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M&A Under China's Anti-Monopoly Law

Emerging Patterns

By Yee Wah Chin

China's Anti-Monopoly Law is becoming a major hurdle for larger cross-border transactions.

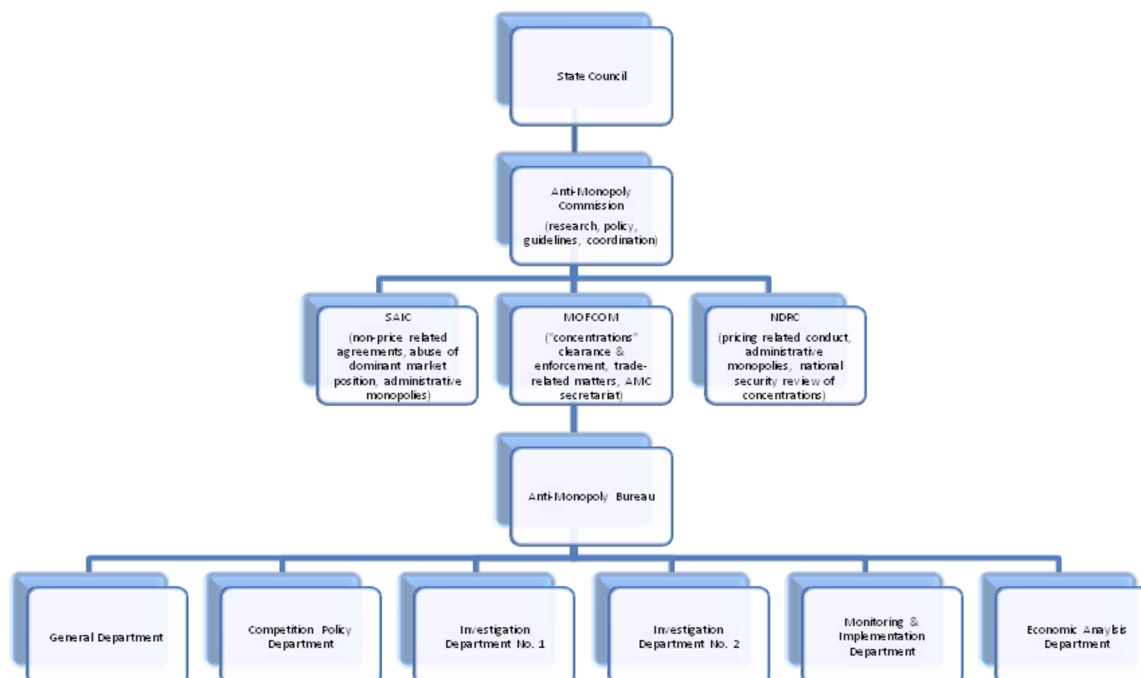
China's Anti-Monopoly Law (AML) became effective on August 1, 2008, following 13 years of drafting. Since then, businesses and lawyers with interests in China have closely followed every development. While there have been draft and final regulations issued by the enforcement agencies on most aspects of the AML, and complaints citing the AML have been filed in the courts and with the agencies alleging monopolistic conduct, the most closely watched developments have been on the M&A front. All but one of the announced government enforcement actions to date have involved transactions. It is clear that China's merger control regime is becoming the third major antitrust hurdle for large, cross-border transactions, along with the United States and the EU. This article summarizes the AML, reviews provisions relating to mergers and acquisitions, and discusses patterns emerging in China's application of the AML in the M&A area.

Overview of AML

The AML is China's first comprehensive antitrust law, and generally is within the mainstream of modern competition laws. It includes the three pillars of most modern antitrust laws, with chapters on (1) "monopoly agreements," or cartels and other multiparty anticompetitive conduct; (2) "abuse of dominant market position," dealing with unilateral conduct; and (3) "concentrations," which covers mergers and acquisitions and joint ventures. The AML also includes distinctive provisions: a chapter on abuse of administrative power that is directed toward rampant local protectionism and articles on state-owned enterprises in sectors that are economically vital or implicate national security, businesses that have exclusive distribution rights pursuant to law, and trade associations.

