

## China Briefing Series



## Enforcement of China's Anti-monopoly Law Takes Shape

A little more than five months since its effective date, the structure and procedure for enforcement of China's Anti-monopoly Law (AML) have begun to take shape. The AML makes clear that transactions subject to notification in China must be cleared there before they can close, a provision for which there was no enforcement power under earlier regulations. The division of responsibility among the Anti-monopoly Commission, the three enforcement departments—Ministry of Commerce (MOFCOM), State Administration for Industry & Commerce (SAIC) and National Development and Reform Commission (NDRC)—has been clarified, the first court cases have been brought, and the Supreme People's Court has specified how administrative law cases alleging anti-monopoly conduct will be adjudicated.

### MOFCOM and Mergers and Acquisitions

MOFCOM has assumed exclusive authority over mergers and acquisitions and concentrations by other means—SAIC has relinquished authority which it nominally held to review concentrations but has never exercised under the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (关于外国投资者并购境内企业的规定) (2006) (the Regulations). MOFCOM created the Anti-monopoly Bureau (反垄断局) to review such matters. The Bureau is led by Shang Ming, who was previously Director-General of the Treaty and Law Department when such Department handled anti-monopoly reviews among its various responsibilities. The Bureau, at present, has six divisions, including two investigation divisions (Division 1 for onshore transactions and Division 2 for offshore transactions), Economic Analysis Division, Competition Policy Division, Law Enforcement and Supervision Division, and General Administration Division. While the two investigation divisions play the lead role in the review of concentrations, the Economic Analysis Division is expected to have an increasingly important position in reviewing future notifications. The Bureau is divided into two sections: one for concentrations between domestic parties and the other for concentrations in which one or more parties are foreign. The Bureau recently stated that it has so far accepted or listed (立案) 13 concentrations for review after acceptance (接收) and issuance of a receipt (发票) for the notification. Of the 13, MOFCOM has cleared seven concentrations without condition and one concentration subject to conditions after review by the Bureau. None have been rejected. Clearances without condition are not required to be notified in writing, but become effective upon expiration of the 30-day first phase suspension period. In practice, oral clearances may, but need not, be given before the suspension period has expired. By contrast, public written announcements are required for rejections of concentrations and for clearances subject to conditions.

The only concentration that has so far been cleared subject to conditions is InBev B.V.'s acquisition of Anheuser-Busch, Inc., for which the gravity lays outside China. This acquisition was notifiable in China because it was not an exempted transaction under Article 22 of the AML, but met at least one of the notification thresholds published by MOFCOM on August 3, 2008:

- (1) Global turnover of all parties to the transaction in excess of RMB 10 billion, and China turnover of at least two parties to the transaction in excess of RMB 400 million, during the previous year; or
- (2) China turnover of all parties to the transaction in excess of RMB 2 billion, and China turnover at least two parties to the transaction in excess of RMB 400 million, during the previous year.

In each case, China turnover refers to turnover in the People's Republic of China, excluding Hong Kong, Macau and Taiwan.

The conditions applicable to the InBev acquisition were not immediately onerous, but appear to reflect a failure to distinguish between MOFCOM's power to regulate mergers and acquisitions through the Anti-monopoly Bureau under the AML and its power to regulate foreign investment in general through the Foreign Investment Bureau. The conditions are:

- (1) Absent MOFCOM approval, Anheuser-Busch may not increase its current 27% minority shareholding in Tsingtao Brewery;
- (2) Any change of control in InBev must be promptly reported to MOFCOM;
- (3) Absent MOFCOM approval, InBev may not increase its current 28.56% minority shareholding in Zhujiang Beer; and
- (4) Absent MOFCOM approval, the combined entity may not seek to hold an equity interest in China Resources Breweries Co., Ltd. or Beijing Yanjing Beer Co., Ltd., the largest competitors in China.

These new and increased investments would have been subject to investment approval by MOFCOM under existing law governing foreign investment. The novelty is that the Anti-monopoly Bureau is asserting its distinctive review authority, and warning that the AML prohibits closure of a notifiable transaction until its review has been completed.

