services remains a cornerstone of the UK economy, providing a fertile environment for the continued innovation and development of global financial services with the reassurance of a balanced and mature regulatory framework."

KHAI NGUYEN, PARTNER,
FINANCE AND BANKING.

Infrastructure and energy

When it comes to foreign investment in energy and infrastructure projects, the UK government's clear message is that if the UK is to remain economically competitive in a globalised world it should remain open to foreign investors.

The UK's demand for investment in infrastructure is clear, and ranges across its water, waste, transport, energy and digital infrastructure sectors. The latest National Infrastructure Plan is expected to require over £460 billion of combined public and private sector funding.

A wealth of opportunity lies in the energy sector, as the UK government seeks to address the crucial issues of decarbonisation, security of supply and affordability of energy.

The greatest opportunities will be for investors who are ready to negotiate the complexities of the UK and EU regulatory regimes. In addition to UK licensing, pricing, compliance and liability issues, investors in EU energy projects must be aware of the European regulatory hurdles, including rules on state aid, public procurement and competition.

In particular, it is crucial that investors are aware of the impact of the EU "unbundling rules" which seek to address anti-competitive behaviour in electricity and gas supply by controlling the circumstances in which transmission companies may also have interests in production or supply assets and vice versa. These rules affect control of electricity and gas assets across the EU and on a group-wide basis. The rules require careful analysis in relation to Chinese SOEs, as two SOEs controlling transmission and generation assets in EU states may be deemed to be part of the same controlling undertaking unless they have a power of decision independent from each other and from the state.

We say…

The competitive value of the British pound and improvement of investment sentiment amongst Chinese investors after the UK demonstrated a commitment to embrace the global market fuelled the steady increase in Chinese investments into the UK.

WANG RONGKANG

EUME MANAGING PARTNER

High-end manufacturing and technology

Chinese businesses are making strategic investments overseas to acquire technologies, research and development capabilities, intellectual capital and recognised brands. As a leading player in the international markets for technology and high-end manufacturing, the UK is and remains an attractive target for Chinese investment.

The facts speak for themselves: there are over 100,000 software companies operating in the UK, including major international vendors; the UK mobile market is the largest in Europe with a value of over £14 billion annually; and successes continue to be reported in the data centres, cloud computing and cyber-security areas. The additional presence of cutting-edge engineering capabilities has made the UK a highly regarded opportunity for investment in a range of specialist manufacturing industries such as automotive, defence and aviation, where it commands a world leading position.

Education

The UK education sector is world renowned for its high standards and illustrious history. In recent years, this sector has seen steady growth in investment from Chinese investors. The investment manifests in a variety of ways, ranging from investments directly into or acquiring UK independent schools and other "teaching" institutions, entering into licensing and/or joint venture arrangements with UK schools to facilitate investors opening well known UK independent schools in China and Asia. We continue to see a strong pipeline of interest in education deals from China.

Consumer brands

In recent years Chinese investors have made significant acquisitions and investments in the retail and leisure sector, particularly in the area of household names and high-end consumer brands. Although there are economic challenges in the UK retail sector, opportunities remain for international investors to access and expand businesses internationally both into and through the UK.

With demand for consumer products steadily increasing in China, investors have been able to introduce sought-after British brands to the Chinese market through acquisition or investment. Opportunities will continue to exist for opportunistic buyers to pick up well known consumer brands across sectors as listed companies and private equity decide to dispose of assets, business lines and divisions.

Pharma/life sciences

The healthcare sector (including pharmaceuticals, life sciences technology, medical devices etc.) has been an area of huge interest to Chinese investors recently. With China's increasing aging population, there will continue to be very significant appetite for high quality assets in this sector. We have seen a multitude of different transaction structures, from acquisitions of entire mid-cap UK pharmaceutical companies, to acquisitions of selected assets from large scale UK pharmaceutical giants (e.g. the acquisition and licence of rights to Seroquel and Seroquel XR by Luye Pharmaceutical from AstraZeneca, which a cross border King & Wood Mallesons team advised on) as well as various joint ventures between UK and Chinese pharmaceutical companies. The UK possesses advanced technology and R&D expertise in this area and we expect to continue to see very significant and sustained growth in Chinese outbound investments into the UK in this sector.

Current themes

Despite the UK being one of the world's most accessible investment markets, there are certain key business and regulatory concerns that are relevant to Chinese and other investors in acquiring, establishing and operating businesses and thereby protecting their investments. This section describes some of the key issues for investors in today's market.

At King & Wood Mallesons, we have a demonstrated ability to anticipate potential surprises and concerns arising in the UK regulatory environment, and the ability to manage such concerns at an early stage to ensure that your transaction progresses smoothly.

UK Merger Control: national security controls on foreign investment continue to widen

The UK government recently decided that the existing measures for managing national security risks of mergers needed to be strengthened. The first step involved making amendments to the jurisdictional thresholds under the Enterprise Act 2002 ("Enterprise Act") where such amendments expanded the government's powers, enabling it to review and intervene in, if appropriate, mergers involving the acquisition of businesses supplying products in the military, dual-use, quantum technology and/or computer hardware sector. The government's proposed changes to the jurisdictional thresholds form part of an extensive plan for the UK government to widen national security controls on foreign investment and we await confirmation of what new long-term government measures are to be implemented as the second step - details of which were published in a White Paper (titled National Security and Investment: Proposed Legislative Reforms) on 24 July 2018.

The UK government published a Green Paper 'National Security and Infrastructure Investment Review' on 17 October 2017 proposing short and long-term proposals to reform how government can ensure that national security is not undermined by inbound mergers or investments, having first identified that in certain sectors of the UK economy, the jurisdictional thresholds under the current merger regime in the UK are no longer working effectively as a threshold for intervention on national security.

Under the Enterprise Act, the UK government can intervene in transactions for national security and other public interest concerns as part of the UK merger control regime. The UK has a voluntary merger notification system for review of transactions on both public interest and antitrust grounds whereby the parties involved make their own assessment as to whether to notify a deal for approval prior to completion.

The Competition and Markets Authority ("CMA") has jurisdiction to review a deal if it has reasonable grounds to suspect that the transaction may give rise to concerns over national security, the stability of the UK financial system or media plurality.

The New Rules

Amendments, which came into force on 11 June 2018, were made to the tests laid out in section 23 of the Enterprise Act 2002 to ensure that the UK government has sufficient powers to deal with threats to UK national security. The threshold tests were amended as follows:

1. The "Turnover Test" is lowered whereby the 'target' business must have UK turnover of more than £1 million per annum (rather than £70 million); and

2. The existing "Share of Supply Test" will still apply even if only the target business has a 25% or more share of supply i.e. there will not be a requirement for both the buyer and the target to supply the same category of goods or services and the test is met even if the share of supply does not increase as a result of the merger (so long as the "Relevant Enterprise" has 25%).

