

Refining China's Anti-Monopoly Law

Law360, New York (April 26, 2010) -- While China's Ministry of Commerce (MOFCOM) has been busy handling the dozens of M&A notifications filed since the Anti-Monopoly Law (AML) took effect on Aug. 1, 2008, MOFCOM, as well as the other agencies with responsibility for implementing the AML, have been busily engaged in rulemaking designed to promote more uniform and predictable implementation of the law.

Familiarity with these rules is essential for practitioners to enhance the prospects for an early and favorable conclusion to the merger review process.

Preparation and Submission of the Notification

The Measures concerning the Notification of Concentrations of Undertakings (MOFCOM December 2009 No. 11) ("Notification Measures") were promulgated on Nov. 21, 2009, with effect from Jan. 1, 2010.

Article 2 of the Measures reaffirms that MOFCOM exercises the concrete tasks of handling and reviewing concentrations. This does not mean that MOFCOM does so without input from other government departments or indeed from the Communist Party, which may influence the review of controversial and high profile concentrations.

Rather, it means that neither of the other two AML enforcement agencies, the State Administration for Industry & Commerce (SAIC) and the National Development and Reform Commission (NDRC), which have responsibility for cartels and abuse of dominance (SAIC) and price-fixing (NDRC), has responsibility for or participates in the review of notifications.

In accordance with the AML, notifiable concentrations under Article 3 include mergers, the acquisition of control through the acquisition of equity or assets, and the acquisition of control through contractual or other means.

The general thresholds for notification are:

- 1) more than CNY 10 billion (US\$1.00≈CNY6.83) total worldwide turnover by all undertakings in the concentration including more than CNY 400 million turnover in Mainland China by at least two such undertakings or
- 2) more than CNY 2 billion total Mainland China turnover by all undertakings in the concentration including more than CNY 400 million turnover in Mainland China for at least two such undertakings, in all cases net of turnover taxes (the thresholds are ten times higher for concentrations in the financial industry under the Measures for Calculating Turnover in Notifications of Concentrations between Financial Industry Undertakings (July 15, 2009)).

The general thresholds were set (Aug. 3, 2008) in the Provisions on Reporting Thresholds for Concentrations of Business Undertakings which provides no automatic adjustments for inflation.

Turnover includes both goods and services under Article 4 of the Notification Measures and is calculated under Article 5 on the basis of the undertaking as a group (excluding intragroup turnover), including (1) the undertaking; (2) undertakings directly or indirectly controlled by the undertaking in the concentration; (3) undertakings which directly or indirectly control the undertaking in the concentration; (4) other undertakings directly or indirectly controlled by an undertaking which controls the undertaking in the concentration; and (5) undertakings jointly controlled by two or more of the undertakings in (i)-(iv).

In accordance with international practice, under Article 7(1) only the turnover of the assets to be acquired is calculated against the threshold in an acquisition, as opposed to a merger. Concentrations by an undertaking in control of the other undertaking or between undertakings under common control are also exempt.

With respect to an acquisition in increments, under Article 7(2) all acquisitions over a period of two years from the date of the first closing to the date of the latest closing are included for the purpose of determining whether there has been an acquisition of control warranting a notification.

An additional review procedure applies to foreign acquisitions of domestic enterprises. Under Article 12 of the Regulations on the Merger and Acquisition of Domestic Enterprises by Foreign Investors (June 22, 2009), such acquisitions are subject to review if they relate to key industries, national economic security, or the control of famous trademarks or ancient Chinese brands.

Each party to a merger files the notification while only the acquirer files in an acquisition under Article 9 of the Notification Measures, albeit in the expectation that the other parties will provide support. The contents of a notification are specified in Article 10 and include:

- 1) the notification form including the names, addresses and scopes of business of the undertakings, and the projected closing date;
- 2) an explanation of the impact of the concentration on the relevant market, including the nature of the concentration, definition of the relevant market in accordance with the Guidelines Concerning Parameters of Relevant Markets (May 24, 2009); respective market shares of the undertakings and their respective market control power; names and market shares of principal competitors (MOFCOM generally requests a list of up to ten competitors); the degree of market concentration; market entry conditions; development conditions in the industry; impact of the concentration on the structure of competition in the market, industry development, technological progress, development of the Chinese national economy, consumers and other undertakings; and an evaluation supported by evidence of the consequences of the concentration on competition in the relevant market (citations to economic literature are helpful);
- 3) the concentration agreement and such relevant documents as the exhibits (MOFCOM will require Chinese-language translations but the extent of the need for translation is subject to discussion with MOFCOM on grounds of need and practicality);
- 4) annual audit reports for the most recent fiscal year for the undertakings (MOFCOM will require Chinese-language translation but the extent can generally be limited to the balance sheet and profit and loss statement); and

5) such other documents and materials as MOFCOM may require. The scope of such other documents and materials is addressed in Article 4 of the Guiding Opinions Concerning Documents and Materials in Notifications of Concentrations between Undertakings (Jan. 5, 2009).

Such documents and materials may include information on the background of the concentration; the nature and form of the concentration; the subject and value of the concentration; control relationships post-closing; production capacity, production volume, prices and costs of production in the affected industry and key products; economic trends and analysis of the concentration; forecasts for development of the industry post-closing and development plans.

