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European Commission Asserts Broad Power to Scrutinize Transactions Involving Chinese State-Owned Enterprises

EC decision considering the control over SOEs may have far-reaching implications for future transactions of all Chinese SOEs in Europe.

In its recent decision in Case COMP/M.7850 - EDF / CGN / NNB Group of Companies, the European Commission (EC) has for the first time found a Chinese State-owned enterprise (SOE) to be controlled by the State-owned Assets Supervision and Administration Commission of the Chinese State Council (Central SASAC). Future acquisitions and formations of joint ventures by Chinese SOEs in Europe may require financial and legal advisers' special attention and additional resources to assessing EU merger control requirements.

Background: General Principles for the Treatment of SOEs in EU Merger Control

When a SOE proceeds with an acquisition or joint venture in the EU, the question arises whether other companies which the same State owns must be considered for purposes of determining, both, jurisdiction (*i.e. should the other SOEs' turnover be included in applying the relevant turnover thresholds?*) and substantive assessment (*i.e. can other SOEs active on the same market be viewed as competitors of the parties to the transaction?*).

The EU Merger Control Regulation and the EC's Consolidated Jurisdictional Notice take the view that common State ownership as such is not sufficient to aggregate revenues and market positions of different SOEs. Rather, the relevant question is whether the SOE concerned should, based on the specific facts at hand, be viewed as forming an "economic unit" with other SOEs, meaning that their commercial conduct is subject to coordination by one and the same "independent center of commercial decision-making," for example a State holding company specifically set up to coordinate SOEs in a particular sector.

The question is of particular relevance for Chinese SOEs given the large number of companies (more than 120, among them such significant international players such as ChemChina) that are subject to supervision by Central SASAC.

Previous EC Assessments of Chinese SOEs

Previous EC decisions have considered Chinese SOEs such as ChinaChem[1] and CNRC.[2] In each case, the Commission could leave open the question of whether these SOEs formed an "economic unit" with other SOEs by virtue of their common supervision by Central SASAC. In all of these cases, the Commission had jurisdiction over the transaction even without needing to consider other SOEs' turnover, and was able to exclude competitive concerns even on a "worst case" assumption (*i.e.* treating all

potential SOEs as if they were parties to the transaction). However, in *DSM/Sinochem/JV*,[3] the Commission already gave strong hints that PRC legislation and the associated information outlined on Central SASAC's website suggested that Central SASAC does in practice have certain powers to involve itself in SOEs' commercial behavior in a strategic manner.

The EC's Decision in *EDF/CGN/NNB*

In contrast to these earlier cases, for the creation of a joint venture between China General Nuclear Power Corporation (CGN) and Électricité de France (EDF) to develop nuclear plants in the UK, the Commission's jurisdiction depended on whether CGN's turnover should be aggregated with other SOEs controlled by Central SASAC. The parties in that case argued against such an aggregation, as CGN's market conduct was, in their view, not controlled by Central SASAC. The parties relied on factors such as:

- CGN's Articles of Association, which only allow Central SASAC to remove directors under limited circumstances
- CGN's management structure, which prevents Central SASAC from determining CGN's commercial behavior
- The absence of interlocking directorships between CGN and other SOEs, and
- Central SASAC's and CGN's internal confidentiality policy, which precludes any exchange of confidential information with other Chinese SOEs

However, the EC came to the opposite conclusion, relying on relevant provisions in PRC law that would appear to apply not just to CGN, but to all SOEs governed by Central SASAC. The EC found that Central SASAC participates in major decision-making, in the selection and supervision of senior management of SOEs and can interfere with SOEs' strategic investment decisions.

While this reasoning strongly suggests that *all* SOEs governed by Central SASAC should be considered as a single "economic entity", the decision then introduces some additional supporting arguments that are specific to the energy sector and could thus be read as suggesting a case by case analysis that could depend on the nature of the economic sector in question. Indeed, the decision points out that the energy sector (and in particular the nuclear energy sector) has been identified by the Chinese government as an "important industry that has bearings on the national economic lifeline and state security" and for which PRC law emphasizes the need for State coordination of the various SOEs' activities. The decision also gives specific examples of such coordination in the nuclear sector.

Nevertheless, the EC decided to assert jurisdiction by holding that CGN's revenue should be aggregated with that of China National Chemical Corporation (ChemChina), a Chinese SOE that has no presence in the nuclear industry, but merely operates refineries that process crude oil.

In terms of substantive assessment, the decision clarifies that the EC could include in its assessment all Central SASAC-controlled SOEs that might be active in a related industry, for example as competitors. Albeit being probable, specific to this decision, however, it is briefly articulated that including in its analysis the market presence of other Central SASAC-controlled SOEs active in upstream nuclear markets (such as China National Nuclear Cooperation) would not materially affect the conclusion.

Consequences for Chinese SOEs Pursuing Future Acquisitions

Despite falling short of providing comprehensive and clear guidance on the treatment of Chinese SOEs, and in particular on the potential relevance of the sector in which the SOE is active, the decision means that any Chinese SOE must now seriously consider the possibility that its turnover should be aggregated

with (all) other SOEs governed by Central SASAC. Thus, even acquisitions by relatively small and domestically-focused Chinese SOEs could be reportable under the EU Merger Regulation.

The decision's implications are even more severe when considering that the national competition authorities of the EU Member States typically follow the EC's interpretation of jurisdictional questions. Some national merger regimes such as Germany's have very low turnover thresholds. If German regulators follow the decision's interpretation, this could mean that any acquisition by any Chinese SOE of a company with turnover of more than €5 million in Germany would have to be notified to the German competition authority.

Failure to notify authorities of transactions can give rise to substantial fines and reputational damage. Chinese SOEs contemplating international transactions should thus carefully analyze notification requirements in light of the decision and take advantage of the possibility of seeking informal guidance from the EC and national authorities.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Amy Beckingham
amy.beckingham@lw.com
+852.2912.2550
Hong Kong

Simon J. Cooke
simon.cooke@lw.com
+852.2912.2709
Hong Kong

David M. Blumental
david.blumental@lw.com
+852.2912.2686
Hong Kong

Qiuning (Frank) Sun
frank.sun@lw.com
+852.2912.2500
Hong Kong

Javier Ruiz-Calzado
javier.ruiz.calzado@lw.com
+32.2.788.6206
Brussels

Sven B. Völcker
sven.voelcker@lw.com
+32.2.788.6242
Brussels

Michael V. Egge
michael.egge@lw.com
+1.202.637.2285
Washington, D.C.

Philipp Gnatzy
philipp.gnatzy@lw.com
+44.20.7710.5847
London

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Endnotes

[1] *See* Cases COMP/M.6082 China National Bluestar/ELKEM and COMP/M.6113 DSM/SINOCHEM/JV

[2] *See* Case COMP/M.7643 CNRC/Pirelli

[3] *See* Case COMP/M.6113 DSM/SINOCHEM/JV