



April 2003

BRIEFING

New Chinese merger control rules

Executive summary

The People's Republic of China (PRC) watched from the sidelines as many countries introduced national merger control regimes. However, it has now joined the fray and introduced merger control rules of its own. Rules that provide for potentially sweeping merger control reporting requirements will come into effect as of 12 April 2003. These will apply to transactions that directly involve the acquisition of domestic companies by foreign investors (onshore transactions) as well as to foreign to foreign transactions (offshore transactions).

Antitrust review for mergers and acquisitions

The new rules are awkwardly called the Provisional Rules on Mergers with and Acquisitions of Domestic Enterprises by Foreign Investors (provisional rules) and have been issued jointly by the Ministry of Foreign Trade and Economic Cooperation (Moftec – now the Ministry of Commerce), the State Administration for Industry and Commerce (SAIC), the State Administration of Taxation and the State Administration of Foreign Exchange. The rules do not give clarity as to their application in many instances. Nevertheless, they raise a potential compliance issue for multinationals for which the PRC is a substantial market.

The rules stipulate that mergers and acquisitions may not 'result in excessive concentration and exclusion or restriction of competition and may not disturb the social or economic order or harm public interests'. The rules also list two sets of thresholds that may trigger filing requirements and scrutiny, depending on whether the transaction is onshore or offshore.

Review triggers for onshore transactions

In the case of a merger or acquisition directly involving a domestic enterprise, the purchaser must submit a report to Moftec and SAIC if any of the following thresholds are met:

- the business turnover of a party to the merger or acquisition in the China market in the current year exceeds RMB1.5bn;
- the aggregate number of mergers and acquisitions of domestic enterprises in the relevant industry in China within one year (it is unclear if this refers to

the calendar year or a rolling 12-month period) exceeds 10;

- the China market share of a party to the merger or acquisition has reached 20 per cent; or
- the merger or acquisition will result in a combined China market share of 25 per cent.

In addition a transaction may be subject to review if a competing domestic enterprise, relevant authority or industrial association so requests, and Moftec or SAIC believes that the merger or acquisition involves 'substantial market share or any other major factor that may substantially influence market competition, the national economy and livelihood or national economic security'.

While the market share provisions appear to set clear standards, they are subject to the inherent complexities of market definition. Further, they are being introduced in the PRC when other countries are replacing them with more objective standards. As for the business turnover threshold, this would be a useful *de minimis* threshold if it were applied in conjunction with market share triggers. However, it appears likely that the thresholds are to be used alternatively, which means that the rules catch transactions regardless of the significance of the market shares or anticompetitive effects involved.

Similarly, the provisional rules do not explicitly link the RMB1.5bn turnover threshold to the industry or market relevant to the proposed merger. Because they adopt a group-wide approach in the turnover calculation, all sales of a foreign conglomerate in the PRC will be combined for purposes of turnover calculation.

Nor is there an exemption for passive minority investments despite the fact that the acquirer would not be able to exert control over the acquired entity. For onshore transactions ‘mergers and acquisitions’ is defined to explicitly cover various transaction structures available for the acquisition of equity or assets of PRC enterprises.

Review triggers for offshore transactions

The new merger control regime explicitly asserts jurisdiction over transactions that take place between entities that are not located in the PRC. Notification must be filed before the merger plan is announced or at the time the merger plan is submitted to the ‘relevant authority’ of the jurisdiction in which it will occur. Any of the following triggers may require PRC notification:

- the assets in China owned by a party involved in the merger or acquisition exceed RMB3bn;
- the business turnover of a party to the merger or acquisition and its affiliates in the China market in the current year exceeds RMB1.5bn;
- the China market share of a party to the merger or acquisition and its affiliates has reached 20 per cent;
- the merger or acquisition will result in a combined China market share of 25 per cent; or
- as a result of the offshore merger or acquisition, the party involved will directly or indirectly hold equity in more than 15 foreign investment enterprises (FIEs) in the PRC.

Of particular note, the assets test, which is not listed as a trigger for onshore mergers, could potentially have an impact on the worldwide M&A activities of major PRC investors. This test could subject an offshore worldwide merger of two large corporations to PRC review and approval in the event that one of the corporations had a substantial capital-intensive investment in China, even though the other had no onshore PRC presence or sales.

Review process and non-compliance penalties

The provisional rules do not set out in any detail the procedural issues for the competition review process and the extent to which a foreign investor can participate in it.

If Moftec and SAIC conclude that a proposed onshore merger or acquisition ‘may result in excessive

concentration so as to jeopardize fair competition and harm consumers’ interests’, a review hearing will be convened within 90 days of the date that the investors submitted their report on the proposed merger. ‘Relevant departments, institutions, enterprises and other interested parties’ may be called to attend the hearing, and Moftec and SAIC will subsequently decide if the merger is approved. The provisional rules do not appear to contemplate a hearing for offshore mergers.

With regard to offshore mergers, it is not even clear whether the parties must obtain approval before closing the transaction, although the provisional rules suggest that notification would be required beforehand.

Article 22 provides that an exemption from merger control may be obtained for transactions that: improve the conditions for fair market competition; restructure any loss-making enterprise with guaranteed employment; introduce advanced technology and administrative professionals and improve the competitiveness of domestic enterprises in the international market; or improve the environment. Informal inquiries with Moftec suggest that this exemption is available only for onshore mergers and will allow mergers which would normally not be approved due to anti-competitive effects to gain approval if there may be offsetting public interest benefits.

The provisional rules do not look at penalties for non-compliance with the reporting or approval requirements for offshore mergers. Presumably, any onshore reorganisation of FIEs to be completed as part of the offshore merger could be frustrated by the approval authorities in the event of non-compliance with merger reporting rules, but it is unclear what additional sanctions might result. It is also unclear if the authorities would issue a formal prohibition decision. Draft antimonopoly legislation suggests that approvals may be issued on a conditional basis in some cases.

For further information please contact

Tom Jones

T + 852 2846 3403

F + 852 2810 6192

E thomas.jones@freshfields.com