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**Fear of the Chinese or Business as Usual at the European Commission?
EU Merger Regulation and the Assessment of Transactions Involving Chinese State-owned Enterprises**

Kiran Desai & Manu Mohan
Mayer Brown LLP

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I. INTRODUCTION

In the first half of 2011 the European Commission ("Commission") published three decisions involving State-owned enterprises ("SOE") that are Chinese.² The Commission stated that it had examined both whether the decision-making power lay with the controlling entity above them and to what extent they competed with other public companies. Joaquín Almunia, European Commissioner for Competition, has stressed that this type of examination was not undertaken because the enterprises were foreign or because there was a prejudice against State control but because it was a relevant aspect to the assessment of effects on competition.³

This is the first time such an assessment has been undertaken by the Commission to a concentration involving Chinese SOEs. This article examines the law relating to assessments of transactions involving SOEs.

The article also deals with issues that will have to be dealt with in the future, and raises the concern that a lack of clarity about the entities whose turnover should be taken into account for the purposes of determination of a notification could: (a) lead to a risk of non-notification of combinations involving SOEs and resultant fines; (b) raise questions about the validity of transactions involving SOEs that were not notified in the past on the assumption that the jurisdictional thresholds were not met; and (c) complicate the substantive analysis on possible coordination between the undertakings directly involved in the combination and other SOEs.

II. SOES AND THE COMMISSION'S JURISDICTION

An examination of whether companies manage their business strategy independently under the EU Merger Regulation⁴ ("EUMR") is important from both a jurisdictional and a substantive point of view. From a jurisdictional point of view, the group companies need to be determined because in many countries merger control notification requirements largely depend on the group turnover that the parties to a transaction have achieved in a given territory. From a substantive point of view, such identification is necessary because the authorities have to analyze

¹ Kiran Desai is Partner and Manu Mohan is an Associate at the office of Mayer Brown in Brussels.

² Case COMP/M.6111-Huaneng/Otppb/Intergen, Case COMP/M.6082 - China National Bluestar/Elkem, Case COMP/M.6113- DSM/Sinochem/JV.

³ Commission SPEECH/11/243, Joaquín Almunia, *Policy Recent developments and future priorities in EU competition policy*, International Competition Law Forum St. Gallen, April 8, 2011, Commission press release IP/11/617 dated May 19, 2011.

⁴ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ L 24, 29.1.2004, pp. 1–22.

the degree of overlaps between merging parties and the respective market position of their group companies.

The EUMR applies only to operations that satisfy two conditions:

1. There must be a concentration of two or more undertakings within the meaning of Article 3 EUMR; and
2. The turnover of the parties to the concentration calculated in accordance with Article 5 EUMR must satisfy the thresholds set out in Article 1 EUMR.

Article 3 EUMR provides that a concentration only covers operations where a change of control in the “undertakings concerned” occurs on a lasting basis. Article 1 EUMR sets out the turnover thresholds that determine whether or not the Commission is competent to investigate the transaction. Article 1 EUMR further provides that this is to be turnover of all the “undertakings concerned.”

A. Undertakings Concerned

When a concerned undertaking belongs to a group, not only is the turnover of the undertaking concerned considered, but the turnover of those undertakings listed in Article 5(4) with which the undertaking concerned has links defined as certain rights or powers is also required to be taken into account. Article 5(4) identifies the affiliates that have to be included as follows:

1. those undertakings in which the undertaking concerned, directly or indirectly:
 - a. owns more than half the capital or business assets, or
 - b. has the power to exercise more than half the voting rights, or
 - c. has the power to appoint more than half the members of the supervisory board, the administrative board or bodies legally representing the undertakings, or
 - d. has the right to manage the undertakings' affairs;
2. those undertakings which have in the undertaking concerned the rights or powers listed in (a);
3. those undertakings in which an undertaking as referred to in (b) has the rights or powers listed in (a);
4. those undertakings in which two or more undertakings as referred to in (a) to (c) jointly have the rights or powers listed in (a).

