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# China: Merger Control

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While enforcement of most of the key prohibitions in the Anti-Monopoly Law (AML) appears to have remained muted for many months after the law took effect in August 2008, the merger control provisions set out in Chapter IV of the AML took effect immediately. In the few short years that have followed, China's merger control regime has developed into one of the most significant antitrust hurdles for many large, cross-border transactions.

By the beginning of 2011, at least 200 proposed M&A transactions have been submitted for review under the regime. Although the vast majority of deals have been cleared to proceed unconditionally, with just seven prohibition or conditional approval decisions by the Chinese authorities to date and an estimated unconditional clearance rate exceeding 95 per cent, the substantial volume of information required to be provided to the authorities and the often lengthy duration of their reviews has meant the China regime has become a priority focus for participants in many transactions.

### Overview of the regime

The basic framework of China's merger review system is set out in 12 articles of the AML, which have now been supplemented by a broad framework of implementing measures, regulations and guidance documents.

According to article 21 of the AML, certain types of mergers, acquisitions and other transactions that meet the definition of a 'concentration' of business operators must be notified to the Anti-Monopoly Bureau of China's Ministry of Commerce (MOFCOM) for pre-approval if they meet specified turnover thresholds and do not meet the criteria for a limited-scope intra-group transaction exemption.

The relevant turnover thresholds, set out in the Rules of the State Council on Notification Thresholds for Concentrations of Business Operators, are as follows:

- the total worldwide turnover of all corporate groups participating in the concentration exceeded 10 billion renminbi and the turnover in China of each of at least two such corporate groups exceeded 400 million renminbi; or
- the combined turnover in China of all corporate groups participating in the concentration exceeded 2 billion renminbi and the turnover in China of each of at least two such corporate groups exceeded 400 million renminbi.

Assessment of whether the thresholds are met is conducted by reference to the turnover in the previous calendar year and will usually exclude the seller group in cases of share or asset acquisitions. Special calculation methodology applies for specific sectors such as for banking and financial institutions.

A 'concentration' is defined as:

- a merger of business operators;
- a business operator acquiring control over one or more business operators by virtue of acquiring their equity interests or assets; or
- a business operator acquiring control of, or the ability to exercise decisive influence over, one or more business operators by virtue of contractual rights or other means.

Draft implementation measures published by MOFCOM in January 2009 (Draft Interim Measures for Notification of Concentration of Business Operators, hereafter 'Draft Notification Measures') provided that an acquisition of control will be considered to arise where one business operator acquires more than 50 per cent of the voting shares or assets of another business operator (the target), or acquires less than 50 per cent of the voting shares or assets of the target but also gains the ability (through contractual rights or other means) to do any of the following:

- decide the nomination of one or more directors or other core members of the target;
- decide the target's financial budget, operation and sales, product pricing or significant investment; or
- decide significant management and operational matters for the target.

However, when a final version of the relevant measures was adopted by MOFCOM in November 2009 (Measures on Notification of Concentration of Business Operators), it omitted any definition or explanation of the terms 'control' or 'decisive influence', and there remains no official guidance from the Chinese authorities on this point. Nonetheless, MOFCOM's practice when it comes to identifying a concentration has been largely consistent with the approach set out in the Draft Notification Measures. Further, interim rules adopted by MOFCOM during 2011 in relation to the new national security review processes (Interim Rules of the Ministry of Commerce on Issues Relating to Implementation of Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors, hereafter 'Interim Security Review Rules') include an explanation of the phrase 'acquisition of control' as it applies in the context of identifying transactions by foreign investors in China that qualify for security review, and that explanation is also largely reflective of the approach set out in the Draft Notification Measures.

Uncertainties do remain, such as the extent to which partial function joint ventures will be treated as concentrations. While MOFCOM encourages business operators to engage in consultation with MOFCOM on issues of uncertainty, it is not uncommon for the guidance provided on such issues to vary according to the official consulted.

### Notification process

MOFCOM has adopted certain measures and opinions (most notably the Directive Opinions on Documents and Information Submitted for Notification of Concentration of Business Operators) which specify the required content of notifications. Among the significant volume of material and administrative documentation required to be submitted is the following information that can be quite onerous to obtain:

- explanations of the current situation in the relevant market(s) concerned by the concentration (including the market share of leading players and details of the main upstream and downstream enterprises) as well as the influence of the concentration on competition in those markets, with a particular focus on the China market or market-segment;

- copies of the latest business licenses and approval certificates (if applicable) of all the PRC investee companies and registration certificates of all the resident representative offices for each of the participating business operators and their corporate groups; and
- an explanation of any relevant efficiencies that may arise out of a concentration, including how the efficiencies are to be achieved, the time required, quantification, the level of the resulting benefit to consumers and whether such efficiencies can be achieved without the concentration.