The law establishes a multilevel and multifaceted enforcement structure under the State Council, the chief executive body. It creates a new entity, the Anti-Monopoly Commission (AMC), to (1) research and draft competition policy, (2) organize and publish studies on the state of competition, (3) develop guidelines, (4) coordinate enforcement, and (5) fulfill assignments from the State Council. The AML specifies that the State Council will designate Anti-Monopoly Enforcement Authorities (AMEA) that will be responsible for enforcement. The State Council designated three existing agencies to share enforcement responsibilities: (a)

Chart 1: AML Enforcement Structure



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the Ministry of Commerce, (b) the State Administration for Industry & Commerce (SAIC), and (c) the National Development & Reform Commission (NDRC). MOFCOM is the secretariat for the AMC as well as the AMEA responsible for merger control and enforcing the AML against anticompetitive conduct in international trade. The SAIC is assigned to enforce the AML with respect to all other violations except for pricing conduct. The NDRC is responsible for prosecuting pricing-related violations. The statute specifies the investigatory authority of the AMEAs, including mandating at least two officials on each investigation and written records of interrogations. The confidentiality of trade secrets is expressly protected. Chart 1 illustrates the AML enforcement structure.

The AML provides a range of remedies. Investigations may be suspended and terminated upon targets addressing the AMEA's concerns. In the case of "monopoly agreements," leniency is available to a participant who discloses the violation and cooperates with the investigation. Otherwise, and also in the case of abuse of dominant market position, "illegal gains" may be confiscated and fines may be imposed of between one and 10 percent of the previous year's turnover. Trade associations that organize monopoly agreements are subject to fines of up to RMB500,000 and cancellation of their registration. Fines and criminal sanctions are authorized for obstructing investigations. The law is notably lacking in significant remedies against competitive abuse of administrative powers. It provides for administrative review and review under the administrative law of AMEA decisions. There are administrative and criminal penalties for AMEA staff members who abuse their powers. Violators may be civilly liable for damages caused to others, creating a private right of action. The Supreme People's Court has designated the intellectual property tribunals of the People's Courts to handle AML cases, apparently because the tribunals may be the sections of the People's Courts most experienced in handling complex matters. Otherwise, intermediate-level courts will adjudicate AML cases.

AML Provisions and Implementing Actions Relating to "Concentrations"

The AML establishes a premerger notification system, requiring transactions above a size threshold set by the State Council to be notified to the designated AMEA (MOFCOM) and undergo a waiting period before closing. Transactions within a corporate family are exempt. The law establishes a three-phase review period of 30, 90, and 60 days. If MOFCOM does not act by the end of a phase, the transaction is deemed approved. The waiting period begins when MOFCOM accepts a notification. Consummation of a transaction in violation of the AML may result in an order to divest, a fine of up to RMB500,000, or other orders to restore the status quo ante.

The AML sets forth the principle that businesses may, voluntarily and through fair competition, combine according to law to expand scale and increase their competitiveness. MOFCOM is to consider in its reviews factors including the parties' market shares, market concentration, and the impact of the transaction on market access, technological advance, consumers, other interested businesses, and national economic development. Transactions that will or may eliminate or restrict competition will be prohibited. Where the pro-competitive effects of the transaction outweigh its adverse effects, or where the transaction may benefit the public interest, MOFCOM may decide not to prohibit the transaction. It may permit a transaction upon conditions. Both prohibitions and conditional approvals must be published. Perhaps most distinctively in this area, the AML provides that where foreign capital is involved in a concentration that implicates national security, the transaction will undergo separate review pursuant to relevant regulations.

Since the AML became effective, the State Council has announced the size-of-transaction thresholds, the AMC has issued market definition guidelines, and MOFCOM has issued procedural measures on premerger notifications and reviews of notified transactions as well as guidance on notification contents and the review process, and provisional rules on required divestitures. Drafts have been circulated regarding the substantive standards for merger review and the treatment of unnotified transactions.

Interaction with Other Laws Relating to M&A

There are reports that a multiministry committee is being formed to conduct national security reviews of transactions, pursuit to a Plan for National Security Review Mechanism that was announced at the March 2010 annual session of the National People's Congress. How that will affect transactions involving non-Chinese parties will be closely watched.

