



# Legal Handbook **2.**

M&A in China

JULY 2021

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# MERGERS

# 01

A merger can be carried out in two ways<sup>2</sup> :

- **Absorption merger:** one or more enterprises merge into another enterprise, with the latter being the surviving entity, and the absorbed enterprise(s) are dissolved.
- **Merger by incorporation of a new establishment:** two or more enterprises merge to form a new entity, and each of the original companies is dissolved in the operation.

## MERGERS BETWEEN FIES

### - ARE MERGERS BETWEEN FIES IN CHINA SUBJECT TO CONDITIONS?

The merger shall comply with the Foreign Investment Negative List (which will be updated from time to time) and the National Security Review requirements, on a case-by-case basis.

The parties to the merger should enter into a merger agreement. Moreover, as provided by the articles of association of the FIEs, the shareholders shall consent to the merger. In case of a joint venture, this consent must be given unanimously if the articles of association of such joint venture has not been revised in accordance with the Foreign Investment Law (FIL) and Company Law<sup>3</sup>.

### - WHO SHALL BE NOTIFIED OF THE MERGER?

- An FIE involved in a merger shall **notify its creditors and announce the news publicly.**
- The transaction shall be registered and/ or filed with the competent State Administration of Market Regulation (**SAMR**) and be reported to the competent Ministry of Commerce (**MOFCOM**) through the Enterprise Registration System upon the registration and/or filing with the SAMR.
- Registration with the relevant tax bureaus is also requested.

## MERGERS BETWEEN FIES AND DOMESTIC ENTERPRISES

### - IS THE PROCEDURE SUBSTANTIALLY DIFFERENT FROM THE ONE FOR MERGERS BETWEEN FIES?

The procedure and requirements are almost the same. For mergers between FIEs and Domestic Enterprises, relevant approval/filing with competent MOFCOM and SAMR is required.

Mergers of wholly state-owned enterprises and state-controlled companies are subject to the process of asset valuation and approval from the State-Owned Assets Supervision and Administration Commission (the “**SASAC**”). In addition to asset valuation and SASAC approval, mergers between key wholly state-owned enterprises and wholly state-controlled companies be approved by the people’s government at the corresponding level.

Today, mergers and acquisitions (M&A) in China are mainly carried out by multinational companies as a means to pursue their expansion in China. During the past few years, M&A deals in China have become much larger and spread across a wider range of industries, such as energy, manufacturing, services and tech. China enacted the Measures on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors in 2006, forming an M&A regulatory regime, which was revised by the competent authority in 2009 (M&A Measures).

Beginning from January 1st, 2020, a new system of laws and regulations went into effect that helped manage foreign invest activities (directly or indirectly) in China. These measures were created by China’s top legislatures, the Standing Committee of the National People’s Congress, as well as the State Council, so that the Foreign Invested Enterprises (FIEs) could enjoy the same treatment as PRC domestic companies. The new FIE law system<sup>1</sup> has substantially changed M&A operations in China and will continue to do so following the implementation of the new laws.





# ACQUISITIONS

Acquisition of an existing company in China can be carried out in two ways: either by purchasing equity interests or by purchasing assets of the target company. Foreign investors are restricted from acquiring equity interests in a PRC entity engaging in a business which falls into the scope of the Foreign Investment Negative List and may be restricted from acquisition in specific industries that require National Security Review.

## EQUITY DEAL

### - WHAT IS AN EQUITY DEAL IN A CHINESE COMPANY?

An equity deal in a Chinese company is the partial or complete capital acquisition of a company by an investor. Every equity deal is subject to Chinese law.

### - HOW CAN AN EQUITY DEAL BE CARRIED OUT?

A foreign investor can purchase equity interests directly by purchasing equity from the target company's existing shareholders, or by subscribing to the increased capital of the target company.

### - WHICH APPROVALS SHALL BE OBTAINED FOR THE ACQUISITION OF AN FIE'S EQUITY?

All changes in the registered capital or shareholders' equity in an FIE triggered by the acquisition shall be reported to the competent MOFCOM through the Enterprise Registration System upon the registration and/or filing with the SAMR. For equity transfers, the transfer shall obtain the consent of more than half of the other shareholders; other shareholders of the company shall have a **pre-emptive right** to acquire the shares on the same term, unless company's articles of association provide otherwise.