The InBev clearance and other notifications provide several lessons. First, MOFCOM will not list a concentration until it is satisfied that the notification is complete, which typically means that the notifying party or parties will have to undergo one or more rounds of questions in writing and/or provide additional documentation after the notification is submitted. The notifying parties should be prepared to respond quickly and fully to such questions to expedite acceptance of the application. Such delay can be frustrating, particularly as some of the questions reveal a lack of familiarity with the principles of competition law as generally understood in more experienced jurisdictions and/or the finer points of the notification, but it ultimately leads to a shorter review process.

Second, the Bureau expects an acknowledgement of the efficacy of the AML and is reluctant to accept an application which fails to show deference to the AML, i.e., an application which declares an intent to close the concentration before clearance has been obtained in China may encounter greater difficulty.

Third, the Bureau may impose conditions on future investments and other concentrations under the presumption that they will restrict competition, even before such concentrations have been contemplated and regardless of their magnitude. In this instance, InBev has received notice that any increase in the combined entity's holdings in competitors will be discouraged and a reduction and/or complete disposition of the combined entities' holdings in the two leading competitors is strongly encouraged by the government.

Fourth, the Bureau did not cite national security or national economic security as a condition for clearance, even though Article 31 of the AML concerns national security and Article 12 of the Regulations concerns national economic security. Such segregation of AML review from national security review would be in conformity with international best practice. It remains to be seen how acquisitions of domestic companies with recognizable brands will be treated, as the Regulations, which have not been repealed, provide for additional scrutiny of foreign acquisitions of Chinese companies with widely recognized trademarks or venerable brands as well as foreign acquisitions in industries with a direct relationship to national defense.

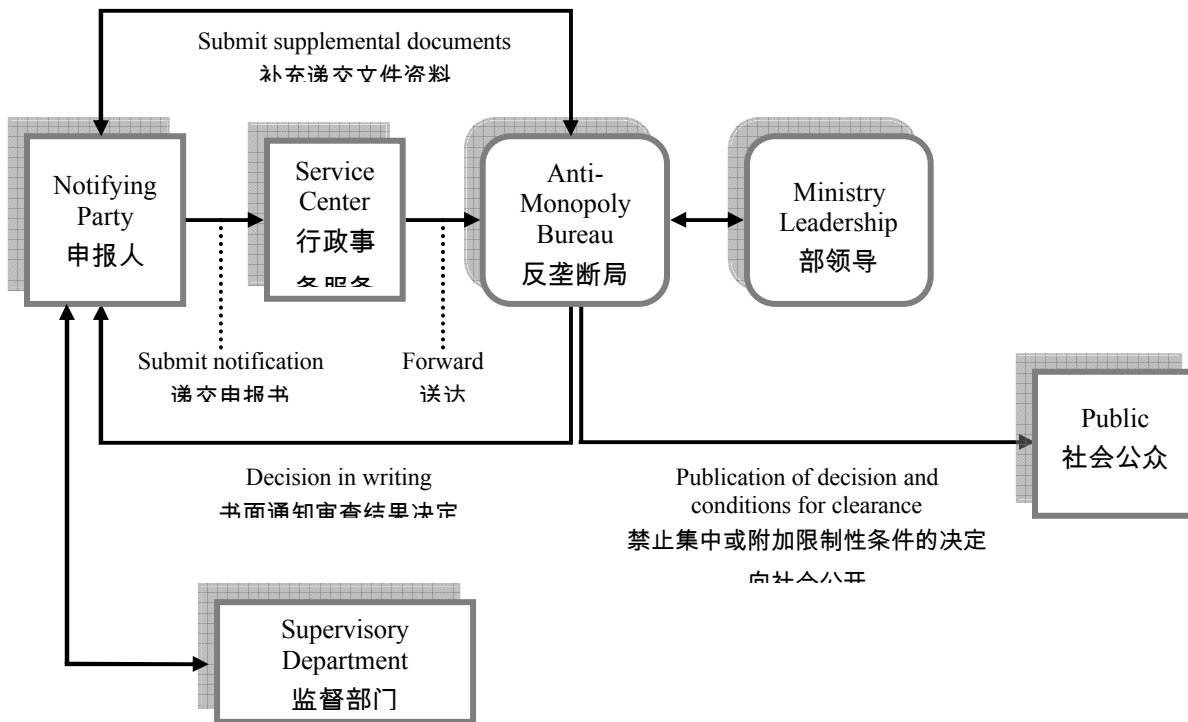
Fifth, the InBev clearance followed closely after clearances from competition authorities in what should be regarded as the principal jurisdictions for the concentration, i.e., the United States and the EU. It remains unclear how willing MOFCOM will be to clear a concentration with its gravity outside of China before the principal clearances have been obtained. It would be imprudent for the parties to let the Chinese notification lag until such other clearances have been obtained, however, as doing so will, at minimum, delay clearance in China.