Under the new rules, the revised tests will only apply to mergers in three sectors of the UK economy:

1. The development or production of military items and "dual-use" items (dual-use being for both military and civilian use) included in the existing UK Strategic Export Control List. This area extends to businesses who hold related software technology or information that can be used in connection with the development or production of such items;

2. The design and maintenance aspects of computing hardware, being businesses that own, supply or create intellectual property in the functional capability of multi-purpose computing hardware (which may have an unintended broad interpretation); and

3. The development, design, manufacturing or production of goods for use in, or supply of services based on, quantum technology, being quantum computing or simulation; quantum imaging, sensing, timing or navigation; quantum communications, and quantum resistant cryptography.

The recent amendments to the Enterprise Act demonstrate the UK government's first step in scrutinising takeovers in the UK by increasing its power to intervene and, if appropriate, ultimately block acquisitions on public interest grounds in three narrow areas of the UK economy deemed to be of particular strategic importance to the UK.

Consumer protection, distance selling and data protection

Whether businesses are based inside or outside the UK they are required to comply with UK consumer protection laws when dealing with UK consumers, not least to safeguard and enhance their reputation in the UK market. UK consumers enjoy protection against contractual terms considered "unfair" and certain commercial practices considered misleading and/or aggressive; certain terms, for example as to satisfactory quality, may be implied.

Consumer-focused e-commerce is also subject to extensive protections. The regulation of e-commerce is largely derived from EU legislation which means that businesses wishing to sell into the EU will have to deal with similar issues throughout the EU member states. The principal protection afforded to consumers purchasing products/services online is that the consumer is generally entitled to a "cooling-off" period of 14 days during which the consumer can change his or her mind about a contract for any reason. If they do so the consumer is usually entitled to receive a refund. This is just one example of consumer protection. Recent legislation has enhanced the position of the consumer even further.

The new General Data Protection Regulation ("GDPR") came into force on 25 May 2018. After Brexit, the current Data Protection Act 2018 will continue to apply and the GDPR will be incorporated into UK law through other legislative measures to ensure alignment between the UK and EU data protection regimes.

Key new elements of the GDPR include:

- Enhanced and new rights for individuals including the right to be forgotten;
- The right to data portability;
- The right to restrict processing solely based on automated data processing or profiling;
- Increasing the amount of information to be included in privacy notices;
- Increasing the requirements for valid consent;
- Implementing data protection by design and by default;
- A data protection officer to be appointed in certain circumstances;
- Enhanced obligations to notify the relevant Data Protection Authority within 72 hours of a data breach;
- The need to carry out privacy impact assessments before high risk processing;
- "Lead authority" approach to cross-border processing; and
- Increased penalties - up to 4 % of group annual worldwide turnover in the preceding financial year

The GDPR is directly applicable throughout the European Union – and beyond with extra-territorial reach in certain circumstances, for example if a company processes personal data of European individuals in relation to the offering of goods or services or monitoring their behaviour within the European Union.

A range of other specific consumer protection regulation applies in particular sectors in the UK, with specific regulations offering protection to consumers in relation to electronic communications services, consumer credit, financial services and advice, energy and a range of other sectors. It is essential for businesses operating in any of these areas to comply with relevant laws when dealing with and selling products and services to consumers in the UK and to factor compliance procedures and costs into their business models.

New approach to land use planning

The UK government has taken a series of steps to streamline the planning system, which has been seen as a barrier to infrastructure and housing investment and an impediment to economic growth.

To optimise land use and protect the environment, planning permission must be obtained before carrying out most building or engineering work or to change materially the use of buildings or land. The system can be cumbersome and often results in delays, but incremental changes over recent years have resulted in a series of exemptions from the need for planning permission. These changes also adjusted the factors relevant to the local authority's planning decisions, provided financial incentives for authorities that encourage development and accelerated procedures. In particular, local authorities have to plan how they will meet the country's need for significant amounts of new housing.

Energy efficiency

The UK government is targeting efficient energy use in buildings as part of its strategy to reduce emissions of greenhouse gases by 80% by 2050. Minimum energy efficiency requirements have been applied to newly built properties for many years, but the government is now extending these to cover existing buildings. From April 2018, it has been illegal to let out buildings that fail to meet minimum energy efficiency standards, unless the owner makes certain cost-effective improvements first.

Competition and antitrust

Merger control

Transactions involving the UK are potentially subject to assessment by the European Commission. Where the deal involves a change of control and both the target and buyer meet certain turnover thresholds (based on global and European sales) a notification to the European Commission must be made. These thresholds are designed to catch large-scale acquisitions that have an EU dimension. Specific rules apply to calculate the relevant turnover, which generally includes the turnover of the acquirer's subsidiaries, parents and sibling companies. Subject to limited exceptions, completion cannot take place until the European Commission has taken a clearance decision. Ultimately, the European Commission may block or impose conditions on the transaction.

If the EU criteria are not met, the transaction may qualify for investigation by various national competition authorities under national merger control laws. In the UK, the relevant authority is the CMA. Notification under the UK rules is voluntary. Despite this, in practice, a number of proposed deals are pre-notified to provide parties with legal certainty that their transaction does not raise competition issues.

Currently, the EU merger rules only catch transactions and investments where the buyer will obtain the power to exercise 'decisive influence' over another business (including through special shareholder rights, such as veto rights over the approval of the business plan). The European Commission is, however, considering expanding its powers to catch certain minority shareholdings. These proposals, if implemented, are likely to increase the regulatory burden on investors in European companies. Acquisitions of a minority shareholding can amount to a merger under UK regulation and UK competition authorities have taken action previously with respect to such shareholdings.

The UK test is lower than under the EU regime and catches three levels of interest - the acquisition of outright control, control over commercial policy and the ability to 'materially influence' commercial policy (which will typically arise on the acquisition of voting rights of around 15% to 20%). Generally, an economics-based competition assessment is carried out, with intervention by the UK government limited to specified public interest grounds, currently: national security, media plurality and the stability of the UK financial system.

Antitrust

Firms doing business in the UK must comply with both EU and UK antitrust laws, which prohibit illicit cartels, abusive behaviour and other forms of anti-competitive arrangements. The European Commission at an EU level, and the CMA in the UK, enforce the antitrust rules. There are also a number of sectoral regulators in the UK which have powers to enforce antitrust laws in their respective sectors (for example, in relation to communications, electricity and gas, water, civil aviation, financial services and railway services).

It should be noted that cartel conduct of a subsidiary may be attributed to the parent company even if the parent did not participate in, or was unaware of, the alleged cartel. This rule has been applied to minority shareholders (including private equity firms and banks) and joint ventures as well as parent companies owning 100% of the shares and can apply even after the disposal of the infringing company.

