Merger Control under China's Anti-Monopoly Law

By Yee Wah Chin, Ingram Yuzek Gainen Carroll & Bertolotti, LLP

Since August 2008, when China's Anti-Monopoly Law[1] became effective, its Ministry of Commerce has reviewed over 450 notified transactions and issued over a dozen decisions. This paper summarizes the merger control regime created under the AML and its implementing regulations. It analyzes the statistics through mid-December 2011 and some of the published decisions through August 17, 2012. MOFCOM has achieved flexibility in the time line for merger review. There remains a risk that the AML merger control process may be politicized and trumped by industrial policy and nationalism.

AML Merger Control Regime

The AML requires transactions above a size threshold set by the State Council to be notified to MOFCOM and undergo a waiting period before closing. The law establishes a 3-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.

MOFCOM is to consider in its merger reviews standard competition factors including the parties' market shares, market concentration, and the impact of the transaction on market access, consumers and other interested businesses. The AML also identifies non-standard factors to be considered – the impact of the transaction on technological advance and national economic development. While it does not otherwise distinguish between foreign and domestic businesses, the AML provides that where foreign capital is involved in a concentration that implicates national security, the transaction will undergo a separate review. Transactions which 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.

Since the AML became effective, the State Council announced the size-of-transaction thresholds,[2] and the Anti-Monopoly Commission created under the AML issued market definition guidelines. MOFCOM issued procedural measures on pre-merger notifications and reviews of notified transactions as well as guidance on notification contents and the review process, and provisional rules on required divestitures. It issued interim provisions regarding the assessment of the competitive impact of concentrations, and interim provisions regarding the handling of notifiable transactions that were not notified. In addition, MOFCOM released a regulation regarding national security review of mergers and acquisitions of domestic enterprises by foreign investors.

---

[1] 中华人民共和国反垄断法 (People's Republic of China Anti-Monopoly Law) http://www.fdi.gov.cn/pub/FDI/zcfg/law_ch_info.jsp?docid=82500 (in Chinese) (visited August 4, 2012).

[2] Notification generally is required under the AML if (1) the total worldwide turnover of all parties in the previous fiscal year exceeds RMB 10 billion (approximately $1.5 billion), and the PRC turnover of at least two parties exceeds RMB 400 million (approximately $62 million), or (2) the total PRC turnover of all parties in the previous fiscal year exceeds RMB 2 billion (approximately $314 million) and the PRC turnover of at least two of the parties exceeds RMB 400 million.

The Numbers

MOFCOM's docket has more than doubled in size since 2009 and it has since August 2008 reviewed over 450 notified transactions. Table 1 sets forth the review time lines for the 16 transactions in which decisions have been issued through August 17, 2012, along with those of several high profile transactions that were approved unconditionally.

Table 1 Merger 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
Uralkali/Silvinit	3/14/11	3/14/11	4/12/11	--	6/2/11
NXP/Dover	12/30/10	~2/18/11	~3/21/11	--	6/14/11*
Alpha V/Savio	7/14/11	9/5/11	9/30/11	--	10/31/11
Yum!/Little Sheep	6/15/11	6/27/11	7/27/11	10/25/11	11/7/11*
GE-Shenhua JV	4/13/11	5/16/11	6/15/11	9/13/11	11/10/11
Nestlé/Hsu Fu Chi	7/14/11	9/21/11	10/21/11	--	12/6/11*
Seagate/Samsung	5/19/11	6/13/11	7/13/11	10/11/11	12/12/11
Tiande-Henkel JV	8/8/11	9/26/11	10/25/11	1/19/12	2/9/12
Western Digital/Hitachi	4/2/11 (withdrawn 11/1/11)	5/10/11	6/8/11	9/7/11	--
	11/7/11	11/7/11	12/7/11	--	3/2/12
Google/Motorola Mobility	9/30/11	11/21/11	12/21/11	3/20/12	5/19/12
UTC/Goodrich	12/12/11	2/6/12	3/2/12	5/31/12	6/15/12
Wal-Mart/Yihaodian	12/16/11	2/16/12	3/16/12	6/13/12	8/13/12

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

From these statistics, we see, first, MOFCOM has imposed conditions on or prohibited about 3% of notified transactions. In comparison, the European Commission imposed remedies in or prohibited about 5% of notified transactions. In the United States, the Department of Justice and the Federal Trade Commission together challenged around 3.5% of notified transactions.