Sixth, although the AML, in contrast to the Regulations, applies to concentrations between domestic parties as well as to concentrations between foreign parties or in which the acquirer is a foreign party, it is still unclear whether the Bureau is prepared to subject concentrations between domestic parties, one or both of which may have a Chinese government patron, to the same intensity of review. While the division of responsibility within the Bureau between domestic and foreign-related concentrations may have a basis in language competency, that should be immaterial, as the core documentation must be submitted in Chinese and arouses concern that the intensity of review will vary.

MOFCOM recently promulgated several guidelines and is currently drafting additional guidelines on notifications, which will provide additional guidance on filing and review procedures.

A flow chart specifies the basic review procedure:

**MOFCOM Concentrations of Operators Anti-monopoly Review Flow Chart**



The Guiding Opinions on the Notification of Concentrations by Operators (关于经营者集中申报的指导意见) provides the procedures for requests for meetings to discuss a concentration prior to submission of the notification (Article 1); the required contents of a notification in accordance with Article 23 of the AML (Articles 4 and 8); the procedures for supplementing, amending and clarifying a notification (Article 6); the listing of notifications (Article 7); the media of a submission (Article 9); the requirements for translation of documents and materials and for certification of copies thereof (Article 10); and for separation of public and confidential portions of the notification (Articles 11 and 12).

The Guiding Opinions on Documents and Materials in Notifications of Concentrations by Operators (关于经营者集中申报文件资料的指导意见) further clarify the requirements under Article 23 of the AML with respect to documents and materials included in a notification. These Guiding Opinions essentially function as a roadmap for submitting a notification and should be followed to increase the prospects for an early listing:

Article 1 (notification signed by the notifying party or parties or their agents specifying the names, addresses and scopes of business of the parties; the nature and background of the concentration; the agreed date of implementation; affected markets; business consolidations and

economic rationale for the concentration; and certification that the notification satisfies the requirements. The notification will include confidential contents so a non-confidential version must also be submitted.)

Article 2 (further details on the parties and the person(s) making the notification, including notarized certificate of incorporation or individual's ID of any foreign person making the notification (notarization has not previously been required))

Article 3 (information on affiliates of the parties, other companies engaged in the relevant business, and subsidiaries and representative offices of the parties in China)

Article 4 (discussion of the concentration, including its background, nature, consideration, value, agreed date of implementation, post-closure affiliates, affected business and principal products, purposes or goals of the notification and its economic rationale, and market impact and plans)

Article 5 (product and geographic market definition and basis, therefore, market conditions, market impact of the concentration, list of affected upstream and downstream entities and impact of the concentration thereon, and supply and demand relationships in affected markets)

Article 6 (market entry analysis, including physical and legal entry barriers, IPR barriers and effect of the transaction on licensors and licensees, materiality of affected products, number and scale of operators in affected markets, actual and potential substitutes, and recent market entries and exits)

Article 7 (horizontal and vertical relationships between the operators, including R&D, profit-sharing, joint production, distribution, supply and information sharing relationships)

Article 8 (impact of the concentration on market structure and industry development, including upstream and downstream operators, consumers, technological advances, economic development and public and social interests)

Article 9 (predicted efficiency of the transaction, including how and when it will materialize and benefits to consumers, as well as the necessity of the concentration)

Article 10 (scale and competitiveness of the parties in markets not affected by the concentration)

Article 11 (the concentration document with a Chinese translation if needed of the entire document or material portions thereof)

Article 12 (financial statements of the parties for the most recent fiscal year with a Chinese translation if needed of the entire document or material portions thereof)

Article 13 (internal and external analyses and reports on the concentration such as feasibility reports, due diligence reports, industry analyses, charts of the concentration, and post-closure forecasts)

