China Antitrust Update

January 31, 2013

Looking back at 2012, four years after China implemented its Anti-Monopoly Law ("AML"), we can discern some important ways in which China's antitrust regime today both mirrors and departs from antitrust regimes in other jurisdictions to which our clients are subject. On the one hand, in 2012, China's Ministry of Commerce ("MOFCOM") developed tools that more closely approximate the US and European merger control system, with a revised notification form, a framework for policing parties that fail to meet notification requirements, increased collaboration with foreign antitrust authorities, and increased transparency regarding merger control statistics. On the other hand, MOFCOM's decisions in several instances depart from decisions reached in other jurisdictions, and certain commentators have noted that MOFCOM's resource constraints and the involvement of other Chinese government agencies make merger review in China a slower process than parties typically experience in the US or the European Union.[1]

Below, we consider the key developments over the past year in China's enforcement of the AML, primarily with regard to its merger control system, but also in terms of enforcement actions and private litigations.

I. Overview of Enforcement Framework Under AML

China has a unique structure for antitrust enforcement, with regulatory power allocated to three separate authorities within the government. MOFCOM has primary responsibility for reviewing mergers, whereas the National Development and Reform Commission ("NDRC") handles price-related allegations and the State Administration for Industry and Commerce ("SAIC") handles allegations not related to price.

In addition, China has an Anti-Monopoly Commission, organized under the State Council, which establishes general policy guidance for and coordinates activities among MOFCOM, NDRC, and SAIC.

II. Merger Control

A. Developments in Merger Control Regime

2012 saw certain critical developments for MOFCOM in the administration of its merger control regime under the AML, particularly with regard to (1) its enforcement of the notification requirements, (2) the drafting of the notification form, and (3) the transparency of merger review.

Enforcement of Notification Requirements. In February 2012, MOFCOM intensified its mechanisms for sanctioning parties that fail to meet notification requirements under the AML by issuing rules – the *Interim Rules on Investigating and Penalizing Violations of Notification Obligations for Concentrations of Undertakings* – that permit the agency to impose penalties for those who violate the AML's obligations. Specifically, MOFCOM can voluntarily initiate such investigations or any third party may report violations to MOFCOM, and MOFCOM can impose fines of up to RMB 500,000 (approximately USD 80,412) and/or require the parties to revert to their original, pre-merger status.

[1] *See*, *e.g.*, D. Daniel Sokol, *Merger Control under China's Anti-Monopoly Law* (Jan. 27, 2013) at 13-14, *available at* **http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2207690**.

Revision of Merger Notification Form. In the summer of 2012, MOFCOM issued an amended version of its notification form. The new form is comprehensive and explains details about notification that had, until 2012, remained ambiguous. Among these requirements, for example, is MOFCOM's view that parties should voluntarily disclose internal studies and reports regarding the proposed transaction.

Notably, MOFCOM believes studies should be disclosed above and beyond those provided to officers or directors. (In contrast, so-called Item 4(c)-4(d) documents that are required to be submitted in the US are limited to documents prepared for officers or directors.) Additionally, MOFCOM is now using specific codes for products and services implicated in each transaction, which MOFCOM believes will permit it and the parties to assess more objectively the competitive issues in a given transaction.

Transparency of Merger Review. MOFCOM has also sought to increase its own transparency, surpassing the AML's requirements, which mandate only disclosure of conditional approvals and prohibited transactions. In September 2012, MOFCOM released all cases approved without conditions since 2008 (458 in total between August 2008 and September 2012). MOFCOM will continue to release such data on a quarterly basis going forward. (In contrast, in the US, the Federal Trade Commission ("FTC") and the Antitrust Division of the US Department of Justice ("DOJ")) release such data on an annual basis under the Hart-Scott-Rodino Antitrust Improvements Act.)