The group therefore includes the undertaking concerned, its parent company or companies, its affiliated companies, and group-owned joint ventures. The purpose of Article 5 EUMR is to explain how turnover should be calculated to ensure that the resulting figures are a “true representation of economic reality.”⁵ The Consolidated Jurisdictional notice specifically provides that for jurisdictional purposes under the EUMR the group is considered to be a single

⁵ Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, OJ C 95, 16.04.2008, ¶128.

economic unit and the different companies belonging to the same group cannot be considered as different undertakings.⁶

The rights or powers listed in Article 5(4)(a)(i)-(iii) EUMR are quantitative thresholds and hence are easily identifiable. The thresholds can also be met if the undertaking concerned has *de facto* the powers listed under Article 5(4)(a)(ii)-(iii) EUMR.⁷ The “right to manage” the undertaking’s affairs contained in Article 5(4)(a)(iv) may exist on a straightforward legal interpretation, for example as a result of voting rights held alone, or in combination with contractual arrangements such as shareholders agreements which enable the determination of the strategic behavior of an undertaking. The right to manage, in addition, also covers situations in which the undertaking concerned has the right to jointly manage an undertaking’s affairs together with third parties.⁸

B. SOEs and Undertakings Concerned

The Consolidated Jurisdictional Notice makes it clear that when the turnover of State-owned entities is being calculated, Article 5(4) EUMR should be read together with Recital 22 EUMR, which states as follows:

In the public sector, calculation of the turnover of an undertaking concerned in a concentration needs, therefore, to take account of undertakings making up an economic unit with an independent power of decision, irrespective of the way in which their capital is held or of the rules of administrative supervision applicable to them.⁹

The above recital is intended to avoid discrimination between public and private sectors mentioned in the preamble of the EUMR.¹⁰ It is to be noted that Member States or other public bodies cannot be classified as undertakings simply because they hold interests in other undertakings which satisfy the conditions of Article 5(4) EUMR. For the assessment of jurisdiction the turnover of only those undertakings are considered that:

- belong to the same economic unit; and
- have the same independent power of decision.

Thus, where there are several State-owned undertakings under the same independent center of commercial decision-making, then those undertakings should be considered part of the group of the undertaking concerned for the purpose of Article 5 EUMR. However, where a State-owned company is not subject to any co-ordination with other State-controlled undertakings, it should be treated as independent for the purposes of Article 5 EUMR, and other undertakings owned by that State should not be taken into account.¹¹

⁶ *Id.* ¶135.

⁷ *Id.* ¶178.

⁸ *Id.* ¶¶179 & 180.

⁹ *Id.* ¶192.

¹⁰ The arrangements to be introduced for the control of concentrations should, without prejudice to Article 86(2) of the Treaty, respect the principle of non-discrimination between the public and the private sectors: ¶22 of EUMR.

¹¹ European Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, OJ C 95, 16.04.2008, ¶¶192 – 194.

The Notice on the concept of undertakings concerned which has been replaced by the Consolidated Jurisdictional notice states that the “mere fact that two companies are both owned by the same State does not necessarily mean that they belong to the same ‘group’. Indeed, the decisive issue will be whether or not these companies are both part of the same industrial holding and are subject to a coordinated strategy.”¹²

Thus, the identification of all the undertakings belonging to a “single economic unit” is critical to the assessment of the jurisdiction of the Commission.

III. THE CONCEPT OF THE SINGLE ECONOMIC UNIT AS APPLIED TO EUROPEAN SOES

The above rules have been applied mainly to SOEs in Germany, France, Spain, and Italy.¹³ The latest case that dealt with this matter in detail involved the nationalization of financial institutions during the financial crisis. The Commission provided some indications as to the factors that need to be taken into account for identifying the undertakings concerned when the transaction involves an entity owned by the State.¹⁴

The background to the Commission’s decision was the acquisition of sole control of the German financial institution Hypo Real Estate AG (“HRE”) by an entity called Sonderfonds Finanzmarktstabilisierung (“SoFFin”). SoFFin was a vehicle for state interventions that the German government created to avert bankruptcies of financial institutions. HRE ran into serious financial difficulties as a result of which Germany considered intervention necessary.

The Commission found that the Federal Ministry of Finance (“BMF”) had sufficient supervisory powers over the Financial Market Stabilisation Fund Agency (“Agency”) to which the task of managing SoFFin had been transferred. It was also found that both SoFFin and the Agency were under the legal and substantive supervision of the BMF. Some of the key factors that led to this decision were that:

- the Agency was bound to conform to instructions and decisions issued by the BMF;
- the Agency was subject to legal and substantive supervision as regards the appropriateness of its activities by the BMF; and
- BMF was entitled to substitute the decisions of the Agency in general or individual cases according to the law on the Financial Market Stabilisation Fund and the Regulation on the Financial Market Stabilisation Fund.

