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China's New Anti-Monopoly Law Provides Valuable Insight Into Future Merger Enforcement for Merger Lawyers

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In August 2007, after 13 years of work, China promulgated its first comprehensive antitrust legislation, the Anti-Monopoly Law ("the Law"). Scheduled to come into effect in August 2008, the Law is intended largely to replace China's existing merger control regime and therefore merits a closer look for counsel advising transactions that could trigger mandatory notification requirements in China. Although the Law will attain greater clarity from the forthcoming implementing regulations, this article provides preliminary analysis of key provisions of the Law relating to antitrust aspects of mergers and acquisitions in China. While the Law establishes a broad merger control framework that is largely harmonized with the US and EU standards, some differences remain that are noteworthy for counsel. Due to the infancy and the sweeping general language of the Law, however, practical observations in this article are necessarily predictive rather than grounded in agency precedents.

Establishment of Anti-Monopoly Commission as Chief Merger Enforcer

The Law calls for the creation of a new agency, the Anti-Monopoly Commission (AMC), to consolidate antitrust enforcement efforts that are currently

supervised by several disparate agencies. While the implementing regulations will provide greater detail on its structure, AMC is expected to serve, at least in the near term, primarily as a coordination agency that directs and harmonizes various enforcement activities by different antitrust authorities, rather than undertaking enforcement activities itself. This somewhat tentative framework hints at not only the intense turf battles that have occurred among the agencies to win greater authority over antitrust issues, but also a careful compromise designed to gradually transition antitrust enforcement in China toward a single agency model. In the case of antitrust merger review, therefore, the principal administrative procedures and enforcement activities will likely continue to emanate from the officials of the Ministry of Commerce (MOFCOM)—the current de facto merger enforcer for all transactions in China involving foreign parties.

Legal Standard for Defining Anticompetitive Mergers

The Law broadly prohibits "concentrations among undertakings that have or are likely to have the effect of eliminating or restricting competition." Notably, this language differs from the Law's prior



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drafts, which required prohibited concentrations to have the effect of “substantially” eliminating or restricting competition. The lowered threshold potentially signals a departure from the prevailing standard in both the US and the EU, where the concept of substantiality is firmly embedded in the statute. In the US, Section 7 of the Clayton Act bars acquisitions only when their effect may be “*substantially* to lessen competition.” Likewise, the EU confines anticompetitive transactions to those that “*significantly* impede effective competition.”

The absence of substantiality from the Law may indicate that AMC could exercise significant latitude to prohibit transactions, even when they demonstrate negligible restraints on domestic competition. In both the US and the EU, the horizontal merger review guidelines provide well-defined economic approaches to evaluating the degree of anticompetitive effect. In China, however, no working guidelines are currently available, making it difficult, for the time being, to predict how this expansive legal standard will be enforced.

Notification Thresholds and Extraterritoriality

The Law contains no pre-merger notification thresholds, instead authorizing the State Council (serving the role akin to the Cabinet in the US) to establish the thresholds by specific regulations before August 2008. Prior drafts of the Law, however, did contain specific thresholds that were based on the merging parties’ market shares, total assets and sales in China and worldwide and the value of assets or securities to be acquired. These draft rules largely mirrored the existing thresholds set forth by MOFCOM and the State Administration for Industry and Commerce (SAIC) in its Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (“Regulations”) the de facto merger control provisions in effect today. The notification thresholds in both the Regulations and prior drafts of the Law, however, faced considerable criticism for their compliance ambiguity and perception of unfairness. Understanding this criticism, nevertheless, provides valuable insight into not only why the drafters of the Law tabled

the adoption of specific thresholds at this time, but also how it will likely shape the forthcoming implementing regulations.

Thresholds Based on Market Share Likely to Be Disfavored

First, ambiguous thresholds based on parties’ market share in China—adopted by both the Regulations and prior drafts of the Law—may ultimately be discarded. The current rules trigger notification obligations when any of the parties to the transaction controls 20 percent or more of the Chinese market pre-merger or attains 25 percent or more of the Chinese market as a result of the transaction. In contrast, however, neither the US nor the EU merger laws exhibit similar market share thresholds and it is easy to see why: market share presupposes a certain product and geographic market definition, which lies at the core of every antitrust analysis of mergers. Parties in China, therefore, were forced into a position in which they divined, often arbitrarily, their own market definition and market share. Overestimating market shares forced the parties partially to concede that their transaction was anticompetitive. On the other hand, underestimating market shares to avoid notification created significant noncompliance risks in China. The Law in its final language appears to recognize this tension and articulates, for the first time, a legal standard for market definition that is substantially aligned with the US and EU standards. The articulation of this legal standard also signals that AMC, rather than the merging parties, will likely bear the task of judging parties’ market share—likely removing this concept from pre-notification considerations.

