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# European Commission asserts its EUMR jurisdiction over (some) Chinese SOEs

In a recent decision, the European Commission (the Commission) determined that the turnover of all Chinese SOEs owned by Central SASAC that are active in the energy sector should be aggregated for the purposes of establishing the Commission's jurisdiction under the EU's Merger Regulation (EUMR). It is unclear whether this extends to all Central SASAC-owned SOEs, or whether it should be interpreted more narrowly.

## The story so far…

**The Commission has in a number of cases – such as *CNRC / Pirelli* and *DSM / Sinochem / JV* – considered whether Chinese State-owned enterprises (SOEs) owned by the Central Chinese Assets Supervision and Administrative Commission (Central SASAC) can be treated as a single entity for the purposes of EU competition law.**

However, until now the Commission has side-stepped the issue of whether the particular SOE in question was independent of other Chinese SOEs, as in all previous cases it has been able to establish jurisdiction regardless of the independence or otherwise of the relevant entity.

### The *EDF / CGN / NNB* case

The Commission faced no such easy way out in its recent decision in *EDF / CGN / NNB*. In this case, the Commission could only establish jurisdiction if it could show that both Électricité de France (EDF) and China General Nuclear (CGN) met the relevant turnover thresholds.

The case concerned CGN's investment in and acquisition of joint control over a number of EDFsubsidiaries, together NNB (the "**Transaction**"). NNB is responsible for the construction of the proposed Hinkley Point C nuclear power plant in the UK, together with related projects to construct nuclear power plants at Sizewell and Bradwell. Clifford Chance advised EDF on the Transaction and the related EUMR filing.

Given that CGN's turnover did not meet the EUMR's turnover thresholds, the Commission would lack jurisdiction to review the substance of the Transaction, unless it could establish that the turnover thresholds were met by aggregating the turnover of other Chinese SOEs active in the EU with that of CGN.

The legal test applied by the Commission looked at whether a Chinese SOE has the power of decision-making independent from the Chinese government. The test is based on the following two criteria:

- **Autonomy** – whether the SOE has autonomy in determining its business strategy; and
- **Coordination** – whether the Chinese government has the

## Key issues

- When will Chinese SOEs be treated as forming part of a single undertaking with other SOEs, such that their aggregated turnover meets the thresholds for a mandatory EUMR filing?
- Does it make a difference if the relevant SOEs operate in the same sector, or are under the supervision of Central SASAC or Local SASACs?
- Will national competition authorities adopt the same approach?
- What are the risks of a failure to notify, and how can they be mitigated?

possibility to coordinate the commercial conduct of Chinese SOEs active in the same market or industry.

## The Commission rejects CGN's independence from Central SASAC

CGN submitted that it operates independently of Central SASAC, such that the turnover thresholds were not met. There were three strands to this argument.

First, the Law of the People's Republic of China on the State-Owned Assets of Enterprises of 2008 (the "**Chinese law on SOEs**") requires Central SASAC to exercise its ownership rights based on the general principles of separation of government bodies and enterprises and non-intervention in business operations. Second, in light of CGN's ownership and management structure, Central SASAC would not have the ability to determine CGN's strategic commercial behaviour. Third, CGN would not have any interlocking directorships with Central SASAC.

The Commission considered and rejected each of these arguments. The Commission's view was that Central SASAC's obligation to act in accordance with the general principles of separation of government bodies and enterprises and non-intervention in business operations is undermined, or contradicted, by other provisions granting Central SASAC the ability to interfere in CGN's strategic decisions. Whilst strategic decisions are prepared in the first instance by CGN's management, the Chinese law on SOEs grants Central SASAC the right to select and supervise SOEs' senior management.

Moreover, as noted by the Commission in *DSM / Sinochem / JV*, the core Chinese legislation and the associated information set out on Central SASAC's website contain a number of provisions which can be read as suggesting that Central SASAC has certain powers to involve itself in CGN's commercial behaviour in a strategic manner, including the right to approve mergers and strategic investment decisions.

In addition, the absence of cross-directorships between CGN on the one hand, and other Chinese SOEs and Central SASAC on the other, does not preclude Central SASAC from influencing CGN's commercial strategy, given the range of powers enjoyed by Central SASAC over CGN noted above.