Second, MOFCOM continues to achieve greater flexibility in the time line for review than is apparent from the AML. The statutory scheme of 30-90-60 days, for a maximum of 180 days, is almost uniformly extended. With the exceptions of Novartis/Alcon and Uralkali/Silvinit,[3] of the 16 transactions for which decisions were issued through August 17, 2012, there was a delay in the acceptance of the notification, triggering the start of the Phase 1 30-day review period, of between 6 and 61 days.

It also appears from anecdotal information that the majority of AML notified transactions go beyond the 30-day Phase 1 review into Phase 2. In contrast, in the United States, historically, fewer than 4.5% of transactions notified under the Hart-Scott-Rodino Antitrust Improvements Act are subject to a "second request", extending the initial 30-day waiting period until after the parties have complied with the additional request for information. Moreover, in the United States, requests for early termination of the waiting period are made in 82% of notifications, and most of the requests are granted.

These statistics may reflect MOFCOM's limited resources, the extensive inter-agency consultations conducted in almost every case, and the newness of the law.

Off the Record

Although a transaction is deemed approved if MOFCOM fails to act within the AML time frame, MOFCOM can effectively prohibit a transaction by simply refusing to accept a notification and therefore to start the clock.

An example of such a "pocket veto" may be the attempt by Sina.com to acquire an interest in Focus Media, which was announced in December 2008. MOFCOM never accepted the notification submitted for the deal, and the parties abandoned it in September 2009.[4] 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.[5] 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.

A variation of this approach may be Diageo's acquisition of control of Sichuan Chendu Quanxing Group, which was approved unconditionally even though it resulted in Diageo controlling the high-end Shui Jing Fang brand of baijiu, white spirit. The deal was announced in March 2010, and cleared over a year later, in June 2011. In March 2011, Sichuan Swellfun, which was controlled by Sichuan Chendu Quanxing and owned the more famous Quanxing baijiu brand, sold the Quanxing brand to a third party. The AML notification for Diageo's acquisition may have been submitted after that divestiture and therefore lacked any reference to the Quanxing brand. Diageo was permitted to acquire control of only the arguably lesser of two brands controlled by Sichuan Chendu Quanxing without a record of any nationalism

[3] There was no delay in the acceptance of the second notification for Western Digital/Hitachi, but there was a 38 day delay in accepting the initial filing for that transaction.
[4] David Barboza, "Sina.com Pulls Out of Deal After Delay", *The New York Times* (online ed, New York, September 28, 2009) http://www.nytimes.com/2009/09/29/business/global/29sina.html?_r=1&th&emc=th (visited August 4, 2012); Mark Lee, "Sina Scraps Planned Purchase of Focus Media Assets (Update2)" Bloomberg (September 28, 2009) http://www.bloomberg.com/apps/news?pid=newsarchive&sid=awNZZ3lhpaFc (visited August 4, 2012).
[5] Norihiko Shirouzu and Sharon Terlep, "GM to Shut Hummer After Sale Collapses," *The Wall Street Journal* (online ed, New York, February 24, 2010) http://online.wsj.com/article/SB10001424052748704240004575084841720106982.html?mod=djemTEW_t#articleTabs%3Darticle (visited August 4, 2012).

concerns.[6]

The Record

MOFCOM's published decisions also accommodate non-competition imperatives without creating a record of competition enforcement skewed by non-competition factors.

Nationalism

The outcomes and stated analyses in the InBev/Anheuser-Busch and Coca-Cola/Huiyuan decisions appeared to accommodate the national pride in retaining domestic control of a local brand name.

MOFCOM's decision on InBev's acquisition of Anheuser-Busch was its first published decision under the AML. MOFCOM found no anticompetitive impact from the transaction yet imposed conditions. In the United States and European Union, a transaction that is found not anti-competitive would have been cleared unconditionally. 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. The merged entity in InBev/Anheuser-Busch would have accounted for 13% of the beer industry in China.