The Commission, however, declined to make a finding as to whether the BMF, as part of the Federal Government, the Federal Government as a whole, or ultimately the German Federal State (“Bund”), constituted the appropriate economic unit as there would be no competition issues even assuming that the Bund was the appropriate level to look at. After it was identified that the BMF was the appropriate level to assess the Commission's jurisdiction the next step was

¹² Commission notice on the concept of undertakings concerned under Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, OJ C 66, 2.3.1998, p. 14–24. The Consolidated Jurisdictional Notice replaced this Notice.

¹³ See COMP/M.2905 – Deutsche Bahn/Stinnes Verordnung (EWG), COMP/M.3210-EDF/EDFT, Case IV/M.216–CEA Industrie/France Telecom/Finmeccanica/SGS-Thomson, Case IV/M.117-Koipe-Tabacalera/Elosua.

¹⁴ Case No COMP/M.5508 - SoFFin/Hypo Real Estate.

to determine the other undertakings under its supervision whose turnover should be included in the calculation of turnover.

Kreditanstalt für Wiederaufbau ("KfW") is a German-based bank under public law that provides financial services for projects considered to be in the public interest. KfW competes with commercial banks in certain markets for financial services such as project and export finance. The Commission analyzed thoroughly the corporate governance of KfW, including the supervisory authorities and their respective competences that the public national law had put in place. Some of the legal elements that the Commission identified that led it to conclude that KfW could not be considered to be an entity constituting an economic unit with an independent power of decision were:

- The BMF has a broadly defined supervisory right related to the entirety of KfW's activities;
- Amendments to by-laws must be approved by the BMF; and
- The Federal Government is empowered to assign certain activities to the KfW if they consider these activities to be in the public interest;

The Commission concluded that the BMF had sufficient powers to determine the commercial conduct of KfW. While the notifying parties had contended that the affairs of SoFFin and KfW were managed by different departments within the BMF, the Commission established that, at least at the level of the BMF state secretary and above, coordination of business behavior could not be excluded. Hence, the Commission included KfW in the analysis as to whether the jurisdictional thresholds were met, and also considered KfW's business activities and respective market position in the substantive analysis.

In the above case the Commission used evidence relating to the management and supervisory structure of the undertakings concerned and also placed emphasis on the rights granted to government bodies by law. Thus, despite the fact that different departments within a ministry were managing and supervising the two undertakings SoFFin and KfW, they were considered as a single economic unit.

IV. CHINA'S SOES

The issue of ownership of Chinese SOEs has been the subject of a recent decision of the Commission that involved a joint venture between DSM and Sinochem.¹⁵ Sinochem is indirectly owned by the Chinese State as 100 percent of its shares are held by the State-owned Assets Supervision and Administration Commission ("SASAC"), an entity directly under the supervision of the State Council of the People's Republic of China responsible for the oversight and management of SOEs.

The Commission found that ownership of Chinese SOEs can lie with the central government, with regional/municipal governments, or occasionally with other public entities. Sinochem is identified as one of the 129 mostly large SOEs that are financed and owned by the central government reporting to central SASAC.

¹⁵ Case COMP/M.6113 - DSM/Sinochem/JV.

The Commission, for the purpose of assessing the chain of control of state-owned companies, sought first to establish whether the company had an independent power of decision and second to determine which was the ultimate State entity and which other undertakings owned by this entity needed to be considered as one economic entity.

The parties argued that Sinochem had an independent power of decision from the Chinese State, that SASAC's limited statutory powers prevented it from exercising a decisive influence over Sinochem, and that SASAC did not intervene in the strategic decision-making process (e.g. approving the business plan or budget). Sinochem claimed separation of ownership from management, absence of interlocking directorships between it and central or other local SASAC owned companies, operational autonomy of SOEs, and a purely supportive role for SASAC that did not interfere in production and operational activities.

The Commission, however, felt that the core legislation and associated information on the SASAC website contained provisions leading it to believe that SASAC did have powers to involve itself in Sinochem's commercial behavior in a strategic manner and also had rights to approve mergers or other strategic investment decisions. The Commission also felt that external sources such as the OECD report on regulatory reform in China and Barry Naughton's book, *The Chinese Economy: Transitions and Growth*, suggested that influence could also be exercised through formal channels such as SASAC as well as in less formal ways. The Commission also pointed out in the decision that the annual report of Sinochem revealed the high degree of cooperation between Sinochem and the Chinese State.

