

Han Kun's 2019 Data Analysis Report for VC/PE Deals

2020.05

HANKUN
汉坤律师事务所
Han Kun Law Offices

36Kr

TABLE OF CONTENTS

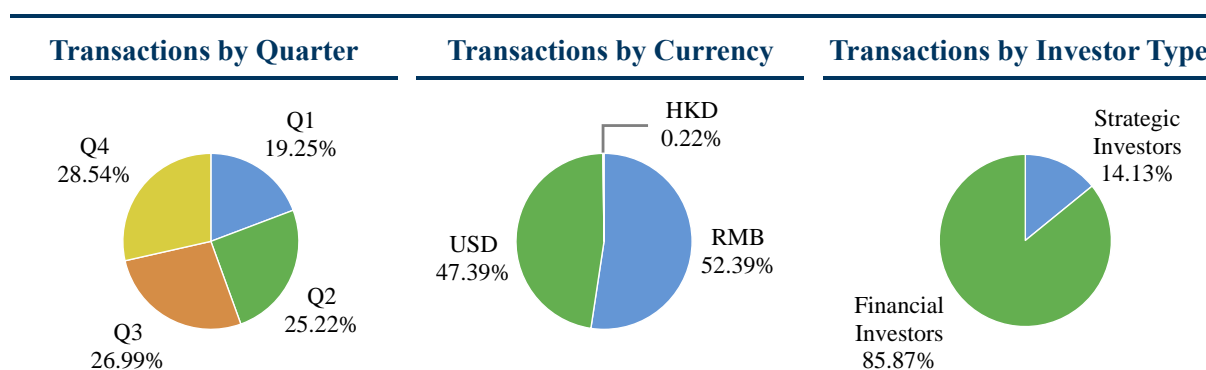
Part 1: Introduction	1
Part 2: Analysis of Specific Terms	4
Liquidation Preference	4
Drag-along Right	6
Redemption	7
Dividend	12
Anti-dilution	12
Preemptive Right	14
Founder Restrictions	14
Right of First Refusal and Co-Sale Right	16
Protective Provisions	18
Information Rights and Inspection Rights	20
ESOP	20
Investors' Share Transfer Restrictions	21
Investor's Investment Restrictions	23
Most-favored Nation	23
Warrant	24
Personal Indemnification Liability of Founders	24
Survival Period for Representations and Warranties	25
Dispute Resolution	25

Part 1: Introduction

Han Kun represents investors and companies in a wide variety of venture capital and private equity transactions involving both PRC and non-PRC structures, RMB and USD denominated. Our clients include well-known PRC and international institutional investors (including financial and strategic investors), and cutting-edge start-ups from various sectors.

We have compiled data from over 500 venture capital and private equity transactions that we closed in 2019. We also compared the 2019 data with data from 1,600 transactions in the past three years. The report summarizes and analyzes key legal provisions, including investment structure, liquidation preferences, drag-along rights, redemption rights, dividends, anti-dilution, preemptive rights, share transfer restrictions of founders, rights of first refusal and co-sale, protective provisions, information and inspection rights, ESOP, warrant, investor restrictions, most-favored nation, founder personal liability, survival period of representations and warranties, and dispute resolution. We hope that our data and analysis on these legal provisions will be a useful guide for the industry.

Han Kun's 2019 VC/PE Transactions



In 2019, the aggregate amount of venture capital and private equity transactions Han Kun participated in exceeded RMB 260 billion.

Executive Summary of Han Kun's 2019 VC/PE Report

■ Volume of Transactions Declined, but Volume of Transactions with a Relatively large Financing Amount Increased

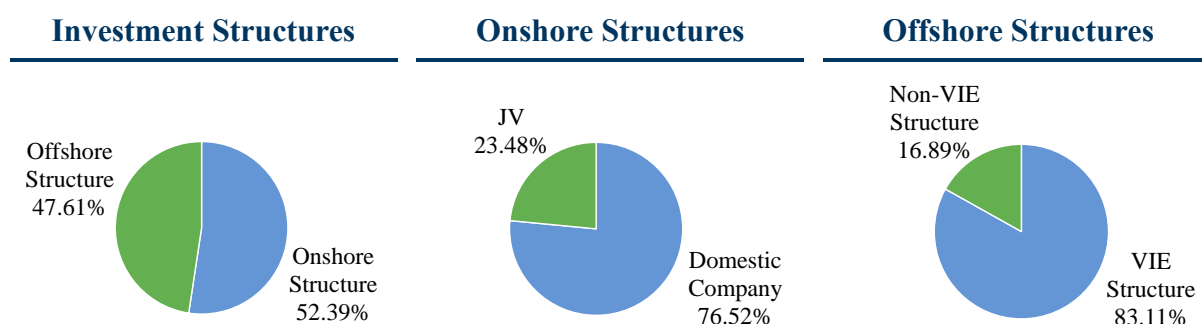
Compared to 2018, the total volume of VC/PE transactions completed by Han Kun decreased slightly. However, the volume of transactions with a relatively large financing amount increased. In particular, the financing amount in transactions involving leading companies in each industry increased significantly.

■ **Allocation Between Financial Investors and Strategic Investors Remains Substantially Constant**

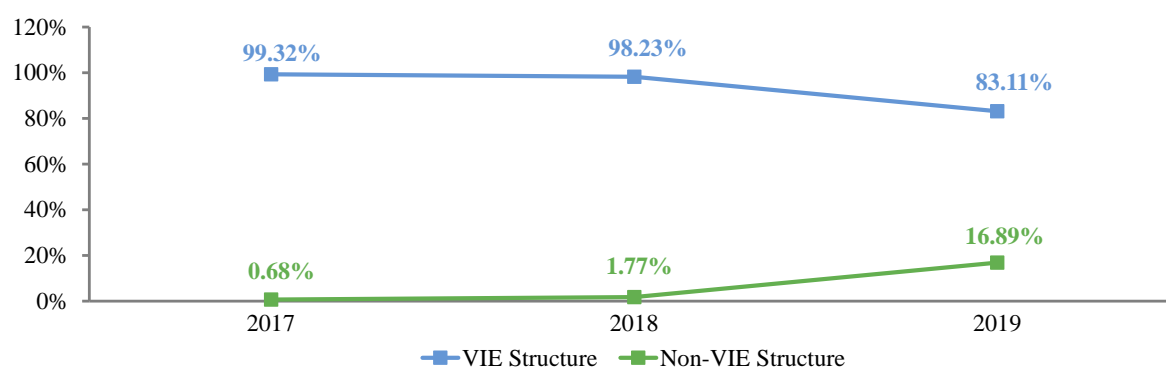
In 2017, 2018, and 2019, between 83%-86% of Han Kun's VC/PE transactions were completed by financial investors, while 14%-17% were completed by strategic investors. There was a slight 2% drop in transactions completed by strategic investors in 2019 compared with 2018. Among the transactions completed by strategic investors, there are around 46% transactions where strategic investors also signed business cooperation agreement with the target company.

■ **Offshore Structures Have Increased, and Non-VIE Offshore Structures Also Have Increased Significantly, Both Reflecting Foreign Investment Liberalization Trends**

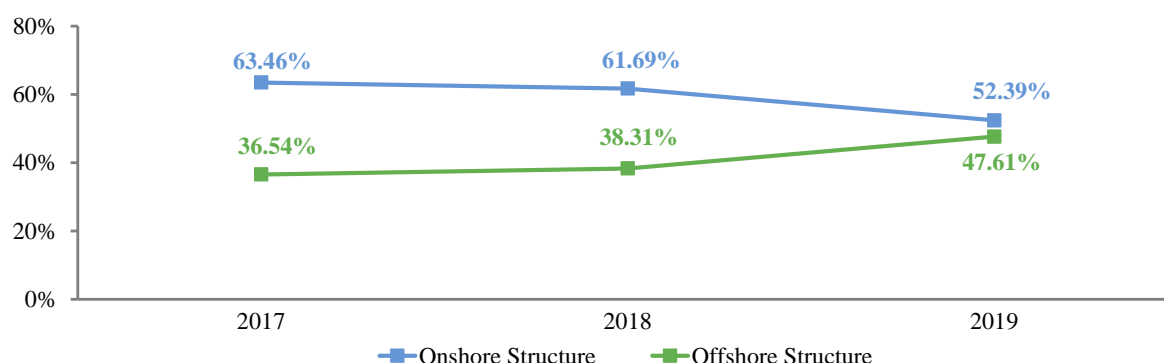
In 2019, 47.61% of Han Kun's VC/PE transactions had an offshore structure (i.e. the parent entity is incorporated outside the PRC, but operations are substantially in the PRC), higher than 38.31% in 2018 and 36.54% in 2017. Within offshore structures, 17% of the structures were not VIE structures (i.e. direct investment into wholly foreign owned entities without the need for variable interest entities), significantly higher compared to 2018. These trends may reflect foreign investment liberalization trends that obviate the need for VIE structures and facilitate direct investment in non-VIE structure offshore parents and onshore PRC parents.



Offshore Investment Structures in the Past Three Years – Fewer VIE Structures



Types of Investment Structures in the Past Three Years – More Offshore Structures



■ Operations Still Centered in a Small Cluster of Major Metropolises

The principal place of business of target companies are Beijing, Shanghai, Shenzhen, Hangzhou and Guangzhou, which collectively account for 78% of all target companies, with Beijing and Shanghai alone accounting for 60%. As these metropolises have active economies and stable, open, and transparent policies, they have always been the first choice for start-ups. The advent of the *Development Plan for Guangdong-Hong Kong-Macao Greater Bay Area* in February 2019, which foresees the development of a “Greater Bay Areas” consisting of Hong Kong, Macau, and nine cities in Guangdong including Shenzhen and Guangzhou, may leads these cities to also become first choices for entrepreneurs in the future.