### - WHAT IS THE PROCEDURE TO PURCHASE EQUITY INTERESTS FROM A DOMESTIC COMPANY?

1. Evaluation and appraisal of the equity to be transferred. The valuation of a transferred equity in a domestic company shall be completed by a certified appraiser in China. Even then, the valuation is often based on net asset value. The price of the acquisition may not be significantly below or above the valuated price. Reinforced obligations exist in the event where such transferred asset or equity is sold by a state-owned company or state-controlled company. Such state-owned asset or equity transfer may involve the organization of listing and bidding procedures with an asset and equity exchange center<sup>6</sup>;
2. Approvals from local government or specific ministries, such as Anti-trust Clearance and National Security Review, if required, depending on the value of the transaction and the nature of the industry;
3. Registration with the competent SAMR for issuance of a new Business License and submission of an initial report through the Enterprise Registration System;
4. Tax declaration with the local tax bureau: if the exit shareholder is a Chinese resident individual, the new shareholder shall withhold the income tax to be undertaken by the exit shareholder; if the exit shareholder is a Chinese resident enterprise, then the exit shareholder itself shall include the equity transfer consideration into its annual income and declare the annual tax with competent tax authority before the end of May of next year<sup>8</sup>.
5. Payment must be made following the issuance of the new Business License and State Administration of Foreign Exchange (SAFE) registration. The payment of the purchase price from a foreign purchaser will be subject to the foreign exchange control, which shall be taken into account in the timeline of the transaction.

## ASSET DEAL

### - WHAT ARE THE DIFFERENT OPTIONS TO CARRY OUT AN ASSET DEAL?

Chinese law provides for two approaches for a foreign investor to acquire the assets of a Chinese company<sup>9</sup>:

- Purchasing the assets of the target domestic company **through an existing FIE** and operating the assets from the FIE, or
- Purchasing the assets of the target company and contributing them in the capital of a **newly established FIE**, or if the company already exists, pursuant to a **capital increase**.

### - WHAT IS THE PROCEDURE FOR PURCHASING ASSETS?

Similar to equity acquisition, the asset transfer price shall be based on an **appraisal** conducted by a qualified appraiser. The target company shall notify its creditors and publish a public announcement on newspapers before the purchaser files for registration<sup>10</sup>. If the assets to be purchased are state-owned, the approval by the SASAC is required and certain procedures in relation to such transaction shall be observed. Whatever rules may apply, every asset deal is subject to Chinese law.

### - ARE THE DEBTS AND LIABILITIES ALWAYS TRANSFERRED TO THE PURCHASER?

**Debts and liabilities** of a sellers' company could be transferred to the purchaser in case that (1) the purchaser has expressly agreed to assume such liabilities, and (2) the creditor has expressly consented to such transfer of debts and liabilities.

## STRUCTURING THE ACQUISITION

### - WHY USING AN EXISTING PRC STRUCTURE TO MAKE THE ACQUISITION?

Using an existing PRC structure to make an acquisition in China will **simplify and shorten the acquisition process** because those investments are usually less monitored than new investments. FIEs, such as holding companies or foreign-invested partnerships, will still be considered as foreign investors.

Since 2019, the SAFE has issued new regulations which have eased the use of capital funds (including capital increase) in an existing FIE to finance the payment of equity or asset transactions in China<sup>11</sup>. And some municipal SAFE has issued notices to allow foreign debts (i.e., shareholder loan from a foreign shareholder or other loan received from foreign entities) to be used for domestic equity investment, but currently only in Shanghai Free Trade Zone and in Shenzhen Free Trade Zone (Qianhai Shekou Area). Before these regulations, the FIEs were exclusively allowed to use the RMB in its current accounts to finance their acquisitions. If capital increase paid by the foreign mother company to the Chinese subsidiary are accepted in principle, verification with local banks and SAFE are still recommended to make sure that the funding of the acquisition will not raise any problem.

The shareholders loans paid by the foreign mother company to the Chinese subsidiary are still limited to certain ratio of capital / total amount of investment or certain multiple of net asset value.

# ACQUISITIONS

## - WHAT IS THE PURPOSE OF BUYING AN OFFSHORE COMPANY?

If the PRC assets or equities are held by an offshore holding company, in most cases **approvals in China will not be required**, except for National Security Review or Anti-trust Clearance. **Tax consequences** and requirements for approvals will influence the choice of jurisdiction for the location of the offshore entity. Acquisitions of an offshore company, holding the capital of a Chinese affiliate, may be seen as an operation taxable in China and require tax declaration in China<sup>12</sup>.

