Chinese merger control

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China's first merger control regime was introduced as part of the Provisional Regulations on Foreign Investors Merging with or Acquiring Domestic Enterprises (the 'Foreign M&A Regulations') issued in March 2003. The regulations apply only to transactions involving foreign parties, and reach even purely offshore transactions if the parties or their affiliates have certain qualified assets or business in China.

These new Chinese merger control procedures are still developing. They occupy only a small portion of the Foreign M&A Regulations, which are labelled "provisional" and will have to be supplemented, revised and/or superseded in the next few years. Their merger control-related articles lack clarity, with most key terms undefined in the regulations or in Chinese law. Because implementing rules have not yet been issued, and no decisions under the regulations have been made public, parties are left to rely on their own interpretation and on informal guidance from government officials. It remains unclear how sophisticated the regulatory review will be, but the present lack of standards and precedents suggests that much regulatory discretion will remain.

On the other hand, Chinese lawmakers and regulators are intent on making China's legal system market-compatible and further encouraging foreign investment activity. Officials have indicated that the passage of a modern antitrust law is a top priority for China as it continues to upgrade its legal system to international standards. Drafts of a more comprehensive Anti-Monopoly Law (including a somewhat different merger control process) evidencing European and US influences have been in circulation for some time. Lawmakers are committed to learning from international practice, even if ultimately they retain some uniquely Chinese perspectives.

Substantive standard

The principal substantive merger control issue under the Foreign M&A Regulations is framed by Articles 20 and 21 and questions whether a transaction will cause "excessive concentration in the domestic market, impede or disturb rightful competition, and harm domestic consumers' benefits". Article 3 also generally requires that foreign investors "must not cause excessive concentration or exclude or restrict competition".

Neither the regulations nor any other portion of Chinese law currently provides any additional insight into how the responsible government ministries will conduct their antitrust analysis. A number of merger filings have already been submitted for review, but no details of any dispositions are publicly available. It is reasonable to assume that Chinese regulators' analysis will be less practiced and technical than that of more mature antitrust jurisdictions. Nevertheless, parties should be permitted to raise whatever competitive arguments and information they have, and are likely to encounter individual regulators with substantial knowledge of Western competition regimes and analysis.

Scope of regulatory coverage

The Foreign M&A Regulations cover only transactions involving foreign parties, which are separated into onshore and offshore transactions:

Onshore transactions

Article 2 states that the regulations cover mergers and acquisitions between foreign investors and domestic Chinese enterprises (ie, 'onshore transactions') of two types:

1. ***Equity transactions***, meaning
   - a foreign investor's acquisition of equity interest in a purely domestic enterprise and the subsequent conversion of that domestic enterprise into a foreign-invested enterprise ('FIE'); or
   - a foreign investor's subscription to the increased capital of a purely domestic enterprise and the subsequent conversion of that domestic enterprise into an FIE; or

2. ***Asset transactions***, meaning
   - a foreign investor's establishment of an FIE to acquire and use the assets of a domestic enterprise (including those of an FIE); or
   - a foreign investor's direct acquisition of the assets of a domestic enterprise (including those of an FIE) and the contribution of those assets to establish and operate an FIE.

As written, the regulations may not cover transactions undertaken by pre-existing FIEs, although they instead may be covered by other foreign investment-related regulations without antitrust review mechanisms.

Offshore transactions

The term "overseas merger or acquisition" (ie, 'offshore transactions') used in Article 21 is not defined in the Foreign M&A Regulations, and its application to the merger review process is therefore uncertain. If interpreted broadly, the term potentially could cover nearly any transaction occurring outside of China, so parties and counsel should carefully evaluate the potential impact of their deal structure and whether their transaction reaches the reporting thresholds for offshore transactions described below.

Other transaction types

Under Article 24, the Foreign M&A Regulations also cover direct acquisitions by foreign investors of equity interests in existing FIEs, to the extent that such transactions are not governed by separate regulations relating to the transfer of stakes in FIEs. Article 24 also states that the regulations cover transactions involving foreign investor-owned China holding companies (in Chinese legal parlance, "foreign investment companies") and domestic enterprises.

Transactions that do not fall within these defined categories do not appear to be covered by the regulations.