- Article 14 (potential impact of a rejection)
- Article 15 (information on industry associations in the relevant markets)
- Article 16 (optional material in an appendix on the perspective of local governments, government departments in charge of the parties, and the public)
- Article 17 (circumstances regarding notifications in other jurisdictions)
- Article 18 (such other items meriting inclusion as potential bankruptcy, impact on national security, industrial policy, state-owned assets, and well-known trademarks)

The Guidelines on the Processing of Anti-monopoly Reviews of Concentrations among Operators (经营者集中反垄断审查办事指南) specifies the procedures for processing a notification:

1. The Anti-monopoly Bureau preliminarily reviews the notification submitted in accordance with the above Guiding Opinions and determines whether to list the notification or return it to the notifying parties for supplementation.
2. If supplementation is required, the notifying parties must complete the notification by the date set by the Bureau.
3. After the notification is listed, the Bureau has 30 days to complete its first stage review and informs the notifying parties if further review is required.
4. A second stage review, if required, will take up to an additional 90 days.
5. The second stage review may, under specified circumstances, be extended for an additional 60 days, i.e., upon agreement of the parties, inaccuracies in the notification, or material changes since the date of the notification.
6. Upon completion of its review, the Bureau forwards the file to MOFCOM leadership, which issues a written decision to the parties.
7. Decisions to reject or approve the notification subject to conditions are prohibited.

The requirement for written notification to the parties by MOFCOM after the review is complete is a new feature.

MOFCOM has circulated draft Guidelines Concerning the Definition of Markets (关于相关市场界定的指南 (草案)) for public comment.

### **Anti-monopoly Commission**

Another reason for concern for potential variations in the intensity of review involves the role of the Anti-monopoly Commission (AMC). The AMC, established under Article 9 of the AML, is responsible for:

- (1) Research and proposal of relevant competition policies;

- (2) Organization of investigations and appraisal of overall market competition conditions and issuance of appraisal reports;
- (3) Formulation and publication of anti-monopoly regulations;
- (4) Coordination of enforcement of anti-monopoly regulations; and
- (5) Such other duties as may be prescribed by the State Council.

The AMC is currently comprised of 14 ministries and other departments of the central government—the NDRC, SAIC, MOFCOM, Ministry of Industry and Information Technology (MIIT), Ministry of Supervision (MOS), Ministry of Finance (MOF), Ministry of Transport (MOT), State-Owned Assets Supervision and Administration Commission (SASAC), State Intellectual Property Office (SIPO), Legal Affairs Office of the State Council, and four industry regulatory commissions: the China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC), China Insurance Regulatory Commission (CIRC) and State Electricity Regulatory Commission (CERC).

The AMC's Secretary-General is former MOFCOM Vice-Minister Ma Xiuhong, but the secretariat is still in the process of formation. Moreover, several ministries and departments with industry-specific regulatory responsibilities, notably the Ministry of Railways and Civil Aviation Administration of China, are not among the 14 represented on the AMC, indicating that transactions within such industries may not be subject to the AML. In particular, it is unclear if the anticipated consolidation of state-owned airlines will be subject to the AML.

While the AMC's role and composition are reasonable in some respects, e.g., there is a need for coordination among the three enforcement departments and transactions in the financial industries will at minimum require specialized regulatory expertise, the presence of SASAC and industry-based ministries suggests that the enforcement departments will encounter difficulty acting in matters that challenge the interests of such ministries.

In addition, as shown below with respect to the SAIC, the delay in establishing AMC's secretariat, complied with potential difficulty in achieving consensus among its members, may result in enforcement departments following their respective compasses without regard to overall policy leadership.

## **SAIC**

SAIC's sphere of authority covers unilateral dominance and monopoly agreements, i.e., cartels, except to the extent that cartels involve price-fixing which falls within the purview of the NDRC. SAIC exercises its authority through the Fair Trade and Anti-monopoly Bureau, an outgrowth of the earlier Fair Trade Bureau which was responsible for enforcement of the Anti-Unfair Competition Law (AUCL). The AUCL, enacted in 1993, is in the process of being amended to adapt better to market conditions in the 15 years since then and to conform more closely to the AML.

