PRC mergers: MOFCOM takes control

Adrian Emch of* Sidley Austin LLP *explains why companies planning transactions with potential effects in China must be mindful of MOFCOM's growing sophistication and assertiveness.

After over a decade of deliberation, China's Anti-Monopoly Law (AML) was enacted in 2007 and finally came into force in August 2008. The new law was quickly hailed as a milestone in China's transition to a fully-fledged market economy. So far, however, the AML's implementation and enforcement has been gradual. Only in the area of merger control has there been a substantive level of activism, with the Ministry of Commerce (MOFCOM) – in charge of merger reviews – active on both the legislative front as well as in individual enforcement cases.

Early in 2009, MOFCOM adopted several rules that govern the merger control procedure on a transitional basis until the enactment of final rules. Shortly thereafter, the regulator circulated a set of five draft procedural measures for public comment. So far, only two of these measures have been adopted, with MOFCOM publishing the enactment of the final rules regulating its review procedure and notification requirements on 27 November, both of which are effective from 1 January 2010. More significantly, perhaps, is that the regulator has been active in investigating individual cases and has not shied away from making some significant decisions.

The merger control framework

China's AML implements a merger control regime similar to those of many jurisdictions worldwide. Essentially, a business transaction – which under the law is classified as a "concentration" between business operators – must be notified to MOFCOM before closing if certain filing thresholds are exceeded. Clearly, mergers and acquisitions of companies are deemed "concentrations". Less certain is whether, and under which conditions, joint ventures are "concentrations" and must be notified.

The filing thresholds of China's new merger control regime focus exclusively on sales revenues. Except for the financial industry, for which there are specific rules, the following thresholds apply to all sectors: the aggregate revenues of all parties to the concentration must exceed RMB 10 billion worldwide or RMB 2 billion in Mainland China (approximately US$1.5 billion and US$290 million respectively). In addition, at least two parties must each have minimum sales of RMB 400 million (roughly US$60 million) in Mainland China.

If a transaction is deemed a "concentration" and the thresholds are met, then notification to MOFCOM is compulsory and the parties are not allowed to close the deal before obtaining clearance from the regulator, or before the mandatory deadlines expire. However, in a significant departure from the situation in most other jurisdictions, MOFCOM is also entitled to examine transactions that do not meet the thresholds if it suspects them to have anti-competitive effects. So far, it does not appear that this option has been used.

In contrast, MOFCOM has been active in scrutinising notified deals. In the following three transactions, considered towards the end of 2009, MOFCOM attached conditions to each of its clearance decisions.

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General Motors/Delphi

The (re)purchase of the car parts manufacturer Delphi by its former parent company General Motors (GM), one of the world's largest car makers, was notified to MOFCOM on 18 August 2009. MOFCOM accepted the notification as complete on 31 August, and issued conditional clearance on 28 September 2009.

In its one-month investigation, MOFCOM found that GM had a "leading position" in the market for passenger vehicles in China, as did Delphi in ten car parts markets in China. Consequently, MOFCOM was concerned that the vertical integration between GM and Delphi could foreclose access to Delphi car parts by GM rivals, and foreclose sales opportunities for Delphi's competitors (as GM might want to favour in-house supplies from Delphi). To alleviate MOFCOM's concerns, the parties offered commitments to reduce the transaction's perceived negative impact. In particular, the parties accepted that GM will guarantee car parts supplies to other operators on a non-discriminatory basis, not illegally use information obtained by Delphi regarding the supply requirements of competing car makers, and continue its multi-sourcing purchasing policy for car parts. The parties also agreed not to raise switching costs for competitors. Finally, the decision imposes an obligation on GM to regularly report to MOFCOM its compliance with these commitments.

Pfizer/Wyeth

On 26 January 2009, Pfizer announced its plan to acquire Wyeth. Both Pfizer and Wyeth are large multinational companies headquartered in the United States whose main activities are focused on the life sciences industry. The notification to MOFCOM was filed on 9 June. After submission of additional documents, MOFCOM declared the notification as complete and registered it on file on 15 June. Exactly one month later, the regulator decided to open an in-depth investigation, and published its decision approving the transaction on 29 September 2009.

