

EU Merger Control and Chinese SOEs

Introduction

The *European Commission* (the Commission) has reviewed a number of concentrations involving Chinese State-owned enterprises (SOEs) this year, including *DSM/Sinochem/JV*¹, *China National Bluestar/Elkem*, *Huaneng/OTPPB/Intergen*, and *PetroChina/Ineos/JV*.² With China having risen to be the world's fifth largest outbound investor, more such cases can be expected.

In this briefing, we discuss the *DSM/Sinochem/JV* decision and consider what lessons can be learnt for future transactions involving China's SOEs. We also consider other recent decisions by the Commission involving Chinese SOEs. Two central questions lie at the core of the treatment of SOEs under EU merger control. First, is the SOE operated in a manner *independent of the State i.e.*, does the State have the power to influence that SOE's commercial strategy? Second, are there risks of *coordination* between that SOE and other State undertakings active in the relevant market in which the SOE operates *i.e.*, does the State actually coordinate the commercial conduct of the particular SOEs concerned or facilitate such conduct? Far from providing clear guidance on these questions for SOEs operating in China's emerging market economy, the Commission's decision is inconclusive and is an open invitation to the Chinese Government to explain how SOEs conduct business in China and abroad.

SOEs and independent power of decision: the test

Recital 22 of the EU Merger Regulation encapsulates the principle of non-discrimination between public and private undertakings. In particular, it provides that for public sector undertakings the relevant question is whether the SOE concerned constitutes an economic unit "*with an independent power of decision*" irrespective of the manner in which the SOE's capital is held or of the rules of administrative supervision applicable to that SOE. The fact that a State is the sole or majority shareholder of a particular SOE does not automatically disqualify it from being regarded as an economic unit with independent power of decision. Additional factors must exist. For example, in past cases the Commission has considered whether:

- the SOE sets its own business plan, budget and/or business strategy independently of the State and from other undertakings owned by the State;

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¹ Case COMP/M. 6113 *DSM/Sinochem/JV*.

² Case COMP/M. 6082 *China National Bluestar/Elkem*; Case COMP/M. 6111 *Huaneng/OTPPB/Intergen*; Case COMP/M. 6151 *PetroChina/Ineos/JV*.

- the directors of the SOE are appointed by the State and whether interlocking directorships exist between undertakings owned by the State;
- there are adequate safeguards that ensure that commercially sensitive information is not shared between SOEs active in the same sector; and
- the decision-making power lies with the State entity above them, at central or regional level, and to what extent the SOE effectively competes with other public companies.

There are, however, no exhaustive or cumulative criteria for the assessment. Each SOE is thus subject to case-by-case analysis by the Commission. In assessing the chain of control of a particular SOE, the Commission will first consider whether that SOE has an independent power of decision, and if not, it will determine the ultimate State entity and which other companies owned by that State entity should be regarded as one economic entity.³ The relevant legal principles were first developed for European SOEs. In its recent cases, however, the Commission has had to apply these general principles to non-European SOEs, which has proved particularly challenging in the context of China.

Independence and lessons for China's SOEs

The Commission applied the approach outlined above in its first phase clearance of *DSM/Sinochem/JV*.

Under the terms of the agreement between DSM and Sinochem, a jointly controlled 50/50 Chinese joint venture would be established to which all of DSM's anti-infectives business (DAI) would be transferred. Sinochem is a Chinese SOE under the supervision of the Central State-owned Assets Supervision and Administration Commission of the State Council (Central SASAC).

The Commission declined the parties' invitation to declare that Sinochem is an economic unit with independent power of decision. The Commission was apparently not persuaded by the fact that relevant Chinese legislation, which indicated that companies owned by Central SASAC, such as Sinochem, operated independently of Central SASAC and, therefore, Central SASAC did not intervene in the strategic decision-making process. The Commission pointed to anecdotal evidence including information on Central SASAC's website, an isolated statement in Sinochem's annual report, and an OECD report dating back to 2009. It claimed that this demonstrated that in practice Central SASAC involved itself in Sinochem's commercial behaviour in a strategic manner, that the Chinese State could influence SOEs, and that there was at least very close cooperation between Sinochem and the Chinese Government.⁴ In sum, the Commission was not satisfied that the decision-making power lay entirely with Sinochem given Central SASAC's ownership of Sinochem and associated rights as shareholder, which included the right to appoint certain members of senior management and the right to approve mergers or strategic investment decisions.