■ VC/PE Investment in Traditional Industries Increased in 2019

The top six industries in 2019 were biomedicine, intelligent hardware (AI, AR), enterprise services, education and training, automotive transportation and entertainment and culture, collectively accounting for 57% of all of Han Kun's 2019 VC/PE transactions. We noticed that the proportion of target companies in traditional industries (such as catering and food, retail, and industrial manufacturing), increased in 2019 compared to 2018. In addition, industries that were previously popular, such as Fintech, social networking, e-commerce, and the sharing economy, were not as popular in 2019 compared to 2018.

Part 2: Analysis of Specific Terms

Liquidation Preference

There are two main types of liquidation preferences, participating liquidation preferences and non-participating liquidation preferences.

Participating liquidation preferences involve investors receiving a specified return and then being able to share in the remaining proceeds on a pro-rata basis.

Non-participating liquidation preferences provide investors with a choice to receive a specified return or forego the liquidation preference and receive pro rata distributions with all other shareholders on a pari passu basis.

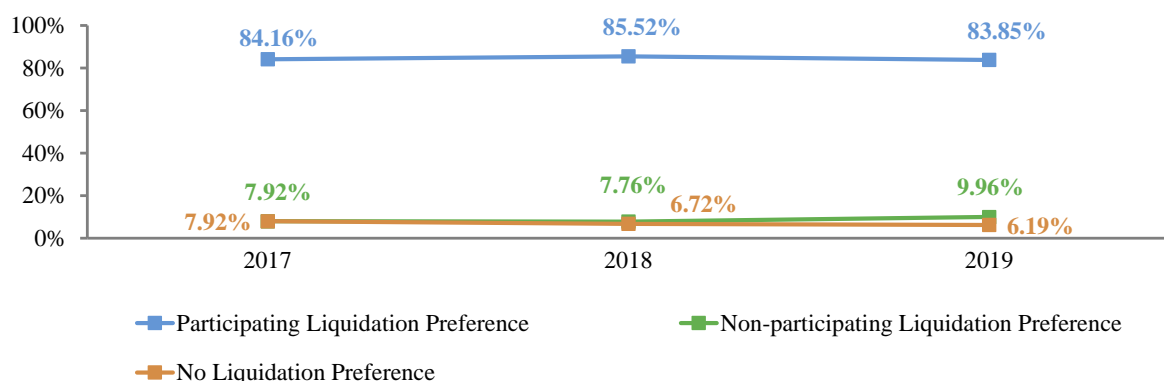
Participating liquidation preferences may be capped at a specified amount (such as a multiple of the original investment cost), after which they become non-participating. Both participating and non-participating liquidation preferences may be ranked, such that later investors are first paid prior to earlier investors (last in, first out), or may be payable on a pari passu basis.

Types of Liquidation Preference	VC/PE Transactions in the US Market
Participating/Double Dipping	Rarely adopted
Capped-participating	Only adopted in certain industries or situations
Non-participating	Commonly adopted

In Han Kun's VC/PE transactions in the past three years, the vast majority (80%) of liquidation preferences are participating, while 10% are non-participating and 5% had no liquidation preferences at all.

The apparent trend in the PRC differs from that of the United States based on publicly available data and the deal documents we have examined from United States VC/PE transactions. There, generally speaking participating liquidation preferences are rarely adopted, capped participating preferences are only adopted in certain industries or situations, and the most widely used liquidation preference is a non-participating liquidation preference. This difference may explain in part the variations in valuation multiples between PRC and U.S. targets in similarly situated industries.

Types of Liquidation Preferences in the Past Three Years



The liquidation preference amount is typically the investment amount plus a certain rate of return or a multiple of the investment amount. Our 2019 data reveals that the average rate of return is 9% simple or compound interest, while the average multiple is between 1 to 1.5x the investment amount.

Onshore Structure

Liquidation Calculation	Liquidation Amount Range	Average
Liquidation Amount is a percentage of the investment amount	(100%-150%) of the investment amount	110.93% of the investment amount
Liquidation Amount is a percentage of the investment amount + simple interest	(100%-150%) of the investment amount + (4.75%-13%) simple interest	101.40% of the investment amount + 9.25% simple interest
Liquidation Amount is a percentage of the investment amount + compound interest	(100%-150%) of the investment amount + (7%-15%) compound interest	101.85% of the investment amount + 9.63% compound interest

Offshore Structure

Liquidation Calculation	Liquidation Amount Range	Average
Liquidation Amount is a percentage of the investment amount	(100%-150%) of the investment amount	112.01% of the investment amount
Liquidation Amount is a percentage of the investment amount + simple interest	(100%-130%) of the investment amount + (5%-20%) simple interest	100.97% of the investment amount + 9.81% simple interest

Offshore Structure

Liquidation Calculation	Liquidation Amount Range	Average
Liquidation Amount is a percentage of the investment amount + compound interest	100% of the investment amount + (6%-15%) compound interest	101% of the investment amount + 9.35% compound interest

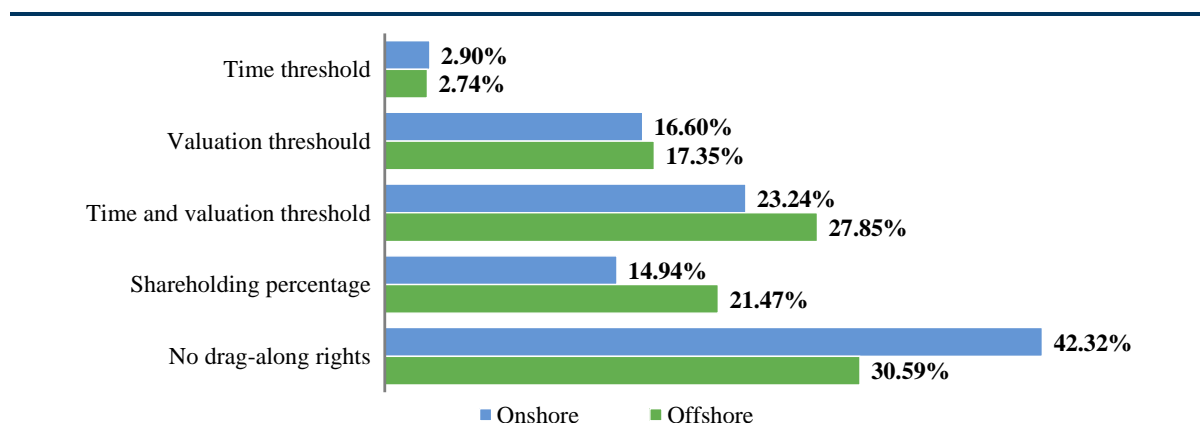
Drag-along Right

A drag-along right provides a specified group of persons (typically preferred shareholders) with the right to require other shareholders (typically ordinary shareholders consisting of founders and management) to vote in favor of a sale of the company. The idea behind a drag-along right is to prevent a situation where minority shareholders or a group of shareholders, either by law or through procedural hurdles such as non-attainment of signatures, are able to block a sale of the company. The drag is typically exercised when (i) the company is doing well but is unable or unwilling to list for reasons specific to the company, thereby making a sale the most viable exit opportunity for both founders and investors or (ii) when the company is doing poorly and the preferred investors view a sale as a way to exit their investment.

The conditions triggering a drag-along right vary, such as the identity of the drag-along holders (i.e. those who may require the other shareholders to approve a sale of the company approved by such drag-along holders), a valuation floor, a time requirement whereby the right may only be exercised after a certain period, or a combination of the above.

In 2019, we noticed more drag-along provisions require founders to approve a sale of the company, especially as compared to 2017. Founder approval is now required in 50% of transactions, compared to 21% in 2017. This may reflect growing concern by founders that they may eventually be dragged into a sale of the company by preferred shareholders.

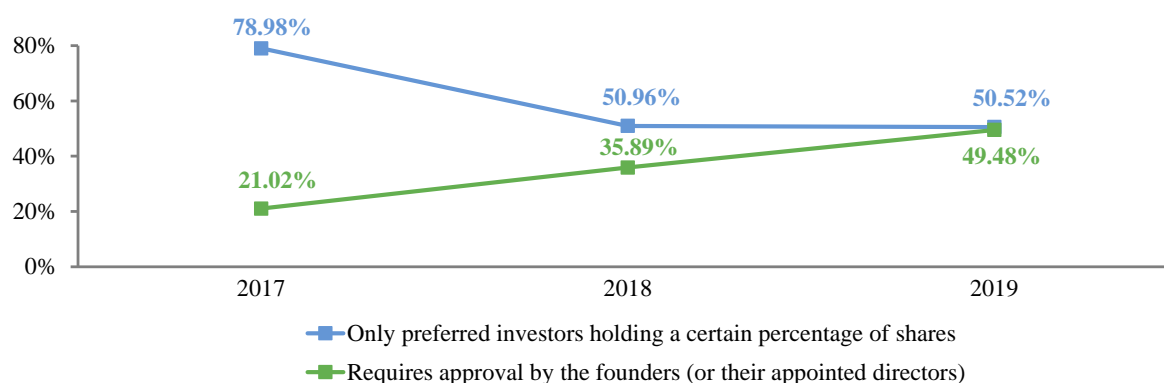
Exercise Conditions



Exercising Parties



Exercising Parties for the Drag-along Right in the Past Three Years – More Founder Approval

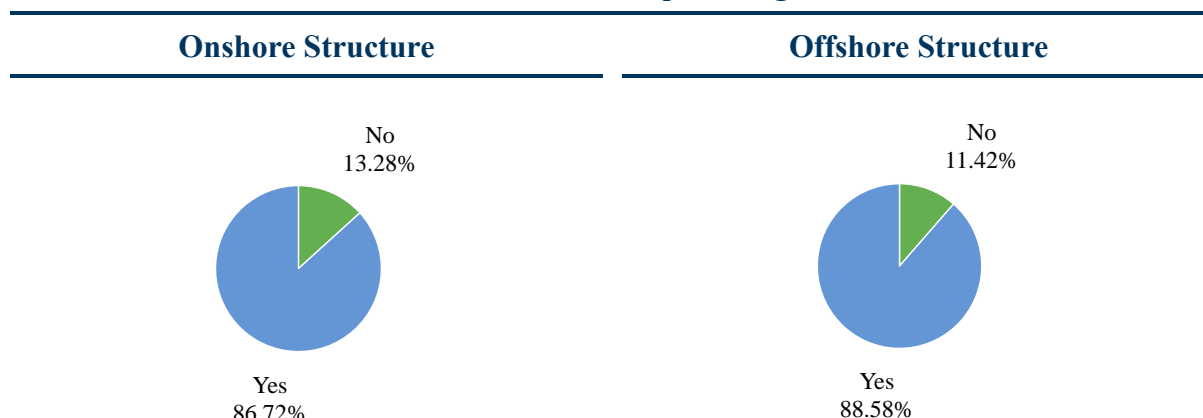


Redemption

Redemption rights allow preferred investors to require the company and/or the founders, to redeem their shares if certain conditions are met at a redemption price equal to the investment amount plus, to the extent applicable, a specified rate of return. Redemption rights, while they may not necessarily be enforced, are commonplace in our transactions, both at the onshore and offshore level and we have not identified any noticeable shifts in this regard.

