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Is China Set to Start Fining Firms Who Don't Obtain Anti-monopoly Approval for Deals?

On 13 June 2011, China's Ministry of Commerce (Mofcom) released a draft version of new interim measures relating to China's merger control regime for public consultation. The draft *Interim Measures on Investigating and Sanctioning Violation of Notification Obligation for Concentration between Undertakings* (Interim Measures) detail the steps Mofcom may take to investigate whether a business operator has failed to comply with the mandatory notification obligation that applies to certain transactions under the Anti-Monopoly Law (AML). The Interim Measures also set out the penalties that may apply in such cases, and explain various related matters.

Publication of the Interim Measures comes almost three years after commencement of the AML, and more than two years after an earlier draft of the Interim Measures was first circulated to a limited group of stakeholders for comment. The long delay in finalising the Interim Measures may be one of the reasons Mofcom is understood to be yet to penalise any business operator for failing to comply with the mandatory notification obligation, and thus release of the new consultation draft along with recent statements by Mofcom officials may signal that the regulator is preparing to take a tougher stance on transgressions.

Background

Under Chapter IV of the AML, mergers and acquisitions that meet the law's definition of a "concentration of undertakings" must be notified to Mofcom for pre-approval if they meet specified turnover thresholds. A full explanation of those thresholds has appeared in our firm's previous publications (such as here), but in summary it can be said that if two parties to such a transaction are each part of corporate groups that achieved more than RMB 400 million (approx. US$62m) sales in China across all sectors in the previous year, then there is a good chance the thresholds will be met.

The mandatory notification obligation therefore casts a very wide net, and many M&A deals with no obvious nexus to China will still trigger the requirement because the broader corporate groups behind the transaction participants have the relevant levels of sales in China. This can lead to long delays, as Mofcom's formal review period can last up to 180 days. Further, there is a risk the relevant transaction will be prohibited (as has occurred once already) or approved subject to conditions (which has occurred seven times).

Consequently, it is not surprising some business operators have been reluctant to comply with the obligation. In some cases, the obligation has simply been ignored, with the transaction parties assuming or hoping that their deal will remain 'under the radar' or that Mofcom will 'look the other way' if it becomes aware of the deal (particularly as it is clear that some large domestic PRC companies have entered into deals without making required notifications). In other cases, parties may have

sought to take advantage of ongoing uncertainties surrounding the AML definition of a "concentration of undertakings", adopting an interpretation that supports the view that their transaction falls outside of the regime and hoping that Mofcom will agree with this interpretation in the event that the transaction comes to its attention.

In many cases, it may be argued that the level of risk arising from this type of approach has been relatively low - particularly for foreign-to-foreign deals with no significant China element to them- given Mofcom's apparent reluctance to invoke its power to impose penalties even in cases involving clear cut transgressions of the mandatory notification obligation. However, business operators who have strived to comply with the obligation in all cases could make the point that maintaining a good relationship with Mofcom (which has responsibilities far beyond antitrust, including general approval for foreign investment in China) and demonstrating 'good corporate citizenship' may help to achieve benefits in relation to future deals (when the enforcement environment may be very different) that will outweigh any short term benefits derived from a present decision not to submit a deal to China merger review.

In any case, release of the Interim Measures may indicate that the overall risk profile for such behaviour is set to change significantly.

Main Features of the Interim Measures

The Interim Measures include the following key details regarding initiation, conduct and conclusion of an investigation by Mofcom into a suspected breach of the mandatory notification obligation:-

- **Who can investigate?** While Mofcom will take charge of investigating any suspected breach of the mandatory notification obligation, the Interim Measures provide that Mofcom may authorise relevant provincial commerce authorities to provide assistance, particularly where the investigation concerns a deal between business operators located in their region.

- **When may an investigation occur?** The Interim Measures make it clear that Mofcom may initiate an investigation of its own accord, or in response to a report by another person or entity. In the latter case, Mofcom will be obliged to initiate the investigation provided the report is in written form and includes a sufficient level of verifiable information about the relevant deal, and the identify of the 'informant' must be kept confidential by Mofcom.

- **What are the main investigation steps?** When Mofcom decides to initiate an investigation, it is required to notify this in writing to the relevant business operator (being the business operator upon whom the notification obligation would rest if it us ultimately held to apply). That business operator is then required to respond to Mofcom within 15 days, providing relevant documents and materials to enable Mofcom to assess the matter. Upon receipt of such information, Mofcom has a further 60 days within which to determine whether a breach has occurred.

- **What investigation powers does Mofcom have?** During the investigation process, Mofcom has broad investigation powers that are analogous to the powers other Anti-Monopoly Enforcement Authorities (i.e. the National Development and Reform Commission and State Administration of Industry and Commerce) have when probing suspected breaches of the AML prohibitions on monopoly (i.e. restrictive) agreements and abuse of a dominant market position. For example, Mofcom officials may attend the relevant business operator's premise to review and copy relevant documents, question employees, and seal or remove evidence. The business operator concerned and its employees are required to cooperate in the investigation, and any failure to do so risks incurring a fine or even criminal penalties.

- **What happens if Mofcom determines that a required notification has not been made?** If Mofcom determines that the business operator subject to the investigation has failed to notify a relevant transaction, it will notify this to the business operator in writing. The business operator must then cease taking any further steps to implement the transaction (until Mofcom approves this in accordance with the usual merger review procedures) and provide Mofcom with a full notification of the transaction within 30 days.

  Mofcom may also impose a fine and/or require the business operators involved to take steps to unwind the transaction (such as disposal of share or assets in a specified period). However, the Interim Measures specify that before making such orders Mofcom must take into account the nature, extent and duration of the business operator's transgression as well as the transaction's effect on competition. This suggests that the penalty for failing to comply with the mandatory notification obligation is likely to be limited to a fine in cases where the relevant transaction does not risk harming competition.

  In this context, it is notable that the scope of the fine that may be imposed is relatively low by international standards. The maximum fine that can be imposed by Mofcom is RMB 500,000 (approx. US$77,000), while in Europe the same type of breach can attract fines of up to 10% of business turnover (for example, a fine of €20 million was imposed on Belgian electricity supplier Electrabel in 2009) and in the US a business operator who implements a deal without the required approval can face penalties of up to US$11,000 per day.

- **Will any Mofcom decision on this issue be made public, and can it be appealed?** According to the Interim Measures, Mofcom has discretion whether or not to announce to the public any determination it makes on whether a party has failed to comply with the mandatory notification obligation.

  If a business operator does not agree with Mofcom's determination, it may apply for administrative review. Administrative proceedings can also be initiated in the event that the business operator does not accept the finding from the administrative review.

Final comments

Mofcom is accepting comments on the Interim Measures until 23 June 2011, after which time they will likely be adjusted as necessary and then brought into force.

Interestingly, Mofcom's decision to issue the Interim Measures for public consultation follows recent statements made by Mofcom Anti-Monopoly Bureau director general Shang Ming in which he noted that Mofcom is aware of several cases where transactions were implemented in clear breach of the AML merger control regime, and stated that such behaviour would in the future be punished. When viewed together, these events may signal that the regulator is finally set to take a tougher stance on transgressions.

Accordingly, business operators who are part of corporate groups that derive turnover from sales in or into China are reminded that they should ensure they are aware of the circumstances in which their M&A deals may trigger the AML's mandatory notification obligation. To avoid risk in this area, legal advice should be obtained in relation to any uncertainties (which may also be the subject of consultation with Mofcom where appropriate).

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