## - ARE YOU FREE TO DEFINE THE TIMELINE OF THE PAYMENT OF AN EQUITY PURCHASE?

Pursuant to the M&A Measures, the purchase price of an equity interest in a PRC domestic company shall be paid by the foreign purchaser within 3 months from the registration of the transactions with the SAMR. This duration may be extended up to one year under some circumstances. However, with the adoption of the new system of the FIE law, the restriction is considered to be not consistent with the principle of "same treatment to domestic and foreign investment." Hence, in practice, the local counterparts at MOFCOM may not actually supervise the implementation of the said payment terms, which will become an issue relating to cross-border payment to be dealt with banks/SAFE. This restricted timeline is not applicable in the case of the acquisition of a portion of a FIE (a joint venture or a WFOE).

## - CAN WE USE EARN-OUT PAYMENT AND PRICE ADJUSTMENT MECHANISM IN EQUITY TRANSACTIONS RELATED TO A CHINESE DOMESTIC ENTITY?

In addition to the restriction in the timeline for the payment of the purchase price, a purchase price shall be fixed at the time the transaction documentation is filed with relevant authorities. Consequently, earn-out and price adjustment mechanisms are not possible per se. Alternative solutions exist and can be discussed on a case by case basis.

## - HOW TO SECURE THE CLOSING IF PRE-SALE RESTRUCTURING OPERATIONS ARE NECESSARY?

As the purchase price shall be paid within a limited period of time following the filing of the transaction documentation with the Chinese authorities, it is advisable to secure pre-sale restructuring operations before such filing is completed. Therefore, drafting of closing stipulations shall take into account specific needs of pre-restructuring and communication of necessary documentation for the filing of the transaction with the authorities.

## - WHAT ARE THE IMPACTS TO DEAL WITH A STATE-OWNED ENTERPRISE (SOE) IN AN EQUITY OR ASSET DEAL?

Unlike companies belonging to the private sector, negotiations with a SOE shall be prepared and handled according to specific Chinese negotiation practices.

In addition, the preparation of the negotiation shall take specific regulations and SOE transfer measures into account that impose constraints on the process of ownership transfers and on its valuation. These constraints will vary depending on whether the company or the targeted assets belongs to a state-owned company, state-controlled company or state-financed company. Failure to comply with such specific constraints may result in the cancellation of the transaction and potential penalties.

## - WHAT ARE THE MAIN SPECIFICITIES OF A DUE-DILIGENCE REVIEW IN CHINA?

Vendors still have limited experience organizing due diligence and data-rooms in China. Provided information remains limited and often incomplete accordingly, risks remain difficult to assess.

It is advisable to verify the following matters in a basic legal due diligence in China, it being specified that this list is non exhaustive:

- The shareholders of the target company and the possibility of shadow shareholders.
- Encumbrances on the equity or assets, such as share pledge and mortgage.
- Possibility to conduct the operations of the target company after the acquisition due to restrictions of foreign investment in certain industries.
- Existence of special licenses or special structures such as VIE structures.

- Capital contributions.
- Validity and duration of the remaining land-use rights on the land and potential impacts on premises. Additionally, consistency between the usages of the land and premises on the planning documents and their intended usages.
- Change of control clause in the main commercial contracts and specific termination clause due to special regulations (for example in some distribution or franchise related matters).
- Environmental status and zoning of specific areas.
- Status of the intellectual property rights.
- Financial and tax risks, including social security benefits of the employees and the employee personal income tax which is withheld at source by the employer.
- Corporate social credits of the company, its staff and its suppliers, that may contaminate the target company and exclude it from some public markets or access to credits.
- Cybersecurity risks and data protection in the context of a growing amount of corporate and personal penalties in case of breach of the data protection and cyber security obligations.

## - WHAT ARE THE MAIN SPECIFICITIES OF REPS AND WARRANTIES IN CHINA?

The declarations related to the reps and warranties are less extended than in Europe.

The main difficulty remains in the low efficiency of financial guarantees to secure the reps and warranties: due to the obligation to pay the purchase price within 3 months from the administrative registration of the equity transaction, it is not possible for the purchaser to retain a portion of the price. Other mechanisms usually adopted in other jurisdictions are difficult to implement in China (for example, escrow account, bank guarantee at first demand, other guarantees).

## - WHAT ARE THE MAJOR NEGOTIATION POINTS OF A SHAREHOLDERS' AGREEMENT OF A CHINESE JOINT VENTURE IN THE CONTEXT OF A PARTIAL ACQUISITION OF CHINESE TARGET COMPANY?