MOFCOM prohibited InBev from increasing its holding of the 27% of Tsingtao Beer that Anheuser-Busch held or its own 28.56% 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. In both Tsingtao and Zhujiang, Anheuser-Busch and InBev were the second largest shareholders. Moreover, InBev must notify MOFCOM of any changes in its controlling shareholders. The result appears to be mostly protection for owners of Chinese brands and Chinese breweries.

Nationalism may have been an even greater factor in the prohibition of the Coca-Cola/Huiyuan deal. This is MOFCOM's only prohibition under the AML of a transaction to date. Huiyuan is the largest Chinese juice company and a major Chinese brand with great consumer recognition. The public reaction was vociferously negative to the prospect of Coca-Cola ownership of the Huiyuan brand in addition to its existing Meizhiyuan brand. Competition concerns were less apparent. Coca-Cola accounted for over 60% of carbonated soft drink sales in China, but Huiyuan was insignificant in that area. The combined entities would have accounted for under 30% of juice sales in China.

Industrial Policy

Industrial policy may have been the non-competition policy most often accommodated in MOFCOM's decisions.[7] Several decisions raise questions about industrial policy influences,

[6] "Beijing did not force the company to divest itself of that brand, but 'it was reasonably clear it had to be done', according to Edward Radcliffe, a partner at Vermilion, the lead adviser on the transaction." Patti Waldmeir and Leslie Hook, "Diageo deal shows China thirst for investment," *Financial Times* (online ed, London, June 28, 2011) http://www.ft.com/intl/cms/s/0/31a00704-a1b8-11e0-b9f9-00144feabdc0.html (visited February 15, 2012).

[7] An indicator that industrial policy has been trumping competition principles may be the fact that major transactions among Chinese companies have been completed without any AML notification or MOFCOM enforcement. State-sponsored reorganizations of the telecommunications, auto and airline industries since the AML became effective have involved transactions that clearly exceed the notification thresholds, without any notification to or review by

including the most recent one, involving Wal-Mart's acquisition of control over the online retail store Yihaodian. MOFCOM's decision in Wal-Mart/Yihaodian effectuates industrial and/or regulatory policy more than it ameliorates any threat to competition.

The Wal-Mart/Yihaodian transaction itself, and therefore the conditions imposed, is opaque, in significant part because of the legal ambiguity of the Variable Interest Entity (VIE) structure involved in the control of Yihaodian. VIE structures are common in China to avoid the restrictions on foreign investment in the telecommunications sector. Licenses are required for a foreign entity seeking to provide an online platform for third party retailers or other telecommunications services, and are difficult to obtain. In a VIE arrangement, management control without formal ownership by a foreign entity of a domestic Chinese telecom licensee is achieved through a series of contractual arrangements.

Wal-Mart was acquiring indirect ownership of 51% of Niuhai Holdings. Niuhai Holdings through two subsidiaries, including Niuhai Shanghai, controls Shanghai Yishiduo Electronic Commerce Ltd's online retail store Yihaodian, apparently through a VIE. Wal-Mart appears to be gaining control of Yihaodian's online retail store by stepping into the shoes of Niuhai Holdings in the VIE. Yihaodian also provides a platform for third party sellers, which are considered "value added telecom services".

MOFCOM concluded that the relevant product market is the B2C online retail business and the relevant geographic market is China. It determined that Wal-Mart could post-transaction extend its competitive strength in brick and mortar retailing to substantially increase the competitiveness of Yihaodian's online retail business, so that the combined entity's strength in retailing might be leveraged into a dominant position in "value added telecom services", to a stronger bargaining position relative to users of those services, and thus to eliminate or restrict competition in "value added telecom services" in China.

MOFCOM therefore conditioned approval of the transaction on:

1. The acquisition of Niuhai Shanghai being limited to that part engaged in direct online retailing on its own platform.

2. Without approval for value added telecoms services, after the transaction Niuhai Shanghai may not use its platform to provide network services to others.