One development that did not occur in 2012 was an effort to reduce the timeframe that MOFCOM takes to review transactions – which has frequently exceeded the timeframe for review in the US or the EU. In 2013, however, MOFCOM is considering new procedures that seek to reduce delays imposed by MOFCOM's review; in particular, MOFCOM would identify and designate simple cases on the basis of the parties' individual market shares and the overall market concentration, with the objective of enabling MOFCOM to identify and more expeditiously clear those transactions it considers unlikely to raise competitive concerns.

B. International Cooperation

China's antitrust authorities have established international cooperation agreements with multiple foreign governments, including the US (which reached its cooperation agreement with China in 2011) and the EU (with which MOFCOM reached a "competition policy dialogue" in 2004). 2012 saw the addition of additional cooperation agreements with the UK, South Korea, and the EU. In April 2012, MOFCOM followed China's two other antitrust authorities – the NDRC and SAIC – in entering into a Memorandum of Understanding with the UK's Office of Fair Trade. And in May 2012, all three Chinese authorities entered into an agreement with the Korean Fair Trade Commission. Finally, in September 2012, the NDRC and SAIC entered into an agreement with the EU that complements MOFCOM's 2004 agreement with the EU.

While these cooperation agreements may facilitate information sharing and collaborative analysis between MOFCOM and other merger control authorities reviewing the same transaction, substantive merger analysis in China departs from the analysis followed elsewhere in significant instances, as we explore below.

C. Nature of MOFCOM's Review and Decisionmaking in 2012

The number of merger notifications that MOFCOM is receiving on an annual basis appears to have stabilized. In 2012, MOFCOM received 201 merger notifications, which is approximately the same as in 2011. MOFCOM expects that figure to remain steady in 2013 and 2014.

MOFCOM has released data[2] that help to gauge what kinds of transactions it reviewed most frequently under the AML in 2012:

- **Structure of transactions.** Over half of transactions through November 2012 (55%) were equity acquisitions of a target's shares, whereas slightly more than one-third (36%) involved the formation of a joint venture ("JV").
- **Competitive analysis.** Approximately two-thirds of transactions (65%) notified involved horizontal competitors, whereas the remaining one-third (35%) involved vertical relationships between, e.g., suppliers and customers, mixed transactions, or other types of competition questions.
- **Industries analyzed.** Over half of the transactions that MOFCOM reviewed in 2012 related to manufacturing and natural resource industries (involving, e.g., petroleum, chemicals, machinery manufacturing, shipping, and mining), although it has also seen an uptick in retail, technology, and service industry notifications.

As a substantive matter, in 2012, MOFCOM imposed conditions on six transactions that it cleared – the high water mark since the AML's inception of imposing conditions on cleared transactions. (MOFCOM has only blocked one merger outright: Coca-Cola's acquisition of the juice manufacturer China Huiyuan Co. in 2009.[3])

Below we review MOFCOM's merger control activities in 2012, both in terms of an analytical overview as well as the details of specific, significant decisions that MOFCOM reached.

a. Analytical Overview

When does MOFCOM impose conditions? In 2012, MOFCOM imposed conditions on JVs as well as acquisitions. It imposed conditions in vertical transactions between buyers and sellers as well as in horizontal transactions between competitors. And it imposed behavioral remedies such as nondiscrimination provisions rather than confining itself to structural remedies such as divestitures.

International convergence? The 2012 *Google/Motorola* transaction highlights one instance among several in which China imposed more stringent conditions upon a transaction than either the US or the EU. (*Western Digital/Hitachi* in 2012 and *Seagate/Samsung* in 2011 are two other recent transactions in which China has either imposed more onerous conditions than the US or EU or has imposed conditions where the US and EU have not.) These cases suggest, therefore, that while MOFCOM may be adopting certain elements that reflect merger control in the US and the EU, there are different and independent factors that determine MOFCOM's analysis, including perhaps MOFCOM's assessment of how Chinese markets, producers, and consumers will be affected.