Environment, health and safety

Businesses operating in the UK are subject to a wide range of laws and regulations aimed at protecting the environment and ensuring the health and safety of workers. Many of these laws and regulations are derived from EU laws. The environmental laws that will apply to a business will depend on the type of

- Waste management, for example the storage, transfer, processing and disposal of waste;
- Discharges to air, land and water, for example the discharge of effluent from factories to sewers and emissions to air from combustion processes;
- The use, storage and disposal of chemicals and hazardous substances, for example fuel storage;
- Nuisances, for example smells, dust and noise;
- Manufacturing, importing and distributing certain substances and products, for example chemicals, electrical and electronic equipment, and batteries; and
- Dealing with radioactive substances.

activities the business carries out, but as a general rule they will regulate operational matters such as:

Environmental, health and safety laws are generally enforced through the criminal law (i.e. by prosecutions). Regulators also have a wide range of administrative penalties and sanctions at their disposal, including powers to search premises, seize documents and other records, and to make orders requiring certain activities to stop or works to be carried out. Company directors and other senior management stakeholders can have enforcement action taken against them personally if they play a role in an offence committed by their company. It is not possible to obtain insurance against fines and other penalties imposed for breaches of environmental, health and safety laws. The government increased the level of fines for environmental offences in 2014 and is likely to increase the level of fines for health and safety offences.

Businesses that cause serious pollution are also at risk of civil claims by persons affected by the pollution. There has been an increase in the number of such claims in the past few years.

Bribery and Corruption

UK businesses must ensure that they have adequate procedures in place to prevent activity which constitutes bribery under the UK Bribery Act 2010.

A commercial organisation (including a company) commits an offence if a person associated with that company bribes another person intending to obtain or retain business or a business advantage for the company. For these purposes, a person is associated with a company if they provide services for or on behalf of the company. If prosecuted, a company may face an unlimited fine and risk mandatory debarment under EU Directive 2014/24 on public procurement, preventing a company from continuing to tender for public sector work.

An offence under the Bribery Act can be committed in the UK or overseas, and is a strict liability offence. In other words, a company will commit the offence if an associated person bribes a third party on the company's behalf even if the company is unaware of, and had no part in, the bribe. The only defence available to the company is to show that it had in place adequate procedures designed to prevent bribery at the time when the offence was committed.

In addition to the corporate offence of failing to prevent bribery, the Bribery Act also imposes personal liability on directors where they have consented to or connived in a bribery offence.

Adequate procedures to prevent bribery include:

- Undertaking a comprehensive risk assessment that considers the sectors and jurisdictions in which the company does business, as well as the nature of its business partners and transactions; and
- Putting in place a policy which requires that:
  - proportionate procedures are implemented to address the bribery risks faced by the company;
  - showing a demonstrable commitment from the Board of Directors and other senior management to ensure compliance with the Bribery Act;
  - conducting due diligence on all associated persons and third parties that provide services for or on behalf of the company;
  - ensuring all employees receive regular and appropriate training on identifying bribery risks, the penalties for committing bribery and the company's policy on anti-bribery and corruption; and
  - regularly monitoring and reviewing the company's policies and procedures to ensure that the policy adequately protects the business from the risks posed.

Getting started in the UK

> "China and Britain have very different systems but we do have a lot in common, and we in the UK think that the rise of China and China's economy and Chinese power can and must be a positive force in the world."
>
> JEREMY HUNT,
>
> SECRETARY OF STATE FOR FOREIGN AFFAIRS AND COMMONWEALTH AFFAIRS

Doing business from outside the UK

Chinese businesses may be able to enjoy the benefits of dealing with UK customers without establishing a place of business in the UK. However, there are a range of local legal issues to bear in mind, including:

- Consumer protection legislation, including distance selling regulations;
- UK tax issues, including VAT registration and the risk of creating a taxable presence;
- Data protection rules such as GDPR;
- Import controls, e.g. on arms, plants, animals, foods, medicines and chemicals; and
- Sector-specific legislation.

Setting up a UK establishment

Establishing a UK branch or subsidiary

Investors looking to establish a new business in the UK will have the option of either registering a UK branch or setting up a UK-based subsidiary. This decision is often tax driven.

Where a foreign company decides to set up a branch or place of business in the UK in order to carry out its business, that establishment is not treated as being separate from its foreign parent company. A foreign company must register a UK establishment under the overseas companies regime in the Companies Act 2006. There is no distinction between a branch or place of business for this purpose - both treated as a UK establishment and must each comply with the same formalities.

Whether a foreign company has established a branch or place of business in the UK will be question of fact. There is no clear definition of a branch. A place of business would be anywhere that a company regularly conducts business or premises that indicate that a company may be contacted there.

Advantages of a UK establishment

- Less regulated than many other forms of presence (including limited liability companies); and
- Only profits attributable to a permanent establishment are taxable in the UK.

Disadvantages of a UK establishment

- Parent company directly responsible for the debts and other liabilities incurred by the branch or representative office;
- Parent company has to provide registration documents;
- Parent company required to file accounts in the UK. They will be publicly available; and
- Possibility that business expands so UK operations have to move to different business vehicle.

Comparison between a UK establishment and a UK subsidiary

- Limited liability is the main advantage of establishing a UK subsidiary. The parent will not normally be liable for the debts and other obligations of its subsidiary (unless it has given a guarantee). If a subsidiary becomes insolvent, the parent company may sometimes be treated as liable as a "shadow director" if it has effectively managed the subsidiary's business. In a very few other restricted circumstances, the UK courts have been willing to impose liability on shareholders, but the basic principle remains that each company carries its own liabilities.
- A UK establishment forms part of the foreign company and has no separate legal identity. The foreign company would be liable not only for the debts and other contractual obligations of the branch, but also for actionable wrongs committed by the branch (e.g. negligent or criminal acts). Accordingly, the use of a UK branch or place of business may expose the parent company to legal proceedings in the UK.

The principal similarities and differences from a tax perspective between these two options are set out in the table below:

UK Branch	UK Subsidiary
Subject to UK corporation tax at the rate of 19% (as of April 2017 and reducing to 17% from April 2020)	Subject to UK corporation tax at the rate of 19% (as of April 2017 and reducing to 17% from April 2020)
Tax paid in the UK usually gives rise to a corresponding credit against the overseas corporation's domestic tax liability (subject to any limitations in that jurisdiction)	The UK does not normally impose withholding tax on dividends
In general, profits attributable to UK operations are subject to UK corporation tax	In general, a UK resident wholly-owned subsidiary will be subject to UK corporation tax on its worldwide profits (subject to double tax relief where appropriate)
Profits can be freely repatriated	Distributions can only be made where there are sufficient distributable profits

Representative office

If the foreign company merely trades "with" the UK via its UK office, then the office is said to be a representative office. Operating a UK representative office will not result in the foreign company being liable for corporation tax.

It is, however, advisable that specific instructions are given to the representative in order that activities do not constitute trading "in" the UK, for example there should be no power to conclude contracts on behalf of the foreign company or power to negotiate whatsoever even if those negotiations are carried out on instructions from outside the UK. Any potential customer should be referred direct to head office for negotiation purposes.

A relevant double taxation treaty may outline the distinction for taxation purposes between a permanent establishment (that is a branch) the profits of which are taxable in the UK and a representative office, the profits of which are not taxable.

Even though the powers of the representative office are limited, if they are sufficient for the foreign company's needs, then it is advantageous for UK tax purposes.

Employment considerations

UK employment law is both complex and fast moving. It is derived from two principal sources: legislation and case law although European Community law also currently heavily influences it. For investors who are unfamiliar with UK employment law, this guide highlights some of the key issues that they should be aware of.

