



Concentration Review Filings Under China's Anti-Monopoly Law

While mergers & acquisitions activity may be down, a slew of new Anti-Monopoly regulations make an acquisition in China more complicated than ever. Edward Epstein, a long-time resident of China and managing partner of Troutman Sanders Shanghai answers questions concerning one critical aspect of the new M&A landscape in China: concentration review filings.

It has been almost two years since the fanfare surrounding China's new Anti-Monopoly Law. Read with great anticipation, the law turned out to be short on details on just about everything. Since its implementation in August 2008, these gaps are gradually being filled with subsidiary rules and regulations.

Since early 2009, draft regulations are spewing forth on matters such as concentration filings, monopolistic agreements and abuse of dominant market position. These rules and regulations represent unprecedented complexity in this area of Chinese law and have been subject to a consultation process involving legal seminars, chambers of commerce and submissions from other interested parties. This is all good. But at the end of the day, as is always the case in China, there are many basic questions that will only be answered as the practice evolves.

For foreign investors and their lawyers on the ground in China, it is still more of an art than a science to determine whether a merger or acquisition must be filed for a concentration review and what the likely outcome will be. What is clear now is that, unlike filings under the Ministry of Commerce's ("MOC") Circular 10 of 2006, which were routinely ignored, the new law has teeth and failure to make a required filing can lead to serious consequences.





Only time will tell how the Anti-Monopoly Law and related regulations will be implemented in practice, but dealmakers are well-advised to become familiar with what these rules say on paper, so that they don't run afoul of clear requirements. Below, Epstein addresses the most important questions businesspeople should be asking, before a deal gets too far along.

When does a Concentration Arise?

The Anti-Monopoly Law defines “concentration” as one of the following:

- A merger
- An acquisition of control by acquiring equity or assets; or
- An acquisition of control rights or de facto decision-making power by other means.

When is a Concentration Review Required?

A concentration filing under the Anti-Monopoly Law is now required if the parties to a transaction satisfy either of the two following thresholds:

1. Worldwide “turnover” of all the parties to the transaction in the preceding financial year exceeds RMB10 billion AND the PRC turnover of at least two of the PRC parties is each RMB400 million in the preceding financial year;

OR

2. PRC turnover of all parties to the transaction in the preceding financial year exceeds RMB2 billion AND the PRC turnover of at least two of the PRC parties is each RMB400 million in the preceding financial year.

A further catch-all provision in the Anti-Monopoly Law requires an investigation even where the above filing thresholds are not met but where a concentration still has the effect of eliminating or restricting competition.

These thresholds were established by the MOC in the ***Regulations on the Threshold for Concentration Filing of Business Operations*** also effective from August 2008. The thresholds are broad enough to catch transactions wholly outside China that may affect competition within China. Crucially, they failed to define both core concepts of “turnover” and “control” but they did anticipate future regulations that would define the method of calculating turnover in what could be endless permutations of transactions involving foreign and Chinese and listed and private enterprises in different sector.

Example: US Public Co. has five subsidiaries in China and acquires UK Public Co., which has three subsidiaries in China. US Public Co. and UK Public Co. have a combined turnover of \$5 billion (about RMB35 billion). One of US Public Co.'s and one of UK Public Co.'s China subsidiaries each has a PRC turnover of RMB500 million. A filing will be required. If UK Public Co.'s three subsidiaries were engaged in export-processing and their export sales therefore excluded from the threshold, no filing would be required.



Definition of Turnover and Control

The draft *Interim Measures for Concentration Filing* define turnover and control as follows:

“**Control**” means either control of at least 50% of the voting rights or management control, which is defined as acquiring the power to appoint key management personnel and make key business decisions by ownership of equity, assets or by contract. Although the definition of “control” is broad enough to include joint ventures, the draft Interim Measures clarify the current law by specifying that the establishment of a Sino-foreign equity or cooperative joint venture (there were 122,821 joint ventures in China in 2007) is a type of concentration. Formation of joint ventures will become even more traumatic.