If the vendor only acquires a portion of equity interests of the target company, it will make the target company a joint venture. Besides operational and business advantages that justify the creation of a joint venture, such form on investment may be compulsory and the only way to provide the foreign investor with an access to a restricted industry against foreign investment in China. As a shareholder of the joint venture, the vendor may wish to secure its interests and certain governing power in the contractual documents such as the shareholder's agreement and the articles of association of the target company. The following major matters will be important throughout negotiation and are impacted by the applicable laws in China:

- Highest authority: the shareholders' meeting is the highest authority. Before the new foreign investment law, the board of directors was the highest authority and, in some transactions, the joint venture contract (ie. Shareholders' agreement) was simply not addressing the powers and rules of the shareholders' meeting.
- Voting rights: a specific voting right can be stipulated in the articles of association. If not otherwise provided, the voting rights exercisable by shareholders at shareholders' meeting shall be based on the ratio of capital contribution.
- Control on major issues: amendment to articles of association, increase and decrease of capital, merger, division, dissolution of the company and change of legal form of the company, which require 2/3 voting rights
- Profit-sharing: proportionate to each shareholder's paid-in equity contribution, but such distribution can be otherwise unanimously agreed by shareholders.
- Number of directors: one single director can be nominated instead of a board of directors; otherwise a board of directors is composed of 3-13 directors.
- Term of office for director(s): no more than 3 years.
- Quorum: no quorum is set forth by Company Law for passing shareholders' decisions. Definition of a quorum is left to the discretion of the shareholders.

This list is not exhaustive and is limited to the matters that are impacted by special regulations in China. Our lawyers remain available to help you to define most accurately the constraints and targets of our transaction and the best checklist to prepare your negotiations.



# ACQUISITIONS

# 02

## ASSET DEAL OR EQUITY DEAL?

### - WHAT ARE THE PROS AND CONS OF ACQUIRING EQUITY?

#### Pros:

- **Acquiring an operational business:** acquiring equity does not require numerous separate approvals of each individual asset because the title to each asset belongs to the corporation. The risks of renegotiation or reapplying for new permits, lease, utilities, facilities, and employment agreements are eliminated. However, special attention must be paid to contracts with “change of control” provisions;
- **Maintaining contracts:** if a company is dependent on a few vendors or customers, an equity purchase may reduce the risk of losing those contracts.
- **Tax impact:** Potential special tax treatment for internal restructuring.

#### Cons:

- **Liabilities:** buyers accept more risks by purchasing company’s equity, and it is more difficult to avoid existing unknown or undisclosed liabilities of the acquired business.
- **Higher levels of due diligence:** equity deals may require more intensive due diligence and pre-deal restructuring.

### - WHAT ARE THE PROS AND CONS OF ACQUIRING ASSETS?

#### Pros:

- **Select the assets:** asset acquisitions enable an investor to select which part of a target company in PRC he wants to purchase;
- **Minimize the liability risk:** usually, existing obligations, liabilities, or restrictions of the target company will not be transferred and will remain the sole responsibility of the target company;
- **Reflecting the asset’s market value:** asset acquisitions allow buyers to allocate the purchase price among the assets to reflect their fair market value. On the tax level, it provides for a higher depreciation and amortization deduction and results in future tax savings.

#### Cons:

- **Complexity of procedures for asset deals:** the acquisition of a business will face regulatory and procedural constraints. The creditors are required to confirm that they do not object to the transfer. Moreover, employment contracts cannot be automatically transferred and will have to be terminated and new contracts will have to be signed with the transferee. Third parties may also consider the transaction as a good opportunity to renegotiate their contracts, adding delay and costs to the deal;
- **Establishment of a PRC entity:** when assets are acquired, it is necessary to establish a commercial presence in the PRC to use the assets for operational purposes, which requires getting approvals from the Chinese authorities. Therefore, the setup of the PRC entity will be required either before the acquisition or as part of the acquisition process.
- **Tax Impact:** asset transfer may have substantial impact on the taxes, in particular for a transfer of real estate.

### - WHAT ARE THE POSSIBLE RESTRICTIONS FOR TRANSFERS OF EQUITY INTERESTS TO NON-SHAREHOLDERS IN A DOMESTIC COMPANY?

The following restrictions may apply for equity transfers to non-shareholders in a domestic company:

- **Right of first refusal:** the other existing shareholders have a right of first refusal over the interests to be transferred unless the company’s articles of association provide otherwise;
- **Consent of other investors:** more than half of the existing shareholders shall consent to the transfer of interests unless the company’s articles of association provide otherwise. If those investors do not agree to the transfer, they will have to purchase the equity interests proposed for sale, and if they do not proceed to such acquisition, they will be deemed to have agreed to the transfer;
- **Unanimous consent of investors in EJV:** in an equity Joint Venture (if its articles of association have not been revised according to Company Law yet), all the other investors must agree to the equity transfer before it takes place, and a resolution of the Board of directors of the Joint Venture approving the transfer is required by the SAMR. The JV agreement can provide for specific dispositions forcing the shareholders to agree to the transfer and causing the director to vote in favor of the transfer., e.g. in case of equity transfer to affiliate entities.



