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China's Anti-Monopoly Law Merger Control Regime - 10 Key Questions Answered (Part I)

China's Anti-Monopoly Law ("AML") has been in force for 19 months. At present, the provisions dealing with merger control are the primary focus of AML regulatory enforcement endeavours, and several decisions under these provisions by China's Ministry of Commerce ("Mofcom") have generated significant international headlines. Perhaps the most notable of these decisions is Mofcom's prohibition of Coca-Cola's proposed acquisition of China juice giant Huiyuan in March 2009. However, in the 12 months since that decision, Mofcom has also applied the AML to impose conditions on deals involving such high profile multinationals as Mitsubishi Rayon, General Motors (GM), Delphi, Pfizer, Sanyo and Panasonic.

These developments have heightened foreign interest in the AML merger control regime, particularly amongst multinationals whose annual China turnover is sufficiently high to raise the prospect that some of their M&A deals will qualify for mandatory reporting in China. Representatives of these multinationals may be nervous about submitting their transactions for review under a regime that is not noted for its transparency, and keen for insights into the regime's track-record and Mofcom's priorities when it comes to the review process.

In this update (the first in a two-part series) we provide comments in response to five questions international business operators commonly pose about the AML merger control regime. Part II of this update series, to be published shortly, will address five further questions, and both updates also provide compliance tips of general application.

Question 1

IS THE REGIME BEING APPLIED EQUALLY TO FOREIGN AND DOMESTIC CHINESE FIRMS?

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 (i.e. InBev/Anheuser Busch, Mitsubishi Rayon/Lucite, Pfizer/Wyeth, GM/Delphi and Sanyo/Panasonic), while the single prohibition decision that has been announced concerned a foreign takeover of a domestic Chinese business (Coca-Cola/Huiyuan). To date, no mergers or acquisitions between Chinese business operators have been the subject of adverse Mofcom decisions.

This raises the question of whether the AML's merger control provisions evidence any inherent bias against foreign firms.

For the most part, the answer is no. Most of the merger control provisions in the AML apply uniformly to foreign and domestic Chinese business operators, and do not contain language that obviously invites application of the regime in a way that may be said to discriminate on the basis of corporate nationality. However, there are some notable exceptions.

For example, Article 27 lists various factors that Mofcom will take into consideration when conducting merger reviews. Most of these relate to general market conditions, and 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". When the AML was promulgated, some commentators queried whether this type of consideration could encourage Mofcom to rule against transactions simply because they may be capable of adversely impacting domestic Chinese companies or the development of Chinese industry.

It is arguable this question has been answered in the affirmative, most notably via Mofcom's decision in the Coca-Cola / Huiyuan case. Although Mofcom spokespersons have stressed that this decision was based solely on "competition law" considerations, the decision statement 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 and the healthy development of the Chinese fruit-juice drink industry more generally. This language suggests that industrial policy considerations played a significant role in the outcome, and that Mofcom may be accused of seeking to protect 'competitors' (when they are domestic entities) as much as the 'competitive process'.

Article 31 of the AML is also significant. This Article applies to transactions involving a foreign investor that are deemed to raise national security concerns, and provides that national security review of such transactions (separate from any required competition review) will be conducted. These reviews will be the responsibility of an inter-agency panel jointly established by Mofcom and the National Development and Reform Commission, which panel is believed to be there modelled on the Committee on Foreign Investments in the US. However, to date, it is not clear whether any transaction has been reviewed under these provisions.

Very little information is available regarding the intended scope and relevant procedural aspects of the 'national security review' process. However, based on comments by senior Chinese officials, it is understood that the definition of "national security" in this context may be read as effectively extending to cover "national economic security" (rather than just matters of national defence) and reflects China's intention of retaining control over key sectors of the economy. Indeed, it is widely assumed that Article 31 of the AML overlaps with provisions in Mofcom's 2006 'Merger Guidelines', which provide for special review of any 'inbound' M&A deals that may affect "key industrial sectors" in China, " the "national economy," or involve "well known trademarks or traditional brands" of China. Obviously the prospect of this kind of review may prove particularly problematic for inbound acquisitions of high-profile or economically significant Chinese companies.

