

Impact of China's export control law to M&A transactions

The PRC Export Control Law will come into effect soon on 1st December 2020. This new law makes a number of substantial changes to China's current export control regulatory regime, indicating that the regulators may take a more active and pragmatic approach to broadly safeguard China's national security and interests (especially in the area of technology) going forward¹.

Implications of these changes, however, may go far beyond the traditional export control regime and impact the compliance requirements of certain global M&A deals going forward, which the transaction parties should be aware of and prepare properly to deal with the regulatory challenges.

1.) M&A transactions involving listed technologies could be captured:

The current Chinese tech-export regulations apply to "transfer of technologies ... from inside of the People's Republic of China to outside of the People's Republic of China". Under the new Export Control Law, export control does not only apply to the transfer of controlled items from the territory of the People's Republic of China overseas, but also to the "provision of controlled items by citizens, legal persons and non-legal person organizations of the People's Republic of China to foreign organizations and individuals" ("deemed export").

The Export Control Law does not set any limitation on the form of "provision", nor impose any geographical limitation, which is likely intended to prevent evasion of the traditional export control via alternative ways (for instance, one can set up a company, contribute the controlled technology into it and then sell the company to foreign purchaser). So technically such "deemed export" may be broadly interpreted to include the sale of a company by a Chinese seller (which could be a Chinese individual, or an entity either incorporated in China or otherwise controlled by a Chinese investor) so long as the company has the technology captured by the relevant control list or the Export Control Law².

Using TikTok as a hypothetical case for illustration purposes, if ByteDance sold TikTok to Microsoft before 1st December 2020, this transaction would not necessarily be subject to the Chinese government's approval, so long as relevant existing technology licenses between ByteDance and TikTok remained untouched, as the relevant IP for operating TikTok was already licensed by ByteDance to TikTok quite some time ago³. Once the Export Control Law takes effect on 1st December 2020, technically this deal will fall under the coverage of the Export Control Law and may require Chinese government approval.

2.) M&A transactions involving unlisted technologies could be captured as well:

Under the Export Control Law, if the technologies to be exported are not within any export control lists or interim export control measures, the exporter will still be obliged to apply to the export control authorities for export licence, if the exporter "knows, or should know, or has been notified by the export control authorities", that such export may have the risk of endangering national security and interests⁴.

1 Please refer to "China New Export Control Law: Key Changes and Challenges" for more details of the Chinese Export Control Law.

2 It is not clear at present and is subject to clarification regarding the scope of the sale, i.e., whether it applies only to 100% sale or sale of majority stake, or otherwise it covers sale of controlling stake as well.

3 In the contrary, the proposed data security arrangement with Oracle, which requires revisions to the current IP license arrangement between ByteDance and TikTok, is subject to China's approval under current Chinese tech export regulations.

4 The Export Control Law, however, does not clearly define the national security and interests. This term is vague and technically may be interpreted in a broad way.

Thus, in case of an M&A transaction between a Chinese seller and a foreign purchaser, even if the technologies of the company may not be on any export control lists, this transaction could still fall under the Export Control Law and would require the Chinese government's approval, if it were to endanger national security and interests of China.

Again using TikTok for illustration purpose, under the Export Control Law, the Chinese government would not need to update the technology export control lists any more in order to capture the transaction⁵. The Chinese government may simply notify ByteDance that the proposed transaction would endanger national security and interests and therefore should be reviewed by the Chinese government. Even if ByteDance did not receive any notification from regulatory authorities, ByteDance would need to assess whether the transaction would cause any national security concerns and interests and thus trigger the application of the Export Control Law, and consider the necessity to voluntarily submit the transaction to the Chinese government for approval.

3.) Enforcement risk and penalties for violation:

The Chinese government may take a series of actions against violations under the Export Control Law. In the event of an M&A transaction which falls under the regime of the Export Control Law and is closed without proper approval, it is theoretically possible that the Chinese government may "order to stop illegal activities", which could be interpreted as the authority to suspend or unwind the transaction. It may confiscate illegal income (if any) and impose an administrative fine of up to 10 or even 20 times the turnover amount of the violation which technically can be interpreted as the transaction value⁶.

In addition, unlike what is commonly possible under other administrative regulations (eg the Anti-Monopoly Law of China), the administrative penalty imposed under the Export Control Law does not appear to be appealable. Instead, the Export Control Law only offers the possibility of initiating administrative review proceedings if one intends to challenge a penalty decision.

There is no doubt that for transactions similar to TikTok, the enforcement risk of non-compliance under the Export Control Law would likely become a top-priority issue that parties would not ignore, given the sensitivity and publicity of the transaction. But for other transactions which are of less public concern, the serious legal consequence under the Export Control Law may still be a factor sufficient for the relevant parties to cautiously consider the enforcement exposure rather than recklessly close the deal without going through the necessary proceedings required under the Export Control Law.

4.) Compliance Steps for Chinese and International Investors:

For M&A transactions with Chinese elements, it is advisable for the transaction parties to consider the following steps in order to comply with the Chinese Export Control Law:

- make an appropriate assessment as to whether the proposed transaction may structurally fit into the scope of "deemed export" under the Export Control Law;
- identify if any technologies involved in the target business are on any Chinese export control list, which may cause the proposed transaction to be subject to any necessary Chinese approval under the Export Control Law;
- where there are no listed technologies involved in the transaction, assess whether the proposed transaction could endanger the national security and interests of China, considering important factors such as the sensitivity of relevant technologies, geopolitical risks, the profile of the transaction, etc.;
- if it is difficult to conclude whether the transaction involves listed technologies or otherwise may endanger the national security and interests of China, seek a clearance letter from the relevant Chinese authorities through a consultation process⁷;
- in the event that the proposed transaction is determined to require Chinese government approval under the Export Control Law, consider a voluntary submission to the relevant Chinese governmental authorities for formal approval.

Looking Forward:

The Export Control Law provides China with a robust regulatory tool to better monitor the flow of controlled items and prevent evasion of the state export control. While this new law may be interpreted to capture certain M&A transactions as described above, it is too early to predict how the Chinese government would utilize it or whether it would eventually turn into a China tech version of CFIUS review. In the meantime, we expect that China's export control regime will continue to evolve with corresponding detailed implementing rules, as are anticipated to be promulgated as a next step. Transaction parties are advised to stay alert and adapt their compliance strategies and practices to further regulatory changes.

5 The government announced the amendments to the *Catalogue of Technologies Prohibited or Restricted from Export* on 28 August 2020. Please refer to "[China: Technology Export Control and Beyond](#)" for details.

6 The administrative fine is up to 10 times of the turnover of the illegal transactions, and up to 20 times of the transaction value if the transaction is with a blacklisted party.

7 The Export Control Law permits consultation with the export control authorities, and the export control authorities are required to respond in a timely manner.

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