Transaction delays. MOFCOM's merger review frequently takes longer than merger review in the US or the EU. This may be due in part to the fact that the US and the EU each have two-phase review systems and China has a three-phase system (of 30, 90, and 60 days in duration, respectively). Or it may be due to the fact that there can be delays of one month or more between the time that MOFCOM receives a notification and the time that it accepts the notification for review. (For example, it took MOFCOM over six weeks to accept for review the notification in the *Tiande/Henkel JV*, in part because it found the initial filing incomplete, and almost two months in the *ARM-G&D-Gemalto JV*.) Alternatively, some believe that

[2] *See* Ministry of Commerce, 2012 Antitrust Work Progress Report Press Conference (December 27, 2012), *available at* **http://www.mofcom.gov.cn/aarticle/ae/slfw/201212/20121208504842.html** (Chinese language).

[3] Some critics have interpreted the *Coca-Cola/Huiyuan* decision as one in which the Chinese government's industrial policy won out over antitrust economics. The wide criticism that followed the release of that decision, however, may have emboldened MOFCOM in emphasizing competitive effects over the policies of other agencies in the Chinese government. *See* Sokol, *Merger Control under China's Anti-Monopoly Law*, at 13-14.

the perceived slowness of MOFCOM's review may be due to resource constraints on the part of MOFCOM's staff and/or to delays imposed by the need to coordinate their review with non-MOFCOM authorities and ministries. As we note above, in 2013, MOFCOM has prioritized creating a new system of merger review that would shorten the review timeframe for uncomplicated transactions.

Absence of explanatory analysis. In the US and Europe, the antitrust authorities frequently clarify their views of proposed transactions in the form of, e.g., press releases, speeches, and competitive impact statements that explain the consent decrees into which they enter. MOFCOM's decisionmaking, however, remains less transparent. For example, in several transactions that we explore here (the *Wal-Mart/Yihaodian* and *ARM-G&D-Gemalto* JV), MOFCOM did not explain in detail its analysis of market definition or competitive landscape, and in the *Google/Motorola* transaction, MOFCOM imposed conditions without detailed explanation, notwithstanding the fact that both the US and EU antitrust authorities cleared that transaction without conditions.

b. Significant MOFCOM Decisions in 2012

Tiande/Henkel JV. In February 2012, MOFCOM issued its conditional approval of a proposed JV in Hong Kong between two chemical producers, Tiande Chemical Holdings Limited ("Tiande") and Henkel AG & Co. KGaA ("Henkel"), where Tiande supplied an input necessary for Henkel's production. MOFCOM concluded that the relevant product markets were ethyl cyanoacetate ("E-C") and cyanoacrylate monomer ("Monomer"), the main products of Tiande and Henkel, respectively; the JV would source most of its raw material E-C from Tiande for the production of Henkel's Monomer. Although MOFCOM found the downstream Monomer market competitive, it found the upstream E-C market highly concentrated, with the two largest providers (including Tiande) each controlling approximately 45-50% market share globally and in China, with strict governmental regulations imposing significant barriers to new entrants. As a result, MOFCOM was concerned that Tiande would raise the price of its input of E-C to other Monomer producers or foreclose them from the E-C supply. Because of this concern, MOFCOM imposed a behavioral remedy requiring Tiande to supply E-C to downstream customers on fair, reasonable, and nondiscriminatory terms.

The Tiande conditions are significant in at least two respects. First, they illustrate MOFCOM's continued willingness to impose conditions on vertical as well as horizontal transactions, following its 2011 decision in *GE/Shenhua*. *See* Davis Polk client alert **China Antitrust Review 2011**. Second, they demonstrate MOFCOM's willingness to use behavioral remedies, such as nondiscrimination provisions, rather than only structural remedies such as divestitures. MOFCOM's use of behavioral remedies is in line with recent trends in US merger control decisions to use behavioral remedies in vertical mergers or joint ventures, as the DOJ did in the *Ticketmaster/Live Nation* transaction and the *Comcast/NBCU* JV.[4]