The definition of control casts the net very widely and will send a chill wind across those businesses which have attracted VC and PE investment in sectors where foreign investment is restricted and prohibited. The last thing they will want is a nosey regulator poring over their complex nominee structures.

“**Turnover**” is income from sales made and services supplied in the preceding fiscal year less taxes (except corporate income tax and VAT). “PRC” turnover does not include export sales from China but it does include the import of sales and services from foreign business operators.

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Turnover is aggregated among affiliates that are either under direct or indirect control of a business operator or under common control. This includes goods and services supplied by affiliates to third parties but excludes supplies between affiliates. So for example, the supply of goods by one company to be distributed by an affiliate would not be counted in the group’s turnover but the sale of those goods to end-users would be counted.

In order to prevent transactions from being broken into smaller pieces that do not meet the concentration filing thresholds, the draft measures require all concentrations within a year of the first transaction to be aggregated and to be filed as a single concentration if in aggregate they meet the filing threshold.

The draft measures are subject to amendment but the public consultation period has expired.

The second threshold applies where the parties may have little or no business outside China but have a sizeable business in China. For example, HK Private Co. has 10 subsidiaries in China with a total turnover of RMB1.5 billion and it acquires a Chinese owned business with a turnover of RMB500 million. If one of HK Private Co.’s China subsidiaries has PRC turnover of RMB400 million, a filing will be required.

Even if the thresholds are not met, the catch-all provision allows the regulator to launch an investigation on its own initiative. That the AMB intends to exercise this broad power is made clear by further draft regulations, which provide that an investigation can be launched when a concentration is “suspected to restrict” or “may restrict” competition. Moreover, the draft regulations make it mandatory for the AMB to conduct a preliminary analysis of the concentration where a complaint has been made in writing (for example, by a competition) and contains relevant facts and evidence.



Who Handles a Concentration Review and What is Required?

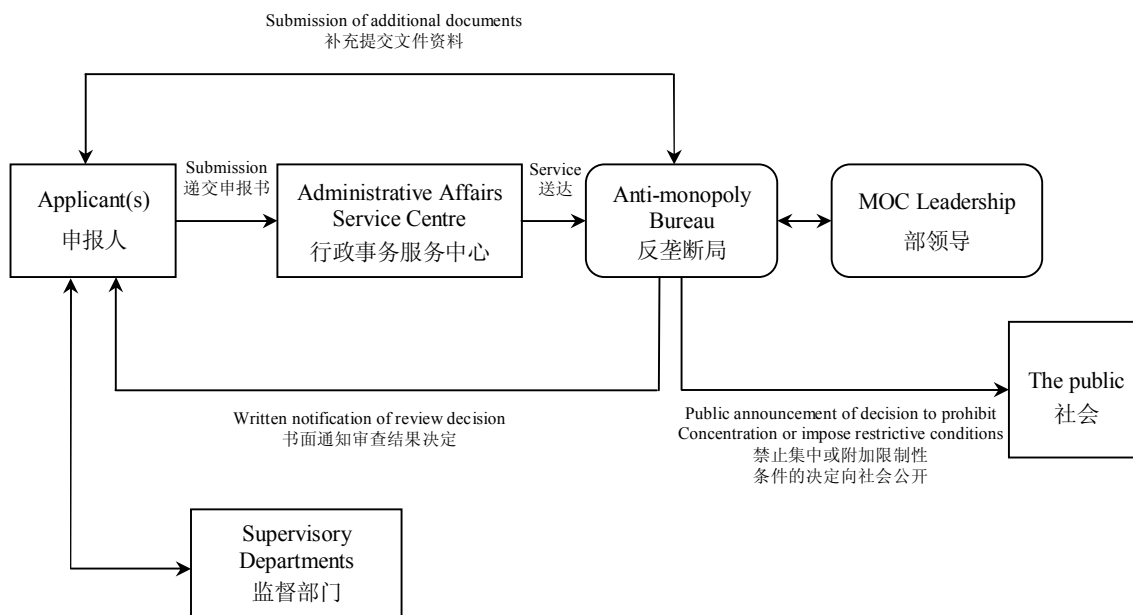
A concentration review is handled by the Anti-Monopoly Bureau (“AMB”) under the MOC.