However, in the absence of representation by the Chinese State and accompanying evidence, the Commission was unable to conclude whether Sinochem enjoyed an independent power of decision. Since the required turnover to apply EU jurisdiction was achieved, the Commission left the issue open. It seems the Commission has also left this issue open in another decision involving a Chinese SOE - China National Bluestar.¹⁶

V. LOOKING TO THE FUTURE

The turnover thresholds prescribed in Article 1 EUMR are designed to govern jurisdiction and not to assess either the market position of the parties to the concentration or the impact of the operation. The thresholds include turnover derived from, and the resources devoted to, all areas of activity of the parties, and not just those directly involved in the concentration. Thus they try to provide a simple and objective mechanism that can be easily judged by the companies involved in a merger to determine if their transaction has a Community dimension and is therefore notifiable.

However, in the case of a Chinese SOE, the determination of whether or not a transaction involving it is notifiable to the Commission cannot be easily handled and raises the following issues:

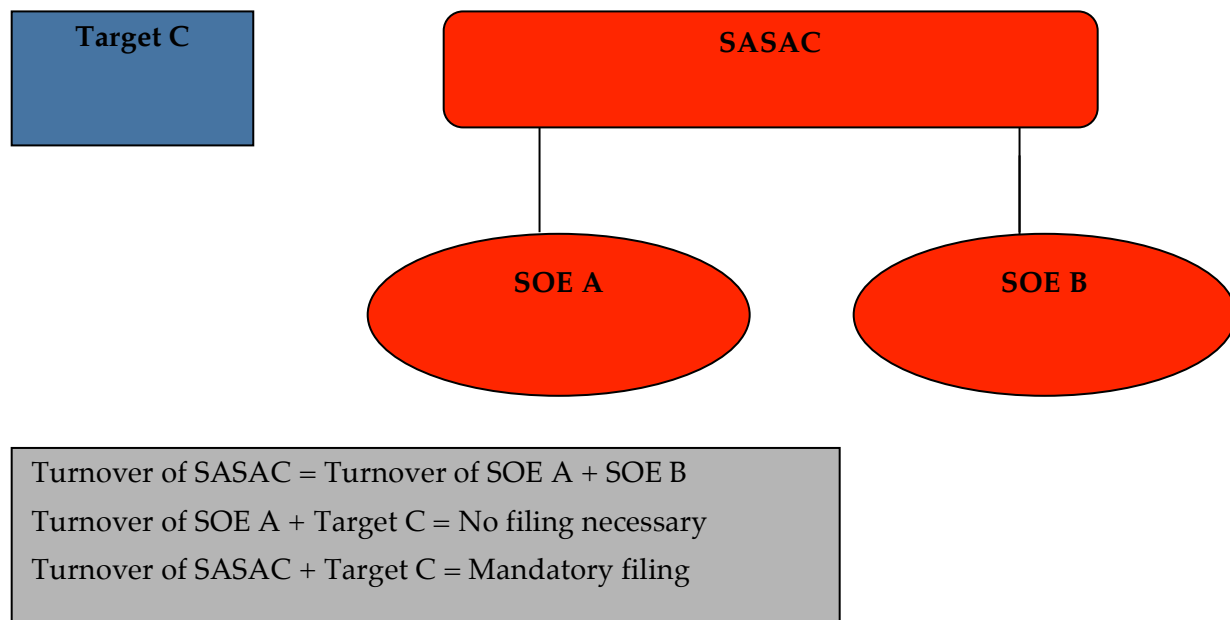
A. Risk of Non-Notification

Pursuant to Article 7(1) EUMR, a concentration with a Community dimension cannot be implemented until it has been cleared by the Commission and, pursuant to Article 14(2) EUMR, the Commission can impose fines of up to 10 percent of an undertaking's aggregate turnover where the undertaking:

¹⁶ Case COMP M.6082 - China National Bluestar/Elkem.

1. fails to notify a concentration prior to implementation; or
2. notifies a concentration but:
 - i. implements it prior to receiving a clearance decision from the Commission;
 - ii. implements it after receiving a prohibition decision from the Commission; or
 - iii. fails to comply with a condition attached to a Commission clearance decision.

Based on the above provisions, in June 2009 the Commission imposed a fine of EUR 20 million on Electrabel for acquiring control of Compagnie Nationale du Rhône, another electricity producer, without having received prior approval under the EUMR. The Commission concluded that the infringement lasted for a significant period and that Electrabel should have been aware of its obligation to receive the approval of the Commission before proceeding with the acquisition.¹⁷ Thus, it is clear that “gun-jumping” will not be pardoned by the Commission, even if it is committed through negligence. Keeping this in mind, we assume the following scenario in relation to a future proposed transaction:



If SOE A were to contend that it is an economic unit that has an independent power of decision from the Chinese State this would not, on its face, be a jurisdictional issue if SOE A, together with the other party, already satisfied the turnover thresholds under the EUMR. However, if those thresholds were not satisfied then SOE A would find itself in a Catch-22 situation when it came to making a decision on notification to the Commission. Non-notification may lead to imposition of fines if the Commission were, at some future point, to conclude that SOEs under SASAC were not independent and as in the above example, SOE A and related

¹⁷ Commission press release IP/09/895 dated June 10, 2009.

entities satisfied the turnover thresholds. Yet, notification on the basis that SOE A and the other SOEs were part of an economic unit (the group) would mean prejudicing its own claims of being an independent market player.