Employment law applies equally to employees at every level of an organisation. However, some more recent legislation applies not only to employees but also to the wider category of "workers". In addition, certain company law provisions apply to directors who are both "officers" of a company and employees.

Separate legal systems operate in Northern Ireland or Scotland from the system in England and Wales, although employment law in all three is relatively similar.

The UK, like all EU countries, is regulated by EU and such regulation is implemented in national law. In relation to Brexit, being British exit from the European Union, the UK government has committed to retain all current EU based national legislation for the time being and it is anticipated that there will be very little weakening of workers' rights from the current position in the foreseeable future. This gives a level of certainty to businesses.

However, all workers must have the technical right to work in the UK by virtue of their citizenship or appropriate working VISA. It is likely that the rules around working VISA's will change; these rules are currently complex and require careful navigation.

The UK employment market is highly competitive. Employers must compete to attract and retain talent not only by paying market level salaries which are under pressure but also by being inventive in their approach.

In addition, employers must comply with a wide range of employment law obligations (which are probably the least onerous in Europe). Such obligations include:

- the provision of a bare minimum contractual information;
- a national minimum wage (with a view to achieving a higher minimum "living wage") for workers which is wider class of people than employees;
- limits on working time;
- extensive non-discrimination rights in relation to gender, race, nationality, sexual orientation and more;
- the right not to be dismissed unfairly;
- sick pay; and
- trade union access.

Family-friendly rights such as maternity and paternity leave and pay have long been fixtures in the UK, and these entitlements are often enhanced above the statutory minimum and are now being extended to be more generous and flexible shared parental leave and pay, providing men and women greater flexibility to care for children in the first year after their birth.

Partly as a result of this as well as the cost of UK office real estate, most UK businesses are embracing flexible working as a way of driving performance whilst meeting employee expectations.

Recent reforms in the UK have streamlined the regulation of business sales, offshoring and outsourcing but these remain a complex and evolving area.

The appetite for employment disputes amongst lower-level employees in the UK appears to have lessened somewhat in the face of recent reforms, but not amongst high-value claimants such as senior employees, for whom the stakes remain high. Further, a roll-back of some aspects of those reforms are likely to see a rise in claims from the more junior employees.

However, terminating the employment of individuals requires special processes (which are dependent on the circumstances of the termination) to be followed and advice should always be sought prior to dismissing someone.

Other topical issues include changes to the pension legislation which has been implemented over a 5 years period and which now applies to all new and existing businesses. This means all employers are required to provide access to a workplace pension and employer pension contributions to that pension scheme for every employee.

Finally, liabilities may arise in the area of health and safety, as employers are under strict obligations to provide a safe place of work.

Tax

Chinese investors invest in UK real estate through a variety of vehicles, the choice being influenced by whether they intend to invest only in the UK or more widely across Europe. Real estate transactions in the UK are generally structured differently depending on whether the Chinese investor intends to hold the real estate in the longer term or with a view to developing and selling it on quickly.

Investment in commercial real estate has, in the main, been relatively straightforward from a UK direct tax perspective, as there has been no UK tax on capital gains on a sale by a non-UK resident of commercial real estate or of a vehicle that owns commercial real estate.

This is set to change from April 2019 as the UK proposes to exercise its full taxing rights where non-residents dispose of UK real estate, as is the case in most other major jurisdictions.

The tax treatment of the acquisition and disposal of residential property in the UK are already more complex. The most appropriate structure to apply will depend upon the investor's intentions in relation to the property.

Buying UK businesses

Private M&A

Acquisitions of private UK businesses are generally lightly regulated and the terms of the purchase agreement are freely negotiated between the parties without the requirement for approvals. However, acquisitions in certain regulated areas are subject to regulatory approval, such as the acquisition of authorised financial services or insurance entities (see box: Acquisitions of banks and other regulated financial services businesses).

In addition, certain acquisitions which have the potential to distort competition may be affected by the UK and EU competition regimes. This will likely be reviewed after Brexit.

Acquisitions will generally be structured as a purchase of the share capital of a company, or of some or all of the company's assets. On a share acquisition, the buyer will purchase the entire company with all its liabilities. If assets are acquired then the buyer will be free to choose which liabilities it is willing to take on if any.

Increasingly, M&A transactions are now taking place by way of auction, which requires buyers to move more quickly and to have a better understanding of the UK investment regime. Further information on the current private M&A landscape is set out in the next section of this Guide.

Public takeovers

Takeovers of UK public companies are subject to the UK Takeover Code. Public takeovers are more highly regulated than private acquisitions due to the need to protect the target's shareholders.

The City Code on Takeovers and Mergers (the "City Code") applies to takeover offers and schemes of arrangement for UK public companies (whether listed or not) and to certain private companies. The City Code is administered by the Panel on Takeovers and Mergers (the "Panel") and is underpinned by statute. Its object is to ensure fair treatment of all shareholders. The rules of the City Code govern the behaviour of the bidder and target before and during the offer process, and the content of the transaction documents, including the offer document to be sent to the target's shareholders.

The City Code also affects stake building activities in relevant companies. Most importantly, where a person (together with any person deemed to be "acting in concert" with that person), acquires an interest in 30% or more of the voting rights in a (public) company, that person must offer to buy out the remaining shareholders on comparable terms. A similar obligation applies where an existing stake of between 30% and 50% is increased. See further below on the public takeover process.

Acquisitions of banks and other regulated financial services businesses

Any person acquiring control over a UK authorised financial services firm must obtain prior regulatory approval before the acquisition can take place. Broadly speaking, the term "control" means 10% or more of the shares or voting rights in the authorised firm or its parent. The appropriate UK regulator (the Prudential Regulation Authority ("PRA") or the Financial Conduct Authority ("FCA")) will consider, amongst other things, the suitability and financial soundness of the proposed controller in order to determine whether to approve, object to or impose conditions on the acquisition. The process can take some time, so it is important to get in touch at the earliest opportunity.

Existing controllers must also obtain prior approval from the PRA or FCA where they intend to increase its control over an authorised firm and the acquisition will result in the level of control crossing one of the following thresholds: 20%, 30% or 50%. Decreases in control need to be notified to the PRA or FCA, but do not require prior approval.

UK mergers and acquisitions

These are exciting times for cross-border acquisitions as global M&A is continuing to grow.

A growing number of corporate and financial buyers in the UK and elsewhere in developed markets have cash on their balance sheets and are seeking acquisition opportunities. Private equity plays a key role due to substantial funds being raised to deploy into acquisition / M&A.

The recovery in global M&A has continued in the first half of 2018. One of the most noticeable emerging trends is the number of Chinese buyers associated with high profile UK acquisitions.

Another aspect of the current market is the need for agility and readiness to compete for high quality assets. In recent years, cash reserves and access to low-cost debt have meant that the pressure to sell assets is reduced, leading to a more challenging and competitive environment for buyers.

To be successful, buyers must be able to compete in auction sale processes, and be ready to present an attractive and straightforward acquisition proposal along with certainty on financing and appreciation of any associated regulatory issues.

