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Chinese Enforcement Evolves

Taking stock nine months after the anti-monopoly law became effective.

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IN THE NINE MONTHS since the Chinese Anti Monopoly Law (AML) became effective on Aug. 1, 2008, the Anti Monopoly Bureau of China's Ministry of Commerce (Mofcom) has made its mark on the global antitrust stage by blocking one high-profile acquisition (Coca-Cola Co.'s proposed $2.4 billion acquisition of Huiyuan Co.) and significantly altering two large cross-border transactions (InBev's $52 billion acquisition of Anheuser-Busch and Mitsubishi Rayon's $1.6 billion proposed acquisition of Lucite International).

These three cases demonstrate that China can become the antitrust watchdog in the critical path to closing cross-border mergers. In the case of Mitsubishi Rayon/Lucite, for example, it was reported that no other antitrust authority imposed conditions to approve the transaction.

Arguably, this means that China is quickly taking a leading role in setting global antitrust policy. To the extent this trend is likely to continue, it will have a significant impact not only on companies doing business in China but also on parties in global mergers with significant revenues in China.

This article takes stock of the nascent developments in Chinese antitrust enforcement, how they compare with recent antitrust experience elsewhere, and what to expect going forward.

The AML in Operation

It took more than two decades for China to emerge in this role, as the early debate surrounding the creation of a comprehensive Chinese antitrust law dates back to the mid-1980s.[1]

The Chinese legislative authority (the Standing Committee of the People's Congress) enacted the AML, which is China's comprehensive framework for antitrust enforcement, on Aug. 30, 2007, after going through several iterations and a consultation process where third parties were given opportunities to comment. Comments were taken from foreign antitrust authorities and international regulatory agencies, the private bar, trade associations and academia. Most comments provided in the consultation process were incorporated into the AML.

> Like most modern antitrust regimes, the AML governs the three pillars of antitrust law: (1) anticompetitive agreements between companies, (2) unilateral conduct of dominant companies, and (3) mergers that 'may have the effect of restricting competition.' It also governs abuses of administrative powers to prevent or restrict competition.

Like most modern antitrust regimes, the AML governs the three pillars of antitrust law:

(1) anticompetitive agreements between companies (defined as "monopoly agreements made between undertakings"), whether they are price fixing between horizontal competitors, or exclusionary "vertical" distribution agreements governing supplier/customer relationships;

(2) unilateral conduct of dominant companies (defined in the AML as "abuse of dominant position by undertakings"); and

(3) mergers that "may have the effect of restricting competition."

The AML also governs abuses of administrative powers to prevent or restrict competition.

The enforcement of the AML falls to three regulatory bodies. Non-merger matters are split between the National Development and Reform Commission and the State Administration for Industry & Commerce. Merger matters remain with Mofcom, which reviewed mergers before the AML came into force, under prior merger regulations.

Mofcom has garnered most of the attention since the AML came into force. In its press release on the Coca-Cola/Huiyuan case on March 18, 2009, Mofcom disclosed that it had received 40 submissions, had reviewed 24, cleared 23 unconditionally, and accepted a remedy on one (the InBev case). These statistics are informative on at least three levels.

First, Mofcom reviewed about 40 transactions in eight months of operation. The point here is that only 40 transactions were reviewed in what is one of the most active merger and acquisition markets worldwide. This shows that the AML jurisdictional thresholds that trigger Mofcom's review are at a level that is appropriate, and not so low that any and all

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transactions trigger Mofcom review.

This also shows that the AML thresholds are on par with those of other merger control regimes. For example, after the EC Merger Regulation came into force on Sept. 21, 1990, the European Commission reviewed 64 transactions in 1991, and 59 in 1992.[2]

The AML jurisdictional thresholds are exceeded if:

(1) the total revenues derived by all parties exceed 10 billion renminbi (or about $1.5 billion) worldwide or 2 billion renminbi (or about $300 million) in China; and

(2) at least two parties to the transaction derive more than $400 million renminbi (or about $60 million) in China.

If a transaction falls above these thresholds, the parties must prepare and send a merger submission to Mofcom for approval, much like they would do if their transactions exceeded the Hart Scott Rodino Act thresholds in the United States or the EC Merger Regulation thresholds in Europe. If a transaction falls below these thresholds, the parties need not file with Mofcom, though Mofcom has discretion to review such transactions.

Second, these preliminary statistics show that the percentage of enforcement actions is on par with other antitrust regimes. Mofcom blocked one transaction out of 40 reviewed, and accepted commitments in two others. This gives a preliminary blocking rate of 2.5 percent with 5 percent of transactions modified. European and U.S. statistics demonstrate a similar pattern.