The notifier under Article 11 may also submit other documents and materials, e.g., documents from local governments and government departments and reports supporting the concentration (the undertakings should also keep MOFCOM apprised of the progress of reviews by enforcement agencies in other jurisdictions to spur MOFCOM to clear the concentration).

Notification should be submitted in OCR medium as well as hard copies under Article 12, and the documents and materials should be rationally organized to facilitate review (in practice this means that the undertakings should follow the format specified in the Form for Notifications of Undertakings. All notifications should be divided between public and confidential versions in both languages, with confidential sections marked accordingly.

The AML provides specific time lines for review periods but the length of the review process is critically dependent on the date when the investigation commences. Under Article 13 of the Measures, MOFCOM verifies the submitted documents and materials for completeness and will not start the review clock under Article 15 until the notification is formally listed. This can result in lengthy delays.

To minimize the prospect of delay, undertakings should consult with MOFCOM in advance of the notification, as authorized by Article 8 of the Notification Measures, to alert MOFCOM to the pending notification and clarify content and procedural issues. They should also use the time before finalization of the deal to draft the notification and prepare required translations.

Review of the Notifications

The Measures on the Review of Concentration between Undertakings (“Review Measures”) were promulgated by MOFCOM on Nov. 24, 2009, also with effect from Jan. 1, 2010. They constitute a companion regulation to the Measures.

The Review Measures under Article 1 are intended to standardize reviews and clarify review procedures. The notifier is encouraged under Article 4 to voluntarily submit documents and materials as early as possible. Article 5 provides the undertakings with the right to communicate with MOFCOM during the review process by mail, fax and other means.

MOFCOM itself has the right under Article 6 to solicit the opinions of relevant government departments, industry associations, undertakings and consumers during the review process. In other words, MOFCOM may proactively solicit the views of government departments, competitors and other interested parties. At present, concentrations between foreign undertakings with a China nexus seem more likely to attract opposition than support from among industrial ministries and competitors in China.

MOFCOM under Articles 7-8 may also convene hearings on its own initiative or in response to requests from relevant parties. The participants may involve the participating undertakings and competitors, upstream and downstream enterprises and other relevant enterprises, as well as relevant experts, representatives of industry

associations, representatives from government departments and consumer representatives (interest group autonomy in China is limited). Rules to preserve confidentiality will be established and enforced.

The length of review periods is set under Articles 25 and 26 of the AML: 30 days for a Phase 1 review and 90 days for Phase 2 review if necessary, subject to extension by up to an additional 60 days if needed or if there has been a material change in circumstances since the notification.

MOFCOM under Article 9 of the Review Measures is obligated to inform the undertakings of a decision to go beyond Phase 1. There is no statutory basis for abbreviating a Phase 1 review although reviewing officers may sometimes orally notify the undertakings if there is no intention to proceed to Phase 2. A Phase 2 review by contrast need not fully run its allotted length.

MOFCOM under Article 10 of the Review Measures will notify the undertakings if in the course of a Phase 2 review it determines that the concentration has the actual or potential effect of eliminating or restricting competition to provide the undertakings with an opportunity to submit a written response. Such response should include facts and rationale with supporting evidence.

The undertakings under Article 11 may also modify the notification to limit the impact of the concentration on competition by (1) carving out assets or business lines; (2) opening networks, platforms or other infrastructure, licensing key technology, or terminating exclusory agreements; or (3) a combination of other structural or conduct fixes. Any such proposed measure should show that it is capable of limiting the adverse effect on competition. MOFCOM under Article 13 may work together with the undertakings on such remedies.

While MOFCOM under Article 25 of the AML is not obligated to provide written notice of a clearance, as expiration of the 30-day clock without notice of a Phase 2 review constitutes clearance. MOFCOM under Article 14 of the Review Measures is obligated to provide written notice of any decision to clear, conditionally clear, or reject a concentration during Phase 2.

The undertakings may proceed to close under Article 14 only if MOFCOM has not rejected a concentration or if the conditions to a clearance are accepted. MOFCOM's decision with respect to rejections and conditional clearances are published and over time have become more detailed (albeit still substantially less so than MOFCOM's EC and U.S. counterparts) thereby providing industry with greater guidance. Phase 1 clearances are unfortunately not published.

MOFCOM under Article 15 of the Review Measures maintains authority to supervise and review compliance with conditional clearances. Although MOFCOM may take enforcement action under Article 48 of the AML with respect to a concentration that closes before clearance, MOFCOM's authority is less clear with respect to the failure to comply with the conditions of a conditional clearance. MOFCOM may have a tendency to impose more stringent structural conditions because it does not have conduct enforcement authority under the AML, that being reserved to SAIC and NDRC.

Conclusion

The merge review notifications process in China has become more standardized. The prospects for a clearance are enhanced by complying with procedural rules, maintaining close contact with MOFCOM, and responding promptly to requests for additional information and explanations.

--By Lester Ross, WilmerHale

Lester Ross is co-partner-in-charge of WilmerHale's Beijing office and a partner in the firm's antitrust and competition, Asia corporate, environmental and international trade, investment and market access practice groups.

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