The acquisition process: challenges and solutions

A. Dealmaking culture

Chinese investors are becoming part of the fabric of the UK M&A environment. Where perceived cultural differences historically put Chinese bidders at a disadvantage, there is now a greater understanding between the parties as to expectations concerning timetable, regulatory conditions and internal approval processes.

UK sellers have three main priorities, particularly in auction situations: the ability to obtain timely regulatory approvals, certainty of financing and the negotiation of reasonable terms without protracted negotiation.

Therefore it is crucial that:

- investors and their advisers are clear how the timetable for NDRC, MOFCOM and SASAC approvals and SAFE registration fits within the seller's timetable;
- investors can demonstrate that they have ready and unconditional access to the necessary funds; and
- negotiators come to the table with the authority to act immediately and be bound by what is agreed.

As a positive step Chinese legislations have been relaxed accordingly to allow Chinese bidders to make non-binding offers prior to obtaining regulatory approvals. We expect that more and more Chinese buyers will take part in sale processes involving UK companies and assets, especially in investment sectors encouraged by the Chinese government.

B. Auction sales

Competition for the highest quality assets has led to auction sales becoming common in the UK M&A market.

Advance planning is crucial in this environment, as is the market knowledge and confidence to make a competitive bid. With sellers often following triple track strategies (IPOs and refinancing being viable alternative options to M&A), the pressure stays on buyers throughout the process.

The auction process often presents multiple challenges for buyers from countries such as China which have significant regulatory hurdles domestically. Timing tends to be tight and regulatory complications can work against a buyer. It is key that the deal team includes players who are experienced at competing in this arena. However, there are no commercial reasons as to why Chinese bidders shouldn't be as successful as local buyers if they are sufficiently prepared.

There are certain key steps that bidders can take to level the playing field and improve their chances in an auction bid:

- **advance planning:** understanding the requirements of the process in both China and the UK can smooth the path of negotiations;
- **advance analysis of obstacles:** knowledge of the regulatory issues and the potential hurdles these may present will allow innovative solutions to be presented at an early stage;
- **prior experience:** where a bidder can demonstrate that it has successfully completed similar deals, this will allay seller's concerns about execution risk;
- **funding:** being able to demonstrate how a bidder will meet the consideration for the deal is crucial, as well as having advisers to hand who are able to explain the funding process (together with any regulatory clearances that may be required) to sellers;
- **team:** having a small, proactive experienced team in order to compete with the private equity buyers who compete in this field; and
- **advisers:** retaining a set of advisors who are familiar not only with local practices but also with practices from the bidder's home country. Legal advisers who are retained early on in the process not only lend credibility to the bidder (illustrating that it's serious) but the advisers will assist in responding to comments on confidentiality agreements and submission of initial or first round indications of interest.

How are bids assessed?

Criteria which will be considered in the Seller's assessment will include:

- Required level of conditionality e.g. regulatory approvals.
- Price and the ability to pay (i.e. transparency in funding).
- Proposed amendments to the Share Purchase Agreement and other documents.
- The bidder's history of completing similar deals.
- The package being offered to the management team.
- The bidder's willingness to assume risk.
- Extent of further due diligence required.

C. Partnering

One way in which Chinese buyers have overcome the challenges of investing in the UK and Europe is by partnering with a local investor, often a private equity investor.

For a Chinese investor, this helps to overcome obstacles in the acquisition process and facilitates risk sharing with a partner who is familiar with the local market. For a local party, the Chinese buyer is in a position to take the acquired business to the Chinese markets and possibly other Asian markets.

The auction process

Phase 1

Confidentiality agreement signed
Information memorandum distributed
Preliminary due diligence
Indicative bids
Shortlist of bidders

Phase 2

Due diligence via online data room
Management presentations
Seller's draft of sale agreement circulated
Time/date set for final offer
Final bids

Phase 3

Exclusivity period with preferred bidder
Exchange of contracts and subsequent completion upon satisfaction of conditions

D. Managing execution risk

- **Regulatory condition**

  The requirement for regulatory approvals can have serious commercial consequences and the need to include regulatory conditions can hold up the bidding or negotiation process.

  UK sellers may be sensitive to the potential for delays due to regulatory requirements, and in some cases may require deposits to be paid against execution of the deal.

  Where a transaction proceeds subject to regulatory clearances, sizeable break fees (and reverse break fees) are often payable if the deal is not completed.

  These issues can be mitigated by effective forward planning and legal structuring.

- **Antitrust issues**

  A major feature in the timing of an acquisition will be whether or not thresholds are met for the application of relevant merger control laws.

  Bidders need to understand their own competition risks and have data to hand showing their analysis of the potential application of the relevant merger control rules.

  See pages 12-13 for an overview of the UK and EU merger control regulations. This regime will likely be reviewed after Brexit.

- **Public M&A: UK regulatory concerns**

  Unlike the United States or Australia, the UK does not have detailed regulatory clearance obligations which must be routinely taken into account on a takeover by an overseas buyer. However, the UK Takeover Panel is reluctant to allow regulatory approvals required by a bidder for outbound investments to be included as conditions of a takeover where it regards the regulator as not being at arm's length from the bidder. In the past this has meant that Chinese bidders have needed to seek outbound regulatory approvals in advance of launching a bid.

  Similarly, the UK Listing Authority has previously scrutinised transactions between SOEs and premium-listed London Stock Exchange companies that have substantial SOE shareholders to ascertain whether they constitute "related party" transactions under the Listing Rules – for which independent shareholder approval is required – on the basis that the key players are all ultimately owned by the state. However, we anticipate that issues such as these will diminish in significance as regulators become more familiar with these transactions and have a better understanding of the independent operation of Chinese SOEs.

E. Managing acquisition risk

In today's fast-paced M&A environment, buyers must walk a fine line between managing acquisition risk and losing key negotiating advantages.

- **Due diligence**

  In most common law jurisdictions like the UK, a seller of shares or a business is not under any general duty to disclose all relevant information to the buyer. It is the buyer's responsibility to conduct its own investigation. The general law does not, in the absence of any fraud or misrepresentation, provide protection to a buyer who later discovers that the business it bought is not what it had understood it to be. Due diligence gives the buyer a degree of comfort about what it is buying and how much it might be worth. Buyers who are unfamiliar with the UK market may not fully appreciate the complexities and risks associated with acquiring a business in the UK and may be reluctant to spend a significant sum on a due diligence process, relying rather on a much more limited due diligence approach. This is of course a commercial decision. A buyer typically has a particular level of investment risk tolerance. Where the collective risks inherent in the business present a level of risk too high for a buyer to bear, such transaction risk may be addressed through more extensive due diligence, a reduction in the purchase price or through increasing contractual protections. However, not only will a properly scoped due diligence process assist a buyer in identifying risks and potential and real liabilities but it also assists with addressing (i) whether the business is worth the price being asked; (ii) what is required to close the deal; and (iii) issues up front as opposed to dealing with them as part of a breach of warranty claim in due course.