SAIC has drafted procedural regulations to implement the AML, which are expected to be issued in early 2009. These regulations, presently labeled the Procedural Regulations of Industry & Commerce Administrative Organizations on the Prevention of Abuse of Administrative Power to Eliminate and Restrict Competitive Conduct (Draft) (工商行政管理机关制止滥用行政权力排除、限制竞争行为程序规定(草案)) and the Procedural Regulations on the Investigation by Industry & Commerce Organs of Cases of

Monopoly Agreements and Abuse of Market Dominant Positions (Draft) (工商行政管理机关查处垄断协议滥用市场支配地位案件程序规定(草案)), are procedural regulations that will set basic procedures for combating administrative monopolies and conducting investigations before policy is set on such thorny issues as the circumstances, if any, under which the exercise of lawful IPR through denial of licenses or other means may constitute an abuse of market dominance. Until then, SAIC's enforcement priorities will be unclear, but its immediate challenges are likely to lie in dividing enforcement responsibilities with the NDRC and in tackling agreements between domestic companies, especially in an industry championed by a member of the AMC.

## **NDRC**

The NDRC, which grew out of the old State Planning Commission, has exercised price regulatory power for many years. The number of commodities subject to fixed prices has substantially decreased over time, and the number subject to guidance prices has also decreased. In other cases as well as perceived exigent circumstances like inflation, NDRC retains the power to determine or shape prices. Its responsibility under the AML is conceptually distinct, namely to regulate price-setting by companies and industry associations that is not guided by the central government.

A pre-AML instance of the exercise of this power involved instant noodles, for which the AML halted an effort in 2007 orchestrated by the industry association to raise the price of the least expensive variety of instant noodles. This indicated that the NDRC has the capability and may act to halt blatant price-fixing orchestrated by an industry association, particularly in an industry dominated by foreign-owned companies selling a product favored by poor people. Such price-fixing is barred by Articles 13(1), 14 and 16 of the AML. It remains unclear how willing and capable the NDRC will be to address less transparent price-fixing agreements, agreements with an indirect effect on the public, and of course pricing arrangements encouraged by government organizations.

## **The Courts**

The Supreme People's Court, in remarks by the President of the Administrative Law Chamber, has indicated how the country's courts are to treat AML cases that involve challenges to government actions. Such cases are basically to be treated in accordance with general provisions governing administrative law cases. In instances where a party also begins a civil law case against the party or parties engaging in monopoly behavior, the case whose outcome is central to the outcome of the other may proceed first. In a recent notice, the Supreme People's Court declared that any civil law cases involving monopoly conduct would be adjudicated by the relevant intellectual property law chambers of the courts.

AML cases have already begun to be filed. Most notably, a case was filed by four food product security companies with the Beijing No. 1 Intermediate People's Court within days after the effective date of the AML against the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), alleging that it had created a monopoly by administrative means with respect to the electronic labeling of product quality to the benefit of an operator in which it held a substantial interest. The case was not accepted by the court for statute of limitations reasons, but the publicity alone serves as a deterrent to future conflicts of interest of this sort.

Private companies have also brought civil cases, under the AML in part, against Baidu, China's largest search engine with a market share reportedly in excess of 60%, for favoring companies which participate in its "bid for ranking" program to inflate search results while disfavoring other companies. These cases



also have yet to be accepted by the courts but have attracted wide publicity and aroused criticism of Baidu by government officials as well as members of the public, leading Baidu to commit to modify its business practices.

## Conclusion

Chinese government departments and courts are moving rapidly to put in place a regulatory structure for enforcement of the AML. Because of the AML's broad reach and the importance of the China market, companies in China and around the world will face heightened competition law compliance obligations with respect to many aspects of business conduct as well as concentrations. An understanding of these obligations and the adoption of compliance strategies to manage the impact on business performance will be critical for many companies.

FOR MORE INFORMATION ON THIS OR OTHER CORPORATE MATTERS, CONTACT:

**Lester Ross** +86 10 8529 7588 [lester.ross@wilmerhale.com](mailto:lester.ross@wilmerhale.com)

**Robert Woll** +86 10 8529 7588 [robert.woll@wilmerhale.com](mailto:robert.woll@wilmerhale.com)

**Kenneth Zhou** +86 10 8529 7588 [kenneth.zhou@wilmerhale.com](mailto:kenneth.zhou@wilmerhale.com)

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