

China Antitrust Review 2011

In many respects, 2011 can be considered the most significant year to date in the development of China's antitrust enforcement regime since the Anti-Monopoly Law ("AML") came into force in 2008. Some key implementing rules were adopted this year that shed further light on how the AML will be administered. Merger control continued to be a central focus, with high-profile decisions which demonstrated that China's merger control law can significantly affect global transactions. In addition, enforcement actions in other areas showed that Chinese antitrust authorities are committed to curtailing anticompetitive market behavior.

This memorandum reviews these important developments. While we emphasize merger control developments in 2011, we also summarize developments in regulating anticompetitive agreements and abuses of dominance as a reminder of their potential implications for those doing business in China.

I. Overview of Enforcement Framework under AML

China has a unique structure for antitrust enforcement: the regulatory power is allocated to three ministerial agencies. The Ministry of Commerce ("MOFCOM") is responsible for reviewing mergers. As for monopoly agreements and abuses of dominance, National Development and Reform Commission ("NDRC") is in charge of price-related violations, the State Administration for Industry and Commerce ("SAIC") handles non-price-related ones.

In addition, there is an Anti-Monopoly Commission under the State Council that establishes general policy guidance for and coordinates activities of the above three enforcers. The daily work of the Commission is handled by an administrative office within MOFCOM.

II. Merger Control

A. 2011 developments

During the past year, MOFCOM published rules that shed light on the method of analysis it follows in assessing the competitive effects of mergers and acquisitions. The rules are entitled *Interim Rules of Assessing Competition Effects of Concentrations of Undertakings*, which came into force on September 5, 2011.

Although worded differently, they in substance endorse the main methodologies from the US and the EU, such as "unilateral effects", "coordinated effects" and "foreclosure effects". In addition, MOFCOM recognizes the "HHI" and "CRn" as important measurements of concentration.

Given limited elaborations of the rules, and a conflicting decision (discussed later) published after their formal adoption, it remains unclear how far MOFCOM will follow the review standards recognized in the US and the EU. The rules nevertheless increase the transparency in MOFCOM's decision-making and shed lights on how filing parties should make their arguments in seeking clearance.

B. Merger review decisions

MOFCOM has been handling an increasing number of filings since 2008. It closed 80 and 117 filings in 2009 and 2010, respectively. The number of closed cases in 2011 reached 168. Over 90% of these cases were unconditionally cleared. Under the AML, MOFCOM is only required to publish the cases prohibited or cleared with conditions. Since 2008, it has prohibited one proposed transaction (Coca-Cola/Huiyuan in 2009) and conditionally cleared ten cases, including four decided in 2011, which are summarized below.

Uralkali/Silvinit. On June 2, MOFCOM conditionally approved the merger between two Russian fertilizer companies, Uralkali and Silvinit. MOFCOM concluded that the relevant product market was potassium chloride. According to MOFCOM, this market was highly concentrated, and the merged firm would be the second largest producer and exporter controlling approximately $\frac{1}{3}$ of the market. Together with the leading producer, the two companies would control roughly 70% of this market. And, as MOFCOM noted, more than 50% of China's imports were supplied by the merging parties. Accordingly, MOFCOM concluded that the merged firm would be able to exercise market power and that the merger would potentially lead to anticompetitive coordination by the leading potassium chloride producers.

From the private sector perspective, the most encouraging aspect of MOFCOM's review is that, despite these findings of likely anticompetitive effects, no "structural remedies" were imposed. MOFCOM neither blocked the merger nor required divestitures. However, the agency did impose "behavioral" conditions which have potentially significant ramifications. More specifically, the merged firm was required to maintain preexisting sales processes and procedures when dealing with customers in China and to continue to meet the demands of Chinese customers. A "monitoring trustee" must be appointed who will report to MOFCOM at least every six months, to assure that the merged entity complied with these conditions.

Given the very general nature of these conditions, it is possible that a *de facto* price control regime has been established whereby an effort by the merged firm to raise price, even where supply and demand conditions warrant such an increase, might be seen as a violation of the MOFCOM conditions. The manner in which these conditions are administered bears careful scrutiny.