- **Warranty & Indemnity ("W&I") insurance**

  In a private M&A transaction, it is market standard in London that sale and purchase agreements contain certain warranties and indemnities given by the seller relating to the target company. The breach of such warranties or indemnities usually results in a claim by the buyer against the seller. Absence adequate seller covenant or for other reasons set out below, W&I insurance policies may be purchased to provide cover for losses suffered in connection with such warranty or indemnity claims and may be taken out by either the seller or the buyer. W&I insurance is widely used in the UK market for the reasons set out below (see "Benefits of W&I Insurance" below). Chinese buyers who

use W&I insurance generally are in a position to offer a more competitive package to the seller (or at least will be in a position that is comparable and not less favourable than other bidders) and therefore increase their chances of a successful outcome to any bid situation.

Under a buyer policy, the buyer claims against the seller up to the liability cap agreed in the sale documents, and then claims against the insurance policy for any losses above the cap.

Under a seller policy, the buyer would claim against the seller under the sale documents in the normal way and may not be aware of the insurance policy. The seller would then make a claim under the insurance policy and remain directly liable to the buyer (the insurer would, however, have the ability to control any defence or settlement of the claim).

Seller policies are less common because W&I insurance typically covers unknown risks and the seller is more likely to know about the risk than the buyer; however, in certain circumstances, insurance policies may be available for known but contingent and/or unquantifiable risks that may otherwise be dealt with as an indemnity from the seller. A most popular form of such special situation insurance is the insurance for a tax indemnity.

So-called seller to buyer 'flips' are increasingly being used in auction processes, whereby the seller procures indicative pricing and coverage terms from an insurer for a policy that will ultimately be taken out by the buyer.

- **Benefits of W&I insurance**

There are several reasons for the parties to insure the transaction. The main reasons are as follows:

1. **Clean exit for seller:** Many sellers, particularly private equity sellers, want to be certain about the amount of sale proceeds (i.e. that no proceeds will be clawed back in the form of claims made by the buyers under any warranties or indemnities), so that they can make a distribution to their investors. However, they are commercially required to provide a market-standard warranty package to the buyer so that there is uncertainty on potential future liabilities. W&I insurance allows for this and provides downside risk mitigation for the buyer as warranties will still be given.
2. **'Topping-up' the seller's liability:** W&I insurance may be used to increase the level of recourse available to the buyer if it is uncomfortable with the cap proposed by the seller, or to extend the time limit for making a claim. Buyers in a competitive auction process may also introduce W&I insurance as a means of enhancing their bid by offering low liability caps to the seller.
3. **Recoverability:** Even with extensive contractual protection, a buyer will still be exposed to the risk that it will be unable to recover damages against the seller. This will be a concern if the seller is an individual (or an SPV) in financial difficulty or in another situation where enforcement against the seller may be difficult in the event of a successful claim. Timing is also an important factor, as a claim against a seller in a foreign jurisdiction may take several years, whereas a claim against an insurer located in the UK would be expected to be resolved in a significantly shorter period of time.
4. **Relationship with the sellers:** Some buyers, particularly private equity sponsors, will be unwilling to make a claim against the warrantor sellers as they are likely to be involved in the continued management of the target business. Although buyers (and insurers) may require the warrantor sellers to have some liability ('skin in the game'), insurance may be used to reduce this and mitigate the risk, enabling the buyer to make a commercial decision not to recover against the warrantors if that is in its best interests whilst still recovering the balance (usually any loss above the first 1% of enterprise value) from the insurer.

The importance of diligence

W&I insurers are particularly focused on ensuring that the transaction has been negotiated as if insurance was not in place and that there has been both a thorough diligence process by the buyer and disclosure process by the seller.

As insurance is intended to cover unknown risks, it is important that buyers intending to insure a transaction agree to a due diligence scope with their advisers that covers the areas that the warranties relate to. The insurance will usually not cover known risks (discovered in the due diligence) for which a solution needs to be agreed between seller and buyer.

Experience shows that Chinese clients tend to agree on a rather limited due diligence scope to save due diligence costs. With a W&I insurance on the table, such approach could become rather expensive in the end as a W&I insurance will not cover warranties that relate to areas where no due diligence has been conducted. Diligence will need to be repeated or the buyer will need to accept the risks. The W&I insurance policy usually includes a so-called warranty spreadsheet that lists in detail whether specific warranties are subject to insurance coverage or not.

Terms and Pricing

Costs for a W&I insurance usually amount to 0.7 to 2% of the insured amount depending on the business of the target, the amount of deductible agreed, the scope of warranties, the term of the insurance coverage and the quality of due diligence and data room. Special situation insurances covering known but contingent and/or unquantifiable risks are usually more expensive (2 – 10% of insured amount). There is also insurance premium tax payable on each policy.

The insured amount is in general lower than the deal volume. Usually, a W&I insurance covers between 20 and 50% of the deal volume and will contain a deductible (i.e. an amount of the insurance claim that is the responsibility of the insured while the insurance policy will only cover the remaining claim up to a cap agreed with the insurer). The deductible usually is 0.5 – 1 % of the deal volume and the seller remains liable under the sale documents up to the amount of the deductible, so that the deductible will often be identical with the cap agreed with the seller.

- **Process**

  The insurer or the insurance broker usually requests to review the draft sale documents, the information memorandum or management presentation, draft due diligence reports, financial statements of the target and asks for access to the data room. Following review of the information provided, there will be an underwriting call, in which questions of the insurer are clarified. Based on this information, the insurer provides a draft of the insurance policy that is then negotiated with the insured. The process usually takes 10 to 14 days and can be labour intensive for all parties concerned. Therefore, it is important to kick start this process as early as possible so it doesn't hold up the transaction.

- **Price adjustment**

  Adjustments to the purchase price may be achieved by way of completion accounts, drawn up following completion and reflecting the actual value delivered at completion, as against the price paid. However, sellers will generally prefer a mechanism which gives the maximum level of certainty as regards price. This is especially true of private equity sellers who are under pressure to distribute the proceeds to their investors.

  Therefore it is common for seller-drafted share purchase agreements to provide for a 'locked box' mechanism, whereby a price is agreed based on a balance sheet, drawn up and settled between the parties to an agreed date in advance of signing. The buyer therefore assumes economic risk from this 'locked box' date, subject to provisions prohibiting 'leakage' of value from the target, such as distributions or intra group payments. Protection from leakage is provided by way of indemnities.

  Certain 'leakage' will be permitted and is a subject for negotiation. Any payments which are likely to be controversial should be identified and dealt with during negotiations.

F. Get-outs: Material Adverse Change (MAC) conditions

Unlike in the US, conditions allowing a buyer to withdraw on the basis of "material adverse change" are rare in Europe and the UK.

Any such provisions are likely to:

- be narrowly drafted;
- be limited to a material detrimental effect; and
- not apply to general economy or industry-wide changes.

In the UK:

- any pre-existing circumstances will not trigger MAC;
- the change must not be temporary; and
- the change must significantly affect the party's ability to perform its obligations.

G. Management incentivisation

Management incentivisation in the UK market takes a variety of forms depending on various factors, such as the nature and size of the company, whether private equity is involved, the reputation of the management team, amongst various other factors. It should be noted that particularly for trophy assets as well as companies that are highly profitable, it is necessary for Chinese investors (especially if they are taking part in an auction sale) to offer a competitive package if they want to retain a management team.