Of course, apart from the issue of how neutrally relevant AML provisions are framed, there is the matter of whether Mofcom will (or can) apply even the most objective aspects of the law in an impartial fashion.

In this context, there are concerns that Mofcom may struggle to obtain the support it needs from high levels within China's Communist Party in order to challenge domestic deals that, whilst raising competition concerns, also align with the Party's policy of encouraging consolidation in domestic markets and the building of national champion firms.

A related 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 ("SOEs"). Although the AML contains provisions that may be read to allow SOEs 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. However, whether or not this turns out to be accurate, a more pressing issue has emerged in that some SOEs appear reluctant to submit to the merger regime at all. This issue is discussed further in our response to Question 2 below.

It would be wrong to conclude on the basis of the factors mentioned above that the AML merger control regime will always be heavily skewed in favour of domestic Chinese business operators, although there is cause for some concern in this regard. Nonetheless, the evidence to date suggests that foreign firms have good reason to be especially vigilant in complying with the regime, and in seeking to foster good relationships with China's enforcement officials.

Question 2

HAVE ANY BUSINESS OPERATORS BEEN FINED FOR NON-COMPLIANCE WITH THE REGIME?

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 RMB 500,000 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 has been fined or subjected to other penalties under the AML merger regime, notwithstanding that there appears to have been several cases where transactions were implemented in clear breach of the relevant provisions.

Perhaps the most notable transaction falling into this category is the October 2008 merger between two of China's leading telecommunications companies - China Unicom Limited ("China Unicom") and China Netcom Group Corporation (Hong Kong) Limited ("China Netcom").

The merger, which was implemented as part of broad reforms of China's telecommunications industry, clearly qualifies as a "concentration" under the AML and - given the enormous China turnover of the parties involved - should have triggered the AML provisions requiring mandatory prior notification to (and approval by) Mofcom. However, it is understood no filing was made by the relevant companies.

When questioned on this, senior Mofcom officials have reportedly expressed frustration, and have confirmed that a filing should have been made. For its part, it is understood that representatives of China Unicom have defended their actions based on the fact that the transaction was consistent with a reform plan drafted by China's Ministry of Industry and Information Technology, and thus was government-approved. This difference of views is likely to have been (and may continue to be) repeated in relation to other transactions by China SOEs for as long as other Ministries at a similar hierarchical level to Mofcom believe that their regulation and management of businesses operating within the sectors they oversee should not be subject to 'second-guessing' by Mofcom.

Given this wilful domestic disregard of the regime, Mofcom may be reluctant to commence penalising foreign firms for similar transgressions - lest they be accused of double-standards.

It is also likely that Mofcom's hesitation in taking action against business operators who fail to comply with the mandatory reporting provisions in the AML reflects its recognition that too many uncertainties have existed in relation to the operation of these provisions. In particular, Mofcom may have taken into account the lack of clarity that has existed regarding which minority share acquisitions and joint ventures qualify for mandatory notification and review, due to the fact that Mofcom's implementation measures dealing with these issues remained in draft form throughout 2009.

However, it should be noted that Mofcom recently finalised several of these measures (such as the *Measures for the Notification of the Concentration of Business Operators and the Measures for the Examination of the Concentration of Business Operators*, both of which were effective from 1 January 2010). These documents do not provide complete clarity on the scope of the AML's mandatory notification regime, but they do resolve several longstanding uncertainties - and Mofcom has made it clear that other issues can be resolved on a case-by-case basis through formal consultation.

In this context, it may be considered that any window for unpunished 'avoidance' of the regime is fast closing.

Question 3

WHAT IS THE CLEARANCE RATE FOR NOTIFIED DEALS?

According to Article 30 of the AML, Mofcom is only required to publish merger review decisions prohibiting or imposing conditions on a transaction. Accordingly, Mofcom has not publicly announced its unconditional clearance decisions, and only rarely releases statistics on the volume of transactions it has reviewed.