The European Commission reviewed about 4,000 transactions since the EC Merger Regulation came into force in 1990, blocked about 20 of them (or 0.5 percent of all filings), and accepted commitments in about 270 (or 6.75 percent of all filings).[3] The U.S. Antitrust Division of the Department of Justice and the FTC reviewed 2,201 transactions in 2007, and issued Second Requests in 63, or 3.5 percent of all transactions notified.[4]

Third, the timing in Coca-Cola/Huiyuan shows that it takes about the same time to get a transaction through the merger-control process in China as elsewhere.

Two-Phase Review Process

Like most, if not all, merger control regimes, the AML provides for a two-phase review.

The first phase gives Mofcom 30 working days following the date it receives complete submission materials from the parties; the submission follows more closely the EU than the U.S. model. The "notification form" itself resembles the EU "Form CO" that parties file with the European Commission. And like in Europe (and in most merger control regimes with the notable exception of the United States), the parties are expected to craft and include in their submission an advocacy piece explaining why their transaction causes no competitive harm.

The second phase of the review, which Mofcom decides to launch if it deems that a transaction presents significant antitrust issues, lasts 90 working days, and may be extended for an additional 60. In short, it takes about six to seven months to get a transaction that raises significant antitrust issues through the Chinese merger-control process. In Coca-Cola/Huiyuan, the parties submitted their file to Mofcom on Sept. 18, 2008, and Mofcom blocked the transaction six months later on March 18, 2009.

The early stages of the European merger control experience provide another interesting comparison. Armed with its new merger control powers, it did not take the European Commission much longer to block a transaction than it took Mofcom to block its first one. The European Commission blocked its first transaction (Aerospatiale/Alenia/De Havilland) in October 1991, or little more than a year after the EC Merger Regulation came into force.[5]

Coca-Cola: Right or Wrong?

Much has been written on whether Mofcom came to the right conclusion in Coca-Cola/Huiyuan, and whether more experienced antitrust regulators, such as the U.S. antitrust agencies or the European Commission, would have reached the same conclusion under the same set of facts. Mofcom's press release announcing its decision to block the transaction listed the factors it took in consideration:

> market share and market control, the degree of market concentration, the impact on market access and technological progress, the impact on consumers and other business operators, and the impact of brands on market competition in the juice market.[6]

While each of these elements is similar to what other antitrust regulators would review, it is difficult to assess, without a fuller disclosure, whether the market conditions warranted a decision to block the transaction.

While Article 30 of the AML requires that Mofcom publicize decisions blocking transactions or imposing remedies, the brevity of its statements contrasts with accepted practice elsewhere. The European Commission must publish fully-reasoned decisions under EU law, for both clearance and blocking decisions.

The U.S. antitrust agencies are less transparent. While they have no obligations to publicize their reasons to "clear" transactions (in contrast to the European Commission, the U.S. agencies do not clear transactions per se, they just let the waiting period expire), the U.S. agencies must file a complaint alleging a credible theory of competitive harm if they challenge transactions.

Mofcom's Coca-Cola/Huiyuan press release also alludes to its theories of competitive harm to block the transaction:

> After the concentration is completed, Coca-Cola could use its market dominance in carbonated soft drinks to limit competition in the market for juice through tying, bundling or other exclusive transactions, resulting in consumers being forced to accept higher prices and reduced variety. At the same time, because brands can restrict entry in the market, it would be hard for the threat of potential competition to remove the restrictive effect on competition.[7]

This is reminiscent of the "portfolio effect" theory that the European Commission articulated in its 1997 review of the Guinness/Grand Met transaction. There, the EC held that the holder of a portfolio of leading brands may gain a better ability for tying, assuming the holder of the portfolio has the brand leader or one or more leading brands in a particular market.[8] While this theory had a somewhat short life span in Europe and was never fully adopted by the U.S. agencies, it seems to constitute the key theory of competitive harm used by Mofcom to block Coca-Cola/Huiyuan.

Mofcom's press release also adds that Coca-Coca's acquisition of Huiyuan would have "reduced the room for small and medium-size juice companies to survive." Such a concern would not have been raised by U.S. antitrust agencies, which focus on competition and not the ability of competitors to survive. Competitors play more of a role before the European Commission, which has historically paid more attention to complaints lodged by competitors.

Suspecting Favoritism

Lack of transparency in merger control can give the impression that the government's antitrust analysis of mergers is an impenetrable black box, and that other considerations may come into play. A recurrent critique against the enforcement of the AML thus far has been that it mixes industrial policy concerns to favor Chinese competitors. Bluntly put, the Chinese antitrust regime would have a strong tendency to protect domestic competitors.

The remedy imposed in the InBev/Anheuser-Busch transaction fueled this critique. It has been reported that InBev and Anheuser-Busch would hold a combined market share of approximately 13 percent of the Chinese beer market. Such a share typically raises no antitrust risk. Indeed, Mofcom approved the transaction subject to remedies unrelated to the transaction before review.

