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The Business Operator Concentration Declaration Rules: An Insight into the Enforcement of China's Anti-monopoly Law

By Wayne Chen and James Weng

On 27 March 2008, the Legislative Affairs Office of the State Council issued the *Provisions on the Declaration of Concentration of Business Operators (Draft for Comment)* (hereinafter referred to as "*the Draft*") to the public. The main purposes of *the Draft* are to define concepts relating to business operator concentration, establish the declaration criteria and adjustment mechanisms for business operator concentration, clarify declaration procedures, and deal with other relevant issues. The *Draft* reflects the approach the relevant state government departments will take in implementing the *Anti-monopoly Law*.

Shifting the Focus from Foreign Mergers and Acquisitions to Business Operator Concentration – a Significant Change in the Anti-monopoly Review System

One of the earliest legal sources for the Chinese anti-monopoly review system was the *Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (hereinafter referred to as the "*Interim Provisions*") issued in 2003. The *Interim Provisions* established the basic criteria for and the procedures applicable to anti-monopoly reviews of foreign mergers and acquisitions for the first time. In 2006, the *Interim Provisions* were replaced by the *Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (hereinafter referred to as the "*M&A Rules*"), which adopted the same anti-monopoly review system established under the *Interim Provisions.* The *Guidelines on Anti-monopoly Declarations for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (hereinafter referred to as the "*Declaration Guidelines*"), issued by the Ministry of Commerce in 2006, provided guidance on a number of specific issues relating to anti-monopoly declarations under the *M&A Rules.* Based on this guidance, the Ministry of Commerce further updated and refined the *Declaration Guidelines* in 2007. Prior to the implementation of the *Anti-monopoly Law*, the *M&A Rules* and the *Declaration Guidelines* were the primary legal sources for anti-monopoly reviews of mergers and acquisitions involving foreign investors.

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The *Anti-monopoly Law* will come into effect on 1 August 2008. The *Draft* reflects in a more specific way the approach the authorities will take in controlling business operator concentration issues under the *Anti-monopoly Law*. Compared to the *M&A Rules*, the *Anti-monopoly Law* and *the Draft* will result in the following significant changes to the anti-monopoly review system for Chinese M&A transactions:

- **A significant change in the applicable scope of anti-monopoly reviews**

  The *Anti-monopoly Law* and *the Draft* abolish the distinction between foreign and domestic investors, with the result that anti-monopoly reviews no longer apply solely to mergers and acquisitions involving foreign investors, but now apply to both domestic and foreign investors.

- **A significant adjustment to those transactions subject to anti-monopoly reviews**

  The types of transactions subject to anti-monopoly reviews under the *M&A Rules* are equity and asset mergers and acquisitions that meet review criteria, regardless of whether the buyer has acquired control of the target company. By contrast, the concept of "business operator concentration" adopted in the *Anti-monopoly Law* and *the Draft* emphasizes mergers or acquisitions in which one business operator will acquire effective control of another business operator through a merger, the acquisition of its assets or equity capital, or by way of any other form of agreement. Therefore, mergers and acquisitions that do not involve any change in control are excluded from the scope of anti-monopoly reviews.

- **A significant change in the criteria for anti-monopoly declarations**

  The *M&A Rules* established separate declaration criteria for offshore and domestic mergers and acquisitions, focusing on domestic market sales revenue, the number of relevant enterprises, market share both before and after the M&A transaction and the discretion of the relevant authorities. In contrast to the *M&A Rules*, *the Draft* establishes declaration criteria based on global sales revenue, domestic sales revenue, market share in the relevant market and the discretion of the relevant authorities. The *Draft* does not stipulate specific criteria for offshore transactions. Further clarification is needed from the authorities on whether offshore transactions are excluded from the scope of *the Draft*, or whether the criteria for domestic transactions also apply to offshore transactions.

- **A significant change in the criteria for declaration exemptions**

  There are four declaration exemptions available under the *M&A Rules*, including: (1) enhancing competition in the market; (2) restructuring loss-making enterprises and safeguarding employment; (3) introducing advanced technology and personnel; and (4) improving the environment. However, the *Anti-monopoly Law* and *the Draft* do not adopt these four exemptions. Instead, the *Anti-monopoly Law* and *the Draft* provide that the parties to an M&A transaction may only apply for an exemption under the two following circumstances: (1) where of all business operators involved in the concentration, one business operator holds 50% or more of the voting shares or assets of every other business operator, i.e., a control relationship exists; or (2) where common control already exists between the parties.