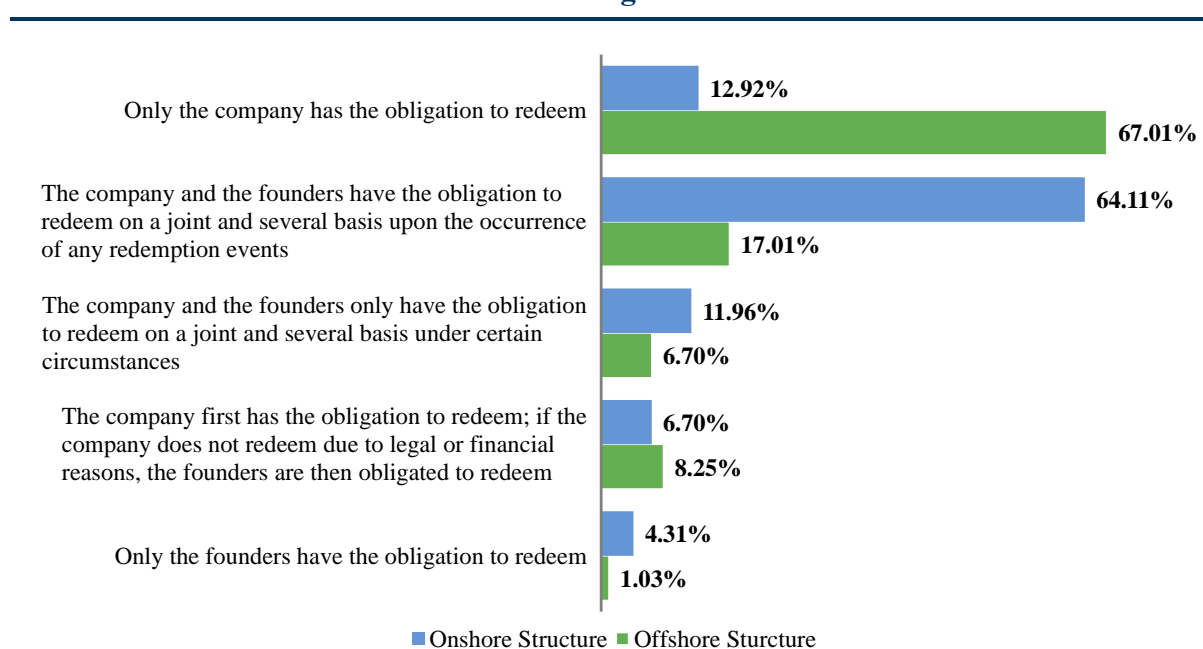
The apparent trend in the PRC differs from that of the United States based on publicly available data and the deal documents we have examined from United States VC/PE transactions. There, generally speaking redemption rights do not exist at all, due to recent development in Delaware case law limiting its impact and market practice generally. This difference may explain in part the variations in valuation multiples between PRC and U.S. targets in similarly situated industries.

Existence of Redemption Rights



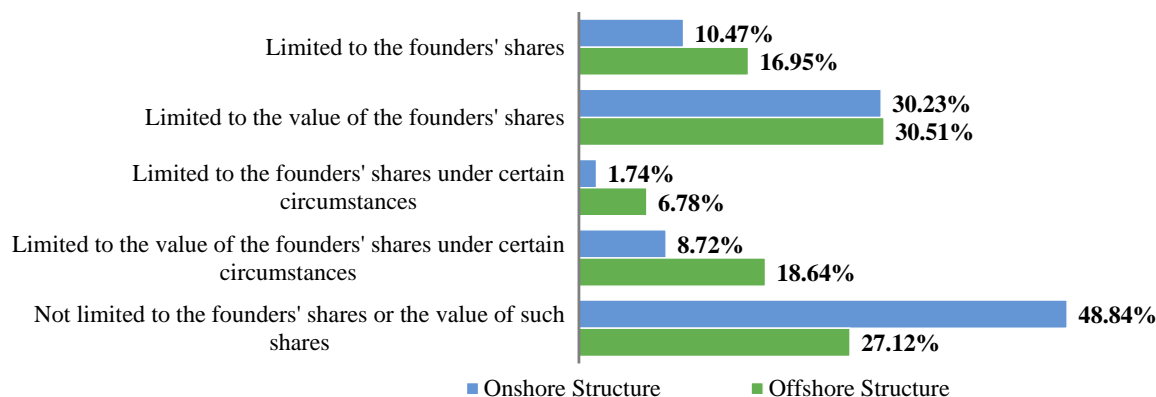
We note a difference between the redeeming parties in onshore and offshore transactions. In most offshore transactions, only the company has the obligation to redeem, whereas in most onshore transactions, the company and the founders are jointly and severally liable for the redemption. The main reason is attributable to legal standards. Whereas the company law of the Cayman Islands generally permits a company to redeem its own shares based on agreed upon conditions as long as the company has available assets for distribution, the PRC's company law and jurisprudence is more restrictive towards the actual enforceability of a redemption provision. There are also more procedural hurdles attributable to enforcing an onshore redemption provisions, such as the completion of a capital reduction procedures that involves the preparation of balance sheets and checklists, notice to creditors, and public announcement procedures.

Redeeming Parties



In some transactions where the founders have a redemption obligation, in order to avoid exposing the founders' own personal or family assets, the obligation is limited to the founders' shares in the company or the value of such shares.

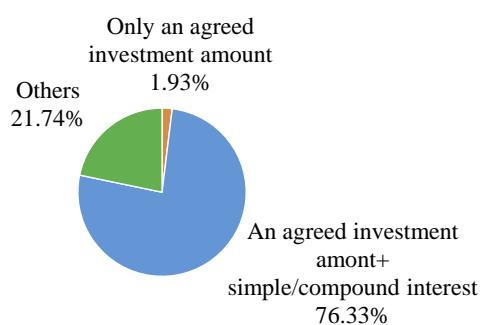
Redeeming Parties – Founders Assume Redemption Obligations



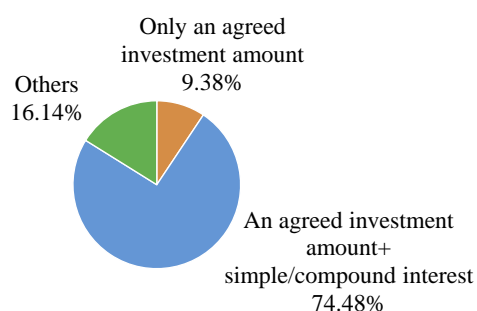
The redemption price in both offshore and onshore transactions includes a specified rate of return in addition to the investment amount, which may reflect each investor's own calculation of its internal rate of return.

Redemption Price

Onshore Structure

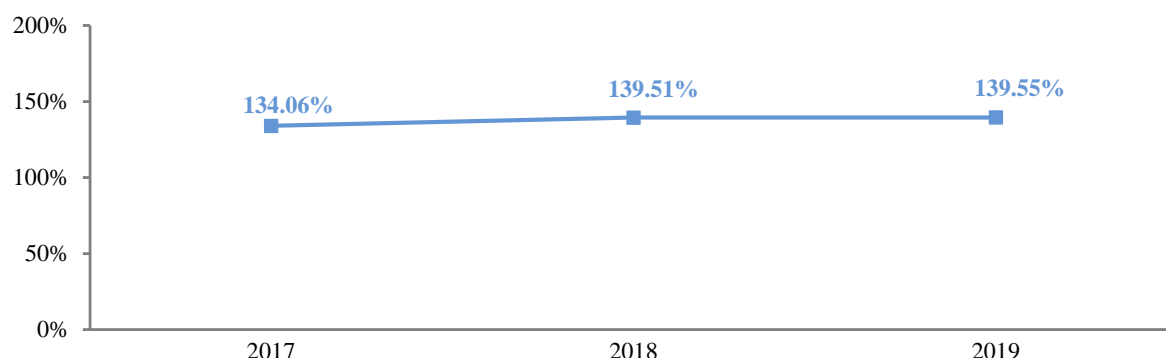


Offshore Structure

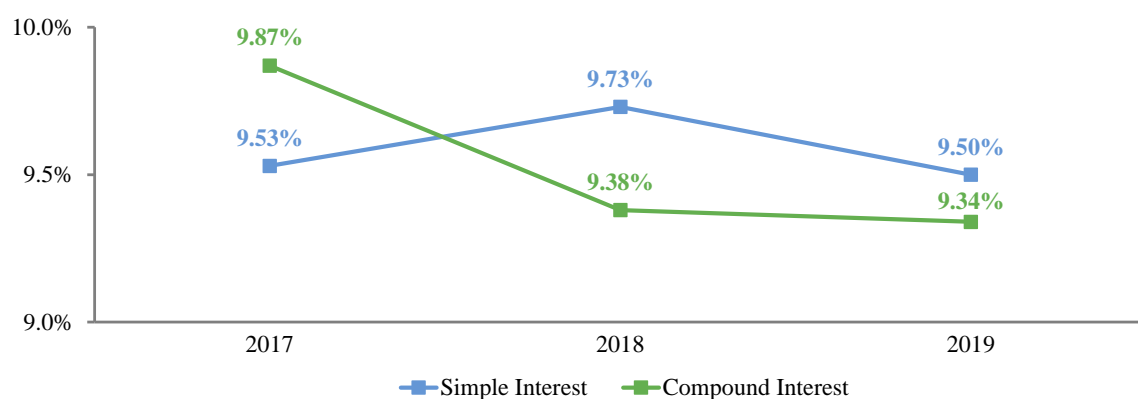


We have noticed in the past three years, however, an uptick in redemption amounts consisting only of a pre-determined amount, which may reflect different or evolving calculations about the time to exit.