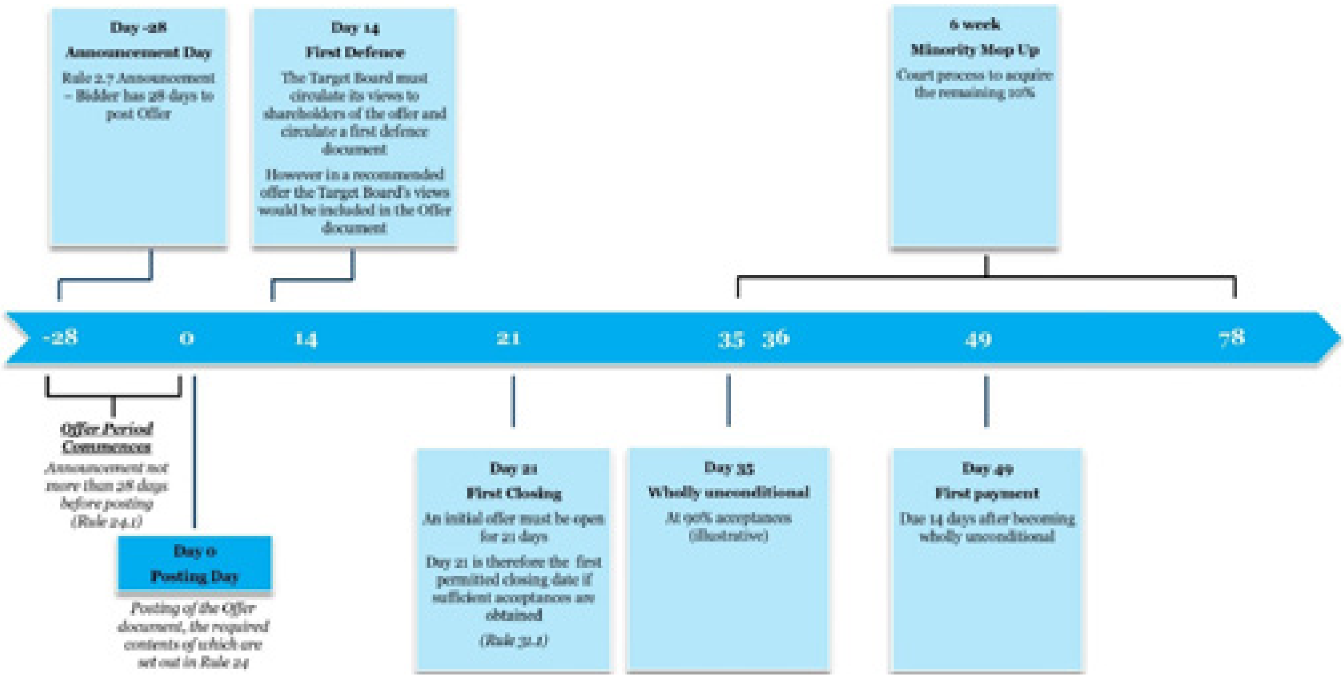
It is also worth indicating that although in the context of an auction sale, the management may not necessarily be the sellers of the shares, it is generally the case that the management will have some degree of influence over the shareholders and therefore in these scenarios, it is especially important that careful and early thought is given to the incentivisation plan that a Chinese investor is likely able to offer, should it acquire the shares of the target company. Management will typically choose to remain with premium, long term and credible bidders who have demonstrated a track record of success in their investments in other companies both in the UK and overseas.

The UK has complex laws and regulations on tax and therefore the structuring of incentivisation plans will frequently centre around tax structuring and maximising tax efficiency from the perspective of all parties. It is therefore important that tax advisors are involved at an early stage.

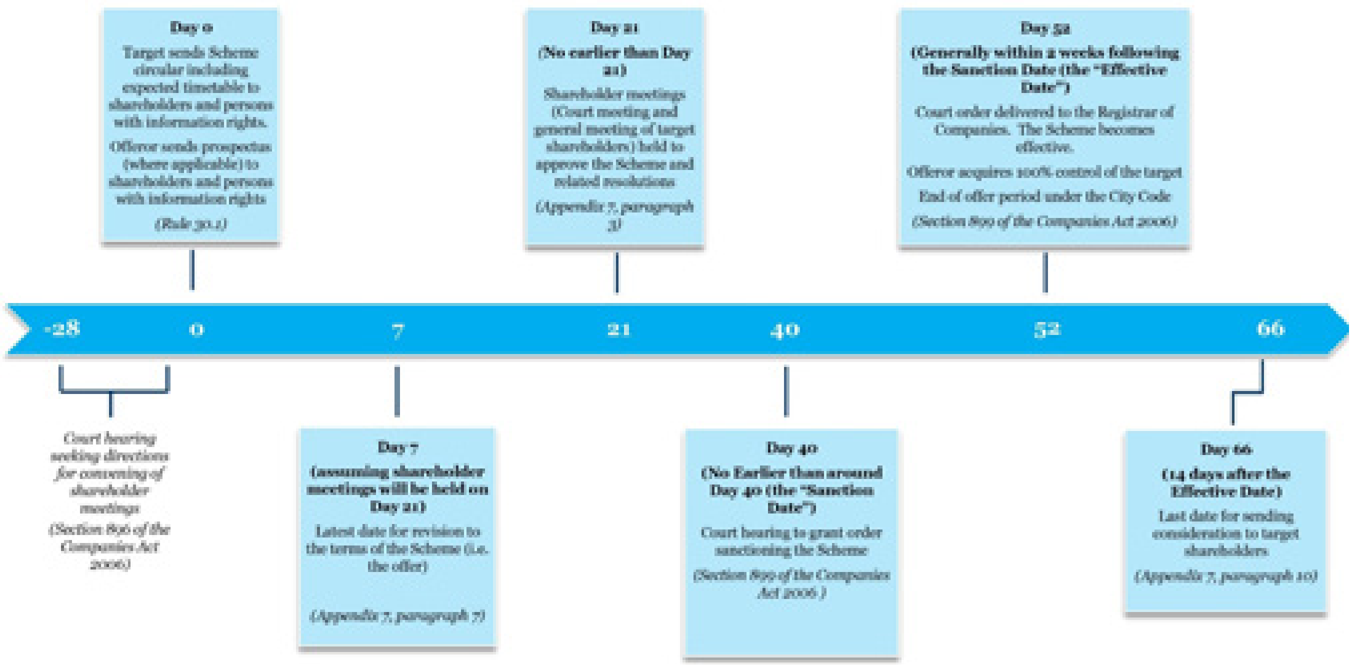
Public takeovers

There are two main ways by which a takeover of a public company may be effected, namely by way of a contractual offer or a court approved scheme of arrangement. There are fundamental differences between the two both in terms of timing and the procedures.