## The Commission's energy sector focus

The Commission proceeded to note that the Chinese law on SOEs grants the Chinese State (via Central SASAC) additional powers to control Chinese SOEs active in sectors that "*have bearings on the national economic lifeline and state security*". The Commission considered that CGN was active in the energy sector – and that this sector has bearings on China's national economic lifeline and state security.

The Commission identified a number of other elements which it considered showed that the Chinese State (via Central SASAC) has the power to influence coordination between companies active in the energy sector, and particularly in the nuclear industry. For example, a number of SOEs came together to form the China Nuclear Industry Alliance ("**CNIA**") under the direction of the government, one objective of which is said to be "*to eliminate detrimental or unseemly competition in export markets*". The Commission considered that the ability of Central SASAC to impose or facilitate coordination between SOEs was also supported by anecdotal evidence, such as the existence of a joint development and marketing agreement between CGN and CNNC (another member of CNIA) in relation to the Chinese Hualong One reactor.

## Aggregation of EU turnover from Chinese SOEs active in the energy sector

The Commission therefore considered that Central SASAC can interfere with strategic investment decisions and impose or facilitate coordination between SOEs at least with regard to SOEs active in the energy sector. Consequently, CGN and other Chinese SOEs in that sector should not be deemed to be independent from Central SASAC.

This meant that, for the purposes of determining the Commission's jurisdiction over the Transaction, the EU turnover of all Chinese SOEs active in the energy industry should be aggregated.

Given that CGN was not aware of the EU turnover of other Chinese SOEs and could not therefore provide the Commission with a sensible estimate of this figure, the Commission relied on the EU turnover of CNRC, a Central SASAC-controlled SOE active in a number of sectors, including the energy sector. The Commission had recently established in its 2015 *CNRC / Pirelli* decision that CNRC's EU turnover alone met the relevant thresholds. The Commission therefore concluded that it had jurisdiction over the Transaction.

## Questions arising from the Commission's decision

This is the first merger control proceeding involving a Chinese SOE in which the Commission has relied on the turnover of *other* Chinese SOEs to establish jurisdiction.

However, the precise implications of the decision are not entirely clear. We consider below some of the outstanding issues and further questions raised by the Commission's decision.

**Should we expect the Commission to conclude that any Central SASAC-owned SOE is also controlled by Central SASAC?**

Much of the decision's reasoning in relation to Central SASAC control of CGN would appear to apply to all Central SASAC-owned SOEs. Nonetheless, the Commission worded its conclusion narrowly, aggregating only the EU turnover of Central SASAC-controlled SOEs active in the energy sector.

**Which sectors (other than energy) does the Commission consider to have a bearing on China's "*national economic lifeline and state security*", such that they are subject to Central SASAC's additional powers?**

Assuming the Commission only considers SOEs that are active in certain sectors to be subject to Central SASAC control (which may not be the case), it is unclear which sectors fall within this category. Chinese law does not provide a legal definition of sectors bearing on China's "*national economic lifeline and state security*" – rather, this is more of a political concept. That said, there is a general understanding in China that the following seven critical sectors bear on China's "*national economic lifeline and state security*": military, grid and electricity, petroleum and petrochemicals, telecommunications, coal, civil aviation and shipping.[1] It seems likely that Chinese SOEs active in these sectors would also be considered to be subject to Central SASAC's additional powers.

**Should the EU turnover only of other SOEs controlled by Central SASAC active in the same sector as the merger party be aggregated, or should the EU turnover of all Chinese SOEs (including those active in other sectors) be included?**

There is no obvious legal basis for aggregating the EU turnover of only a subset of SOEs controlled by Central SASAC – clarification of this point by the Commission would therefore be helpful.

**How closely related must an SOE's activities be to a given sector for its EU turnover to be relevant for these purposes?**

For example, in determining that CGN's EU turnover should be aggregated with that of CNRC, the Commission considered that CNRC was "*active among others in the energy area through several refineries that process crude oil.*" It is unclear why CGN and CNRC were considered to be active in the same economic sector, given the absence of clear horizontal or vertical overlaps between nuclear power generation and crude oil refining.