However, it is worth noting there are signs MOFCOM is becoming more willing to 'waive' certain filing requirements if it can be demonstrated (through pre-filing consultation or submissions) that the relevant information otherwise required to be provided is extraneous and its production will be unduly onerous for the parties concerned.

### Substantive test

The substantive test applied by MOFCOM in merger review is whether a transaction will or is likely to have the effect of eliminating or restricting competition in China. However, MOFCOM may decide not to prohibit such a transaction based on public interest factors or if the participating business operators can prove that the pro-competitive elements of the concentration obviously outweigh any detriment.

Article 27 of the AML lists various factors that MOFCOM will take into consideration when conducting merger reviews. Most of these relate to market conditions and broadly align with key aspects of merger assessment that apply in mature antitrust jurisdictions like the US and EU. However, one of the factors listed in article 27 is 'the effect of the proposed concentration on the development of the national economy', which (along with other factors explained further below) is considered to sanction MOFCOM consideration of industrial policy factors during merger review.

### Decisions

Pursuant to articles 28 and 29 of the AML, MOFCOM is empowered to prohibit a concentration or attach conditions to a clearance decision. MOFCOM's Measures for Review of Concentration of Business Operators further provide that conditional clearance may involve structural or behavioural remedies, or a combination of both. In the six conditional approval decisions it has made to date, structural remedies alone have been applied on one occasion and behavioural remedies alone on three occasions. A combination of the two types of remedies has been applied twice.

In July 2010, MOFCOM adopted new rules (Provisional Rules for the Implementation of Asset or Business Divestitures Required for Concentrations of Business Operators) which set out procedures to be applied where structural remedies imposed by MOFCOM include a requirement to divest business operations or assets. Among other things, these rules provide for trustees to be appointed by the parties to the concentration (or MOFCOM) to monitor (or, if this is not done in sufficient time by the parties to the concentration, effectively implement) the divestiture.

### Review process

Once MOFCOM is satisfied that a submitted filing is complete, it conducts review (commonly referred to as 'Phase I' review) for up to 30 calendar days. If MOFCOM identifies that there are serious issues to consider further, it may notify the concerned parties before the end of the 30 day deadline that it will be conducting extended (Phase II) review. Where no such decision is conveyed to the parties during the Phase I period, approval is deemed to have been provided at the end of such period. According to statements by MOFCOM officials during 2010, almost 60 per cent of notified concentrations are being cleared within Phase I review.

Where MOFCOM notifies the parties that it will conduct Phase II review, this review is required to be completed within 90 calendar days (although the deadline may be extended up to an additional 60 days if the parties consent, if the submitted documents are inaccurate or require further verification, or if relevant circumstances significantly change after the initial notification).

Accordingly, MOFCOM's formal review process in relation to notified deals can last up to 180 days.

However, it should be noted that MOFCOM has sole discretion in determining what constitutes a complete filing and may make multiple requests for additional materials after a notifying party has made its initial submission. Therefore, MOFCOM's delay in accepting an initial submission can considerably prolong the overall review period.

By way of example, it is understood that the period between submission of an antitrust filing and its acceptance by MOFCOM as being complete (after relevant supplemental information requests) in respect of transactions for which a decision has been published has ranged from approximately one week in the case of the *Pfizer/Wyeth* transaction to over three months in relation to *Sanyo/Panasonic*. Interestingly, in the case of the *Novartis/Alcon* transaction, the filing was accepted on the same day as submission, which suggests that significant pre-filing consultation may have occurred during which key aspects of the proposed filing were shared with MOFCOM.

MOFCOM officials have publicly stated that the vast majority of deals are cleared within the Phase I formal review period, and the evidence available to date supports this. However, several important factors need to be taken into account by parties considering the potential review period for deals:

- For the five deals in relation to which prohibition or conditional approval decisions have been made by MOFCOM at the end of a Phase II review period, the average formal review period was approximately 125 days.
- It is common for MOFCOM to engage in broad consultation on notified concentrations, including inviting comments (in writing, or in person at oral hearings) from stakeholders such as government agencies, industry associations, competitors and upstream/downstream enterprises. The consultation process can be lengthy and it is not uncommon for deals to be moved into Phase II review for no other apparent reason than accommodating solicitation of (and responses to) views from all major stakeholders identified by MOFCOM.