A. Offer indicative timetable



B. Scheme indicative timetable



C. Do's and Don'ts – tips for the initial stages of a public takeover

The UK Code on Takeovers & Mergers (the "Code") has very strict rules regarding action that can and cannot be taken by bidders at various stages of a public takeover process. We set out below certain suggested points which bidders should be mindful of in order to ensure that they do not inadvertently breach any of the rules prescribed by the Code.

Maintain utmost secrecy:

- Do not make public statements concerning yourselves (the "Company"), the offer or the target without first clearing the statement with the Company's advisers.
- Do not speak to the press without first consulting the Company's advisers. Particular care must be taken not to release material new information in discussions with the media. Any press enquiries should be directed to a designated individual to ensure a controlled and co-ordinated response.
- Limit information about the proposed offer to a small number, being those who really need to know.
- Do not use the target's real name, especially on the telephone or in places where anyone can overhear.
- Avoid public hints and clues about the proposal e.g. as to who you are meeting, where you are going and what you are doing.
- Bidders undertaking pre-approach due diligence, or looking to advance discussions pre-approach, will need to be careful about the number of parties they enter into discussions with - if the bidder extends discussions to more than a very restricted number of people (the "six person" rule), this could in turn force it to make an early announcement.

Avoid steps which, under the UK's Takeover Code, could restrict subsequent freedom of action:

- Do not deal in any securities (including the use of derivatives of any kind referenced to such securities) of the target without taking advice from the Company's financial and legal advisers (this could set a base price for any subsequent bid or trigger a requirement for cash consideration or a mandatory offer).
- Do not encourage anyone else (e.g. fellow board members, executives, pension fund, business associates, spouse, minor children or trustees of any family trusts) to deal in the securities of the target (action by concert parties could also restrict subsequent freedom of action).

Avoid accidental insider dealing:

- Do not receive non-public price sensitive information from the target without considering the implications.
- Do not encourage anyone else to make purchases or sales securities of the target or encourage them to refrain from making purchases or sales.

D. Breaches of the Code

The Code rules are administered by the panel to ensure fair and equal treatment of all shareholders in relation to takeovers. Non-compliance may result in sanction by the Panel, the FCA and any regulatory body to which the offending organisation belongs and the withdrawal of the facilities of the market.

In practice, this means that a breach of the Code rules could lead to:

- the bidder having to make a premature decision as to whether to proceed with the offer and, if deciding not, it will be locked out of making another offer for 12 months;
- the bidder being required to pay a price at least equal to any price it may have paid for shares acquired shares before offer;
- triggering of a mandatory takeover offer resulting in the requirement to make an offer for 100% of the shares in cash;
- being censured publicly or privately by the Panel (if they do not adhere to Panel requests or flagrantly breach the rules); and/or
- being cold shouldered (meaning that financial advisers in London will not work with a bidder on public transactions) for a period of time – this has severed reputational issues in the London market for any institutions or individuals who are cold shouldered.

E. Key rules

In addition to the six general principles, the Code has 38 detailed Rules, Notes on each Rule and 7 Appendices. There are also a number of Practice Statements and Panel Statements. A number of the key rules of the Code affect bidders more than target.

In addition to the rules set out on this page, Rules 24 and 25 of the Code specify the required contents of documents sent to shareholders.

We set out below a simple breakdown of the various rules and the party to which it mainly impacts upon:

	Main impact	
Key rules	**Target**	**Bidder**
Rule 2 Secrecy and Announcements	√	√
Rule 3 Independent Advice	√	
Rule 4 Dealing Restrictions	√	√
Rule 6 Minimum Bid Price		√
Rule 8 Disclosure of Dealings and Position	√	√
Rule 9 Mandatory Bids		√
Rule 13 Conditions		√
Rule 14 & 15 Offers for Other Classes / Options		√
Rule 16 Special Deals and Management Incentives	√	√
Rule 19 Information	√	
Rule 20 Equality of Information	√	
Rule 21 Restrictions on Frustrating Action	√	

In summary

The UK's newly energised M&A market holds opportunities for foreign investors who can come to the negotiating table ready to bid competitively for the best assets. A winning bidder will offer, in addition to a competitive price, the prospect of a smooth acquisition process, ready-made solutions to any regulatory challenges, competitive management incentivisation plans and a reasonable attitude towards assuming its share of the acquisition risk.

Seller concerns/bidder solutions	
Certainty/ conditionality	Important for sellers given competition amongst bidders is fierce. Bidders need to understand their own regulatory issues and have solutions to hand. Bidders must demonstrate access to funds.
Contractual terms	W&I insurance may avoid protracted warranty negotiations.
Clean exit	Locked box accounts give greater price certainty. Limited long-term continuing liabilities.

When things go wrong: dispute resolution in the UK

Governing law of contracts

Unlike in the case of inward investment into China, the parties are free to choose the governing law of contracts for investment into the UK. English law is one of the major systems of law which governs international financial transactions in practice. English law is well known for its generally predictable approach to contractual interpretation: where parties to a commercial transaction have expressed their rights and obligations by the use of clearly drafted clauses, effect will be given to the plain and ordinary meaning of the words used. It is this predictability and ease of use of the English courts which has led to English law being the choice of law for the majority of transactions involving an international element (even for transactions that have no connection with England).

Arbitration

Arbitration is an increasingly popular method of dealing with disputes and it can have several advantages over litigation, particularly in China/UK contracts.

First, international arbitration benefits from the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "Convention"). The Convention provides for the enforcement of both international arbitration awards and international arbitration agreements. Unlike foreign court judgments which can be difficult if not impossible to enforce, arbitration awards are generally enforceable in more than 140 countries under the Convention, including the UK and China.

For this reason, arbitration is widely used as the dispute resolution method for investments by Chinese companies in UK businesses.

Second, arbitration allows the parties to refer their disputes to a neutral forum. This may be important to parties wary of referring disputes to the "home" courts of their contracting partner.

Arbitration also allows the parties to designate arbitral tribunals with specialised knowledge and expertise, which can be of particular importance in complex commercial disputes.

Arbitration is also private and allows the parties to keep their commercial matters confidential. While there is some evidence that the confidentiality of arbitration is being progressively chipped away, the nature of arbitration is that it is consensual and as such parties can seek to agree watertight confidentiality provisions when they agree to arbitrate.

Selecting the appropriate institution and place of arbitration can be complicated. Drafting a clear dispute resolution clause is critical, as arbitration rules and practice vary by institution and location. Some of the major institutions for resolving commercial contract disputes are as follows:

- Hong Kong International Arbitration Centre (HKIAC)
- International Chamber of Commerce (ICC)
- International Centre for Dispute Resolution (ICDR)
- London Court of International Arbitration (LCIA)
- Singapore International Arbitration Centre (SIAC).

While arbitration is often preferred for resolving disputes involving foreign parties, there are some instances where arbitration may not provide sufficient protection to commercial interests. For example, where intellectual property rights are at issue, the power to award and enforce interim and permanent injunctive relief and other remedies may lie with local courts rather than arbitral tribunal. This is something to be considered with input from counsel on a case-by-case basis when determining the proper forum for dispute resolution.

Meet the team

Your team to unlock China and Asia opportunities

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