MOFCOM's investigation focused on two types of pharmaceuticals for human consumption – broad spectrum penicillin, and anti-depressants and mood stabilizers – and on certain animal vaccines. In its investigation, MOFCOM found competition problems to exist in only one product market: swine vaccine for porcine enzootic pneumonia. In that market, MOFCOM found that the parties' combined market share in China was 49.4 percent, and that entry barriers were high.

Given its concerns in that market, MOFCOM placed conditions on its clearance of the transaction. Pfizer was ordered to divest its swine pneumonia vaccine business under the Respisure and Respisure One brands, including corresponding intellectual property rights (IPRs), to a suitable buyer. MOFCOM required the purchaser to meet certain eligibility criteria and to obtain its prior approval. During an interim period of six months following MOFCOM's clearance of the transaction, the business to be divested must be managed by a hold-separate trustee to be appointed by Pfizer. If the divestiture process is not concluded during the interim period, MOFCOM itself may appoint a new trustee.

For three years after the divestiture, Pfizer is under obligation to provide technical support to the new owner, assist in the procurement of raw materials and provide technical training for the new owner's staff.

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Panasonic/Sanyo

Panasonic's acquisition of Sanyo was publicly announced on 19 December 2008. Large conglomerates based in Japan, Panasonic and Sanyo are mainly active in the manufacturing and sale of consumer and technology products, and the planned acquisition was notified to MOFCOM on 21 January 2009. After its initial review indicated possible competition issues, MOFCOM opened a 90 day in-depth investigation, which it subsequently extended by two months. On 30 October 2009, MOFCOM cleared the transaction subject to conditions. According to the summary published on its website, the regulator found that the proposed acquisition would result in anti-competitive effects in three relevant markets for batteries, two of which were found to be worldwide in geographic scope. MOFCOM found that the parties' overlapping products led to combined market shares of 61 percent, 46.3 percent and 77 percent in the markets for rechargeable coin-shape batteries based on lithium, nickel-metal hydride batteries for personal use, and nickel-metal hydride batteries for use in vehicles, respectively.

After more than two months of negotiations, MOFCOM accepted the remedies proposed by the parties, which essentially consist of the sale of parts of either the Panasonic or Sanyo business (including assets located in Japan) in the three product markets to a suitable buyer within a period of six months (which can be extended for a further six months with the regulator's approval). MOFCOM ordered the parties' businesses in these markets to operate separately until the divestitures have been completed. In case the parties do not implement the divestitures within the stipulated deadline, MOFCOM has reserved its right to approve one or more third parties to acquire the designated Panasonic or Sanyo businesses.

Lessons to be learned

MOFCOM's increased transparency: In many ways, the *GM/Delphi, Pfizer/Wyeth* and *Panasonic/Sanyo* cases illustrate MOFCOM's increasing confidence in handling complex merger cases, exemplified by the increasingly detailed summaries of the decisions which the regulator posts online compared to previous summaries (such as those in the *Inbev/Anheuser-Busch* and *Coca-Cola/Huiyuan* cases). For example, MOFCOM now on a regular basis defines what constitutes a relevant market, which better allows companies operating in the same sectors to evaluate their positions in these markets.

Patterns regarding MOFCOM's substantive assessment are emerging: The recent decisions provide better insight into MOFCOM's substantive analysis. In the case of horizontal product overlaps between merging parties, it appears that combined market shares of 45 percent and above can be problematic. However, MOFCOM does not appear to focus exclusively on market share but also considers other factors such as entry barriers.

In addition to horizontal overlaps, MOFCOM has also examined so-called "conglomerate mergers" (where the parties' products are complements) and vertical mergers. In the *Coca-Cola/Huiyuan* case in 2008, the regulator based its decision prohibiting the acquisition on a bundling theory, essentially arguing that the complementary nature of the parties' products allowed Coca-Cola to leverage its market power from soft drinks into the fruit juice market. However, some observers claim that MOFCOM's decision was heavily influenced by non-antitrust factors.