In the end, the Commission left open the question of Sinochem's independence noting that the transaction would not result in a significant impediment to effective competition even if all SASAC owned companies were deemed to act as one entity in the context of the competitive assessment.⁵ The Commission concluded its appraisal by inviting the Chinese Government to explain how SOEs such as Sinochem operate in practice observing "*in the absence of representations by the Chinese state and accompanying evidence, it is not possible to conclude whether or not Sinochem enjoys an independent power of decision in the sense of the Merger Regulation.*"⁶

The Commission's decision makes clear that the approach to the question of the independence of China's SOEs remains to be settled. Indeed, the case leaves ample scope for the Commission to dismiss independence claims by other SASAC owned enterprises unless that SOE adduces concrete evidence of independent behaviour.

³ See also *China National Bluestar/Elkem*, paragraph 12.

⁴ See paragraph 16.

⁵ For now, this is the approach the Commission seems comfortable to follow as other cases involving SOEs show.

⁶ See paragraph 16.

More importantly, in the absence of representations from the Chinese Government and evidence in support, *DSM/Sinochem/JV* creates a rebuttable presumption that SASAC owned enterprises can be treated as a single entity. Such a presumption has obvious implications for future transactions involving SASAC owned enterprises – for example, in relation to turnover calculation in cases where a particular SASAC owned entity does not meet the EU merger control thresholds, or the competitive analysis of a transaction. It is also worth noting that the Commission's approach, if taken to its logical conclusion, would require the Commission to decline jurisdiction in the case of concentrations between SASAC-owned companies in the same sector, or in cartel cases involving SASAC owned companies active in the same sector – as they are already presumed to act as one entity. Indeed, as per EU practice, intragroup restructuring is not covered by the EU merger control rules and intragroup agreements are normally not caught by the EU competition rules.

Other issues that are not addressed in this decision, but may influence future cases, are the treatment of non-SASAC owned SOEs, the level of State ownership that may trigger concern, and potential coordination between privately owned companies and Chinese SOEs, such as through trade associations and other platforms that are supervised by the Chinese State.⁷ In addition, the Commission did not distinguish between Central SASAC and regional SASACs that operate under the direct supervision of regional authorities, although this may ultimately depend on the dynamics of the industry concerned. In *DSM/Sinochem*, the Commission chose not to distinguish between Central SASAC and affiliated SOEs and regional SASACs and SOEs under their supervision and active in the anti-infectives business. In direct contrast, the Commission found no indication in *China National Bluestar/Elkem* that regional SASACs and the SOEs under their supervision and active in the silicon industry formed one economic entity with Central SASAC and affiliated companies with activities in the same industry. It noted in particular that the silicon (and generally the chemical) industry in which Bluestar and its parent company operated was characterised by relatively limited public ownership and a fragmented market structure.⁸

Coordination of competitive behaviour and lessons for China's SOEs

The Commission's market investigation yielded a mixed picture about the degree of competition between Chinese SOEs. The decision notes that most respondents expressed concerns that the proposed joint venture and other Chinese SOEs might have incentives to coordinate behaviour on the relevant markets and that such coordination was likely, and that some respondents also raised concerns that the transaction was part of Chinese SOEs continued attempts to gain more leverage on the markets in question, whilst others indicated "... *that the possibilities for SOEs to act completely independently might be more limited than for private enterprises.*"⁹ However, customers also confirmed during the Commission's market investigation that Chinese suppliers in the market compete with one another – at least to some degree.¹⁰

For the Commission, the existence of some degree of competition between Chinese companies was not surprising since the products in question are commodities with very limited product differentiation. The Commission also found that the "*coordination of the behavior of DSM and Chinese SOEs through the proposed joint venture is unlikely given the limited scope of the joint venture.*"¹¹

In its competitive analysis, the Commission examined two different scenarios, *i.e.*, a scenario where Sinochem is deemed to constitute an economic unit with an independent power of decision from the Chinese State and a scenario

⁷ The Commission examined whether the Chinese State could influence the behaviour of private Chinese suppliers active in the market, but concluded that this was not the case – at least not in the "*present case*" (see paragraph 26, footnote 15).