Redemption Price - Only An Agreed Investment Amount Past Three Years



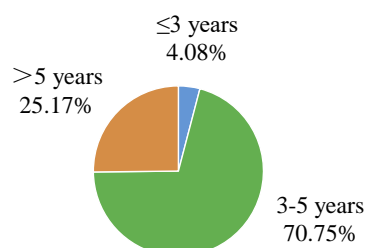
Redemption Price – Simple/Compound Interest Past Three Years



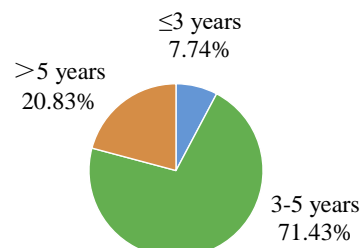
The most common redemption trigger is the company’s non-completion of an IPO (sometimes a “QIPO” with specified conditions) within a date certain. The length is typically 3-5 years and depends on the financing round and the maturity of the target company.

Redemption Trigger – The Company Does Not Complete an IPO within an Agreed Term

Onshore Structure

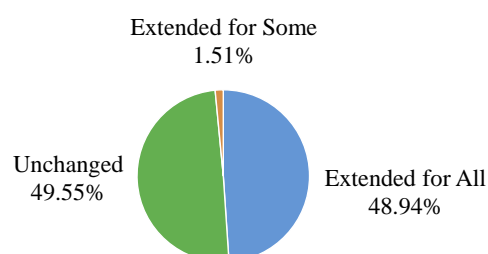


Offshore Structure



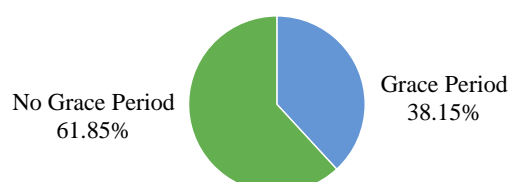
A common negotiation point is the status of a redemption trigger tied to the completion of an IPO by a date certain when the company receives a new round of investment. From the company's perspective, the time trigger for all investors should be amended to a date after the closing of the new round of investment. From the existing investor's perspective, the time trigger should remain the same and should not in any event be later than the time trigger for the new investor. From the new investor's perspective, the time trigger should not be later than the time trigger for the existing investor, or there should be a "cross trigger" stating that the new investor may exercise its redemption rights when other investors have exercised their redemption rights.

Redemption Trigger – If the Company Does Not Complete an IPO within the Agreed Term, Whether Prior Round Investors' Redemption Term is Extended

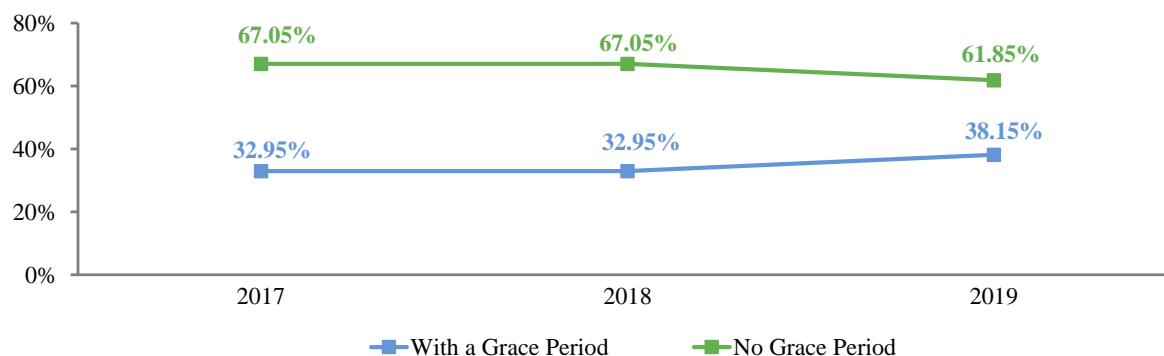


A redemption trigger tied to a "material breach" of transaction documents by the company or the founders is also common in both offshore and onshore transactions. "Material" is typically undefined in the transaction documents. Companies may request grace periods to remedy a "material breach" prior to the redemption being triggered. In the past three years, grace periods tied to "material breaches" have become more commonplace, reflecting growing awareness by the company and the founders of this trigger and its potential consequences.

Redemption Trigger – Grace Period for Material Breaches of the Transaction Documents by the Company or the Existing Shareholders



Redemption Trigger – Grace Period for Material Breaches of the Transaction Documents by the Company or the Existing Shareholders – Past Three Years

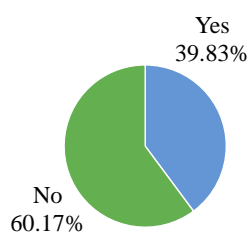


Dividend

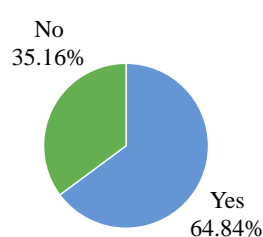
A dividends provision provide preferred investors with the preferential right to receive dividends prior to and in preference to ordinary shareholders, typically at a specified rate, typically between 5%-10%. However, in practice, dividends are only paid when and if declared by the board, and typically are not paid prior to an IPO.

Existence of Dividend Rights

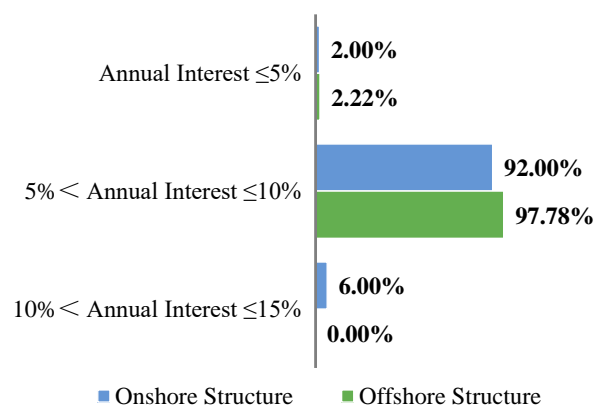
Onshore Structure



Offshore Structure



Dividend Yield



Anti-dilution

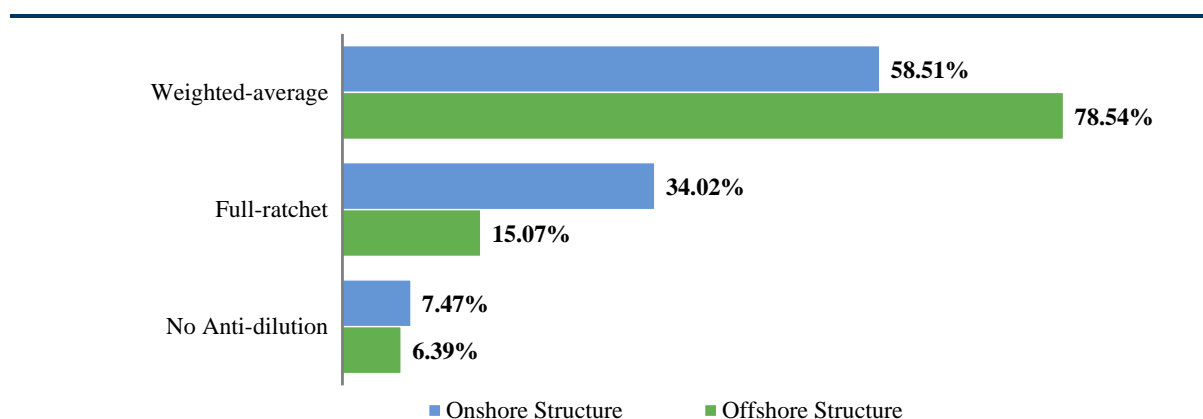
Anti-dilution rights provide investors with protection if the company issues shares at a price per share lower than the price per share paid by such investors, typically in the context of a down round financing, and subject to exceptions such as ESOP issuances and issuances approved by preferred investors. The protection can be “full ratchet”, meaning an adjustment of the investors’ price per share to the new price per share, or be based on a formula such as narrow or broad based weighted average.

In offshore structures, anti-dilution rights are implemented through the adjustment in the conversion price between the subject preferred shares and ordinary shares. No new securities are actually issued to the investors, based on the idea that the conversion price adjustment mechanism will apply on an IPO (where the preferred convert to ordinary) or if the company is sold.