Law Continues to Suffer From Lack of Jurisdictional Nexus to China

Second, the Law’s final implementing regulations are also likely to incorporate greater compliance fairness, most likely by adopting notification thresholds that demand the transaction’s clear competitive nexus to China. The Regulations and the prior drafts of the Law both predicated pre-merger notification

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on *any* party to a transaction meeting specified asset or sales thresholds in China. This significantly compounded compliance burdens, particularly for large multinationals operating in China, by triggering notification even for mergers that produced little or no increase in market concentration within China. For many US corporations with sufficient assets or sales in China, the rules triggered notification even when acquiring a target in far-flung regions outside China that had neither operations nor sales in China. In contrast, antitrust thresholds in both the US and the EU emphatically demand competitive nexus to their territories by requiring the target firm to have minimum thresholds of sales and/or assets in the United States and to generate certain annual turnover within the EU territories, respectively.

In an effort to allay this concern, the drafters of the Law have now specifically addressed the scope of extraterritorial application of the Law. Under Article 2, the Law expressly limits its application to concentrations outside China only when such concentrations have “the effect of eliminating or restricting competition in the *domestic* market”—a provision that seemingly conflicts with the current rules. This affirmative restraint of jurisdiction, significant in itself in the context of Chinese lawmaking, brings the Law one step closer to harmonization with the US and EU standards and may portend the implementation of thresholds that are predicated on domestic sales and assets of *both* parties to a transaction.

Consultative Process at AMC Could Substantially Improve Transparency

Third, even if the implementing regulations do not introduce thresholds that are explicitly tied to domestic competitive effect, the increasing fluidity and transparency exhibited by MOFCOM in its recent merger practices strongly suggest that AMC could retain sufficient administrative authority either to waive notification requirements or limit its burdens for appropriate transactions. For instance, MOFCOM has recently introduced a pre-notification consultative process, during which parties to a transaction may request informal

discussions with the agency's staff to assess the scope and burden of notification obligations—akin to a pre-filing discussion that is familiar to the EU procedure. Although the Law is currently silent on AMC's advisory consultative authority, prior drafts have explicitly empowered the agency to “adjust the standard for notification,” making it probable for the provision to find its way back into the implementing regulations upon incorporating final thresholds. If so, the procedure could provide a ready mechanism by which AMC's staff could quickly dispose of transactions that raise little or no competitive concern, such as purely foreign-to-foreign transactions, acquisitions of non-voting securities and other *de minimus* acquisitions. These transactions are already exempt from notification under the US laws.

Timetable for Agency Merger Review

The Law establishes a timetable for merger review that, while not identical, is substantially analogous to both the US and EU process. Unlike its shortcomings on notification thresholds and extraterritoriality, however, the merger review process under the Law appears to provide surprising predictability and transparency in some areas that the corresponding US provisions lack. These “pockets” of advantages may be well worth noting.

The Law initially grants AMC 30 days from the date of notification to review the transaction to determine if it warrants further antitrust review. This period is analogous to the initial 30-day Hart-Scott-Rodino (HSR) waiting period in the US and the preliminary 25-day waiting period afforded under Phase-I review in the EU. However, the Law appears to afford one significant timing advantage over the US rules for transactions that are critically time-sensitive: the Law does not appear to punish parties' incomplete submission of materials by restarting the statutory waiting period, as the US rules permit the antitrust agencies to do. In the US, omitted or inaccurate materials in the parties' regulatory filing, particularly those relating to competitive analyses of contemplated transactions (so-called “4(c) documents”), could force the parties to re-file and restart the regulatory review

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period, dealing a substantial delay to time-sensitive acquisitions. However, the treatment of incomplete submission under the Law is substantially more lenient, mandating the parties simply to “file [missing] supplementary documents and materials within the time limit specified by the [AMC].” In other words, the Law, in its present form, does not tie incomplete submission to setbacks in the statutory waiting period, effectively allowing the mandatory waiting period under the Law to continue to run while the parties remedy their filing deficiencies in consultation with AMC’s staff. This may allow parties under tight transaction schedules, in appropriate circumstances, to initiate regulatory review early by submitting notification first and amending its deficiencies over time, without fear of holding up the waiting period.