The AML itself does not distinguish between foreign and domestic businesses. However, until July 2009, foreign investors were also subject to premerger notification and competition review under the Provisions on M&A of a Domestic Enterprise by Foreign Investors (Foreign M&A Provisions). In July 2009, the Foreign M&A Provisions was amended to conform its premerger notification and review provisions to the AML, so that foreign buyers would be subject to only one competition notification and review requirement, that under the AML. Significantly, the 2009 amendments retained the requirement of a

Table 1: Notification Review Timelines

	Submitted	Accepted	2d Phase	3d Phase	Decision
InBev/Anheuser-Busch	9/10/08	10/27/08	—	—	11/18/08
Coca-Cola/Huiyuan	9/18/08	11/20/08	12/20/08	—	3/18/09
Mitsubishi Rayon/Lucite	12/22/08	1/20/09	2/20/09	—	4/24/09
GM/Delphi	8/18/09	8/31/09	—	—	9/28/09
Pfizer/Wyeth	6/9/09	6/15/09	7/15/09	—	9/29/09
Panasonic/Sanyo	1/21/09	5/4/09	6/3/09	9/3/09	10/30/09
HP/3Com	12/4/09	12/28/09	1/27/10	—	4/7/10*
Novartis/Alcon	4/20/10	4/20/10	5/17/10	--	8/13/10

* No decision was published as it was an unconditional approval.

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notification to and review by MOFCOM of transfers of control of domestic businesses that involve a critical industry, implicate national economic security, or own any famous trademarks or venerable Chinese brands. This clause, though not cited in MOFCOM's AML decisions, may underlie the difficulties experienced by foreign companies in several merger investigations. MOFCOM's AML decisions thus far raise questions of whether national brands will play an outsized role in premerger reviews even though the AML is silent in this respect.

Emerging Patterns

As of June 2010, there were over 140 transactions notified, and six decisions published. MOFCOM stated on August 12, 2010, that 95 percent of the notified transactions were cleared unconditionally, and that over 60 percent were cleared during the first phase of 30 days following acceptance of the notifications. On August 13, 2010, a seventh decision was announced. The seven decisions published to date reflect economic and competition analysis, though in some cases arguably analysis that has been abandoned by other jurisdictions. The analysis should become more refined with experience. What is of greater concern and more difficult to ameliorate is an emerging pattern of a merger control process that may be politicized and trumped by industrial policy and nationalism. The fact that all the published decisions relate to transactions involving non-Chinese entities may reflect that. Also, MOFCOM has introduced more procedural flexibility than is apparent in the AML.

The flexibility that MOFCOM has introduced into the process is revealed in its handling of filings. Since the AML time frame applies only after a notification is accepted, MOFCOM has effectively elongated that time frame by the time it takes to accept a notification, sometimes by months. Table 1 illustrates this effect.

Thus, although the AML may contemplate that a review would end after a maximum of 180 days, or six months, after a notification is filed, the reality has exceeded in one case over nine months. On the other hand, although the default under Chinese law is that "days" are "business days," MOFCOM has treated "days" under the AML to mean "calendar days" and adhered to the AML timeline once it accepts a notification. This provides parties with some certainty. Nonetheless, the practical effect is that, in a transaction that MOFCOM concluded had no anti-competitive effect, it took over two months to complete its review and impose conditions. Hopefully, the fact that MOFCOM accepted the Novartis/Alcon notification on the day it was submitted indicates that there will be less advantage taken in the future of the flexibility that has been introduced into the AML time line.

Moreover, although a transaction is deemed approved if MOFCOM fails to act within the AML time frame, MOFCOM effectively prohibits a transaction by simply refusing to accept a notification and therefore to start the clock. An example of this "pocket veto" may be the attempt by the Internet portal company Sina.com to acquire an interest in Focus Media, a Chinese advertising and digital media company. The transaction was announced in December 2008 and notification submitted to MOFCOM. MOFCOM never accepted the notification, and the parties finally abandoned the deal in September 2009 since they could not close it without the expiration of the waiting period, which never began. Similarly, the proposed acquisition of General Motor's Hummer division by Sichuan Tengzhong Heavy Industrial Machinery may have been abandoned in February 2010 after being announced in June 2009, in significant part because MOFCOM apparently never accepted notification of the transaction. This may be one method to deter transactions that MOFCOM does not want to approve, without publishing any reasons. In both cases, it is unclear that there was any competitive impact reason for blocking the deal while there may have been industrial policy reasons to do so.