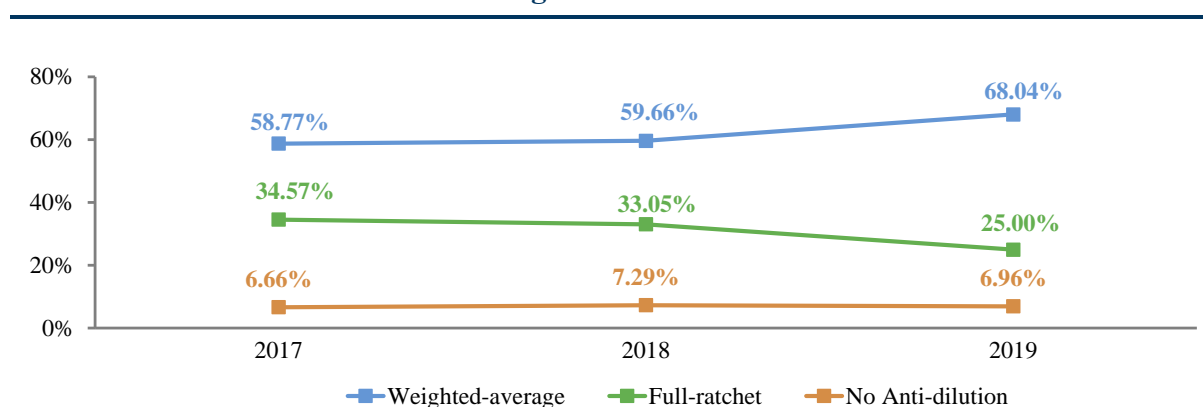
In onshore structures, as there is no concept of preferred equity under PRC law, thereby nullifying the conversion mechanism in offshore structures, the anti-dilution is implemented through securities transferred to the investors, either by the company or the founders at a nominal price.

In Han Kun's VC/PE transactions in the past three years, weighted average has become increasingly common than full-ratchet.

Anti-dilution



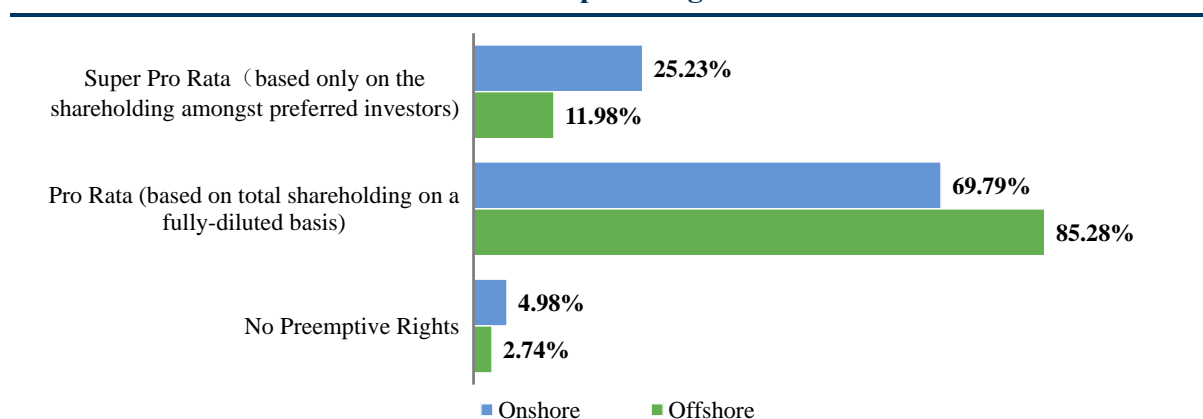
Anti-dilution Rights in the Past Three Years



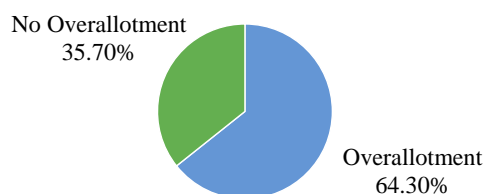
Preemptive Right

Preemptive rights provide shareholders (typically preferred shareholders) with the right to subscribe for new securities of the target company when the company issues new securities in order to preserve such shareholders’ percentage ownership in the company, or in the case of a “super pro rata” formula or overallocation rights, to potentially increase it. The ratios for preemptive rights consist of “pro rata” (percentage required for the investor to preserve its current ownership percentage in the company), “super pro rata” (percentage determined without reference to the ordinary shareholders, who are removed from the denominator), and one of the above plus overallocation rights (the right to subscribe for securities not subscribed for by other investors).

Preemptive Right



Preemptive Right – Right of Overallocation



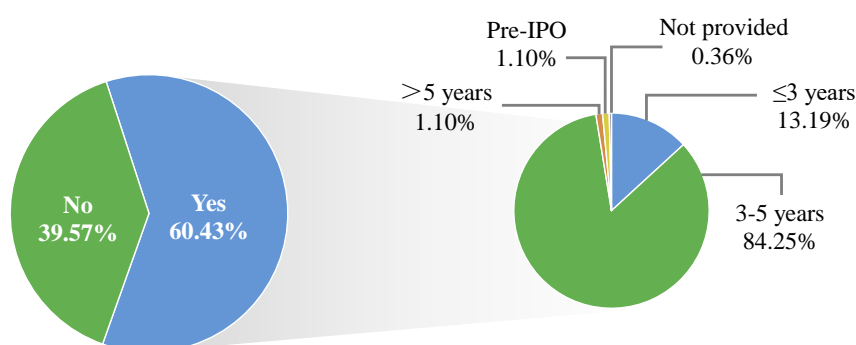
Founder Restrictions

In both offshore and onshore transactions, investors attach importance to the founders and management. Accordingly, transaction documents require founders to provide full-time and non-competition undertakings. In addition to restricting the founders’ shares (i.e. providing the company with the right to repurchase such founders’ shares at cost pursuant to a vesting period if the founders leave during the vesting period), there are also blanket restrictions on the

sale of the founder's shares until an exit, with specified exceptions in certain instances (such as for bona fide estate planning purposes, to trusts, or permitting sales of a small percentage of such founders' shares).

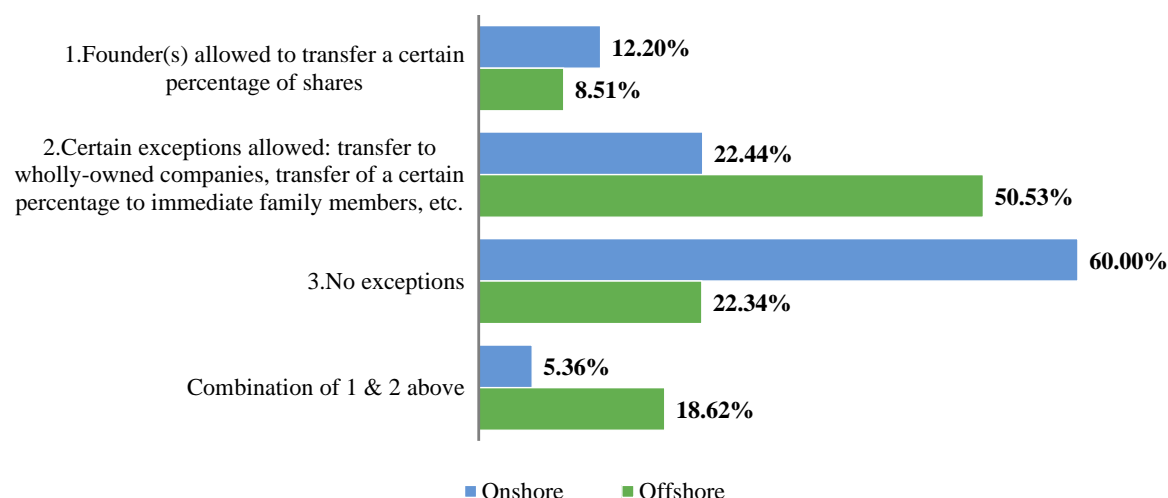
The apparent trend in the PRC differs from that of the United States based on publicly available data and the deal documents we have examined from United States VC/PE transactions. There, generally speaking founder shares are restricted but there is no blanket restriction on transfer on top of such restriction. This may reflect cultural differences whereby United States investors attach less importance to the founders and management and more importance to the company and its corporate governance as a whole.

Founder Restricted Shares



Founder Transfer Restrictions

Founder(s) prohibited from selling any shares prior to an IPO or Trade Sale without investors' approval.



Right of First Refusal and Co-Sale Right

Right of first refusal provide shareholders (typically preferred shareholders) with the right to purchase a specified portion of securities proposed to be transferred to a third party by specified parties (typically founders).

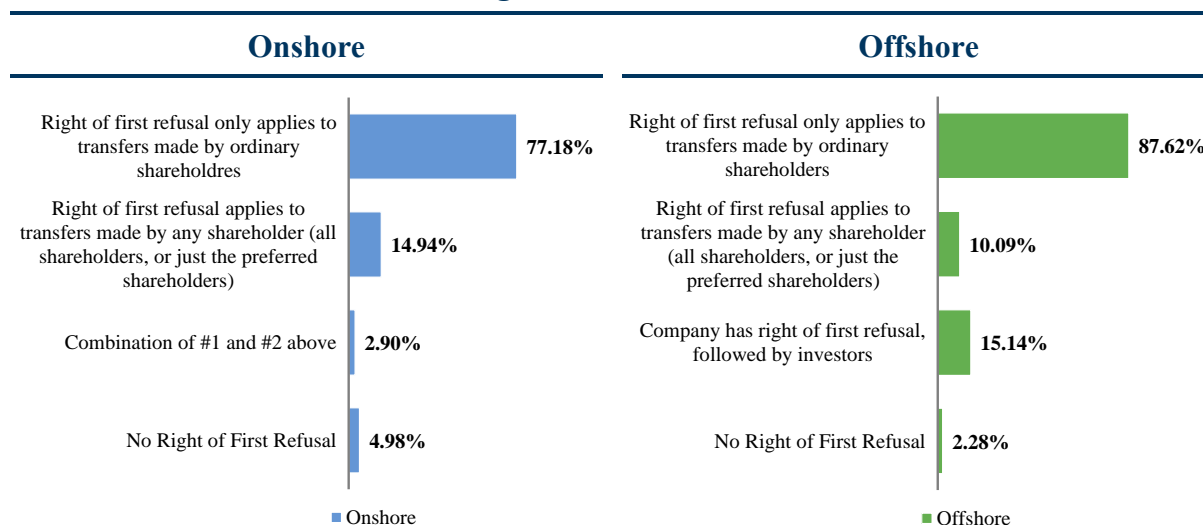
Based on 2019 transactions, ordinary shareholders (mostly founders) are subject to rights of first refusal, but there is a minority of transactions where all shareholders are subject to rights of first refusal. Strategic investors have attempted to negotiation rights of first refusal applying to all shareholders (including preferred investors), as a way to potentially increase their stake in the company, perhaps at the expense of competitors.