Regulatory authorities

MOC and SAIC

Under Articles 20 and 21 of the Foreign M&A Regulations, both the Ministry of Commerce ('MOC' or 'MOFCOM,' formerly the Ministry of Foreign Trade and Economic Cooperation or 'MOFTEC') and the State Administration of Industry and Commerce ('SAIC') are empowered to receive and review merger control filings. The same two agencies (or their local subordinates) also are responsible for the approval and registration of foreign investments. Both agencies have been involved in drafting the new Anti-Monopoly Law, which may result in the creation of a separate, new antitrust enforcement agency. SAIC is also designated as one of the chief enforcement agencies for China's Anti-Unfair Competition Law.

The extent of each agency's responsibilities and its reviewing standards, methods, and procedures are not clearly set forth in the Foreign M&A Regulations. This lack of clarity presents significant challenges for foreign investors preparing, submitting, and defending merger notification filings.

Specialised industry review

Neither the Foreign M&A Regulations nor other Chinese law provides for competition-based merger review by other government ministries. However, laws and regulations governing foreign investment in China (such as the Investment Catalogue) may affect the feasibility or approval of foreign M&A transactions, providing transactions in certain industries with higher scrutiny or even across-the-board prohibition. In general, MOC and SAIC (or their local subordinates) may notify and consult with other relevant government authorities regarding each transaction.

Mandatory reporting requirements

The thresholds for mandatory reporting are different for onshore and offshore transactions. Some thresholds relate to the size of the parties and their affiliated enterprises as measured by business turnover, cumulative annual number of acquired businesses, market share, or size of assets. Others relate to the effect of the transaction on market concentration as measured by combined market share. Each applicable threshold will independently trigger mandatory merger notification and approval.

Onshore transactions

For onshore transactions, Article 19 of the Foreign M&A Regulations provides four independent thresholds requiring merger notification and review:

- one party (if foreign, including affiliates) has a one-year China business turnover exceeding RMB1.5 billion (US$181 million);
- one party (if foreign, including affiliates) has in one year acquired more than ten domestic enterprises in related industries;
- one party's (if foreign, including affiliates') China market share already has reached 20 per cent; or
- as a result of the transaction, one party's (if foreign, including affiliates') China market share will reach 25 per cent.

Offshore transactions

Article 21 of the Foreign M&A Regulations provides five separate thresholds for mandatory reporting of offshore transactions:

- one party holds assets within China worth over RMB3 billion (US$362 million);
- one party has a business turnover in the China market in that year worth over RMB1.5 billion (US$181 million);
- one party's (along with its affiliated enterprises') China market share has already reached 20 per cent;
- as a result of the transaction, one party's (along with its affiliated enterprises') China market share will reach 25 per cent; or
- as a result of the transaction, one party will directly or indirectly hold equity interests in more than 15 FIEs in related industries.

Exceeding any of these thresholds requires that the offshore transaction plan be reported to MOC/SAIC either (a) before the plan is publicly announced or (b) simultaneously with the submission of the plan to the regulatory authorities in the country where the transaction is to occur. The regulations thus appear not to require reporting when neither public announcement nor a merger filing in the country of the transaction is necessary.

No minimum transaction size

It should be noted that, unlike in some jurisdictions, transaction size itself is not relevant to the mandatory notification thresholds for onshore transactions. Thus, for example, a transaction in a small and economically insignificant industry still may require antitrust notification and review if the parties' combined market share will exceed 25 per cent.

For offshore transactions, the scope of potential reporting obligations is even broader. The regulations may require reporting of transactions even if they have no competitive effect in China, so long as one party's China market share, business turnover, or assets exceed the threshold limits. However, the use of special acquisition vehicles may help to avoid some such results.

Use of acquisition vehicles

For onshore transactions, the requirement that the market share, business turnover, and prior domestic acquisitions of all "affiliates" of foreign acquirors be aggregated means that mandatory reporting cannot be avoided by the use of special acquisition vehicles. In any event, Chinese law generally does not permit the use of such vehicles in domestic transactions.

For offshore transactions, however, tests (1) and (2) above apparently do not require the China assets or business turnover of a party's affiliated enterprises to be aggregated with those of the party itself. Thus, it may be possible to structure offshore transactions using special acquisition vehicles to avoid mandatory reporting in China, as long as the aggregated market share and number-of-FIE thresholds are not reached.

