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China's MOFCOM Finalizes Two Merger Control Rules

On November 27, 2009, China's Ministry of Commerce ("MOFCOM") published two merger control rules: Rules on the Notification of Concentrations between Undertakings (the "Notification Rules") and Rules on the Examination of Concentrations between Undertakings (the "Examination Rules"). Both will come into force on January 1, 2010.

I. BACKGROUND

MOFCOM, the Chinese agency responsible for merger control, has actively developed a body of implementing rules since the Chinese Anti-Monopoly Law (the "AML") came into effect on August 1, 2008.[1] In January 2009, MOFCOM published for comment, among others, drafts of the provisional Notification Rules and the provisional Examination Rules.[2] After review of the comments received, in March 2009, the Legislative Affairs Office of the State Council published second drafts for another round of public comment. MOFCOM finalized the Notification Rules and the Examination Rules on November 27, 2009.

Combined with the Guidelines on Notification of Concentrations between Undertakings (the "Notification Guidelines") and the Guidelines on Notification Documents and Materials, both adopted in January 2009, the Notification Rules set out the basic procedures for the notification of transactions under the merger control provisions of the AML. Similarly, together with the Guidelines on Merger Control Examination of Concentrations between Undertakings, also adopted in January 2009, the Examination Rules provide an overview of MOFCOM's procedures for the investigation of notified transactions.

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1 A table summarizing these rules is attached to our Alert Memorandum, "*China's Anti-Monopoly Law: One Year On*", available at http://www.cgsh.com/chinas_anti-monopoly_law_one_year_on/.

2 Please see our Alert Memorandum on the draft provisional rules published in January 2009 (the "January Alert"), available at http://www.cgsh.com/proposed_merger_control_rules_under_the_chinese_anti_monopoly_law/.

II. ANALYSIS OF THE NEW RULES

A. THE NOTIFICATION RULES

The final version of the Notification Rules provides less detail than the first and second drafts, leaving many questions unanswered. This is consistent with other Chinese rules and guidelines, which, perhaps purposefully, are quite vague and leave significant discretion to the antitrust enforcement authorities. We understand that additional clarification may be provided by an upcoming revision to the Notification Guidelines.

Some of the major issues and outstanding questions are summarized below:

1. Definition of Control

Under the AML, a concentration arises when two or more undertakings merge or when an undertaking obtains "control" or "decisive influence" over another undertaking. In the January Alert, we noted that while the draft Notification Rules provided some additional information regarding the definition of "control", the definition remained vague, and we noted that the relation between the AML's conception of "control" and "decisive influence" was unclear. The final Notification Rules completely omit the draft's definitional language.

The deletion of the proposed clarification of the definition of "control" leaves MOFCOM with greater discretion and flexibility with respect to its jurisdiction over transactions other than straightforward acquisitions or mergers, such as joint ventures. In such cases, companies will continue to face uncertainty as to whether a particular transaction results in the acquisition of "control" or "decisive influence," and thus (when the notification thresholds are met) a filing obligation.

2. Joint Ventures

The final Notification Rules also omit somewhat confusing language from the drafts dealing with the treatment of joint ventures. The draft Notification Rules confirmed that the joint establishment of a new entity by two or more undertakings qualified as a concentration under Article 20 of the AML. The draft did not, however, clarify whether a joint venture is notifiable regardless of whether it is "full function" or whether one or more undertakings will have "control" over the venture.

The discussion of this issue has been dropped in the Notified Rules, again leaving companies with greater legal uncertainty than had been expected. We understand, however, that MOFCOM takes the view that notification of joint ventures is captured by the existing language in Article 20 of the AML, which states that a concentration includes "obtaining control of or the capability to exercise decisive influence over other

undertakings by contract or other means." This language says nothing about joint control or whether a joint venture must be "full function" to qualify as a notifiable undertaking. Thus, a joint venture that would be considered "competitive" and not subject to merger control in the EU might require notification in China.

3. Calculation of Turnover

The Notification Rules confirm that, when a transaction involves an acquisition of control over part of an undertaking, only the turnover of the target or the turnover generated by the assets being sold, as opposed to the turnover of the seller's entire corporate group, should be taken into consideration when determining whether the transaction exceeds the turnover thresholds. While the draft Notification Rules also contained this language, MOFCOM officials have provided varying advice regarding this topic.

In addition, MOFCOM deleted language explicitly excluding from "Chinese turnover" revenue generated by sales in Hong Kong, Macau, and Taiwan. It should be noted, however, that this exclusion has been common practice since 2003, well before the language was included in the draft Notification Rules. Thus, the deletion of this language does not appear to represent a change in MOFCOM's position that Hong Kong, Macau and Taiwanese revenue should not be included in applying the turnover thresholds.