⁸ *China National Bluestar/Elkem*, paragraphs 16 and 29. At Central SASAC level in the silicon industry, only one SOE, namely Bluestar/ChemChina, is active in this business. Most of the silicon metal companies in China are privately owned. To the extent that other SOEs had a presence in the industry – around 200 and estimated to account for only about 10-20% of Chinese silicon metal production – their ownership was dispersed between the more than 100 regional SASACs. This contrasts with the anti-infectives industry where the market is relatively concentrated and is characterised by the presence of significant anti-infectives producers at Central and regional SASAC level.

⁹ See paragraph 24.

¹⁰ See paragraph 25.

¹¹ See paragraph 25.

where this is not the case and where Sinochem's market position is taken together with other Chinese SOEs.¹² However, as under either scenario the concentration would not lead to any competition concerns, the Commission left open the independence of Chinese SOEs. Similarly, in *China National Bluestar/Elkem*, the Commission found that horizontal competition concerns could be ruled out since even if other SOEs at central or regional level and active in the relevant market were taken into account, no significant competition issues would arise.¹³ It also found that there were no vertical issues given Elkem's relatively limited market position in the upstream silicon metal market, the availability of significant alternative suppliers post-merger, there would be no significant change in volumes supplied to the merchant market, and Bluestar and other SOEs under Central SASAC represent a limited proportion of total global demand of silicon metal (< 10%).¹⁴

Conclusions

The Commission's decision makes clear that legal or contractual provisions establishing the independence of a particular SOE will not suffice for the "*independent power of decision*" test. The Commission will look at the SOE's actual conduct in the marketplace and examine business documents, including internal business documents, if available. The Commission may also rely on anecdotal evidence to (dis)prove the SOE's independence.

The Commission will consider any economic evidence that points to the SOE's reduced incentives to compete with other SOEs or private companies active in the same market. "*In other words, [the Commission will] look carefully at whether, through the State, companies in the same sector act as one or different entities. This is not because they are foreign or we have a prejudice against State control, but because it is a relevant aspect for assessing if competition will be significantly reduced or not.*"¹⁵ Even if an SOE qualifies as an economic unit with an independent power of decision, collective dominance concerns (through structural and/or other links) cannot be ruled out entirely in particular in oligopolistic markets.

The Commission's decision is both pragmatic and cautious, which it was able to do in the circumstances of this case. It left open the independence of Chinese SOEs, as the transaction did not raise significant competition concerns even if SOEs active in the same sector were considered to act as one entity. The Commission also chose not to delve into the competitive dynamics between Chinese companies given the absence of substantive competition concerns. There is a risk of possible delays and/or detailed review of the conduct of Chinese SOEs in cases involving significant post-merger combined market shares. The decision thus raises the prospect of additional burdens on Chinese SOEs as they seek to establish their independence from the State.

¹² The Commission's market definition analysis sets a useful precedent for pharmaceutical cases. The Commission accepted the parties' argument that suppliers could easily switch production – usually within days – using the same production lines between different anti-infectives despite the existence of different suppliers, market shares, pricing and regulatory approvals (see paragraph 21). This supply side substitution argument can also be applied to the production of other pharmaceuticals resulting in wider product markets provided the pharmaceuticals are no longer patent protected (see paragraph 23, footnote 14). The decision does not include the market shares for production of individual anti-infectives.

¹³ *China National Bluestar/Elkem*, paragraphs 33, 69, 85, 96-97, 110-114 and 124-128. See also *PetroChina/Ineos/JV*, paragraph 31.

¹⁴ *Ibid*, paragraphs 48-55. See also paragraphs 116-122 and 129-134.

¹⁵ Speech of Joaquín Almunia, "*Recent developments and future priorities in EU competition policy*", International Competition Law Forum St. Gallen, 8 April 2011, available at: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/243&format=HTML&aged=0&language=EN&guiLanguage=en>

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