Alpha V/Savio. On October 31, MOFCOM cleared Alpha Private Equity Fund V's ("Alpha V's") acquisition of Savio Macchine Tessili S.p.A. ("Savio"), subject to the condition that Alpha V divest its 27.9% interest in a Swiss competitor of Savio, Uster Technologies AG ("Uster"). Alpha V was Uster's largest shareholder. MOFCOM found that Savio and Uster are the only two providers of certain electronic yarn clearers with roughly equal market shares both globally and in China. MOFCOM closely examined voting patterns at shareholders' meetings, minutes of those shareholders meetings, and the composition and voting pattern of Uster's board of directors. MOFCOM could not rule out the possibility that Alpha V would influence Uster's operations and that the transaction could enable Alpha V to coordinate the operations of Savio and Uster. It therefore required Alpha V to divest its interest in Uster.

Interestingly, MOFCOM chose a divestiture remedy rather than less drastic measures, such as firewalls and conversion of voting stock to a nonvoting stock, which the US Federal Trade Commission deemed a sufficient response to similar concerns regarding minority interests held by private equity.¹ *This decision should be studied carefully by private equity funds that hold significant but non-controlling portfolio company interests.*

Finally, this transaction involving French and Swiss companies apparently was not subject to a merger control filing in any country other than China, illustrating the relatively low filing thresholds prevailing under the AML.²

¹ *In the Matter of TC Group, L.L.C.*, Docket No. C-4183 (2007). It is worth noting that the European Commission does not have jurisdiction to review minority acquisitions that are short of decisive control. See, e.g., *Aer Lingus/Ryan Air* (July 6, 2010). This is in contrast to the power of some of the EU member states. Indeed, it has been reported that the Office of Fair Trading in the UK is now investigating Ryanair's minority stake in Aer Lingus to determine if that holding may substantially lessen competition.

² To trigger antitrust review, at least two of the participating undertakings must have at least RMB 400 million (approximately USD 63 million) turnover in China, and aggregate turnover of all the participating undertakings must be at least RMB 10 billion (approximately USD 1.58 billion) worldwide or RMB 2 billion (approximately USD 316 million) in China.

GE-Shenhua JV. On November 10, MOFCOM conditionally approved the establishment of a joint venture (“JV”) between General Electric (China) Co., Ltd. (“GE”) and China Shenhua Coal to Liquid and Chemical Co., Ltd. (“Shenhua”), a state-owned energy company, to develop technology for coal-water slurry gasification (“CWSG”). MOFCOM concluded that (1) the market for such technologies is highly concentrated in China; (2) GE was the leading licensor of such technology; (3) Shenhua was the largest supplier of the coal used in CWSG projects; and (4) there were high entry barriers to the development of CWSG technology. Accordingly, MOFCOM concluded that the transaction could enable Shenhua to restrict competition in the market for licensing CWSG technology through its control over China’s coal supply. It therefore imposed a behavioral condition which prohibits requiring that purchasers of coal for CWSG projects also use the GE technology or otherwise raising customers’ costs of using alternative technologies.

This decision clarifies MOFCOM’s view that the formation of a joint venture is subject to the merger control provisions of the AML.³

Seagate/Samsung. On December 12, MOFCOM conditionally approved Seagate’s acquisition of Samsung’s hard disk drive (HDD) business. MOFCOM defined the relevant market as the worldwide HDD market, and found it highly concentrated, with Seagate (33%) and Samsung (10%) ranked first and fifth, respectively. MOFCOM concluded that the transaction would remove a key market player and increase the probability of coordination among the remaining HDD producers.

MOFCOM imposed significant remedies on the transaction. Most importantly, Seagate must maintain Samsung HDD as an independent competitor, including ensuring that Samsung products are independently priced and marketed with no restrictions on Samsung’s volume of production, and setting up firewalls to protect competitively sensitive information. In addition, Seagate was required to expand Samsung’s production capacity as it had promised and to report both Seagate and Samsung production and capacity to the monitoring trustee. Both these conditions are subject to review one year from the decision, thus giving MOFCOM the opportunity to assess whether they remain necessary in light of then prevailing market conditions.⁴

While MOFCOM imposed significant conditions on the Seagate/Samsung transaction, both the FTC and the EU issued unconditional clearances. It remains to be seen whether increased international cooperation in merger review (discussed below) will significantly reduce conflicting outcomes.