Western Digital/Hitachi GST. In March 2012, MOFCOM approved hardware manufacturer Western Digital's acquisition of Hitachi Global Storage Technologies ("Hitachi GST"), a subsidiary of Hitachi, but with significant conditions attached. As we have explained previously in our client alert, **Chinese Antitrust Authorities Approve Western Digital/ Hitachi GST Deal with Significant Conditions**, Western Digital and Hitachi GST are among the world's largest manufacturers of data storage drives, including hard disk drives ("HDD"). MOFCOM defined the relevant market as the worldwide HDD market, finding the market highly concentrated, with Western Digital (29%) and Hitachi (18%) ranked first and fifth, respectively. MOFCOM concluded that the transaction would remove a key market player, increase the probability of coordination among the remaining HDD producers, and harm Chinese consumers.

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[4] Final Judgment, United States v. Ticketmaster Ent., Inc., Civ. No. 10-00139 (RMC) (D.D.C. July 30, 2010), *available at* **http://www.justice.gov/atr/cases/f260900/260909.pdf**; Final Judgment, *United States v. Comcast Corp.*, Civ. No. 11-00106 (RJL) (D.D.C. Sept. 1, 2011), available at **http://www.justice.gov/atr/cases/f274700/274713.pdf**.

The US and the EU authorities had both approved the transaction, subject to a condition requiring Western Digital to divest Hitachi GST assets related to the manufacture of 3.5-inch HDDs (so-called "desktop" HDDs) to Toshiba Corp. In addition to ordering this divestiture, MOFCOM imposed a broader set of remedies, the most notable of which was the requirement that Western Digital maintain Hitachi GST as an independent competitor on a worldwide basis. Under the supervision of a monitor, Western Digital must ensure that Hitachi GST products are independently manufactured, priced, and marketed; refrain from exercising its shareholder rights in Hitachi GST in an "anticompetitive" manner; maintain independence between the two entities' research and development groups; and establish firewalls to prevent the transmission of competitively sensitive information between the two entities.

On their face, such remedies may preclude Western Digital and Hitachi GST from achieving the efficiencies and synergies that they expected through their respective acquisitions, and it is not entirely clear why MOFCOM did not seek to block the transaction outright. It is possible that MOFCOM hesitated to bar the transaction when other antitrust authorities had already cleared the transaction, but it still had concerns that were not met by the US and EU's divestiture remedy – such as a concern that China is home to many downstream manufacturing firms that purchase HDDs to produce PCs and other devices.

MOFCOM's decision in the *Western Digital/Hitachi GST* transaction is significant for several reasons. Critically, MOFCOM made the determination to impose conditions that were very different from the US and the EU's both in substance and in form – and conditions that MOFCOM required would apply worldwide. As to form, the US and EU both opted for a structural remedy (divestiture), while MOFCOM made clear that it was willing to use behavioral remedies for horizontal as well as vertical transactions.

Google/Motorola Mobility. As we have discussed previously, *see* **Chinese Antitrust Regulator MOFCOM Approves Google's Acquisition of Motorola with Conditions**, in May 2012, MOFCOM conditionally cleared the acquisition by Google Inc. ("Google") of Motorola Mobility Holdings, Inc. ("Motorola Mobility"), one of a number of handset manufacturers that use Google's Android operating system in their smart mobile devices. Google announced that it was acquiring Motorola Mobility, in part, because the target held a patent portfolio that would protect Google's Android operating system.

MOFCOM articulated several concerns, however, about the effect of the transaction on the smart mobile device operating system market, rooted in Android's dominance in China (then, and likely in the future), the dependence of OEM developers of Android-compatible software and Android end users on Android, and high barriers to entry into the mobile operating systems market. MOFCOM noted that Google could provide Android to Motorola Mobility handsets on discriminatory terms that favored Motorola Mobility at the expense of its handset maker rivals (e.g., through advance access to Android updates or licensing Motorola-owned patents to competitors on unfair terms). Accordingly, MOFCOM required Google to continue its current commercial practice of licensing Android in a free and open source manner, treating all OEMs in a nondiscriminatory manner, and honoring Motorola's existing current "fair, reasonable and non-discriminatory" obligations with respect to Motorola's patents.