### Notable aspects of MOFCOM's decision making and methodology

Assessment of the sophistication of MOFCOM's decision making processes and the methodology it applies in respect of matters such as market definition and prevailing theories of harm is complicated by the fact that MOFCOM has not published any formal guidance regarding its merger review methodology and it also does not publish unconditional clearance decisions. Additionally, the few decision statements that have been published are quite brief (although they are becoming more detailed over time) and until recently predominantly focused on explaining the proposed transaction and any specific conditions imposed by way of approval rather than MOFCOM's process of analysis.

Notwithstanding this, the information that is available suggests that MOFCOM's broader review credentials, and in particular the analysis and enquiries of the economics division within the Anti-

Monopoly Bureau, are becoming increasingly sophisticated. However, as summarised below, some aspects of MOFCOM's decision making still appear at odds with what many experts would consider best practice assessment:

*Horizontal overlaps*

Three of the deals that MOFCOM has cleared subject to conditions have been between parties with particularly significant business overlaps (*Mitsubishi Rayon/Lucite*, *Sanyo/Panasonic* and *Pfizer/Wyeth*).

MOFCOM's decisions in these cases evidence a tendency to rely on high existing market shares as a basis upon which to assume that the merged business operator will not be adequately constrained from unilaterally raising prices, and may in relevant cases be able to significantly limit downstream supply or further marginalise sales of competitors (particularly if the other leading competitors in that market have substantially lower market shares).

Accordingly, business operators notifying such a deal to MOFCOM need to present a convincing case to avoid the imposition of conditions. Based on its decisions to date, MOFCOM is likely to otherwise consider imposing remedies such as divestment of some capacity, or restrictions on further acquisitions in the relevant sector (or even, most worryingly, on organic growth, such as occurred in *Mitsubishi Rayon/Lucite*, where MOFCOM ordered that the post-merger Mitsubishi Rayon may not build new manufacturing plants relating to a relevant market in China without prior approval).

MOFCOM's decision in relation to the more recent *Novartis/Alcon* transaction also warrants mention. MOFCOM imposed a decision requiring Novartis to cease distribution in China for five years of certain pharmaceutical products. These products related to a market in respect of which Alcon's market share in China was approximately 60 per cent; however, the market share of Novartis was less than 1 per cent, and Novartis had announced its intention to shut down its business in that product line globally. It is difficult to understand the rationale for this decision. Additionally, it has been noted that an order requiring Novartis to divest the relevant product line may have been more appropriate in terms of preserving the existing levels of competition in the market.

MOFCOM also determined that the merged entity would account for almost 20 per cent of contact lens care product sales in China. MOFCOM expressed concern that the combination, together with Novartis's distribution arrangement and strategic partnership with another significant player in the China market would increase the likelihood of coordinated anti-competitive conduct. This marked the first time MOFCOM has focused on coordinated conduct concerns in one of its published decisions.

*Vertical issues*

Several MOFCOM decisions to date have dealt with what are commonly termed 'vertical' competition issues, in which products manufactured and/or sold by merging parties are not substitutes but are somehow vertically related or complementary to one another. Examples include *General Motors/Delphi*, *Mitsubishi Rayon/Lucite* and *Coca-Cola/Huiyuan*.

Accordingly, business operators holding a relatively strong position in one or more markets in China can expect heightened scrutiny by MOFCOM of any M&A transactions they conduct with parties who have a vertically related product portfolio. This should be no surprise to business operators with experience of other mature antitrust regimes. However, whereas the burden of establishing that there is a high risk of vertical foreclosure or other competitive harm (such as through leveraging practices) will usually fall on the regulator in other jurisdictions and require satisfaction of a high burden of proof, it is not clear that the same advantage exists for transaction parties submitting to China's merger control regime.

*Imposition of conditions in the absence of identified harms*

In *InBev/Anheuser*, the merging parties were both active in China's beer market, although market researchers have estimated that their combined market share immediately prior to consummation of the deal was just 13 per cent. Nonetheless, MOFCOM decided to attach conditions to the deal (which, for example, restrict the merged party from taking a further stake in specific Chinese brewers without prior MOFCOM approval) on the apparent basis that any further China-focused M&A by the merged party might lead to an unhealthy level of market concentration. This type of 'forward looking' condition is highly unusual from a modern antitrust perspective.