General Comments

Lengthy review period. Under the AML, official review of a transaction can take up to 6 months (three phases of 30, 90 and 60 calendar days respectively). However, the clock only starts ticking after MOFCOM accepts the case. The usual comment-response period before acceptance can range from a week to a couple of months. For example, both the GE-Shenhua JV and Seagate/Samsung reviews entered into phase III and were concluded roughly seven months after submission. It is within MOFCOM’s sole discretion whether to extend its review into another phase, and it sometimes does so just because of excessive workload or internal procedural delays. Given this lengthy and unpredictable review timeframe, companies should plan for their filings as early as possible to avoid unnecessary delays. It appears that

³ Under the AML, a “concentration of undertakings” is defined as any of the following: 1) merger; 2) obtaining control through acquisitions of equity interests or assets; or 3) obtaining control or the power to exercise decision-making influence by contractual means or otherwise.

⁴ In a contemporaneous HDD merger involving Western Digital and Hitachi, the EU conditioned its clearance on Western Digital’s ability to find a suitable buyer for its 3.5-inch HDD business. MOFCOM may be of the view that the conditions it imposed on Seagate/Samsung can be modified or dropped if a suitable buyer is found for the Western Digital assets to be divested.

only very few transactions can be cleared within the 30 days of phase I review, so even for “easy cases” companies should normally allow more time in obtaining MOFCOM’s clearance and be prepared for potential extensions. And where remedies are likely to be required, offering them early in the process can save valuable time.

Wide range of behavioral remedies. In addition to structural remedies such as the divestiture required in Alpha V/Savio, MOFCOM is also authorized to impose a wide range of behavioral remedies, and it indeed did so in most of the published cases in 2011. The use of behavioral remedies creates opportunities for creative solutions to perceived competition problems while permitting strategically important transactions to go forward.

C. International cooperation

To promote communication and cooperation, China and the US signed an antitrust Memorandum of Understanding in July 2011 to initiate a cooperative framework. Later in November, FTC, DOJ and MOFCOM developed further guidance for cooperation⁵. The guidance provides that the two countries’ agencies may decide to exchange information regarding a merger that they are both reviewing, such as timing of their respective investigations, market definition, evaluation of competitive effects, theories of competitive harm, economic analysis, and remedies.

Such increasing communication and cooperation between China and US antitrust merger control agencies are aimed at reducing conflicting outcomes and may lead to relatively formal coordination between the countries’ practices. Companies that engage in reportable transactions in both jurisdictions should plan their filing strategies accordingly to ensure consistency of the information and arguments in their multinational filings.

III. Monopoly Agreements and Abuses of Dominance

The AML targets monopoly agreements (analogous to restrictive agreements in the EU), and abuses of dominance. Long-expected rules regarding these violations took into force in 2011. These rules provide guidance as to how the authorities will approach conduct investigations. Both NDRC and SAIC have adopted a leniency program for whistle blowers in monopoly agreements.

In 2011, SAIC imposed its first antitrust fine against a concrete association and its 5 members in Jiangsu province for market allocation; NDRC penalized a paper association in Zhejiang province for price-fixing, and issued its largest fine to date (over RMB 7 million, approximately USD 1.1 million) against two pharmaceutical companies in Shandong province for market allocation and price-fixing.

Most significant was NDRC’s investigation of China Telecom and China Unicom, the largest state-owned telecommunications companies. These two firms are the only sources for broadband backbone networks (the upstream market), who are also active in broadband supply business (the downstream market). The investigation seeks to determine whether these two firms have abused their upstream dominance by charging downstream rivals higher prices than those charged non-rivals in order to lessen competition in the downstream market. If the allegations are substantiated, both may face penalties of up to 10% (RMB several billion) of their annual revenues. Several months after NDRC started the probe, the companies pledged to take remedial measures and asked for suspension of the investigation. NDRC is still considering their request.

⁵ *Guidance for Case Cooperation between the Ministry of Commerce and the Department of Justice and Federal Trade Commission on Concentration of Undertakings (Merger) Cases*, available at <http://www.ftc.gov/os/2011/11/111129mofcom.pdf>.

These conduct cases and investigations should serve to alert companies doing business in China that have achieved significant market shares to the need to adopt antitrust compliance programs to insure that their conduct does not render them vulnerable to charges of monopolization or abuse of dominance.

IV. Conclusion

2011 was a year of vigorous enforcement of the AML in both the merger control and conduct areas. While the new rules and cases shed some light on how the Chinese antitrust authorities will enforce the AML, uncertainties remain which will pose challenges to multinational companies planning mergers and joint ventures which require filings before MOFCOM. In addition, increased enforcement involving claims of market allocation, abuse of dominance and other unlawful conduct must be given careful consideration by companies doing business in China. This past year clearly demonstrated that Chinese antitrust enforcement must be reckoned with by counsel and clients.

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