Both the US and the EU cleared this transaction without conditions. It is also worth noting that, after taking almost two months to accept the notification as complete, MOFCOM's review took almost the maximum 180-day review period in this case, with a decision that lagged behind the US and EU's determinations by approximately three months.

UTC/Goodrich. In June 2012, MOFCOM approved the acquisition of Goodrich Corporation ("Goodrich") by United Technology Corporation ("UTC"), both of which are prominent aircraft component manufacturers, subject to the condition that Goodrich divest its electric power system business and 60% equity interest in a separate JV that Goodrich had entered. Here, however, unlike the transactions we consider above, MOFCOM's structural remedy of divestiture preceded the conditions imposed by the US and the EU, which also generally paralleled MOFCOM's conclusions in substance.

Wal-Mart/Yihaodian. In August 2012, MOFCOM cleared the acquisition by Wal-Mart Stores Inc. ("Wal-Mart") of a controlling interest in the largest Chinese online supermarket, Yihaodian, subject to certain conditions.

MOFCOM raised the concern that Wal-Mart might seek to leverage its advantages in physical retail supermarket stores (procurement, storage, product lines, store networks, services, logistics, and brands) into Yihaodian's online retail supermarket and its third-party online sales platform, potentially strengthening its control of bargaining power against online platform users and gaining the ability to eliminate or restrict competition in that platform. Consequently, MOFCOM approved the transaction subject to several conditions, including that the acquisition of Wal-Mart shall be limited to the direct online sales segment of Yihaodian, and that Wal-Mart shall not conduct business through Yihaodian's third-party online sales platforms without obtaining a license from the Chinese government. Among the conditions were that MOFCOM forbade Wal-Mart from using a variable interest entity ("VIE") structure to conduct business on Yihaodian's third-party online sales platform.[5]

This transaction is notable for several reasons. First, as a matter of antitrust law, the transaction makes clear that the Chinese government will consider competitive effects between markets and the ability of one firm to leverage its competitive advantages in a separate but related market. Second, MOFCOM's express reference to the VIE structure, which has come under increased scrutiny by Chinese authorities in recent years, suggests that MOFCOM will consider a transaction structure's compliance with non-antitrust laws and regulations in China in reviewing merger filings and may not approve a transaction if its structure is not in compliance with Chinese laws and regulations.

ARM-G&D-Gemalto JV. In December 2012, MOFCOM approved the formation of a JV among three technology companies, ARM Holdings PLC ("ARM"), Giesecke & Devrient GmbH ("G&D") and Gemalto NV ("Gemalto"), with behavioral conditions.

MOFCOM defined the relevant product market as the market for Trust Execution Environments ("TEEs"), a security solution that protects resources and data in trusted programs. MOFCOM concluded that the JV would enable ARM to discriminate against competitors on the licensing terms for the technology or to degrade the performance of competitors' TEEs through certain specific designs of ARM's own intellectual property. MOFCOM required ARM to release information on its specialty security technology to competitors on a nondiscriminatory basis and prohibited it from designing its own intellectual property to degrade the performance of competitors' security products.

In the ARM JV, MOFCOM again demonstrated its willingness to employ behavioral remedies to curb the potential for anticompetitive conduct. Additionally, MOFCOM subjected ARM to annual reporting on these performance obligations. ARM has the ability to apply to MOFCOM for release of these remedies eight years after the date of MOFCOM's decision.

III. Enforcement Actions

Outside of merger control enforcement by MOFCOM, 2012 saw notable developments in antitrust enforcement actions in both the price-related context (enforced by NDRC) and the non-price-related context (enforced by SAIC), since China implemented its rules regarding monopoly agreements and abuses of dominance in 2011. In particular, 2012 enforcement actions demonstrate the Chinese government's willingness to impose significant fines against entities that violate these rules.

