



THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY

China's Anti-Monopoly Law: An Early Report Card

Lester Ross

Wilmer Cutler Pickering Hale and Dorr LLP

China's Anti-Monopoly Law: An Early Report Card

Lester Ross¹

I. INTRODUCTION

China's Anti-Monopoly Law ("AML") took effect on August 1, 2008. Even before then, officials had been busy creating enforcement structures and drafting regulations to implement the AML. Because it proved politically impossible to create a single unified enforcement department, the three pre-existing government departments with competition-related enforcement functions have been assigned AML enforcement functions under the AML. The Ministry of Commerce ("MOFCOM") has responsibility for concentrations, the State Administration for Industry & Commerce ("SAIC") has responsibility for anti-monopoly agreements (other than price-fixing) and unilateral abuse of dominance, and the National Development and Reform Commission ("NDRC") has responsibility for price-fixing agreements. To avoid potential jurisdictional conflicts, NDRC and SAIC have concluded an internal agreement specifying that authority with respect to the investigation of agreements will lie with the department which first lists (li'an) the matter. The Anti-Monopoly Commission ("AMC"), which was newly created by the AML with responsibility for research, investigations for overall market conditions, policy guidelines and coordination among the three departments, does not yet appear to have had its working rules formulated by the State Council.

MOFCOM, which previously had handled competition issues involving transactions through its Department of Treaty and Law, has created a separate Anti-Monopoly Bureau under the former Director-General of the Department of Treaty and Law to handle its expanded work load under the AML. SAIC has created an Anti-Monopoly Enforcement Division under the renamed Anti-Monopoly and Anti-Unfair Competition Enforcement Bureau, which is responsible for enforcement of the AML as well as the Anti-Unfair Competition Law ("AUCL"), the latter of which is a longstanding SAIC function. The NDRC, which has overall responsibility for price regulation with respect to those commodities subject to command prices or guidance prices, assigned its responsibility to its Price Supervision and Inspection Bureau.

¹ Lester Ross is co-partner-in-charge of WilmerHale's Beijing office and a partner in the firm's Asia Corporate Practice Group.

II. REGULATIONS

Regulations are being drafted to implement the AML. Within days after the AML took effect the State Council (not the AMC) promulgated the *Regulations Concerning the Standards for Notification of Concentrations of Undertakings* (the “Standards Regulations”). The Standards Regulations set two alternative notification thresholds: (a) worldwide turnover of all parties in the preceding year of 10 Billion Renminbi, including turnover of 400 Million Renminbi for at least two of the parties, or (b) turnover in China of all parties in the preceding year of 2 Billion Renminbi, also including turnover of 400 Million Renminbi for at least two of the parties. Special thresholds are to be set for concentrations in the financial industry, but these have yet to be formulated. The Standards Regulations are not sufficiently clear with respect to certain issues, e.g., whether turnover calculations in an asset acquisition should be based only on turnover of the target’s relevant assets (although this is apparently the case in practice). Moreover, while those concentrations which do not meet either threshold are exempt, the Standards Regulations allow MOFCOM to initiate an investigation *sua sponte* if the facts indicate an actual or potential danger to competition in China. Acquirers should, in practice, consider meeting with MOFCOM in advance of closing to explain why particular concentrations which impact China but do not meet the thresholds also do not constitute a danger to competition under the AML.

MOFCOM has also drafted four pending sets of regulations and rules with respect to the review of concentrations: *the Provisional Measures on the Notification of Concentrations between Operators*, *Provisional Measures on the Review of Concentrations between Operators*, *Provisional Measures on the Handling of Investigations of Concentrations between Operators Not Notified in Accordance with Law*, and *Provisional Measures on the Collection of Evidence for Suspected Monopolistic Concentrations between Operators Which Do Not Meet the Notification Thresholds*. These four sets of regulations are directed at the obligation to notify and the content of notifications, the review of concentrations, the investigations of concentrations which meet the notification thresholds but have not been notified, and the initiation of proceedings with respect to concentrations with potentially monopolistic features which do not meet the notification thresholds.