On the other hand, the *GM/Delphi* transaction gave rise to the second published decision in which MOFCOM found vertical competition problems to exist, with the regulator voicing concern that the vertical integration between GM as a car maker and Delphi as a car parts supplier would have negative effects on their rivals at both levels in the production chain. In this case, MOFCOM's decision went far beyond those of the US Federal Trade Commission and the European Commission, which appear to have issued unconditional clearance. Indeed, in the United States and the European Union, vertical mergers very rarely give rise to competition concerns, and in any case

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only if the merging parties have a very strong market position on at least one of the two levels.

In contrast, MOFCOM did not find that either GM or Delphi would be in a dominant market position or have significant market power, but still imposed remedies at both levels. MOFCOM's far-reaching position in *GM/Delphi* could perhaps be interpreted either as a case and sector-specific solution (the car industry being of considerable importance in China) or as heralding a stricter approach to vertical mergers. Thus, companies subject to MOFCOM antitrust review should be sensitive to the vertical aspects of their transactions, particularly in key industry sectors.

Focus on remedies: One lesson that may be drawn from the three recent decisions is that MOFCOM appears to dedicate considerable time and attention to reviewing the adequacy of proposed remedies. In the *Panasonic/Sanyo* case for example, the discussion of remedies consumed approximately half of the decision's published summary. The three cases also show that MOFCOM has been experimenting with many types of remedies to alleviate competition concerns, ranging from structural remedies (such as divestiture) to behavioral remedies (such as non-discrimination obligations). This relative flexibility could be interpreted as a learning-by-doing process, intended to lay the foundations for the new procedural regulation on remedies which regulators are currently drafting.

Importantly for businesses, it may also indicate that MOFCOM realises that there is no one-size-fits-all solution but that each case must be dealt with on its own merits. For example, while in *Pfizer/Wyeth* the regulator asked the parties to divest related IPRs, licensing of IPRs was found to be sufficient in *Panasonic/Sanyo*. MOFCOM's perceived flexibility could give companies subject to scrutiny more scope for offering remedies that minimise the negative impact on their business.

Time-consuming process: MOFCOM's review process in *Panasonic/Sanyo* lasted over nine months from the date of formal notification to clearance (not including the pre-notification phase). Moreover, MOFCOM waited more than three months before accepting the parties' filing. Such a lengthy delay recalls the regulator's earlier cases in 2008 and contrasts with its investigations in the *GM/Delphi* and *Pfizer/Wyeth* matters, where the notifications were accepted thirteen and six days after filing respectively. Uncertainty as to MOFCOM's timing renders the planning of deals that need to be notified in various jurisdictions increasingly challenging.

Third party participation: MOFCOM's investigations in recent cases suggest substantive reliance on the input of third parties, including competitors and customers. MOFCOM routinely invites industry associations and government departments to make their views known, and sends questionnaires to customers and competitors of the merging parties. In *Panasonic/Sanyo,* MOFCOM also inspected facilities. For companies planning transactions that are likely to be subject to scrutiny, it is advisable to make an early assessment as to whether customers, competitors or sectoral regulators can be expected to oppose the transaction, and prepare a coherent strategy to deal with expected complications.

Impact of MOFCOM decisions: Among the cases with published summary decisions, *Panasonic/Sanyo* is the first case where MOFCOM found the relevant product market to be worldwide in scope. This global view not only illustrates MOFCOM's increasingly economics-based approach to market definition; it could also be interpreted as a sign that the regulator may exert jurisdiction even where the impact of its decision goes beyond Chinese territory.

In the same vein, while the US Federal Trade Commission and the European Commission cleared the *Pfizer/Wyeth* and *Panasonic/Sanyo* transactions subject to similar conditions as those imposed by MOFCOM, both appear to have issued unconditional clearance in *GM/Delphi* while MOFCOM imposed remedies. Taken together, these cases may indicate MOFCOM's increasing willingness to act in concert with antitrust agencies in other jurisdictions but to go its own way where it deems necessary. Accordingly, companies should take MOFCOM's growing sophistication and assertiveness into account when planning transactions with potential effects in China.

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