**What proportion of an SOE's activities should be related to a critical sector for its EU turnover to be relevant for these purposes?**

CNRC's major European business is Pirelli, which would not be considered an energy company; and its parent company is China National Chemical Corporation, which refers to itself on its website as "*China's largest chemical company*". It is unclear whether it is sufficient for just a small proportion of an SOE's business to be in the relevant critical sector for its EU turnover to be aggregated, or whether more substantial activities in that sector are required.

**What about SOEs controlled by Local SASACs or other agencies?**

The Commission left open the question of whether SOEs controlled by local Chinese Assets Supervision and Administrative Commissions ("**Local SASACs**") should be considered as forming a single entity with SOEs controlled by Central SASAC. Under Chinese law, there is no direct subordination between Central SASAC, which reports to the State Council, and Local SASACs, which report to their respective local governments.[2] If an SOE is controlled by a Local SASAC, should its EU turnover be aggregated with that of other SOEs controlled by the same Local SASAC? And what about SOEs controlled by other Local SASACs, or by Central SASAC?

[1] A statement given by the former director of the Central SASAC and published on the Chinese government's official website, identified these sectors when stating that "*the state-owned capital keeps absolute control over important industry and key fields that have bearings on the national economic lifeline and state security".*

[2] Central SASAC carries out its administrative duties on behalf of the State Council and its senior officials are appointed by the State Council. Local SASACs perform their duties on behalf of the local governments, and their heads are appointed, removed and paid by their respective local governments.

Similarly, there is no clear guidance on the position of SOEs held through other agencies, such as the State owned banks held by CIC.

**What approach will be taken by National Competition Authorities ("NCAs")?**

It is not yet clear whether NCAs will follow the Commission's approach and expect notifying parties to aggregate the turnover of all / certain Chinese SOEs in national merger control proceedings.

In January 2015, the German NCA cleared the merger between two Central SASAC-owned SOEs active in the manufacture of trains, China CNR Corporation Limited (CNR) and CSR Corporation Limited (CSR). However, that does not necessarily mean that the German NCA accepted, or even considered, arguments that the merging parties were independent.

Similarly, the Competition Commission of Singapore accepted that the same merger constituted a notifiable transaction "*based on the parties' submissions that CNR and CSR are independent undertakings*" and without any detailed consideration of whether this was indeed the case.

**Will Chinese SOEs be considered to be a single economic unit for the purposes of Article 101 TFEU?**

Article 101 TFEU prohibits anticompetitive agreements and concerted practices between undertakings; however, this prohibition does not generally apply to undertakings considered to belong to a single economic unit. If Chinese SOEs can claim that they form part of such a single economic unit, they will be in a position to cooperate more closely and potentially to coordinate certain aspects of their conduct.

## Implications for the substantive review of transactions involving Chinese SOEs

A further implication of an SOE being subject to Central SASAC control is that in assessing the competitive effects of a transaction involving that SOE the Commission will consider the market power not merely of that SOE, but of all other SOEs active in the same sector and also subject to Central SASAC (and, potentially, Local SASAC) control. This could have implications for the substantive outcome of transactions: if the SOE directly involved in a transaction is only a minor player in a given market, but is found to be part of the same economic unit as an SOE with much greater market power, it is more likely that the Commission will raise concerns. This could extend and complicate the Commission's review process, and could potentially lead to a need for remedies to be agreed to secure clearance.

## Conclusion

The Commission has until now avoided reaching a firm conclusion as to whether and to what extent Chinese SOEs are subject to the control of a single entity, such as Central SASAC. Its hand was forced in relation to the Transaction, in order for it to establish jurisdiction and subject the Transaction to its review. Even then, its decision was worded very narrowly, and provides relatively little clarity going forwards as to which Chinese SOEs will be considered to form a single economic unit – other than those SOEs that are subject to Central SASAC control and are active in the broadly-defined energy sector.

These uncertainties give rise to considerable risks for SOEs making acquisitions in Europe. Penalties of €20 million were imposed in both of the most recent cases of failure to notify (on Electrabel in 2009 and Marine Harvest in 2014). In order to mitigate these risks, SOEs should seek early legal advice and, where appropriate, seek informal guidance from the Commission.

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