*Protection of competitors, as well as the process of competition?*

Consistent with most modern competition laws, article 1 of the AML references 'protection of market competition' as one of the primary goals of the law. However, at least one of MOFCOM's merger review decisions to date indicates that the law may also be used to protect specific (domestic) competitors as well as (or perhaps in place of) the process of competition. Specifically, MOFCOM's decision statement in the *Coca-Cola/Huiyuan* case justifies the prohibition order in part by referring to the harm the transaction could have caused to China's domestic small and medium sized manufacturers. However, this aspect of MOFCOM's decision has perhaps drawn less attention than suspicions the review result was most significantly impacted by concern over the potential loss of control over a well-known Chinese brand to a foreign company.

*Role of industrial policy considerations and protectionism*

Senior representatives of MOFCOM's Anti-Monopoly Bureau have publicly stated that domestic and foreign business operators are treated equally under the AML merger control regime, both from a procedural and 'substantive review' perspective.

Despite this, it is telling that all of MOFCOM's conditional approval decisions to date have applied to transactions wholly between foreign multinationals, while the single prohibition decision that has been announced concerned a foreign takeover of a domestic Chinese business (*Coca-Cola/Huiyuan*).

While most of the merger control provisions in the AML apply uniformly to foreign and domestic Chinese business operators, there are concerns that MOFCOM's ability to make decisions with reference to the effect of the proposed transaction on "the development of the national economy" empower it to rule against transactions simply because they may be capable of adversely impacting domestic Chinese companies or the development of Chinese industry.

A further problem is that many of China's largest companies (and thus many of the domestic companies whose deals are likely to qualify for AML merger review) are State Owned Enterprises. Although the AML contains provisions that may be read to allow such enterprises operating in key industrial sectors in China to receive special treatment under the law, MOFCOM has indicated that this will not be the case in respect of the merger control regime. Nonetheless, it is understood that a wide number of transactions among Chinese companies (and, in particular, state-sponsored reorganisations of the telecommunications, auto, and airline industries) have been completed since the AML commenced without any AML notification or MOFCOM enforcement.

### Penalties for not filing and other violations

Where business operators implement a transaction in violation of the AML merger control regime (including as a result of a failure to comply with the mandatory notification provisions), MOFCOM is empowered to order parties to terminate and/or unwind the transaction, dispose of relevant assets, shares/equity or businesses within a certain period, and take other measures to restore the conditions that existed before the transaction. MOFCOM may also impose fines of up to 500,000 remninbi on the business operators responsible for the violation, and those business operators could additionally be the subject of private action claims for damages.

However, to date, no party appears to have been fined or subjected to other penalties under the AML merger regime, notwithstanding that MOFCOM's director general has stated publicly that MOFCOM is aware of several cases where transactions were implemented in clear breach of the relevant provisions.

### National security review

The AML also contemplates that foreign investment transactions should undergo national security review in relevant cases and a circular published by the State Council in February 2011 (Circular of the General Office of the State Council on Establishment of a Security Review System Regarding M&A of Domestic Enterprises by Foreign Investors) formalised the process of such review from 5 March 2011. Under the circular, several types of transaction that may result in a Chinese enterprise coming under foreign control must be pre-notified to MOFCOM for consideration of whether this new form of review is required. If so, a new multi-agency committee guided by the State Council and led by MOFCOM and the National Development and Reform Commission will assess the transaction, and may effectively block the deal, or impose conditions on it, if it considers that such measures are appropriate to address concerns about the transaction's impact on national security, the stable operation of the national economy, basic social order, or the research and development capabilities of key national security technologies.

According to the Interim Security Review Rules adopted by MOFCOM in March 2011, foreign investors may voluntarily submit proposed transactions to this review process by providing relevant notification documents to MOFCOM, or alternatively may be ordered to submit such documents by MOFCOM after petitioning by government bodies, industry associations and/or other bodies such as participants in the relevant sector. MOFCOM will then take up to 20 days to determine whether to invite the security review committee to look into the transaction and, if so, that committee's formal review process may take up to 95 days (or longer, if the committee is divided on the appropriate decision and thus refers the transaction to the State Council for input). As per merger review, the final decision made can either be clearance, conditional clearance, or outright prohibition.

### Conclusion

MOFCOM has now published a significant number of measures, rules and other guidance documents to supplement the merger control provisions in chapter IV of the AML. Together with seven published clearance decisions, this framework of documents ensures China's merger control regime now operates with a degree of transparency and predictability far greater than that which existed under the pre-AML merger control regime (under the 2006 Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors).

While some divergence between MOFCOM's decisions and the review practices of other major regimes continues, the growing transparency of the regime, combined with evidence of increasingly sophisticated review processes and methodology, provide some comfort for business operators implementing transactions that require MOFCOM pre-approval.