# PROTECTION OF THE MARKET

## MAIN PRINCIPLES

### - WHAT ARE THE MAIN LEGAL PROVISIONS REGARDING COMPETITION AND ANTI-MONOPOLY LAWS (AML)?

China's Anti-Monopoly Law (the "AML") was promulgated on 30th of August 2007 and came into force on 1st of August 2008. Foreign investors in China should carefully consider how the AML impacts their operations and investments and should act accordingly to ensure compliance.

In order to guarantee fair competition in the market, China AML regulates three types of economic behaviors:

- The prohibition of **Monopoly Agreements**: a difference must be made between a horizontal monopoly and a vertical monopoly:
  - » **Horizontal monopoly agreements**: agreements between competitors to fix prices, limit production or sales volumes, share markets, restrict technology purchases or development, or to boycott competitors or customers.
  - » **Vertical monopoly agreements**: agreements between a company and its trading partners to fix resale prices, or to restrict minimum resale prices to third parties.

Both agreements are regarded as unfair practices and are forbidden. Some exceptions can be made by the authorities:

- In some specific business areas to protect them from economic downturns or their "legitimate interests", the latter refers especially to foreign trade or foreign economic cooperation as well as enhancing the competitiveness of SME operators;
- For the purpose of improving technologies, researching and developing new products;
- For the business that enables or improves the "protection of social public interests".
- The prohibition of Abusing **Dominant Market Position**: Chinese AML prohibits any business with a dominant market position to abuse such dominance. Abuse may be characterized by "unfairly high prices", sales below costs (if not otherwise justified), unreasonable trading conditions or refusal to deal with partners.
- The regulation of "**Concentrations**": also called "mergers control" for which Chinese authorities require notification exposing the transaction when certain thresholds are exceeded. The applicant shall wait for government clearance validation – which usually takes between 30 and 180 days.

### - WHICH AUTHORITIES ENSURE ANTI-MONOPOLY AND FAIR COMPETITION COMPLIANCE?

Following a new plan passed by the 13th National People's Congress on March 17, 2018, the three agencies, the State Administration of Industry and Commerce (SAIC), the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC) which have shared anti-monopoly power for the past 10 years, are consolidated into one agency, and renamed the **State Administration for Market Regulation (SAMR)**. And **Anti-monopoly Bureau (AMB)** is a specialized bureau under SAMR.

Since then, anti-monopoly enforcement has become a one-shop stop with unified rules and procedures. On the one hand, this provides more consistent guidance for companies as well as reducing concerns of facing double punishments for one violation. On the other hand, this consolidation could lead to a more aggressive AML enforcement, notably regarding large global companies.

### - WHAT ARE THE SANCTIONS FOR BREACHING THE REGULATIONS?

- For monopoly agreements and abuse of a dominant market position: a "**cease-and-desist**" decision can be issued to confiscate all the gains arisen from this illegal abuse and to impose fines – up to 10% of the previous turnover.
- A fine up to 500,000 RMB may be imposed if the monopoly agreement is reached yet not fulfilled.
- For concentrations affecting the National Economic Security: the authorities can ask the Parties not to proceed with the deal or to adopt other measures to eliminate the impact on national economic security and can impose a **fine up to RMB 500,000**.
- **Non-cooperative behaviors, including but not limited to submitting fraudulent materials and concealing evidences, will be ordered a rectification and a fine up to RMB 100,000 on individuals and RMB 100,000,000 on entities.**

## MONOPOLIES OR RESTRICTIVE AGREEMENTS

Monopolies, or restrictive agreements, are prohibited by law, except in some cases.

### - HOW DO YOU DEFINE A MONOPOLY?

Monopolies are defined as agreements, decisions and other concerted practices between economic operators that have the aim or effect of eliminating or reducing competition. Competing operators are prohibited from entering into agreements fixing or modifying the price of goods, reducing the quantity of goods produced or sold, dividing the market, hindering the acquisition of new technologies or equipment, and establishing a collective boycott. Agreements between competing operators are considered «horizontal agreements». «Vertical agreements», which are agreements between a company and its trading partners, setting resale prices and limiting minimum resale prices, are also prohibited.