Perhaps most significantly, for the first time China's antitrust authority sanctioned international companies, and it did so with the highest penalties in the history of Chinese antitrust enforcement to date. Specifically, NDRC levied RMB 353 million (approximately USD 56.8 million) in fines against six

[5] The VIE structure is an investment structure used in China due to restrictions on foreign investment in restricted industries (such as telecommunications). In such industries, only domestic entities are permitted to hold the relevant licenses. In a VIE arrangement, the foreign entity would enter into a series of contractual arrangements with the domestic entity that holds the relevant licenses, through which control and benefits of the domestic entity's business would be passed to the foreign entity.

international LCD panel manufacturers – two South Korean companies (Samsung and LG) and four Taiwanese companies (Chimei Innolux, AU Optronics, Chunghwa Picture Tubes, and HannStar) – for participating in a price-fixing cartel. NDRC also required several commitments from the LCD panel defendants (including fairly supplying television makers with new technology and extending LCD warranties), which approximate the sort of behavioral remedies that MOFCOM imposes in merger cases. Notably, signaling its willingness to take a flexible approach to imposing liability, NDRC relied not upon the AML but China's Price Law to impose penalties, because the conduct occurred during a period (2001-06) that preceded the AML.

While the LCD international cartel might be the most high-profile non-merger enforcement action, it is not the only such action in 2012 in which the Chinese government imposed fines for conduct that violated the AML. In February 2012, NDRC imposed a fine of up to RMB 10.12 million (approximately USD 1.6 million) upon a Chinese chemical company for participating in a price-fixing cartel, which is the largest fine ever imposed upon a single Chinese company. And in August 2012, SAIC's branch in Henan province also imposed a large penalty of RMB 1.73 million (approximately USD 0.28 million) against local second-hand car traders for a monopoly agreement.

IV. Private Litigation

Since the AML became effective in 2008, private plaintiffs have initiated numerous cases, but the majority have been unsuccessful. For example, in a 2012 lawsuit alleging a resale price maintenance provision as anticompetitive, the Shanghai No.1 Intermediate People's Court ruled in favor of the defendant, Johnson & Johnson, finding that plaintiff Ruibang Yonghe Technology and Trade Co., Ltd., had failed to establish an anticompetitive effect from the agreement. (This judicial ruling appears to contravene the NDRC's view of resale price maintenance agreements, for which it has levied sanctions as violations of the AML).

It is possible, however, that more private suits might be triggered by new judicial guidelines setting forth a framework for private enforcement of the AML. That interpretation (the so-called "*Provisions on Several Issues Concerning the Application of Law in Hearing Civil Cases Caused by Monopolistic Conducts*"), which became effective as of June 1, 2012, is the first judicial interpretation of the Supreme People's Court on antitrust enforcement under the AML.

V. Conclusion

In 2012, China's three antitrust agencies demonstrated an increasing willingness to strengthen China's antitrust enforcement regime and to exact monetary, structural, and behavioral relief from parties who have violated or could violate the AML.

In terms of merger control, MOFCOM is in the process of implementing new procedures, including penalties for failing to notify mergers and expanded notification obligations, and the agency has demonstrated its willingness to impose both structural and behavioral remedies – even when those remedies come substantially later than the decisions of other antitrust authorities and depart from the reasoning of those authorities. Going forward, entities engaging in transactions that must be notified to MOFCOM will need to consider with counsel the impact of MOFCOM's review timeline, as well as the possibility that its analysis will diverge from that of other jurisdictions.

Beyond merger control, there is evidence of increasing risk of antitrust liability under the AML. On the enforcement side, China's remaining antitrust authorities (NDRC and SAIC) have now demonstrated in 2012 a willingness to impose unprecedented fines for AML violations and to do so to sanction international companies. And while private enforcement of the AML has achieved little traction, the new judicial guidelines creating a framework for private enforcement may increase plaintiffs' incentives to litigate and success rates in the future.

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