- **Improvements to the declaration procedures**

Based on practical experience with anti-monopoly declaration procedures in relation to, for example, the major declaration documents and the pre-examination consultation mechanism under the *M&A Rules* and the *Declaration Guidelines*, *the Draft* further improves the declaration procedures. The *Draft* separates the review procedure into two phases, i.e. initial examination and further examination. In addition, it stipulates post-declaration procedures and procedures for the treatment of confidential information.

- **The legal consequences**

As a set of departmental rules, the *M&A Rules* do not specify the legal consequences for parties who violate the declaration procedures or anti-monopoly provisions. The *Anti-monopoly Law* and *the Draft* stipulate that where business operators pursue concentration in violation of these provisions, the State Council's Anti-monopoly Law Enforcement Authorities may order them to cease pursuing the concentration, dispose of their shares or assets within a specified period of time, transfer their businesses or adopt other necessary measures to restore the market to its existing state prior to the concentration, and may impose administrative fines.

Comments and Discussion on the Draft

Prior to the release of the *Anti-monopoly Law*, the rules for and practical operation of anti-monopoly reviews in China were not clear, due to the inadequate statutory support for anti-monopoly reviews in the mergers and acquisitions field. The release of the *Anti-monopoly Law* has addressed these weaknesses and established a framework for the anti-monopoly system in China. However, the *Anti-monopoly Law* is in essence a principles-based law, while the effect of its implementation will depend on both the further detailed rules issued by the State Council and the Anti-monopoly Committee, and the Anti-monopoly Law Enforcement Authorities' interpretation of the relevant rules in practice. From this perspective, the major function of these detailed rules, including *the Draft*, is to provide certainty and clarity on the *Anti-monopoly Law*.

The *Draft* first clarifies the definition of the term "acquisition of control of another business operator" and "exert a decisive influence on another business operator" as used in the *Anti-monopoly Law*, which includes (1) the acquisition of 50% or more of the voting shares or assets of another business operator; (2) becoming the biggest holder of another business operator's assets or voting shares; (3) acquiring effective control of the majority of voting rights in another business operator; (4) participating in and deciding on the appointment of 50% or more of the directors on another business operator's board of directors; and (5) any other circumstances determined by the State Council's Anti-monopoly Law Enforcement Authorities. The term "exert a decisive influence on another business operator" means that a business operator is able to exert a decisive influence on the operations and decision-making processes of another business operator. Generally speaking, this definition provides a clearer practical guidance. However, certain details still need to be discussed, such as the definition of "becoming the biggest holder of another business operator's assets or voting shares".

The declaration criteria for anti-monopoly reviews, which are set out in *the Draft*, apparently differ from those set out in the previous rules. In addition to the market shares of all business operators involved in the concentration in the relevant Chinese market, the global sales revenue and domestic sales revenue of all business operators involved in the concentration in excess of certain thresholds are subject to a declaration requirement. There is some uncertainty in *the Draft*, which may lead to doubts over its application in practice. For example, on what basis should sales revenue be calculated - the business operator's own sales revenue, the business operator's sales revenue as stated in its consolidated financial statements, or the combined sales revenue of all the business operator's related parties? In addition, should a business operator's sales revenue in the relevant market be the only factor that needs to be considered in calculating sales revenue, or should the business operator's sales revenue in other markets also be considered? Likewise, how should the relevant market (including the relevant geographic market and the relevant product market) be defined? All of these issues and some other uncertainties need to be further clarified to avoid unnecessary disputes.

The *Draft* both supplements and improves the *Anti-monopoly Law* on the declaration procedures for business operator concentration, and makes a positive contribution to anti-monopoly practice, one of the most noteworthy features of which is that it explicitly emphasizes the establishment of a fast-track initial review system that requires timely decisions on business operator concentration that will clearly not eliminate or restrict competition. This principle will have a positive impact on merger and acquisition activities in daily commercial life.

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