### - ARE THERE EXCEPTIONS TO THIS PROHIBITION?

Horizontal and vertical monopoly agreements are not illegal if the parties can bring the evidence that:

- The agreements will not significantly impact competition in the market;
- Consumers will benefit from these agreements;
- If objectives are achieved, for example: technological advances, product development, improvement in overall product quality;



# PROTECTION OF THE MARKET

## MERGER CONTROL

Under the AML, all concentrations above certain thresholds must be notified to the AMB, which will conduct a review to ensure that the concentration may not induce the elimination or inhibition of competition in the relevant market.

### - WHAT IS A CONCENTRATION ?

The concentration of operators means the followings<sup>15</sup>:

- merger of operators;
- equity or asset acquisition where the acquirer obtains controlling power of one or more target operators;
- ability to exercise decisive influence over other operators by contract or other means.

“Control” in reference to the concentration of operators includes sole and joint control. Whether an operator obtains control over other operators or is able to exercise decisive influence over other operators through transactions depends on a number of legal and other factors. The concentration agreement and the articles of association of the target operator are important basis for determining control, but not the only ones. If it is unable to be determined from the concentration agreement and articles of association whether the control is obtained, but the operator is actually granted the control due to other share diversification reasons, the control shall be deemed obtained in concentration of operators.

As a consequence, the creation of a joint venture is also considered a concentration if the resulting company is a jointly controlled entity with a certain degree of independence and sustainability from its parent companies. In this case, a joint venture shall be declared and approved before the incorporation of this entity.

### - WHAT ARE THE THRESHOLDS TRIGGERING SPECIAL PRIOR NOTIFICATION BEFORE ISSUANCE OF THE BUSINESS LICENSE?

Companies must notify the Anti-Monopoly Bureau if they engage in any transactions that qualify as concentrations throughout their last completed accounting year.

- The aggregate worldwide turnover in the previous financial year of all the business operators involved in the transaction exceeds RMB 10 billion, and at least 2 of the business operators to the deal have, individually and separately, a turnover exceeding RMB 400 million within the PRC in the previous financial year.

- The aggregate turnover within the PRC in the previous financial year of all the business operators to the transaction exceeds RMB 2 billion; and at least 2 of the parties to deal **have, individually, a turnover exceeding RMB 400 million within the PRC in the previous financial year.**

Those thresholds can be met through imports into China alone where no Chinese asset or presence is needed, and regardless of whether a transaction takes place in China or offshore.

Once the thresholds are met, the operators shall make a declaration to the Anti-Monopoly Bureau, otherwise, the concentration shall not be implemented<sup>17</sup>.

In some cases, even if those thresholds are not met, the Anti-Monopoly Bureau will still require an anti-monopoly review if the facts and evidence collected indicate the concentration may eliminate or restrict competition.

### -HOW LONG DOES THE PROCEDURE WITH THE ANTI-MONOPOLY BUREAU TAKE?

The Anti-Monopoly Bureau has **30 days** to do a preliminary review of the transaction, this period can be extended for 90 days, and in certain circumstances for an additional period of 60 days.

At the end of this review period, the **Anti-Monopoly Bureau either clears the concentration, with or without conditions, or prohibits it.** If the Anti-Monopoly Bureau does not make any decision at the expiry of the review period, the parties are free to implement the concentration.

### -WHAT ARE THE LEGAL LIABILITIES FOR THE CONCENTRATION OF OPERATORS?

Where the operators implement concentration in violation of AML and relevant regulations, Anti-Monopoly Bureau may impose **fines up to RMB 500,000**, instruct them to discontinue such concentration, and within a specified time limit to dispose of their shares or assets, transfer the business and adopt other **necessary measures to return to the state prior to the concentration.**

In recent years, the Anti-Monopoly Bureau has gradually increased its enforcement of undeclared cases, and the amount of penalties has also increased. Pursuant to the draft revision of AML released by SMAR on January 2020, the maximum fine for undeclaration is proposed to be revised to 10% of the aggregate turnover in the previous financial year of the operator.





# PROTECTION OF THE MARKET

## **CONTROL OF DOMINANT POSITION ABUSE**

The AML also prohibits a company from taking advantage of its dominant position in a market, providing for **finest of up to 10% of the previous year's total turnover**, and forfeiture of income resulting from illicit agreements. Agreements that violate the AML are automatically invalid.

### **- WHAT IS A DOMINANT MARKET POSITION?**

A dominant position is the ability of a company, or companies, to control the price or quantity of goods in a given market. It is also the ability to alter the terms of a transaction, by blocking or affecting the entry of other economic operators into the market.

### **-WHAT IS THE CRITERIA FOR DOMINANT MARKET POSITION?**

When an operator satisfies the following criteria, it shall be deemed as holding a dominant market position<sup>18</sup>:

- An operator holds half of the market share in the relevant market;
- Two operators hold an aggregate of two-thirds of the market share in the relevant market;
- Three operators hold an aggregate of three quarters of the market share in the relevant market.