Nationalism may be reflected in the treatment of the InBev/Anheuser-Busch transaction. The merged entity would have accounted for only 13 percent of the beer industry in China. The four largest brewers in China together accounted for around 41 percent of industry revenues. In its conditional approval of the deal, MOFCOM found no anticompetitive impact from the transaction yet prohibited InBev from increasing its holding of the 27 percent of Tsingtao Beer that Anheuser-Busch held or its own 28.56 percent holding of Zhujiang Brewery, and from buying interests in two other Chinese beer brewers without prior MOFCOM review even if the transactions would otherwise be exempt from AML review. InBev must notify MOFCOM of any changes in controlling shareholders. MOFCOM stated that the conditions were imposed because of the size of the transaction and the market position of the resulting entity, to minimize potential adverse effects in China's beer market. In the United States and EU, a transaction that is found not to be anticompetitive would have been cleared unconditionally. MOFCOM's approach seems to reflect concern over greater foreign control over a noted Chinese brand, Tsingtao, and foreign control over Chinese companies generally. It also may reflect a concern that, if there are anticompetitive consequences later, which would presumably fall under the jurisdiction of the SAIC and/or the NDRC, those agencies may fail to act, so that a prophylactic was adopted.

Nationalism may have been an even greater factor in the prohibition of the Coca-Cola/Huiyuan deal. The public reaction was vociferous and overwhelmingly negative, in the Internet and in the media, to the prospect of Coca-Cola ownership of the Huiyuan brand. Competition concerns were less apparent. Coca-Cola accounted for over 60 percent of carbonated soft drink sales in China, but Huiyuan, China's largest juice manufacturer, was insignificant in that area. The combined entities would have accounted for under 30 percent of juice sales in China. MOFCOM based its prohibition on (1) Coca-Cola's post-acquisition ability to leverage its dominant position in carbonated drinks to fruit juice, thus affecting other fruit juice competitors and harming competition and consumers; (2) the potential of the merged entity to eliminate competitors, limit competition, and harm consumer welfare by tying, bundling, and other exclusionary practices; (3) the increased entry barriers resulting from the control that Coca-Cola would have on two major juice brands, Minute Maid and Huiyuan, when coupled with its position in carbonated drinks that may increase its dominance in juice; (4) the decreased opportunities for domestic small and medium-sized juice businesses to compete and innovate; (5) the adverse impact on competition in the China juice market and development of the Chinese juice industry; (6) the lack of offsetting positive effects or public interest; and (7) the lack of adequate remedies offered by Coca-Cola. This explanation is controversial among the antitrust bar and leaves the impression that it was the pretext for a

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decision based on nationalism and political expediency.

The outcomes and stated analyses in the InBev/Anheuser-Busch and Coca-Cola/Huiyan transactions raise questions regarding the application of the Foreign M&A Provisions. MOFCOM made no reference to the Foreign M&A Provisions in its decisions, but it may be difficult to escape the conclusion that at least the national brands article of the Foreign M&A Provisions played a role. It may be nationalism more than industrial policy that prevailed in these two cases, since there appeared less an issue of protecting or building a national champion and more the national pride in retaining domestic control of a local brand name.

Industrial policy may be reflected in the conditions MOFCOM imposed on Mitsubishi Rayon's acquisition of Lucite. This transaction cleared competition law reviews elsewhere without fanfare, yet went into the second phase in China. The merged entity would have accounted for 64 percent of methyl methacrylate monomers produced in China, but new capacity was expected to come online shortly that may lower the merged entity's position below 40 percent. There was significant competition internationally. The key factor appears to have been the concern of Chinese competitors and customers. MOFCOM also noted that both Mitsubishi Rayon and Lucite are vertically integrated, so that there was the potential for exclusion of competitors in downstream markets. MOFCOM conditioned its approval on (1) Lucite China selling at cost 50 percent of its annual MMA production for five years to an approved third party, with a divestiture trustee to be appointed to complete that sale if it is not completed in six months; (2) Lucite China operating independently from Mitsubishi Rayon China's MMA monomer business until divestiture; and (3) the merged entity refraining for five years from further acquisitions or new plant construction in China in MMA monomer, PMMA polymer, or cast acrylic sheet without prior MOFCOM approval. A similar prohibition on greenfield expansion was last imposed in the United States 40 years ago, in *Ford Motor Co. v. United States*, 405 U.S. 562 (1972), requiring Ford to divest Auto-Lite, a spark plug and automotive parts manufacturer that Ford purchased in 1961, and prohibiting Ford from manufacturing spark plugs for 10 years. This draconian condition on Mitsubishi Rayon would seem justifiable only on industrial policy grounds, to promote domestically owned industry, when the transaction raised little competitive concerns by most competition analyses.