Issues for clarification

Pending the promulgation of implementing rules or other official guidance, many issues remain to be clarified, including:

- which party is responsible for reporting the transaction, or whether both must independently or jointly file;
- what degree of control or cross-ownership is required for "affiliates";
- the time period over which to measure China business turnover;
- what "related industries" are;
- how to measure "China market share" and determine the relevant product market(s);
- what accounting principles must be used in determining a party's total China assets and business turnover; and
- what "directly or indirectly" means in the context of holding equity interests in FIEs, and how large those interests must be to qualify.

Discretionary review of onshore transactions

Even if the thresholds for mandatory reporting are not met, under Article 19, MOC and SAIC may be requested by domestic competitors, relevant government authorities, or industry associations to

engage in discretionary review of an onshore transaction. MOC and SAIC may require the parties to such a transaction to report a transaction if, upon such a request, the regulators determine that the transaction will "involve a very large market share" or there exist factors that will "seriously influence market competition, the national economy, and the livelihood of the people and national economic safety". Article 3 supports this by stating that foreign investors "must not disturb social and economic order or damage social and public interests". These broad terms provide substantial room for domestic competitors, local authorities and/or regulators to require review of onshore transactions independent of their competitive significance.

There is no similar discretionary reporting mechanism for offshore transactions.

Exemptions from review

Finally, under Article 22 of the regulations, the parties to a reportable transaction may seek an exemption from regulatory review if the transaction "can improve conditions for fair market competition," "restructures loss-making enterprises and assures employment," "introduces advanced technologies and managerial talent and improves the enterprise's international competitiveness," or "can improve the environment".

As with other practice under the regulations, the exemptions require approval from MOC/SAIC and thus may be subject to substantial administrative discretion.

Notification and approval procedures

The Foreign M&A Regulations do not provide much detail about the procedures for reporting and review of covered transactions.

When to report

The regulations do not specify a time period within which the parties to a transaction must report an onshore transaction meeting the reporting thresholds. However, they must submit their merger filings (and perhaps evidence of clearance) in order to obtain foreign investment approval and registration.

The regulations expressly require that the parties to a reportable offshore transaction notify MOC/SAIC of their merger plan before it is publicly announced or at the same time that it is submitted to regulators in the country in which the transaction will occur.

What to report

The regulations also provide no detail about what information must be provided to MOC/SAIC as part of the reporting process, beyond the fact that a proposed transaction is reportable. Other articles in the regulations require the submission of certain documentation for foreign investment approval and registration, but that documentation does not appear to include any separate competition-related information. Thus, the details of any document submissions will likely be the subject of case-by-case discussions with regulatory authorities.

Review and approval

The regulations also provide little detail about how, on what basis, and when MOC and SAIC will review and approve or disapprove a proposed transaction based on competitive concerns.

The only required process is set forth in Article 20, which provides that, for onshore transactions, MOC/SAIC may first determine that a transaction "might cause excessive concentration in the domestic market, impede or disturb rightful competition, and harm domestic consumers' benefits," in which case the ministries will "jointly or separately convene the appropriate departments, institutions, and enterprises as well as other concerned parties for a public hearing within 90 days of receiving all requisite documents". After this hearing, MOC/SAIC "will then decide whether to approve or reject the application according to law." No similar procedure is provided for offshore transactions, which are not explicitly barred from closing pending merger review.

Without implementing rules, the regulations do not make regulatory compliance and deal planning easy. There are many potential opportunities for extra-competitive concerns and administrative discretion to enter and affect the review and decision processes. Moreover, given the absence of clear procedures and timing, there is no way to accurately predict how long merger review may take. For example, the regulations do not specify:

- how MOC/SAIC make the preliminary determination that the transaction is of competitive concern and requires a hearing;
- whether and how the parties may provide information and argue their case prior to such preliminary determination;
- what "requisite documents" are to be provided by the parties;
- what information may be provided by or required of third parties;
- the timeline for MOC/SAIC to request and parties to provide documents or information;
- how MOC/SAIC determine what governmental departments, institutions, enterprises and concerned parties may participate in the hearing;
- the procedures for conduct of the hearing itself;
- the timeline for MOC/SAIC to make their final determination; and
- what legal principles, arguments, and analytical methods MOC/SAIC will consider in the review process.

This is compounded by a lack of clarity regarding the division of reviewing responsibilities between MOC and SAIC. There is no assurance that the two agencies will employ consistent and transparent review standards. Thus, China's merger review process may present formidable challenges for foreign investors whose transactions require notification and review.