In response to expectations of transparency under the WTO, the AMB has for a Chinese bureaucracy gone to unprecedented lengths to document the form and process for a concentration filing. There are detailed filing guidelines, including a standardized application form and a flowchart to explain the application and approval process (*Guidelines for Business Operator Concentration Submission of Documents* effective January 7, 2009), which seem to require the applicant to disclose every detail of possible relevance to the concentration.

Apart from a description of the proposed transaction, the main details will be

- a market demarcation
- overview of the relevant industry
- list of competitors and market share
- evaluation of the impact of the concentration
- statement of the applicant’s market share and control, and ease of entry as well as various competition issues such as competition and market structure and even the views of local government.

In practice, we can hope that short and summary application materials will be preferred. The truth is that Chinese bureaucracies are not used to handling and therefore dislike reams of paper and complex submissions.



The applicant files to the Administrative Affairs Service Center, which acts as an agent to submit the completed application to the AMB. The AMB is merely a department within the MOC and is subject to the policy “leadership” of the MOC as a whole. It is therefore reasonable to expect that decisions will be taken on broad policy grounds as well as what is enunciated in the law.



Where an applicant is unsure whether a concentration review is required for a specific transaction, the filing guidelines allow a pre-filing consultation. Consultations may be oral or in writing but must be preceded by a preliminary written request including the relevant background information and the questions to be addressed.

How long will the process take? What will be the outcome?

The Anti-Monopoly Law splits concentration reviews into two stages and requires the preliminary review to be completed within 30 days from the date of first submission. During this time, the transaction cannot close. If a decision is not issued within 30 days, the transaction may be closed.

If the AMB decides that a substantive review is required, it has a further 90 days in which to make its final decision. If the final decision is not made within this time limit, the transaction may be closed. However, the AMB can extend the time limit to up to 180 days from the date of first filing by requesting the applicant to submit supplementary materials. The flow chart specifically anticipates this. In this case, the old adage will apply: a deal that drags is a deal that dies.

The concentration review of Coca Cola's proposed acquisition of Huiyuan Juice is reported to have taken exactly 180 days. Whether or not the decision really required 180 days of deliberations is not the point. In Chinese regulatory practice, work always expands to fill the time available.

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The Anti-Monopoly Law provides six relevant considerations for deciding whether or not to approve a concentration:

- market share and market control
- the level of concentration in the relevant market
- the impact of concentration on access to and technological development in the market
- the impact on consumers and other business operators
- the impact on economic development
- other considerations.

The AMB's decision in the Coca Cola-Huiyuan Juice case focused on the first four considerations. In particular, the leverage of Coke's position in the carbonated drinks market to reduce competition in the juice drinks market must have been a concern, as it was in 2003 when Coke's bid for a leading Australian juice drinks maker was rejected. As China's anti-trust law is a transplant of Western legal tradition, it would be expected that the AMB is reviewing foreign anti-trust decisions as part of a learning process.



The Coke-Huiyuan case should not be regarded as representative because both are iconic consumer brands in their respective markets and it is inevitable that cultural and political considerations will play a role. It has been reported that the AMB has reviewed some 30 concentration cases since August last year and more than 80% of them have been approved without conditions. The public only hears about cases which are rejected or restricted because the AMB is only required to publish its decisions in those cases.

What if We Don't File?

Deal-makers can no longer take the “under the radar” approach to concentration filings because under further draft regulations expected to become law in the near future, the AMB will have the power to investigate and take action against concentrations which it suspects should have been filed. The AMB will have the power to impose penalties for the failure to file and if it decides that the concentration will affect competition, it has the same powers to restrict or unwind transactions as stated in the Anti-Monopoly Law.

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