Two of the more recent decisions raise fewer questions because the results were consistent with those in other antitrust jurisdictions. In approving GM's acquisition of Delphi, MOFCOM imposed firewalls and other conditions to ensure that GM's and Delphi's competitors would not be disadvantaged by the vertical integration. In Pfizer/Wyeth, with the merged entity accounting for almost 50 percent of swine mycoplasma pneumonia vaccine in China, the next largest competitor at only 18.35 percent, and high entry barriers, MOFCOM required Pfizer to divest two brands of the vaccine in China within six months to a MOFCOM-approved buyer. However, the conditions for an approved divestiture apparently meant that effectively only a Chinese buyer would be approved and that significant intellectual property would be transferred, leading to concerns that China may have taken the opportunity to further industrial policy. Harbin Pharmaceuticals was the buyer, becoming the largest producer of swine vaccine in China.

The decision on Panasonic's acquisition of Sanyo is notable for both the lengthy process and the extraterritorial conditions imposed. For the first time, MOFCOM defined worldwide relevant markets and required divestitures outside China, of battery plants in Japan. The later unconditional approval of the HP/3Com transaction, which received early termination of the Hart-Scott-Rodino waiting period in the United States and unconditional clearance in the EU, raised hopes of a continuing development toward rigorous competition analysis, as it might have been an opportunity to further industrial policy in the guise of remedying a competition concern by requiring a divestiture entailing technology transfer.

The latest published decision, granting conditional approval of Novartis's acquisition of Alcon, offers mixed support for those hopes. MOFCOM for the first time expressly considered the possible increased likelihood of coordinated anticompetitive conduct as a result of a transaction. The Novartis/Alcon combination would have accounted for almost 20 percent of contact lens care product sales in China, which by itself was unproblematic. MOFCOM was concerned that the combination, together with Novartis's distribution arrangement and strategic partnership with Hydron Contact Lens, the largest seller in China which accounted for over 30 percent of sales of lens care products in China, would create competitive issues by increasing the likelihood of coordination over price, volume and territory by two players that together account for over 50 percent of sales in China. It required Novartis to terminate the distribution arrangement with Hydron within 12 months. On the other hand, MOFCOM also required Novartis to exit the distribution in China of ophthalmic anti-infective and anti-inflammatory compounds where it had less than 1 percent of sales and refrain from re-entering for five years, because the transaction would have resulted in a combined market share of over 60 percent. This minimal 1 percent increase in market share would be unlikely to result in the imposition of any condition in developed antitrust jurisdictions, especially since Novartis had expressed the intent of shutting down its business in that product line globally. Moreover, the remedy imposed, exit rather than divestiture, would seem to lessen instead of preserve competition. The decision offered little guidance as to the reasoning behind the conclusion of anti-competitive concern or remedy.

The strongest indicator that industrial policy trumps competition principles may be the fact that major transactions among Chinese companies have been completed without any AML notification, and any MOFCOM enforcement. State-sponsored reorganizations of the telecommunications, auto, and airline industries in the last few years have involved transactions that clearly exceed the notification thresholds, without any notification to or review by MOFCOM. A notable example is the China Unicom/China Netcom transaction in October 2008. A number of mergers of state-owned enterprises have been announced as approved by the State Council without any reference to the AML or MOFCOM.

Conclusion

There appear to be emerging patterns of industrial policy and nationalism trumping competition policy, greater procedural flexibility in the merger control regime than apparent at first glance, and analytic

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approaches that may have been abandoned elsewhere. Nonetheless, the increasingly detailed published MOFCOM decisions reflect a policy of increasing transparency and applying economic analysis in merger control, to be in the antitrust mainstream. Moreover, MOFCOM's sensitivity to perceptions of discriminatory enforcement of the AML is reflected by the fact that the Director General of its Anti-Monopoly Bureau held a press conference on August 12, 2010, apparently for the specific purpose of emphasizing that China never discriminated against foreign companies in the enforcement of the merger control provisions of the AML and that conditions were placed on transactions because they would otherwise adversely affect competition. Hopefully this sensitivity will temper deference to industrial policy and nationalism.

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Additional Resources

For other materials related to this topic, please refer to the following.

Business Law Today

Keeping Current: Antitrust

China Passes Comprehensive Anti-monopoly Law

By Jonathan S. Gowdy

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