In onshore transactions, existing shareholders have right of first refusal on a pro rata basis as a matter of law. Alternative arrangements, such as a “super pro rata” basis (percentage determined without reference to the ordinary shareholders, who are removed from the denominator) may be set forth by contract.

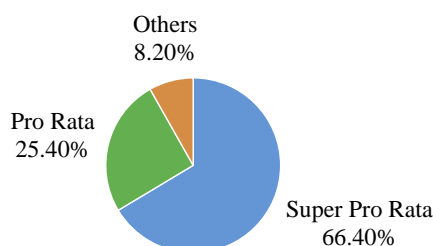
A common negotiation point is whether an exercising holder is required to purchase all, or only some, of the securities it is entitled to purchase. If the exercising holder is only entitled to purchase some, then it may impact whether a prospective transferee is still willing to purchase from the transferor a reduced number of securities. If the exercising holder has rights overallotment (the right to subscribe for securities not subscribed for by other investors), the amount that may be transferred to the prospective transferee may also be impacted.

Rights of first refusal should be viewed in the context of blanket restrictions on transfer (see above), as they would not be exercised unless the founders' were authorized to sell their shares to third parties. Exceptions to such blanket transfers may also state that those exceptions are not subject to rights of first refusals. We also noticed that in United States transactions the right of first refusal is sometimes provided to the company first, which differs from PRC practice.

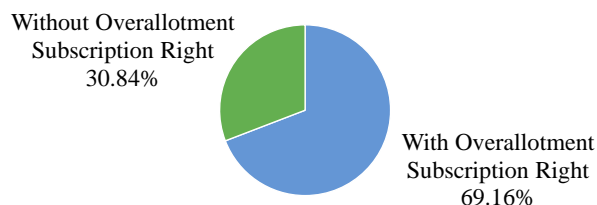
Right of First Refusal



Right of First Refusal – Super Pro Rata and Pro Rata



Right of First Refusal – Right of Overallotment



A right of co-sale provides shareholders (typically preferred shareholders) with the right to participate in a sale of securities by specified parties (typically founders) based on an agreed upon formula, the most common of which is the percentage held by the investor divided by the percentage held by all investors exercising the co-sale right plus the percentage held by the transferor.

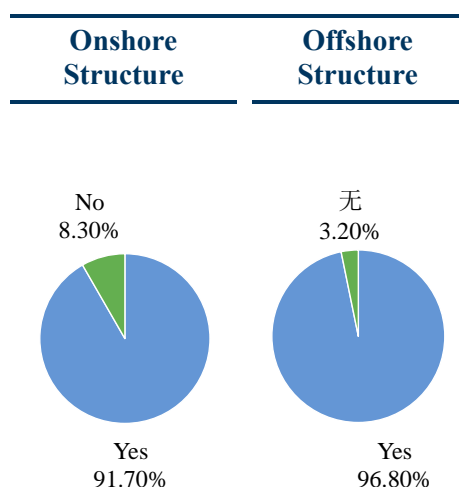
Co-Sale Calculation	Onshore	Offshore
Shares held by the investor/(shares held by all investors exercising the co-sale right + shares held by the transferor)	73.78%	74.29%
Shares held by the investor/(shares held by all investors entitled to exercise the co-sale right + shares held by the transferor)	17.33%	20.00%
Shares held by the investor/(shares held by all investors + shares held by the transferor)	2.22%	1.43%
Shares held by the investor/all issued and outstanding shares	2.67%	0.95%
None of the above	4.00%	3.33%

Protective Provisions

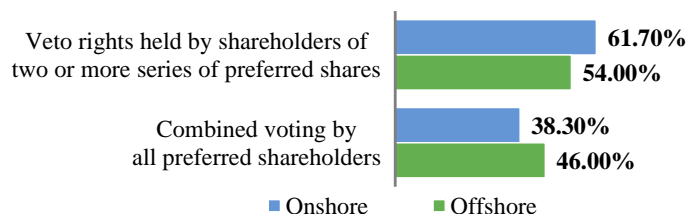
Protective provisions are specified matters that require the approval of a specified number of preferred shareholders or directors appointed by preferred shareholders. The threshold can be combined voting (e.g. a percentage of preferred shareholders as a group where no one preferred shareholder has an individual veto), class voting (e.g. a percentage of preferred shareholders in a certain group), or tied to an individual shareholder (e.g. an individual shareholder has a veto). Individual veto rights or thresholds that have the effect of individual veto rights are more common during early stage financings where there are few preferred shareholders. As the company matures and receives more financings, individual vetos evolve into class voting in order to prevent the company from having to obtain required consents from many different shareholders.

The apparent trend in the PRC differs from that of the United States based on publicly available data and the deal documents we have examined from United States VC/PE transactions. There, combined voting is generally introduced earlier in the company's life. However, we note that international funds, especially international private equity funds, may apply different standards as to veto rights in the PRC compared with the United States. In PRC transactions, these international funds will typically insist on individual vetos, or a combined veto with other international funds, irrespective of when the financing occurs.

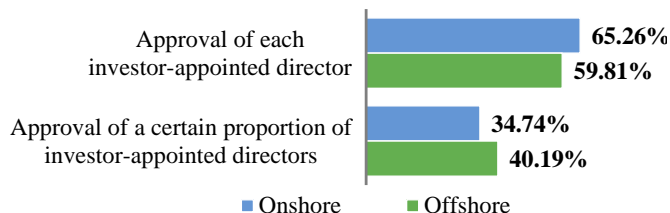
Existence of Protective Provisions



Approval Mechanism by Shareholders



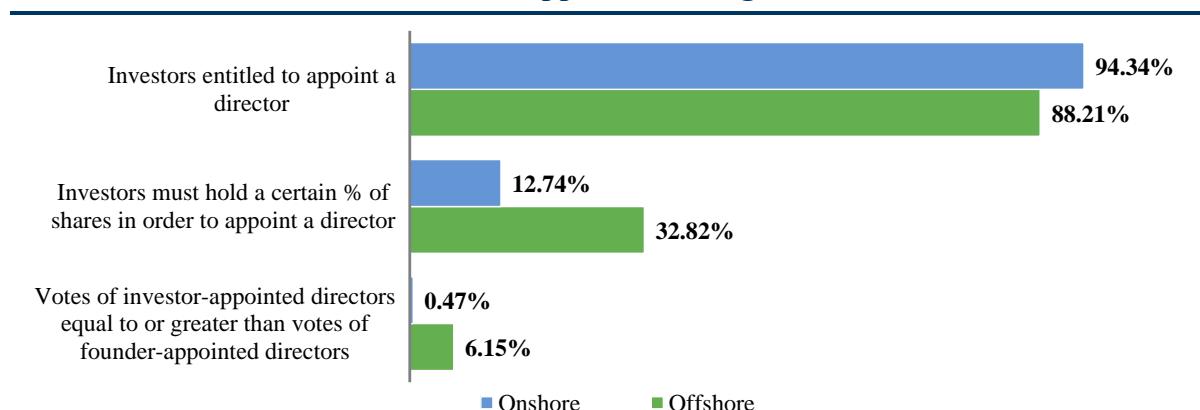
Approval Mechanism by the Board of Directors



The overwhelming majority of investors require board representation, though in PRC transactions the founders will typically nevertheless control the majority of members of the board. As target companies mature, they may set minimum shareholding thresholds for investors to keep their board seats.

The apparent trend in the PRC differs from that of the United States based on publicly available data and the deal documents we have examined from United States VC/PE transactions. There, as target companies mature the founders and management may cede control of the board to investor appointed directors or a combination of investor appointed directors and independent directors. However, this dynamic rarely occurs in PRC target companies and in fact continues after listing, thereby affirming the importance attached by investors in the founders and management.

Board Appointment Rights



Information Rights and Inspection Rights

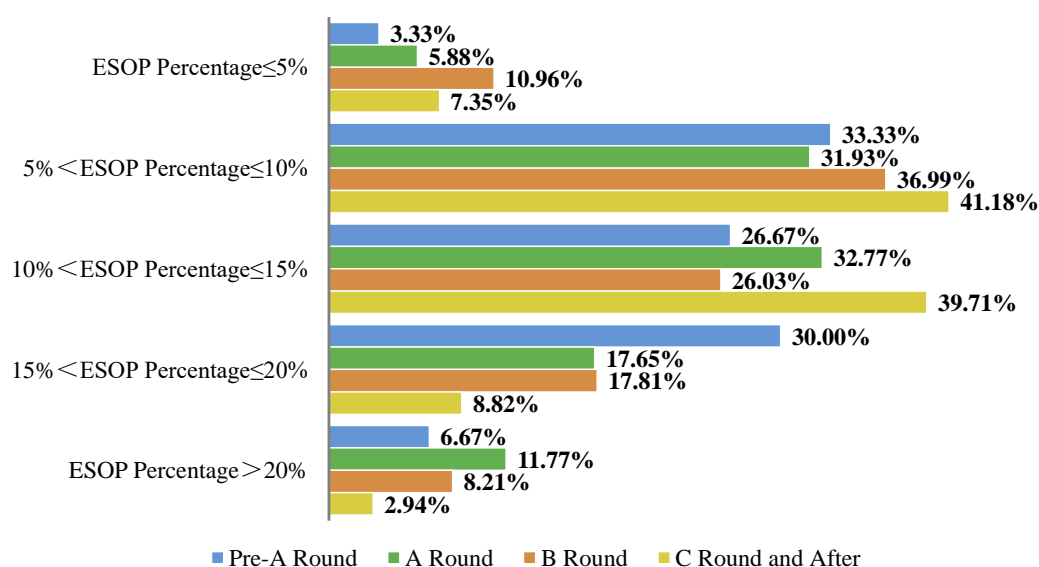
Information rights provide investors with the right to receive information from the target company that may be material to such investors, such as financial information, the annual business plan and budget, and the target company's capitalization table. Inspection rights provide investors with the right to inspect the books and records of the target company and inquire about its operations.