However, from the information available to date, it is understood that the rate of Mofcom's unconditional clearance decisions is presently at least 93 percent. This is on the basis that:

- There have been six published decisions to date in which notified deals have been prohibited or approved subject to conditions.
- According to data published by Mofcom at the end of July 2009, it concluded review of 52 transactions during the first year of the AML's operation. Even assuming that rate of concluded reviews (i.e. 4.3 per month) has continued at the same level in subsequent months (and it is believed to have markedly increased), this suggests that around 80 - 85 deals will have passed through Mofcom's review during the first 19 months of the AML merger control regime.

However, it is worth repeating that there appears to be a number of transactions (particularly involving SOEs in China) that have not been reviewed by Mofcom, notwithstanding that they appear to qualify for mandatory reporting under the AML. This may make Mofcom's clearance rate appear more favourable than it would otherwise be, particularly as some commentators believe that a number of the consolidation transactions that have occurred between China's largest SOEs in recent times have warranted close antitrust analysis.

Question 4

WHAT IS THE LIKELY TIMEFRAME FOR A MOFCOM DECISION?

Chapter IV of the AML sets out a clear timeline for Mofcom's merger reviews. Specifically:

- 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 competition or national security 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.
- 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 it 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) was approximately two weeks in relation to the GM / Delphi deal, four weeks in relation to the Mitsubishi Rayon / Lucite deal, seven weeks in relation to the InBev / Anheuser deal, two months in relation to the Coca-Cola / Huiyuan deal and three months in relation to the Sanyo / Panasonic deal.

Mofcom officials have publicly stated that they expect the vast majority of deals to be 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 six deals in relation to which prohibition or conditional approval decisions have been made by Mofcom, the average formal review period has been approximately 90 days. However, this includes two deals (InBev/Anheuser Busch and GM/Delphi) in respect of which conditional approval decisions were handed down within the 'Phase I' period. This means that 120 days of formal review was the average for the other four deals which underwent Phase II review.
- In practice, once notified transactions are approved by Mofcom's Anti-Monopoly Bureau, they are escalated to senior Mofcom officials outside of the Anti-Monopoly Bureau for 'final sign-off'. Although it is widely perceived that this step in the approval process is an administrative formality, it has occasionally resulted in delays in approval decisions (when relevant senior officials have been unavailable for extended periods).

Question 5

IS THERE ANY PROSPECT OF 'SHORT FORM' NOTIFICATION OR 'EXPEDITED' REVIEW FOR DEALS THAT DO NOT APPEAR TO HAVE ANY REAL CHINA NEXUS?

The AML's mandatory notification obligation will commonly apply where two business operators participating in a relevant transaction (such as two merging parties) are each part of corporate groups that achieved RMB 400 million (US$58.6 million) sales in China in the previous financial year.

That China turnover does not need to have been derived from a business within the corporate group that is directly related to the transaction - it can come from other distinct business lines or affiliates which are essentially unrelated to that transaction. This is true whether the transaction is conducted in China or elsewhere.

As a result, it is not uncommon for foreign transactions with no obvious nexus to China to qualify for mandatory reporting under the AML. This can lead to unforeseen costs and delays.

At this stage, Mofcom has not introduced any measures or processes by which such transactions, or other relevant deals with no significant China impact, may benefit from 'short form' notification requirements or qualify for 'expedited' review.

This differentiates China's regime from a number of mature merger review jurisdictions, which have "fast track" or "simplified" review procedures for transactions that (for example) can be shown not to raise substantive issues in the relevant domestic market.

However, it is worth noting that 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. Experience has shown that Mofcom is more likely to indulge such waiver requests in relation to deals that have no direct nexus with or relevant impact on a market in China.

In Part II of this update series, we will address five further questions, as follows:

- What type of transactions will be subject to close scrutiny?
- Has Mofcom clarified the extent to which minority share acquisitions must be notified for review?
- Is Mofcom following Europe's lead in making a distinction between "full function" and "partial function" joint ventures under the AML merger review process?
- Does Mofcom have regard to the decisions of other foreign antitrust regulators, or accept input from other interested parties?
- What are the next big developments we can expect to see in relation to China's merger control regime?

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