B. Validity of Transactions

As stated above according to Article 7(1) EUMR, a concentration with a Community dimension cannot be implemented until it has been cleared by the Commission. According to Article 7(4) EUMR the validity of any transaction carried out in contravention of Article 7(1) would be dependent on a decision pursuant to Article 6(1)(b) or Article 8(1), (2) or (3) or on a presumption pursuant to Article 10(6) EUMR.

This raises an interesting question as to the validity of transactions which have already been concluded by Chinese SOEs and which have not been notified to the Commission on the assumption that the jurisdictional thresholds have not been met. If it is indeed the case that the Commission were to ultimately conclude that a central or regional SASAC or any other Chinese SOE had to be included in the calculation of turnover this would affect the jurisdictional and substantive analysis of a consummated merger.

C. Analysis of Coordinated Effects

When a transaction is notified by a Chinese SOE the Commission examines whether the decision-making power lies with the controlling entity above the concerned enterprise, at a central or regional level, and to what extent the company effectively competes with other public companies. Thus it would be examined whether, through the State, companies in the same sector act as one or different entities.

The Commission in the transactions involving China National Bluestar and Sinochem examined the possibility of coordination by the Chinese State of market behavior of Chinese SOEs in the same sector. In the case of China National Bluestar customer opinion suggested that there was no coordination of market behavior. Considering the limited market share of the combined undertaking on the markets concerned, and the presence of strong players serving the European customers, the Commission concluded that the transaction did not raise competition concerns.¹⁸

As for the transaction involving Sinochem the Commission stated that the information obtained during the market investigation contained indications that the possibilities for SOEs to act completely independently might be more limited than with private enterprises. The Commission, however, also found that customers based in the EU, along with the only respondent in China, indicated that Chinese suppliers in the market do compete with one another, at least to some degree, considering that the relevant products are commodities where no major differences in product offering can be expected.¹⁹

The Commission considered both the scenario where Sinochem was deemed to constitute an independent economic unit and also the scenario where Sinochem's market position is taken

¹⁸ Case COMP M.6082 China National Bluestar/Elkem, Commission press release IP/11/394 dated April 1, 2011.

¹⁹ Case COMP/M.6113 — DSM/Sinochem/JV, ¶¶24 & 25.

together with Chinese SOEs. The Commission concluded that, although there would be a change to the relevant market share, there would be no competition concerns.²⁰

If, on the basis of insufficient evidence, the Commission chooses to leave the issue open (as in the above cases), it could pose difficulties for a Chinese SOE wishing to obtain a clearance decision in the future. This is potentially the case as the Commission may find it easier to allege coordination between Chinese producers if the input from its market investigation is that the undertakings are not entirely independent. In this regard it is important to note that the Commission has already observed, “the possibilities for SOEs to act completely independently might be more limited than to private enterprises in question.”²¹

On the other hand, a conclusion by the Commission at the jurisdictional stage that a Chinese SOE would not constitute an independent economic unit could also have a significant bearing on the substantial analysis. This is because the market shares of related Chinese SOEs operating in the same sector would lead to a finding that the undertakings concerned have a higher share of the market.

VI. CONCLUSION

It is likely that there will be more transactions in the future involving Chinese SOEs. The questions and risks highlighted above will necessarily come into focus thus posing interesting questions.

Considering the number of companies that come under the purview of central or local SASACs, it is likely that there will be concerns regarding possible coordination between the enterprises operating in the same sector. This may have a significant bearing in bid situations, where a seller may consider that the analysis of a transaction involving a Chinese SOE purchaser may be subject to a more in-depth analysis or even prohibition by the Commission. Therefore, even if a Chinese SOE may be willing to offer a higher price the vagueness surrounding the examination of the transaction by the Commission may result in the seller being put off. The conclusion is that a) engaging with the Commission at an early stage, and b) a more substantial analysis of the effects of the transaction prior to filing would be prudent in the case of a transaction involving Chinese SOEs.

²⁰ *Id.* ¶26.

²¹ *Id.* ¶24.