Information and inspection rights are common in PRC VC/PE transactions but the exact scope and parameters will depend on the circumstances of each transaction. In recent years, target companies have required confidentiality undertakings and restricted access to strategic investors, thereby evidencing growing aware of these provisions and their consequences.

ESOP

Han Kun's VC/PE data reveals wide variation in the amount of share capital reserved for issuance pursuant to employee share option plans. The amount is 5% to 20% prior to the Series C round and 5% to 15% in the Series C round and thereafter. 11.77% of Series A round transactions have amounts above 20%, while a number of Series B round transactions have amounts below 5% or above 20%.

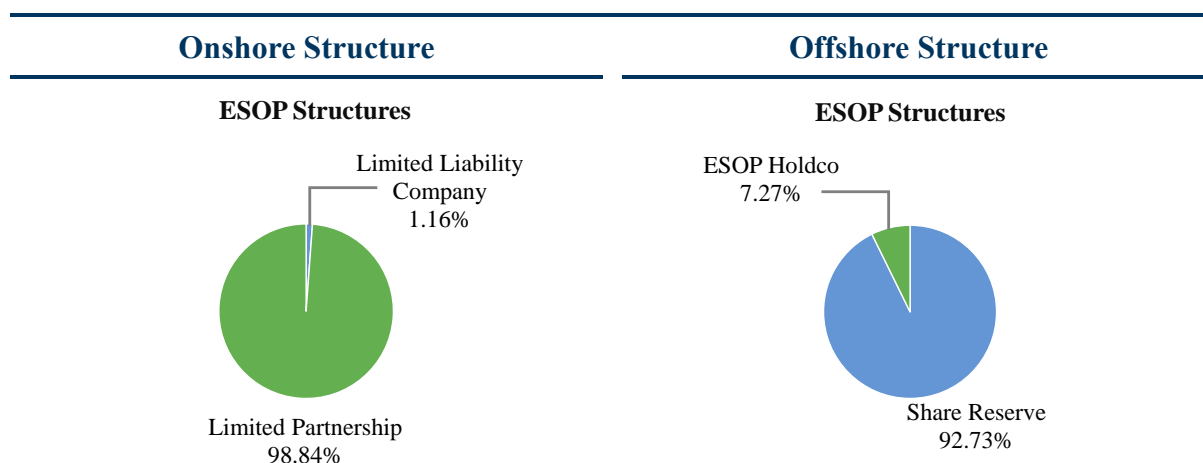
Post-closing ESOP Reserve (Including Options and Restricted Shares)



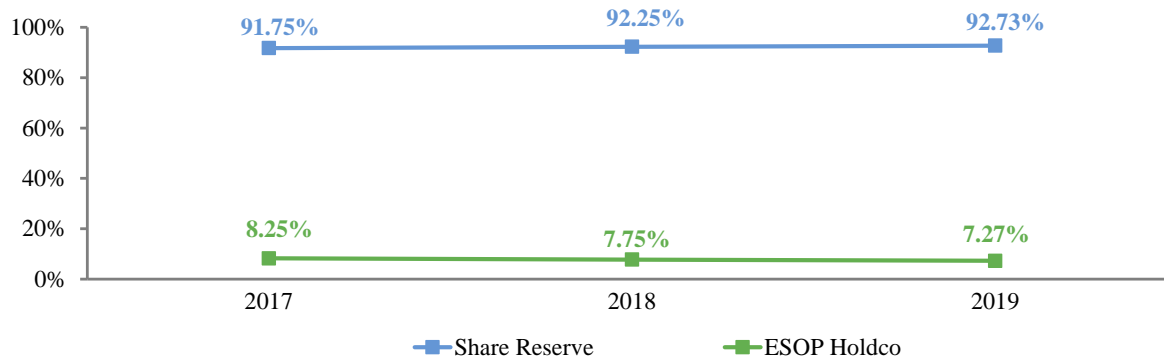
The structure of the employee share option plan differs in offshore and onshore transactions. In offshore transactions, there is a pool of reserved shares that are not actually issued until options are exercised. There is a small minority of offshore transactions where the pool is a shareholding platform that directly owns shares associated with the pool. The shareholding platform is ordinarily controlled by founders or management who have duly completed

required foreign exchange registrations. The shareholding platform then issues its options to beneficiaries. In onshore transactions, there is no legal concept of a share option pool. For tax reasons, the employee share option plan consists of limited partnerships (or a small minority of cases limited liability companies), which owns shares associated with such plan. The limited partnership then issues its options to beneficiaries.

ESOP



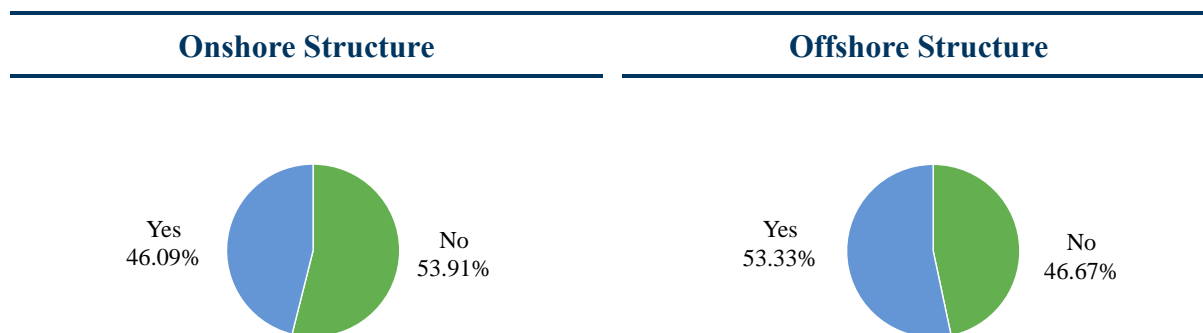
Offshore Structure – ESOP Structures in the Past Three Years



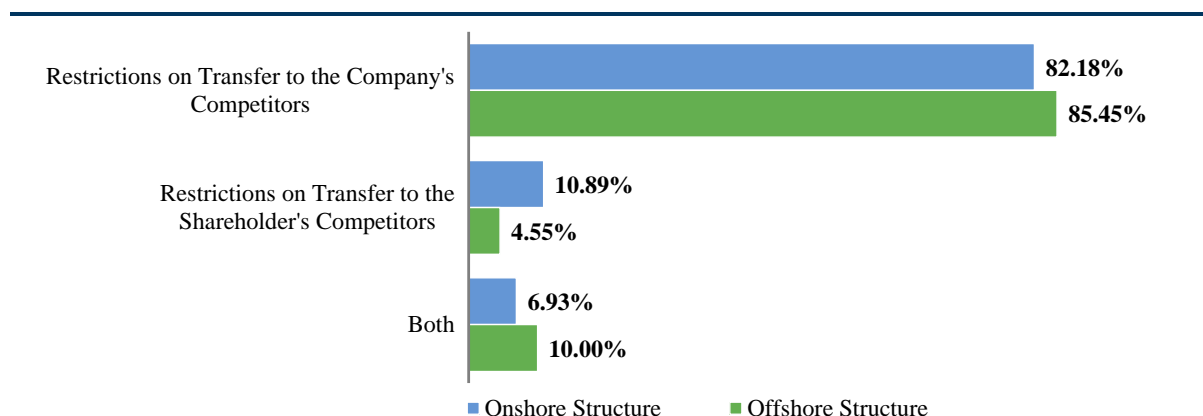
Investors' Share Transfer Restrictions

For financial investors, a secondary sale is one exit option, which is why financial investors are loath to accept any restrictions on the disposition of their equity. However, in recent years, target companies have imposed restrictions on their investors, preventing them from selling their equity to the company's competitors. In some instances, founders will only have right of first refusal to purchase equity proposed to be sold to designated competitors of the target company.