### **- WHAT BEHAVIORS ARE CONSIDERED ILLEGAL?**

A dominant position is not unlawful in itself, but the abuse of that position is not legal. The following is a non-exhaustive list of examples of such illegal abuses<sup>19</sup>:

- Selling goods at unfairly high prices, or buying goods at unfairly low prices;
- The sale of goods below the cost price for no legitimate reason;
- Refusal to deal with an economic operator for no legitimate reason;
- Restrict trading counterparts to transact only with the operator or with designated operators for no legitimate reason;
- Bundle sale of goods for no legitimate reason or imposition of any other unreasonable terms of transaction during a transaction;
- Implement differential treatment for terms of transaction (such as transaction price) for similar trading counterparts for no legitimate reason.





# CONTROL OF THE NATIONAL SECURITY

The new FIL has further principally established the national security review system for foreign investment. Under the new FIL, the security review shall be conducted for foreign investment that affects or will likely affect the national security of China, echoing the National Security Law which is effective from July 1st, 2015.

Before the new FIL, in 2011, the General Office of State Council and MOFCOM, had introduced the notice/implementing provisions regarding the security review system specifically pertaining to mergers of domestic enterprises by foreign investors; and in 2015, the General Office of State Council released notice regarding the security review of foreign investments in Pilot Free Trade Zone.

In December 2020, nearly a year after the implementation of the FIL, the NDRC and MOFCOM have released the Measures for the Security Review of Foreign Investments (effective from 18 January 2021), which means the M&A security review system established from 2011 has upgraded to foreign investment security review system under the FIL and is estimated to substantially replace the M&A security review system.

## - WHAT DOES THE TERM “NATIONAL SECURITY” REFER TO?

“National Security” is defined as “the relative absence of international or domestic threats to the State’s power to govern and the capacity to protect security in a sustainable manner,” and includes “sovereignty, unity and territorial integrity, the welfare of people, sustainable economic and social development, and other major national interests<sup>20</sup>.” Security reviews for mergers and acquisitions include the impact on national defense, stable operation of national economy, basic order of society, and research and development abilities of core technologies involving national security<sup>21</sup>.

## - WHAT KINDS OF FOREIGN INVESTMENTS WILL TRIGGER THE NATIONAL SECURITY REVIEW?

**Applicable investments:** there are three types of foreign investments (including M&A transactions) which will trigger national security reviews (“NSR”):

- Foreign investors invest, solely or jointly with other investors, in new projects or establishing enterprises in China; or
- foreign investors acquire equity or assets of domestic enterprises by way of merger and acquisition; or
- foreign investors make investments in China in any other form.

**Scope of security review:** for foreign investments within the following scope, foreign investors or the relevant parties in China shall take the initiative to declare for security review **prior to implementation of the investments**<sup>22</sup>:

- investments in military industry, military industrial supporting and other field relating to the security of national defense, and investments in areas surrounding military facilities and military industry facilities (“**Military Investments**”);
- investments in important agricultural products, important energy and resources, significant equipment manufacturing, important infrastructure, important transportation services, important cultural products and services, important information technology and Internet products and services, important financial services, key technologies and other important fields which are related to national security, and obtaining **actual controlling rights** in the invested enterprises.
- **Obtaining actual controlling rights** refers to:
  - » The foreign investors hold more than 50% of the equity of an enterprise;
  - » the foreign investor holds less than 50% of the equity of an enterprise, but the voting rights enjoyed by the foreign investor in respect of the equity held have a significant impact on the resolutions of the board of directors or a shareholders’ general meeting;
  - » Other circumstances where the foreign investor may have significant impact on the enterprise’s operational decisions, human resources, finance, technology and etc.

**No Evasion.** The M&A transactions will be analyzed based on their substantial contents and actual impacts. Foreign investors shall not substantially avoid security review through, including but not limited to, holding shares on behalf of others, trust, re-investment at multiple levels, lease, loan, control through agreement, overseas transaction.

## - WHO OVERSEES THE NATIONAL SECURITY COMPLIANCE?

The Working Mechanism, which office is set at the NDRC and is led by NDRC and MOFCOM, is the competent authority entitled to undertake the security review on foreign investments<sup>23</sup>.

With the new FIL, any decision that follows a security review will be final and cannot be appealed or be reviewed again.