3. Post-transaction, Wal-Mart may not use a VIE structure to conduct the value added telecoms services business now operated by Shanghai Yishiduo Electronic Commerce Ltd.

MOFCOM's decision appears basically to clear Wal-Mart's "acquisition" of Yihaodian's online retail store, the aspect of the transaction with the likeliest competitive consequences, while prohibiting Wal-Mart from entering the value added telecoms services business unless Niuhai Holdings's subsidiary Niuhai Shanghai gets a license for that business. Presumably if Niuhai Shanghai obtained the requisite licenses, Wal-Mart would be able to enter the value added

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.

telecoms services business, regardless of competitive consequences. The decision essentially mandates compliance with foreign investment and sectoral regulations.

Caution

MOFCOM's results also appear to reflect skepticism about lack of motivation to act anticompetitively, and may reflect recognition of the reality of the structure of China's economy. These aspects are exemplified in GE-Shenhua.

MOFCOM's decision in the General Electric-Shenhua joint venture is significant because it is the first involving a state-owned enterprise (SOE) and a JV and identifying the relevant market to be the licensing of a technology. The facts that the GE-Shenhua JV was announced by China's President[8] and involved a SOE, but still went into Phase 3, may reflect an assertion of independence from non-competition considerations in MOFCOM'S merger reviews. The GE-Shenhua decision also makes it clear that the merger control provisions of the AML cover JVs. The identification of a technology licensing market as the relevant market further confirms that intellectual property is integral to MOFCOM's analyses.

The GE-Shenhua JV was established by a GE subsidiary and a subsidiary of the state-owned Shenhua Group, to develop a coal-water slurry gasification technology and a licensing program for the technology in China. GE would license its coal-water slurry gasification technology to the JV while the Shenhua subsidiary contributes its expertise in coal gasification and coal-fired power generation. The Shenhua Group is the largest supplier in China of coal suitable for coal-water slurry gasification.

MOFCOM found that coal-water slurry gasification technology is significantly different from other coal gasification technologies. Domestic customers sourced the technology only from suppliers within China. There are only three major suppliers of the technology in China, with GE holding the largest market share, and the other two being Chinese entities. Entry barriers are high for other coal-water slurry technology, since it is complex and requires substantial engineering expertise to master, with substantial start up time and investment and significant commercial risks. A new technology would generally need a licensee that is willing to underwrite some of the costs of the prototype.

MOFCOM concluded that the JV is likely to restrict or eliminate competition in the licensing of coal-water slurry gasification technology in China, being a combination of the largest supplier of raw coal for coal-water slurry gasification and the largest supplier of coal slurry gasification technology. The JV may leverage Shenhua's position in raw coal and control its supply.

As conditions for approving the formation of the JV, the joint venturers are prohibited from forcing technology customers to use the JV's technology or raising the costs of using other technologies, by restricting the supply of raw coal for use with coal-water slurry gasification technology or by conditioning the license of the JV's technology on the supply of raw coal.

The JV appears to be a complementary one, of GE's industrial gasification technology and

[8] General Electric Co., GE and Shenhua Announce Formation of Cleaner Coal Technology Joint Venture in China (Press Release, January 18, 2011) http://www.genewscenter.com/Press-Releases/GE-and-Shenhua-Announce-Formation-of-Cleaner-Coal-Technology-Joint-Venture-in-China-2ddd.aspx (visited July 5, 2012).

Shenhua's coal gasification and coal-fired power generation expertise, which generally raises few competition law concerns. It is unclear that Shenhua's market position in raw coal for coal-water slurry gasification is so large as to raise concerns about exclusion of downstream competitors to the JV's technology or increased costs of using downstream competing technology. On the other hand, Shenhua's status as a SOE, which was not highlighted in the decision, may more than outweigh any lack of market share. MOFCOM's decision may reflect recognition of this market reality while expressing the concerns in conventional antitrust terms.

