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Pre-merger Notification Requirement for Certain Foreign M&A Transactions Under China's New M&A Provisions

China has recently joined the 60 or so countries that have adopted anti-trust regulations with extraterritorial effect. In regulations that came into effect on April 12, 2003, which in part legitimize and liberalize the current foreign investment regime in China to facilitate domestic M&A transactions involving foreign acquirers, the relevant Chinese ministries have included a pre-merger notification requirement for foreign mergers or acquisitions that meet certain criteria.

Article 21 of the Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the "Interim Provisions"), adopted by the Ministry of Foreign Trade and Economic Cooperation ("MOFTEC"),[1] requires a party to a foreign merger or acquisition transaction that satisfies any of the following criteria to file the merger or acquisition proposal with MOFTEC and the State Administration for Industry and Commerce ("SAIC")[2] *prior to* any public announcement of the merger or acquisition or *concurrently with* the submission of the proposal to the competent authority in the relevant country:

- A party to the foreign transaction owns assets in China with a value of renminbi 3 billion yuan[3] or more; or
- A party to the foreign transaction has sales revenues in the Chinese market of renminbi 1.5 billion yuan[4] or more for that year; or
- The market share in China of a party to the foreign transaction, together with its affiliates, is 20% or more; or
- The market share in China of a party to the foreign transaction, together with its affiliates, will be at least 25% as a result of the transaction; or

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1 MOFTEC, the central government authority with responsibility for foreign direct investment in China, was recently merged into the new Ministry of Commerce in March 2003.

2 SAIC is the central government authority responsible for, among other things, registration of businesses.

3 Equivalent to US$362,446,000 (approx.).

4 Equivalent to US$181,223,000 (approx.).

- The transaction will cause a party to own, directly or indirectly, the equity of more than 15 foreign invested enterprises in China in the same domestic industry

Following any such filing (for which all documents to be submitted must be in Chinese), MOFTEC and SAIC are to examine the filing to determine whether circumstances exist that would cause (i) excessive concentration in the domestic Chinese market, (ii) harm to legitimate domestic competition or (iii) damage to domestic consumer interests. Based on their determinations, these two examination and approval authorities will decide whether or not to approve the transaction.

The Interim Provisions have not yet been supplemented with detailed implementing rules. Until then, the provisions of Article 21 raise a number of questions. To determine whether a foreign merger or acquisition meets any of the criteria set forth in Article 21, how is the value of assets held in China by a party to be valued — based on their book value or fair market value? How is a party's market share in China to be determined? In the equivalent Hart-Scott-Rodino filings made in the United States, the parties are required to enter revenues in the same manner as information is collected for the census of industries – using the North American Industry Classification System – is there a similar (and reliable) objective standard to give an indication of revenues in China? Will the sales revenues test be based on revenues in the most recently completed fiscal year of the relevant party or will it need to be calculated for the 12-month period preceding the filing of the application? Will filings be required to be made by both the acquiror and the acquiree in the foreign merger or acquisition transaction? When will the form for the filing be prescribed and made public? What document will satisfy the requirement to file "the merger or acquisition proposal"? What supporting documentation will need to be submitted? What are the filing fees? How long will MOFTEC and the SAIC have to make their determination? What are the consequences for the failure to make a filing? What are the consequences for consummating the foreign transaction notwithstanding that approval in China has been denied?

It is noted that Article 22 of the Interim Provisions allows a party to a merger or acquisition transaction to apply for an exemption from MOFTEC and SAIC examination in certain cases.[5] It is not clear, however, if Article 22 is available to parties to a foreign merger or acquisition transaction.

Finally, the broader question is how Article 21 (which appears to focus on the protection of China's domestic industry) will interplay with the long proposed (but not yet promulgated) Anti-Monopoly Law (which is expected to be applicable to both domestic and foreign companies)? The adoption of the Interim Provisions in advance of the promulgation of the Anti-Monopoly appears to be an attempt by MOFTEC to usurp the power of the anti-monopoly authority that is to be established under the State Council to administer the Anti-Monopoly Law. Hopefully, the antitrust regulatory

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[5] That is, if (i) the transaction may improve conditions for fair market competition, (ii) the transaction will involve the reorganization of loss-making enterprises and ensure employment, (iii) the transaction involves the introduction of advanced technical and management talent and is able to improve the international competitive edge of an enterprise, or (iv) the transaction may improve the environment.

regime will be clarified with the adoption of the Anti-Monopoly Law. Parties to relevant foreign merger or acquisition transactions may otherwise find themselves in an uncertain legal environment with respect to the extraterritorial reach of Chinese law.

In any event, until the Chinese authorities issue more detailed rules on the application of Article 21, foreign parties need to be aware of this new Chinese pre-merger notification requirement and, if applicable, take into consideration the filing and approval requirement as one additional condition to closing, even though the merger or acquisition transaction that they are involved in is an offshore transaction and may only involve China indirectly.

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This memorandum constitutes only a general description of Article 21 of the Interim Provisions and should not be construed as legal advice. For further information or to discuss the Interim Provisions, please contact:

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