In addition, the Law also has the benefit of establishing a fixed, maximum statutory review period—an element absent under the US law. Following the initial 30 days of review, AMC may initiate further review by extending the review period for up to 90 additional days. If AMC exhausts 120 days of review, it may further extend its review period by up to 60 days only in very limited circumstances specified under the Law. All in all, the Law requires AMC to reach a final decision on transactions within 180 days from the date of notification, regardless of circumstances. If no decision issues within this period, the Law expressly permits the parties to close their transaction. This review period is noticeably shorter than that observed for many competitively problematic mergers in the US, where the regulatory waiting period remains open-ended and can at times be extended much longer by agreement between the parties.

National Security Review and Other Less Traditional Antitrust Issues Affecting Merger Review

Despite its focus on antitrust, the Law leaves ample room to incorporate either non-antitrust or less traditional antitrust considerations into its merger review—potentially undermining the transparency

and legitimacy of the process. These subjective factors have garnered much press attention in recent months and three provisions are worth noting here. First, under Article 31, the drafters of the Law added, fairly late in the drafting process, a national security review provision—analogous to and mostly likely motivated by national security review process in the US, undertaken by the Committee on Foreign Investment in the United States (CFIUS). The Law is sparse on detail and does not specify how the review will be carried out, but some predict that a sister antitrust agency, the National Development and Reform Commission (NDRC), could undertake this review. The scope of review could also be much broader than that in the US, considering not only factors relevant to national security concerns, but also issues affecting a broader Chinese economy, including job security, economic stability, protection of important national brands and technologies.

Second, Article 27 of the Law instructs AMC to consider not only core antitrust concepts such as the degree of post-merger market concentration and entry barriers, but also less tangible economic concepts such as the merger’s effect on “technological progress,” “the development of the national economy,” and any “other factors” that AMC “deems relevant” to market competition. Article 28 adds even greater ambiguity to the process by allowing an otherwise anticompetitive merger to proceed if its “positive effects” “obviously outweigh its negative effects” or the merger is “in the public interest.”

Despite the Law’s opaqueness, however, recent comments from high-ranking government officials in China provide some texture to these languages. For instance, Cheng Siwei, Vice Chairman of the Standing Committee of the National People’s Congress, has recently stated that he views correct valuation of target firms and the potential for future “asset growth” of firms as two key factors in reviewing cross-border mergers. Viewed in this context, factors contributing to “technological progress,” “the development of the national economy” or “positive effects” of mergers may include a host of meaningful arrangements that parties could contemplate in advance of merger review, such

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as licensing or transfer of intellectual property rights, introduction of new products or services that spur further innovation or potential collaboration efforts in product and research development in China.

The fluid set of factors at play under Articles 27, 28 and 31 suggests that some of these broader economic considerations may overlap and reinforce one another during review. Nonetheless, merging parties could also take proactive steps in the planning stages. For example, parties could identify all assets in the target firm early on that may raise potential national security concerns and craft a “fix-it-first” solution—such as a spin-off of specific business units—to separate problematic assets from antitrust review. Parties should also proactively consider negotiating an agreement that incorporates provisions to best buttress the argument that the transaction will spur competition for new products and greater technology innovation in the Chinese market.

Conclusion

China's overall efforts and transparency to bring its merger control laws in line with the prevailing global standards have been nothing less than praiseworthy. Despite the largely harmonized standards, however, merger control process in China is likely to demand, at least in the near term, more art and diplomacy than science until AMC gains sufficient independence and antitrust expertise to guard against strong domestic political cross-currents. Mindful of this dynamic, counsel

advising on mergers and acquisitions in China should develop, as early in the transaction life cycle as possible, advocacy strategies and materials that are specifically tailored to communicate its pro-competitive qualities—in view of both antitrust theories and broader economic development considerations in China. In light of China's strong commitment to market reforms, counsel who can effectively bridge the regulatory gap by conveying mutual benefits of the transaction on both core antitrust and uniquely domestic economic concerns, should be able to substantially allay anxiety for firms facing merger review before AMC.

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