SAIC has drafted five pending sets of regulations and rules to implement its functions under the AML: *the Regulations on the Prohibition of Monopoly Agreements*, *Regulations on the Prohibition of the Abuse of Dominant Market Positions*, *Regulations on the Prohibition of Administrative Monopolies*, *Rules on Procedures for the Investigation and Penalization of Monopoly Agreements and Abuse of Dominant Market Positions*, and *Rules on Procedures on Prohibiting the Abuse of Administrative Authority to Eliminate or Restrict Competition*. Two sets of regulations and one set of procedures are directed at monopoly agreements and/or abuse of dominant market positions. One set of

regulations is directed at administrative monopolies, i.e., government-created monopolies that have not been expressly approved by the central government in conformity with the AML, while one set of procedures is directed at the conduct of enforcement personnel.

The NDRC has yet to release any regulations, even in draft form, with respect to its responsibilities.

III. ENFORCEMENT

As of this time there has been no public indication that the SAIC or the NDRC have conducted enforcement proceedings under the AML, in part because implementing regulations have yet to be promulgated. MOFCOM by contrast has been actively involved in reviewing concentrations in continuation of its role with respect to acquisitions by foreign parties (but not domestic parties) under the 2003 *Provisional Regulations Regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* and their successor 2006 *Regulations on Mergers and Acquisitions by Foreign Investors* (collectively, the "Foreign Investor Regulations"), the latter of which has not been abolished and therefore formally remains in effect. The AML has provided MOFCOM with the enforcement power to sanction a failure to notify and other actions that it lacked under the Standards Regulations.

As of March 18 MOFCOM had received some 40 concentrations for review, of which 29 had been listed, i.e., accepted for review. Of these 29, some 23 were cleared without conditions and one (InBev's acquisition of Anheuser-Busch) was cleared with conditions, in particular, a requirement that any future percentage increase in their existing investments in China be subject to clearance under the AML. As there was apparently no *de minimis* exception to this condition, it effectively constituted a warning to InBev as the surviving party that any future acquisition in the beer industry affecting China would likely be subject to heightened scrutiny. In other words, MOFCOM was using the occasion of its clearance of one concentration to advise the parties to refrain from as yet unannounced prospective or future acquisitions. This would be in addition to other approval requirements for foreign investment.

IV. COCA-COLA-HUIYUAN

March 18 was also the date on which MOFCOM made its long-awaited decision on Coca-Cola's proposed acquisition of China Huiyuan Juice Group Ltd. (Huiyuan), a Hong-Kong listed producer of fruit juices in China. This was MOFCOM's first rejection of a concentration and, to its credit, the first time that MOFCOM published an explanation of a decision under the AML.

Although based in China, Huiyuan is incorporated in the Cayman Islands. This concentration, as an offshore transaction, would not have been subject to review by any

Chinese government authority prior to the institution of anti-monopoly review. But under the AML, any concentration that meets the applicable thresholds is subject to mandatory notification.

MOFCOM's practice is to subject a notification to extensive preliminary review for completeness before commencing the formal review. In this instance MOFCOM took nearly two months to accept the notification for review after submission, and followed that with the statutory 30-day first phase review and a nearly 90-day second phase review. The review might have been extended had the contract not provided a deadline for closing the acquisition. Active discussion to address MOFCOM's concerns took place during this period between MOFCOM and Coca-Cola, which had offered a nearly 200 percent premium to Huiyuan's shareholders.

Under Article 27 of the AML, MOFCOM was required to consider several factors in its review, including market shares and ability to control the market, the degree of market concentration, and the effect of the transaction on market access and technological progress. Other factors for MOFCOM to consider were the effect of the transaction on consumers, other undertakings, and national economic development.

MOFCOM considered that Coca-Cola's dominant position in the carbonated beverages market could enable it to bundle or tie the purchase of fruit juice beverages to the purchase of carbonated beverages or to control the fruit juice market through other means. MOFCOM stated that these possible actions would restrict competition in the fruit juice market to the detriment of consumers, who could be forced to pay higher prices and have fewer choices. MOFCOM further stated that smaller domestic competitors would be pushed out of the market, in part because Coca-Cola would acquire Huiyuan's leading "domestically-owned" fruit juice brands. Indeed, published reports indicated that MOFCOM was prepared to clear the concentration subject to conditions, most crucially divestment of Huiyuan's brands.

MOFCOM, in accordance with Coca-Cola's submission, determined that the relevant product market was the vegetable and fruit juice market rather than the broader soft drinks market, because of the low substitutability of fruit juice with carbonated beverages (in which Coca-Cola reportedly held a 52.5 percent market share), or the narrower pure juice and fruit nectar markets (in which Huiyuan reportedly held 42.6 percent and 39.6 percent market shares, respectively) because of the high substitutability of such products with beverages containing varying proportions of juice. While this determination was reasonable, MOFCOM's ultimate rejection of the concentration is troubling for several reasons.