Investor Share Transfer Restrictions

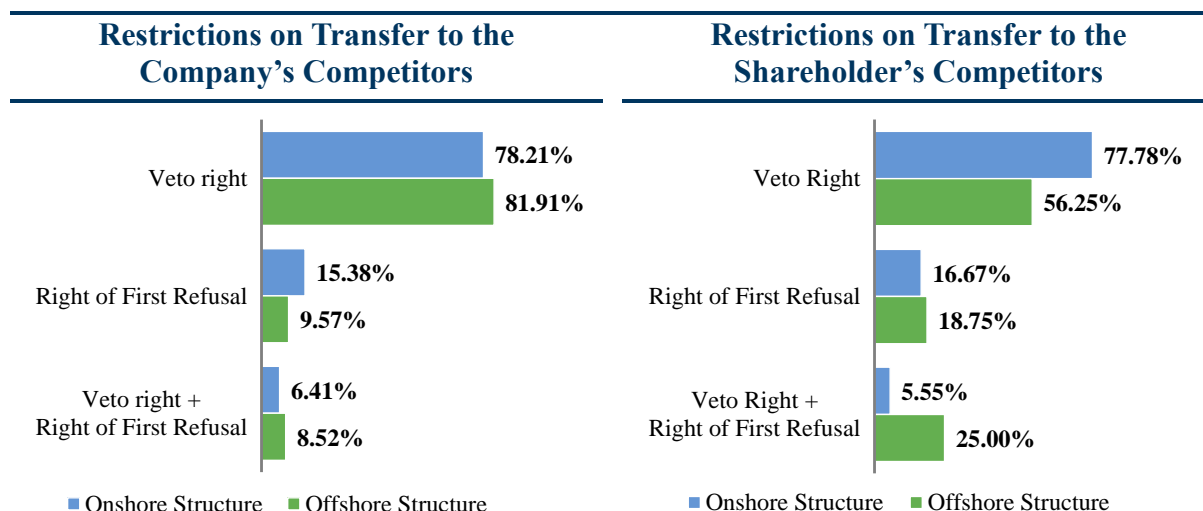


Investor Share Transfer Restrictions



Where there are major strategic investors, such strategic investors may further impose transfer restrictions, effectively preventing the target company from existing outside of a specified ecosystem. In a common compromise, such strategic investors will only have a right of first refusal to purchase equity proposed to be sold to such strategic investors' designated competitors.

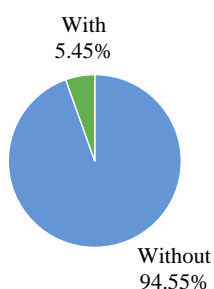
Investor Share Transfer Restrictions



Investor's Investment Restrictions

In addition to increasing restrictions on investors' transfer of shares to the competitors of the target company, in recent years there are exceptional cases where an in-demand target company is able to require investors not to invest in or cooperate with designated competitors of such target company following the investors' investment in such target company. To the extent these provisions exist, they are often heavily negotiated and qualified. One compromise is that investors who invest in or cooperate with designated competitors of such target company will no longer have information rights or other investor rights.

Investor May Not Invest in or Cooperate With Others



Most-favored Nation

A most favored nation provision states that a preferred shareholder (typically a new investor) will receive terms that are not less favorable than those provided to other shareholders. A most favored nation can apply to existing shareholder (look back), or prospectively to future

transactions (look forward). A look back most favored nation provision is typically negotiated in the term sheet, as the new investor is usually not aware of existing terms at the term sheet stage and seek to ensure that its terms will not be less favorable than those provided to current shareholders. A look forward most favored nation applies to future financings that are undefined, which may impact the terms provided to future investors, so to the extent they apply they are often qualified or negotiated (e.g. only certain terms are subject to the most favored nation). A related concept is a veto provision on future financings, which allows existing shareholders to determine the terms of a future financing as it applies to them.

In Han Kun's 2019 VC/PE transactions, 29% had most favored nation clauses in the transaction documents.

Warrant

A warrant provides the holder with the right to purchase additional equity of the target company in the future at an agreed upon price or mechanism to determine the price. Investors typically negotiate warrants to ensure additional investment at a set valuation within a certain time in the future.

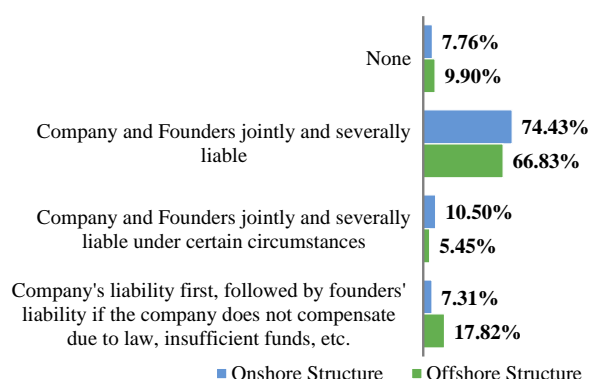
In Han Kun's 2019 VC/PE transactions, 10% involved warrants provided to investors.

Personal Indemnification Liability of Founders

In PRC VC/PE transitions, investors usually require the target company and its founders to make representation and warranties on a joint and several basis. Depending on the nature of the undertaking, this joint and several liability mechanism may also apply to post-closing undertakings, such as rectifying non-compliance identified prior to closing. Founders typically attempt to limit their exposure by requiring the investors to first seek recovery from the company, and limiting their liability to the shares they hold in the company or its value.

The apparent trend in the PRC differs from that of the United States based on publicly available data and the deal documents we have examined from United States VC/PE transactions. There, any personal liability of the founder is considered virtually unthinkable, even in early stage investments where the target company may not have sufficient assets at closing to satisfy any post-closing indemnification obligations. This difference may also be impacted by risk of enforcement, as instituting actions in the United States is relatively easy compared to the PRC, where initiating arbitration proceedings both in Hong Kong and mainland China can be time-consuming and lead to high upfront costs.

Founder Indemnification



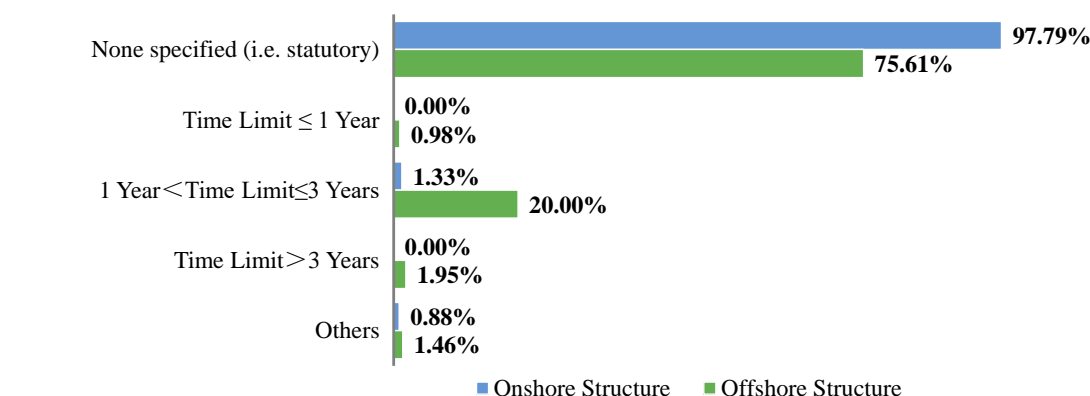
Founders Indemnification Liability Limit



Survival Period for Representations and Warranties

We have noticed target companies starting to negotiate survival periods in for representations and warranties in transaction documents, instead of accepting a default to the applicable survival periods under applicable law. While most PRC offshore and onshore VC/PE transactions still do not have survival periods, this trend may reflect greater awareness of target companies and founders of potential future actions pertaining to representations and warranties.

Survival Period for Representations and Warranties



Dispute Resolution

In Han Kun's 2019 VC/PE transactions, 96.30% elected for dispute resolution by arbitration and 3.70% elected for dispute resolution by litigation. Below is a chart comparing arbitration to litigation in the context of PRC VC/PE transactions.

Item	Litigation	Arbitration
Timing and predictability	Lengthy procedural hurdles; no time limits; less predictable judgements	Decision is final and non-appealable; greater sensitivity to time; generally more efficient and predictable outcomes due to arbitration procedures and rules and adherence to them
Confidentiality	Open court proceedings; judgments available to the public	Proceedings and decisions not public unless otherwise disclosed by the parties by mutual consent
Service of Process	Cross-border service must be effected through diplomatic channels	Not subject to judicial sovereignty but rather through arbitration rules, including e-mail or fax
Location of Proceedings	Jurisdictional limits, such as personal and subject matter jurisdiction; potential conflict of laws issues	Determined by contractual agreement
Procedure of Proceedings	Must follow rules of civil procedures; may not choose judges, venue, language, procedures	Parties may determine terms pursuant to contractual agreement, including the qualifications of arbitrators, venue, language, arbitration rules and costs
Court Costs	Filing, enforcement, and security fees generally lower than corresponding arbitration fees	Filing, enforcement, and security fees generally higher than corresponding court fees
Joining Third Parties	Court may add an interested third party and consolidate cases into one	Arbitration proceedings may not compel third parties to participate in the arbitration; cases may not be consolidated in the absence of consent by the parties

Disclaimer

This report is an important work product and copyright of Han Kun and should be treated as confidential information of the firm. No third party may copy, distribute, publish or reproduce this document, in whole or in part, unless with our written consent.

This report should not be relied on as legal advice or regarded as a substitute for detailed advice in individual cases. If you have any further questions or need professional legal services or support, please feel free to contact us.

Beijing

9/F, Office Tower C1, Oriental Plaza, 1 East Chang An Ave.
Dongcheng District, Beijing 100738, PRC
Telephone: +86 10 8525 5500
Facsimile: +86 10 8525 5511/5522
Email: beijing@hankunlaw.com

Shanghai

33/F, HKRI Centre Two, HKRI Taikoo Hui, 288 Shimen Road (No. 1)
Jing'an District, Shanghai 200041, PRC
Telephone: +86 21 6080 0909
Facsimile: +86 21 6080 0999
Email: shanghai@hankunlaw.com

Shenzhen

Room 2103-04, 21/F, Kerry Plaza Tower 3, 1-1 Zhongxinsi Road
Futian District, Shenzhen 518048, Guangdong, PRC
Telephone: +86 755 3680 6500
Facsimile: +86 755 3680 6599
Email: shenzhen@hankunlaw.com

Hong Kong

Rooms 3901-05, 39/F., Edinburgh Tower, The Landmark
15 Queen's Road Central, Hong Kong SAR, PRC
Telephone: +852 2820 5600
Facsimile: +852 2820 5611
Email: hongkong@hankunlaw.com



Beijing · Shanghai · Shenzhen · Hong Kong

© 2020 Han Kun Law Offices