Non-compliance

The Foreign M&A Regulations do not provide a mechanism for penalising non-compliance with their merger reporting or other requirements. There is no express authorisation for MOC/SAIC to seek the reversal of a transaction that was not properly reported for merger review. Thus it is unclear whether any such non-compliance might result in administrative or civil fines, a cease and desist order, rescission or unwinding of a transaction, or even criminal penalties, although all are possibilities. MOC believes the new merger control regime to be enforceable on its face and already has received a number of filings for merger clearance.

In order to obtain foreign investment approval and registration for onshore transactions, however, Articles 12 and 15 of the regulations require that the parties submit their merger filings (and perhaps evidence of antitrust clearance) to the foreign investment approval authorities. Accordingly, if the relevant authority determines that a transaction should have been reported for antitrust review, it may simply refuse to approve or register the transaction, rendering it legally ineffective even if consummated by the parties. In extreme cases, the authorities could issue rectification orders and even suspend or revoke the business license of the relevant FIEs.

Appeal

Although the regulations do not provide for any appeal mechanism, Chinese administrative law permits a party wrongfully denied approval to seek review either through administrative appeal or by filing an administrative suit in the relevant Chinese courts. As a formal matter, Chinese courts may not have the judicial power substantively to review such a denial. However, a favourable court decision may be useful in helping to convince the ministry to reconsider (if not reverse) its decision.

The draft Anti-Monopoly Law

China's lawmakers currently are considering a draft comprehensive Anti-Monopoly Law that addresses a broader range of antitrust/competition issues than do the Foreign M&A Regulations. The latest publicly circulated draft of that law includes a chapter governing the approval of enterprise consolidations, which:

- applies to all consolidations, whether by merger, asset or share acquisition, joint venture, or any other means;
- covers consolidations involving foreign or domestic companies;
- covers all transactions, onshore or offshore, that restrict or affect competition within China;
- employs reporting thresholds based upon market shares without considering other factors such as business turnover, assets, or the total number of controlled or affiliated enterprises;
- envisions a new regulator, the Anti-Monopoly Management Body of the State Council ('AMB');
- provides a list of the types of documentation and information the parties must provide to the AMB for review, including financial statements, information about assets, sales, profits, production and operating costs, the reasons for the proposed consolidation, and any "other documents required by the AMB";
- requires the AMB to make a decision on whether to approve or not approve the transaction within 90 working days after receiving all requested documentation; however, "special circumstances" may permit extension of the time period, and no time or other limits apply to the AMB's requests for information, so the review period remains potentially unbounded;
- permits the AMB to "attach restrictive conditions" to any approval;
- requires the AMB to "not grant approval" if a proposed consolidation would (1) exclude or restrict market competition; (2) hinder the healthy development of the national economy; or (3) harm social and public interests; and
- provides that the State Council may nevertheless grant approval if consolidation of enterprises which otherwise exclude or restrict market competition would "substantially benefit the national economy and the social and public interests".

Although generally more detailed than the Foreign M&A Regulations, this proposed merger control scheme also leaves many questions unanswered. Moreover, the draft Anti-Monopoly Law has since been further revised by MOC and submitted to the State Council for possible revision and/or passage. The specifics described above – including the single regulatory authority, market share-based reporting thresholds, and a more detailed review mechanism—all remain subject to further change. It also is unclear whether the Foreign M&A Regulations and the Anti-Monopoly Law will provide one consolidated or two separate merger review regimes (three if foreign investment approval is added), although at least regulators intend them to be consistent. MOC has continued to solicit detailed input on both the draft law and the provisional regulations from Chinese and foreign antitrust law experts. Chinese lawmakers appear eager to consider and incorporate many elements of standard international merger control practices, although perhaps only gradually and at the same time accounting for uniquely Chinese concerns and market conditions.

Conclusion

Without implementing rules or detailed official guidance, China's merger control regime is still to a large degree a work-in-progress. In terms of practical application, the new regime in its current form leaves many issues unaddressed, including substantive standards, time periods, and procedures for merger review. In the near term, merger notification and approval requirements remain uncertain at best and should be evaluated on a case-by-case basis. Consultations with experienced counsel may be necessary to assess the potential impact on any given transaction and determine an appropriate transaction structure and course of action.

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