First, the combined market shares of Coca-Cola (11.8 percent) and Huiyuan (8.5 percent) in the vegetable and fruit juice market was a mere 20.3 percent, much lower

than the norm for determining the existence of a concentrated market under the widely accepted HHI Index. This distinguishes the instant concentration from the Australian Competition and Consumer Commissions' rejection in 2003 of Coca-Cola Amatil Limited's proposed acquisition of Berri Limited, an Australian juice producer with a market share just shy of 50 percent.

Second, as described earlier, authority for enforcement of the AML is divided among MOFCOM, SAIC, and NDRC. MOFCOM's authority to review concentrations is based on Chapter IV of the AML. To the extent that it based its determination on the potential for the combined entity to engage in bundling or tying, MOFCOM was straying into SAIC's authority to regulate monopoly agreements under Chapter II of the AML. In other words, MOFCOM could have approved the concentration subject to a restriction on bundling or tying. Doing so, would, however, have constituted relinquishing some of its power to SAIC. The rejection of this concentration thus appears to constitute evidence of an incipient bureaucratic rivalry between MOFCOM and SAIC based on the division of enforcement authority among different government departments.

Third, MOFCOM appears to have reasoned that an increase in market share through acquisition by a technologically sophisticated and well-capitalized undertaking is inimical to consumer interests. However, the concept of consumer welfare, a hallmark of competition law in the United States that is increasingly recognized elsewhere in the world, was not mentioned in MOFCOM decision. Conversely, MOFCOM's decision appears to have given considerable weight to the interests of domestic competitors, whose interests are not necessarily aligned with those of consumers.

Fourth, MOFCOM's apparent conditioning of approval on the divestment of trademarks suggests some resonance with the 2006 Foreign Investor Regulation which treated Chinese ownership of brands and trademarks as factors to be considered in the review of concentrations by foreign parties. Moreover, there was a great deal of popular opposition to the transfer of ownership of a prominent Chinese trademark official, albeit one barely 20 years old, to foreign ownership on bulletin boards among so-called netizens. Although MOFCOM stated that such pressure did not impact its review, such pressure may nevertheless have exerted some influence.

The Coca-Cola-Huiyuan determination indicates that acquisitions by foreign parties of successful Chinese-owned parties may encounter difficulty under the AML. This is particularly so if the acquiree has a brand or trademark around which patriotic fervor can be aroused, even in a consumer products industry with no evident linkage to national security. This may adversely impact Chinese consumers, as well as shareholders, the latter of whom will be less likely to enjoy acquisition premiums.

V. THE COURTS AND INDUSTRY

Private parties have begun to make use of the civil litigation provision of the AML. While the courts have issued few if any decisions on AML suits, litigation has nevertheless had an impact in some instances. The insurance industry provides an example. After the AML went into effect, a suit was filed against the Chongqing Insurance Association in Chongqing, its domicile, for requiring automobile insurers to follow the Association's guidelines on premiums. The plaintiff alleged that this violated Article 16 of the AML which bars industry associations from organizing undertakings in their industry to engage in monopoly conduct in violation of the provisions concerning monopoly agreements. Indeed, industry associations are obligated under Article 11 to guide undertakings in their industry to engage in competition in accordance with law. The case was settled in December when the Association modified its provision to specify that only companies or their parent companies had the right to set premiums.

The Insurance Association of China, which represents the industry on a nationwide basis, then convened discussions on the impact of the AML on the industry. Drawing upon U.S. and European practice, member companies were advised not to engage in price fixing, the allocation of markets on a consumer or geographic basis, setting unjustifiably high market entry barriers, and/or industry self-disciplinary measures that constituted a restraint on competition. Insurance associations across the country were instructed to conduct themselves and to educate their members with respect to compliance.

VI. CONCLUSION

China's AML has been in effect for less than a year. The enforcement authorities are progressing with respect to structure and regulations. The Coca-Cola-Huiyuan decision has aroused concern that the competition provisions are being applied in a manner that is biased against foreign acquirers of Chinese companies. This should not be construed as a more general trend to disfavor foreign investment, however, as MOFCOM in particular has recently promulgated measures to simplify some foreign investment approval procedures and the Chinese government has spoken out strongly against protectionism. The AML moreover appears to be having a pro-competitive impact in some respects as shown with regard to the insurance industry.