As before, concentrations between the same companies or between companies belonging to the same groups that take place within a specified period of time are treated as one concentration for purposes of applying the mandatory notification thresholds. The Notification Rules increase the relevant time period from one year to two.

4. Documentary Submissions

The draft Notification Rules required the submission of extremely broad and ill-defined categories of documents "in support of the concentration agreement" (examples given in the draft included feasibility studies of the concentration, due diligence reports, research reports on industry development, reports on the concentration plan, and forward-looking reports on the development prospects after the transaction). This requirement is eliminated from the final Notification Rules. Instead, Article 11 makes the submission of these kinds of documents voluntary. On the other hand, Article 10 leaves room for MOFCOM to demand "other documents and materials required by the Ministry of Commerce." This change also results in an inconsistency between the Notification Rules and the Notification Guidelines adopted in January 2009.

5. Two Continuing Issues

Under the Notification Rules, MOFCOM retains complete discretion to determine whether a notification is complete and to refuse to accept the notification for an indefinite period of time until it is satisfied. This issue could prove especially significant given the lack of clarity in the Notification Rules about which documents and information will be required.

As expected, the final Notification Rules did not institute any kind of short form notification or simplified procedure for non-controversial cases.

Together, the uncertainty involved in preparing a notification that MOFCOM will consider complete, without including extensive information that may not be required, suggests that notifying parties may wish to engage in pre-notification discussion with MOFCOM at least in complicated cases.

B. THE EXAMINATION RULES

The Examination Rules are largely unchanged from the published drafts. The following issues and changes are worth noting:

Like the draft rules, the final Examination Rules do not contain detailed provisions on the methods by which MOFCOM may collect evidence. The Examination Rules allow the notifying parties to submit materials or make statements in defense of the transaction. MOFCOM may seek the opinions of other government agencies, industry associations, customers, and other undertakings.

MOFCOM may also convene hearings to which it may invite notifying parties, competitors, customers, suppliers, and experts, as well as representatives of other government agencies, industry associations, and consumers. Separate hearings may be held for confidentiality reasons. Unlike the draft rules, the final Examination Rules do not mention the creation of a written record of hearings.

If MOFCOM determines that a more in-depth investigation (a "Phase II" review) is required, pursuant to the Examination Rules it must inform the parties of its concerns and provide them with an opportunity to respond. Such a "Statement of Objections" was optional under the draft rules. Unlike in the EU and certain other jurisdictions, in China the opening of a Phase II review does not appear to trigger any special procedural requirements, and transactions can be cleared early in Phase II if MOFCOM determines that the transaction does not raise significant substantive issues.

During the review process, the undertakings concerned may propose remedies to eliminate or reduce any potential anti-competitive effects of the transaction. The draft

rules gave MOFCOM the express power to propose remedies. Although this power is not contained in the final rules, MOFCOM will still likely be closely involved in formulating any proposed remedies. The undertakings concerned and MOFCOM may modify the proposed remedies or propose new ones during the review process.

Remedies may include structural remedies, behavioral remedies, and combinations thereof. Over the past year, we have seen MOFCOM adopt each of these categories of restrictive condition. As a general rule, MOFCOM appears to be more open to accepting behavioral remedies than the U.S. or EU competition authorities.

The draft rules and MOFCOM's decisions were inconsistent in stating whether proposed remedies had to completely remove anti-competitive effects or whether remedies alleviating such effects could suffice. The Examination Rules clarify that either may suffice.

III. CONCLUSION

MOFCOM's continuing efforts to create a body of merger control law and regulations are commendable. On the other hand, the new rules, particularly the Notification Rules, do little to provide transaction parties with the clarity and certainty needed to allow for effective planning. Perhaps with time, sufficient, consistent decisional precedent will help clarify these issues.

MOFCOM has published drafts of a number of other merger control implementing measures that still have not been finalized. These are: draft Provisional Rules on the Investigation and Handling of Concentrations between Undertakings that are not Legally Notified, draft Provisional Rules on the Collection of Evidence regarding Concentrations between Undertakings below the Thresholds but Suspected of being Anti-Competitive, and draft Provisional Rules on Investigation and Handling of Concentrations between Undertakings below the Thresholds but Suspected of being Anti-Competitive.

We also understand that MOFCOM is editing the Notification Guidelines, drafting guidelines on the definition of "undertakings concerned" and developing substantive guidance on its analysis of the competitive effects of transactions.

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Antitrust and Competition under the "Practices" section of our website at http://www.clearygottlieb.com.

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