# CONTROL OF THE NATIONAL SECURITY

## - WHO WILL INITIATE THE NSR?

1. **The foreign investor(s):** where the foreign investments fall into the scope of the security review, the foreign investor(s) or its the relevant parties in China shall submit the security review declaration to the Working Mechanism Office.
2. **The Working Mechanism:** for the Military Services, the Working Mechanism Office can request the parties concerned to make declaration<sup>24</sup>.
3. **Interested parties:** relevant authorities, enterprises, social groups or the general public deem that a foreign investment affects or may affect the national security, they may propose suggestions on security review to the Working Mechanism Office<sup>25</sup>.

## - HOW LONG WILL THE PROCEDURES OF NSR TAKE?

After reception of the security review declaration, the Working Mechanism will make a preliminary judgment on whether the foreign investment falls into the scope of security review within 15 working days and inform the parties concerned; if the Working Mechanism Office decides that the foreign investment needs security review, it shall complete the general review within 30 days from the date of decision. Upon general review, if it is deemed that the declared foreign investment will not have an impact on national security, the Working Mechanism Office shall make a decision on passing the security review; if it is deemed that the foreign investment will or may have an impact on national security, the Working Mechanism Office shall make a decision on initiating the special review. The special review shall be completed within 60 working days from the date of initiation; under special circumstances, the review period may be extended.

The uncertainty associated with NSR review period will affect the certainty of the transaction, and hence the prior planning and communications are of great importance.

## - WHAT ARE THE CONSEQUENCES FOR FAILURE TO DECLARE FOR NSR?

For any foreign investment that falls within the scope of declaration, if the parties concerned make investment without making declaration, the Working Mechanism Office shall order them to make declaration within a time limit; in the event that the parties concerned refuse to make declaration, the Working Mechanism Office shall order them to dispose of equity or assets and to take other necessary measures within a time limit to restore the equity or assets to the status before the implementation of the investment and eliminate impact on national security. Such activity shall also be included in the relevant credit information system of the China as parties with poor credit records, and be subject to joint punishment in accordance with the relevant provisions.

## Reference

1. The new system of FIE laws mainly includes: 1) Foreign Investment Law of PRC; 2) Implementation Regulations for the Foreign Investment Law of the PRC; 3) Special Administrative Measures (Negative List) for Foreign Investment Access (Edition 2020); 4) Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (Edition 2020); 5) Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Foreign Investment Law of the PRC; and 6) Measures on Reporting of Foreign Investment Information.
2. Articles 172 and 173 of Company Law of PRC; and Article 3 of Provisions on Merger and Division of Foreign Investment Enterprises.
3. A five-year transition period is applicable to the existing EJV, which shall revise their articles of association against the new FIL and Company Law before 31 December 2024.
4. Article 9 of the Measures on Reporting of Foreign Investment Information, effective from 1 January 20.
5. Article 9 of the Measures on Reporting of Foreign Investment Information, effective from 1 January 20.
6. Article 13 of Regulatory Measures on Transactions of State-owned Assets of Enterprises, effective from 24 June 2016.
7. Article 5 of Announcement of the State Administration of Taxation on Promulgation of the Administrative Measures on Individual Income Tax on Income Derived from Equity Transfer (Trial Implementation) (State Administration of Taxation Announcement [2014] No. 67), effective from 1 January 2015.
8. Articles 53 & 54 of Enterprise Income Tax Law of PRC, effective from 29 December 2018.
9. Article 2 of M&A Measures.
10. Article 13 of M&A Measures.
11. Article 2 of the Notice of the SAFE on Further Promoting the Facilitation of Cross-border Trade and Investment, effective from October 23, 2019.
12. Announcement of the State Administration of Taxation on Several Issues Relating to Enterprise Income Tax on Transfer of Assets between Non-resident Enterprises (State Administration of Taxation Announcement [2015] No.7).
13. Article 16 of Measures on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, effective from 22 June 2009.
14. A five-year transition period is applicable to the existing EJV, which shall revise their articles of association against the Company Law before 31 December 2024.
15. Article 20 of AML.
16. Article 3 of Guiding Opinions for the Declaration of Concentration of Operators (revised in 2018).
17. Article 21 of AML.
18. Article 18 of AML.
19. Article 17 of AML.
20. Article 2 of the National Security Law of PRC, effective from 1 July 2015.
21. Article 2 of the Notice of the General Office of State Council on Establishment of Security Review System Pertaining to Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, effective from 3 March 2011 ("M&A NSR Notice").
22. Article 4 of Measures for the Security Review of Foreign Investments, effective from 18 January 2021 ("NSR Measures").
23. Article 3 of the NSR Measures.
24. Article 4 of the NSR Measures.
25. Article 15 of the NSR Measures.

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