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Mayer Brown JSM operates in association with Mayer Brown LLP and Mayer Brown International LLP. Our global presence was enhanced by our combination with Mayer Brown, a leading global law firm. Mayer Brown JSM provides a full range of legal services in key business centres across Asia, Europe and the Americas. As one of the largest law firms in the world, we offer clients the experience of more than 1,600 lawyers located in 21 locations throughout Asia, Europe and the Americas, who advise clients on projects and transactions spanning the globe.

Our Antitrust and Competition team is at the forefront of emerging antitrust and anti-unfair competition issues globally. We have more than 70 lawyers practicing antitrust and competition law and who are dedicated to delivering the highest quality service in meeting clients' needs. We fully understand today's complex competition issues, as well as the increasingly complex relationships among corporations in a global economy. As a leader in US and EU competition law, we offer up-to-the minute guidance concerning mergers, cartel investigations, distribution and IP licensing issues, alleged abusive conduct by dominant firms and state aid, which includes counsel at the federal and state levels in the US, and for both member states and the EU in Europe.

Adding to our global capabilities, our antitrust lawyers in Hong Kong and China are skilled at navigating the range of competition and other laws impacting trading and licensing arrangements in the region, and offer clients the benefit of extensive China antitrust filing experience and strong relationships with key competition agencies. China in particular is under a rapidly developing antitrust regime. Our lawyers fully understand these developments and can assist our clients to navigate the unique aspects of this regime. We have a close working relationship with the key administrative agencies in China dealing with competition affairs. We specialise in assisting businesses to develop legal compliance programmes tailored for China's unique antitrust and competition regime.

Chambers Asia announced that Mayer Brown JSM's Antitrust & Competition Team has been ranked as one of only five "Tier 1" international firms in the practice of China antitrust law.

**Hannah Ha**
Mayer Brown JSM

Hannah Ha, partner and co-head of Mayer Brown JSM's Antitrust & Competition team, was ranked among the leading competition/antitrust lawyers in China by *Chambers Asia* in its 2009, 2010 and 2011 surveys. Hannah continues to receive wide recognition for her work on China antitrust and competition issues via other organisations as well, being recognised as a leading lawyer in this field by *IFLR1000 2011* and *PLC Which Lawyer? 2011*. In conjunction with other Mayer Brown antitrust partners, Hannah was also a recipient of the team that won *Global Competition Review*'s 2011 'M&A Transaction of the Year, Asia-Pacific, Middle East & Africa' award.

Hannah's scope of China antitrust related work includes handling a range of antitrust filing matters and advisory work, as well as prominent speaking appointments in antitrust conferences in the region. Hannah's client base is a mix of significant multinational companies and local firms and her experience in this practice area extends to co-authorship of significant publications such as Mayer Brown JSM's *Guide to the Anti-Monopoly Law for In-House Counsel*, and stewardship of Asian-focused compliance programmes for international conglomerates.

**Gerry O'Brien**
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Gerry O'Brien is a senior associate in the team and has been described in the previous two *Chambers Asia* guides as being 'an associate to watch' in the field of antitrust practice and 'a real example of a competition law expert'. Gerry joined Mayer Brown JSM in Hong Kong in mid-2007 after seven years practising competition law in Australia (both with law firm Mallesons Stephen Jaques and via an in-house role with Telstra Corporation Limited). Gerry works closely with Hannah Ha and John Hickin to assist clients in respect of the antitrust regimes of both Hong Kong and China, and has been a prolific author of articles in relation to Anti-Monopoly Law issues in particular. Gerry also has significant experience assisting large corporates to develop and implement tailored trade practices compliance programmes, including major banks and resources companies, and has worked on a large number of merger control filings in regimes including China. Gerry joins John and Hannah as co-author of the firm's *Guide to the Anti-Monopoly Law for In-House Counsel*.

**John Hickin**
Mayer Brown JSM

John Hickin, partner and fellow co-head of the Antitrust & Competition Team, continues to advise a broad range of clients in relation to their preparations for the proposed Hong Kong competition law and remains actively involved in consultations with the Hong Kong government and its competition law consultants on this issue. John has been appointed by a number of leading industry organisations in Hong Kong to advise on antitrust issues and is a member of the Hong Kong General Chamber of Commerce expert working group on competition law, as well as similar working groups for several other chambers of commerce. John is also a regular speaker at antitrust seminars in Hong Kong, is regularly asked to contribute to competition law articles published by Hong Kong's leading legal and news publications, and is co-author of the firm's *Guide to the Anti-Monopoly Law for In-House Counsel*.

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