The remedy, rather, constrains InBev's future M&A activity in China. To get the Anheuser-Busch transaction through, InBev committed not to increase its equity stakes in two Chinese brewers (Tsingtao Brewery and Guangzhou Zhujiang Brewery), or to seek to acquire "any shares" in two other Chinese Brewers (China Resources Snow Brewery and Beijing Yanging Beer).

Because such a remedy may be unprecedented, may not have been warranted by the transaction under review, and, at least on its face, seems aimed at favoring domestic competitors, it has bolstered the critique that industrial policy plays a role in Mofcom's antitrust analysis.

But it could be that the most relevant sign of industrial policy considerations is what Chinese enforcers have not yet tackled. The elephant in the room is the lack of AML enforcement actions against cartels.

Most antitrust regulators agree, often outdoing themselves in rhetoric, that the detection, prohibition and punishment of cartels is their number one priority. To assist with the detection of cartels, about 60 antitrust regimes have adopted "leniency regimes," which provide incentives for cartel conspirators to cooperate with antitrust enforcers and provide evidence against their fellow participants. Interestingly, the AML does not contain a leniency regime.

Could it be that no such detection tool is needed in China as cartels openly operate, at least in some sectors of the economy? And why wouldn't they if they were not banned before the AML came into force? Again, this is reminiscent of the European experience, where member states were obligated to adopt antitrust principles upon joining the European Union. There, the transition took time, and, as old habits die hard, the remnants of cartels generated investigations and litigations on both sides of the Atlantic.

Here, the transition to a cartel-free economy is also likely to take some time, especially to the extent that some sectors are controlled by state-owned enterprises, which some officials thought would be exempt from the AML.[9] The arguments heard last November before Judge David Trager of the Eastern District of New York, in the *In Re Vitamin C Antitrust Litigation*, are informative here.

Plaintiffs allege that Chinese vitamin C producers acted in concert to raise prices and limit the supply of vitamin C in violation of the U.S. antitrust laws. In their motion to dismiss, which was rejected last November, defendants invoked act of state immunity and international comity, essentially arguing that the Chinese government had compelled their price-fixing activities. In response to a direct question by Judge Trager, China's Ministry of Commerce noted that Mofcom could require price fixing for any industry.

But it would be a mistake to think that the AML's sole impact thus far has been merger control. Private actions brought under a variety of antitrust theories are wending their way through the courts and are likely to generate more scrutiny in the near future.

For instance, a complaint was filed against Microsoft claiming that the company abused its dominant position through excessive pricing. Recently, a medical information Web site brought a monopolization claim against Baidu, the leading search engine in China, claiming that Baidu had abused its dominant position by taking retaliatory measures aimed at reducing the number of hits that plaintiff generated on Baidu.

A few other cases have been brought against wireless carriers, loosely inspired by the AML. The first case that made it to court was brought by a Web-based book publisher (Beijing Sursen Electronics) alleging that its competitor Qidian had abused its dominant position by not allowing a famous author to publish on the Beijing Sursen Electronics Web site.

Lessons From Year One

The key takeaway from the first year of AML enforcement is that the Chinese antitrust agencies have been tackling antitrust issues presented to them, particularly in the merger context, and have not shied away from imposing creative antitrust theories to address their concerns. Parties to global M&A transactions now need to assess antitrust risk in China with the same level of scrutiny as they assess antitrust risk in other jurisdictions.

The next frontier of AML enforcement seems to be classic antitrust offenses, such as a price fixing and monopolization, and the specific challenges that they may bring to state-owned enterprises and an economy used to functioning without such constraints.

1. For a comprehensive discussion of the preliminary steps taken to enact the AML, See, e.g, Stephen Harris, Jr., "The Making of an Antitrust Law: The Pending Anti-Monopoly Law of the People's Republic of China," 7. Chi. J. Int'l L. 169 (2006).

2. See, http://ec.europa.eu/competition/mergers/statistics.pdf.

3. See, http://ec.europa.eu/competition/mergers/statistics.pdf.

4. See, http://www.ftc.gov/os/2008/11/hsrreportfy2007.pdf.

5. See, http://ec.europa.eu/competition/mergers/cases/decisions/m53_en.pdf.

6. See http://blogs.wsj.com/chinajournal/2009/03/18/china%e2%80%99s-statement-blocking-coca-cola-huiyuan-deal/.

7. See id.

8. See, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998D0602:EN:HTML.

9. In August 2008, Chinese news briefings reported that a member of a research institute at the state-owned Assets Supervision and Administration Commission (SASAC), the administrative agency supervising China's large State Owned Enterprise, claimed that the restructuring of state-owned enterprises were exempt from the AML. See, e.g., Dina Kallay, "China's New Anti-Monopoly Law: An International Antitrust Convergence Perspective," remarks delivered at Melbourne Law School's "Unleashing the Tiger? Competition Law in China and Hong Kong" Conference. However, based on our recent experience, it is clear that Mofcom has taken a position that any merger between state-owned entities should obtain merger control clearance as well.