Decisiveness

MOFCOM's conditional approval of United Technologies' acquisition of Goodrich may reflect its confidence in merger control in contexts where no major Chinese industry is likely to be especially affected. The decision is noteworthy in that China was the first major competition law jurisdiction to complete review of the transaction. MOFCOM concluded that the transaction may adversely affect competition in AC aircraft power generators, and conditioned approval of the transaction on divestiture of Goodrich's power systems business. In contrast, both the European Commission and the United States later imposed conditions that exceeded MOFCOM's, requiring divestiture also of Goodrich's engine control systems business.

There are six manufacturers globally of aircraft power generators, including UTC and Goodrich, with 72% and 12% market shares, respectively, as the first and second largest suppliers. MOFCOM found that in 2007-2011, UTC won the majority of aircraft power generator contracts awarded by aircraft makers. Moreover, UTC controls leading aircraft power generator technology. Aircraft power generator manufacturers must have substantial capital resources and technological capacity, in order to meet the demands of lengthy and costly preproduction R&D, stringent technical requirements, and delayed return on investment. They commonly must tailor their products to the specifications of each aircraft platform. At the same time, product life cycles are lengthy for aircraft power generators, since once a generator is specified for an aircraft platform, the specification cannot be changed for some time, up to decades. While opportunities for new entry may arise with new aircraft platforms and/or new technologies, the stringent entry requirements and limited and uncontrollable new market opportunities mean that entry barriers are fairly high.

MOFCOM concluded that other aircraft power generator makers cannot provide effective competitive constraints on the merged entity. It found that the transaction would further strengthen UTC's market power, lessen the choices of buyers for suppliers of aircraft power generators, and thus lessen competition in the global aircraft AC power generator market.

Therefore, MOFCOM conditioned its approval of the transaction on UTC selling Goodrich's power systems business and 60% interest in its Aerolec joint venture with Thales Avionics Systems. Especially coming before that of any other major competition law jurisdiction, the decision may reflect MOFCOM's confidence in merger control where no major Chinese industry is likely to be affected.

Conclusion

MOFCOM's approach may demonstrate how a developing competition law regime accommodates non-competition values that may be domestic imperatives. Its balancing act addresses structural factors that China confronts, far beyond the purview of the AML, which may ultimately limit the effectiveness of the AML.

ABOUT THE AUTHOR

ywchin@ingramllp.com

250 Park Avenue
New York, New York 10177
T: +212 907 9613
F: +212 907 9681

Yee Wah Chin

Ingram Yuzek Gainen Carroll & Bertolotti, LLP - Counsel

Yee Wah's practice encompasses all aspects of antitrust counseling and litigation, advising on all matters with antitrust exposure. She has defended clients before the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission in investigations over transactions and conduct as well as for criminal price fixing, and litigated antitrust matters in Federal courts in New York and other parts of the country.

Yee Wah was Co-Chair of the ABA Section of International Law International Antitrust Committee. She is also a past Chair of the Antitrust & Competition Committee of the DC Bar International Law Section. Ms. Chin is a member of many ABA working groups on China's Anti-Monopoly Law and regulations.

Yee Wah is AV® rated.

ABOUT THE FIRM

Ingram Yuzek Gainen Carroll & Bertolotti, LLP

Ingram Yuzek Gainen Carroll & Bertolotti, LLP *is a "New York Area Top Ranked Firm", with more than one out of four of our lawyers having achieved the LexisNexis® Martindale-Hubbell® AV® Preeminent™ Peer Review Rating*^{SM}*. This rating indicates the rated lawyer has been deemed by his or her peers and members of the judiciary to have demonstrated the highest level of ethical standards and legal ability.*

The firm has a client-driven practice offering exceptional legal counsel without big firm attitude – or big firm rates. Our clients trust and depend on our skill, judgment and integrity, and stay with us long-term. The firm's attorneys are well trained, highly skilled, extremely efficient and practical, with a range and depth of experience rarely found in smaller firms.

The firm places a premium on collaborating among its practice groups and view each client relationship as the collective responsibility of its entire firm. Our practice groups range from antitrust, commercial litigation, construction and design, to privacy and information management, real estate and taxation.

For more information, please visit www.ingramllp.com.