

MOFCOM Solicits Comments on Draft Merger Remedies Rules

On March 27, 2013, China's Ministry of Commerce ("MOFCOM") published for public comment "Rules on Attaching Restrictive Conditions to Concentrations between Undertakings (Draft for Comment)" (the "Draft Rules").¹ As the first comprehensive guidance on merger remedies under the Chinese Anti-Monopoly Law (the "AML"), the Draft Rules address a wide range of issues, including the design, implementation, monitoring, modification and waiver of merger remedies, as well as liability for breach.

The Draft Rules provide welcome clarity on a number of issues. For example, the Draft Rules provide that MOFCOM must inform notifying parties about the nature of its concerns, and they include new details on the timetables for proposing and implementing merger remedies, in particular divestitures. On the other hand, the Draft Rules provide no guidance regarding the circumstances in which MOFCOM intends to apply the types of unusual behavioral remedies that it has required in a number of recent cases. The Draft Rules also include a worrying new provision allowing MOFCOM unilaterally to impose stricter remedies after the fact when it concludes that the originally approved remedies were insufficient.

MOFCOM will accept comments on the Draft Rules until April 26, 2013. It is to be hoped that MOFCOM's final rules will address the shortcomings in the Draft Rules. In past consultations, however, MOFCOM has tended to respond to criticism by deleting or shortening controversial provisions rather than by making significant substantive revisions. It seems likely, therefore, that the final rules will continue to leave significant questions unresolved.

I. BACKGROUND

The AML allows MOFCOM to impose remedies to lessen the negative impact of a concentration on competition (Article 29) and obliges MOFCOM to make public in a timely manner decisions imposing restrictive conditions on a concentration (Article 30). When analyzing whether remedies are required, MOFCOM may consider the impact of the concentration on consumers and other relevant enterprises, as well as on the development of the national economy (Article 27).

¹ See <http://tfs.mofcom.gov.cn/article/as/201303/20130300068492.shtml>.

MOFCOM has addressed certain issues relating to merger remedies in prior rules and interpretations, but these measures do not provide a comprehensive framework. MOFCOM's Provisional Rules on Divestitures of Assets or Businesses to Implement Concentrations between Undertakings (the "Divestiture Rules"), adopted on July 5, 2010, deal with certain aspects of divestitures as merger remedies.² MOFCOM's Examination Rules on Concentrations between Undertakings (the "Examination Rules"), Interpretation regarding Rules on Notification of Concentrations between Undertakings and the Examination Rules (the "Interpretation") and Provisional Rules on Examining Competition Effects of Concentrations between Undertakings (the "Competition Effects Rules") also contain general provisions on merger remedies.

The Draft Rules are intended to provide a comprehensive set of merger remedies rules under the AML. The Draft Rules reflect the input of experienced practitioners and scholars and other antitrust authorities consulted by MOFCOM, including during closed-door seminars in April and August 2012. Participants in the August seminar discussed an unpublished advance draft of the Draft Rules (the "August Draft"), which were more detailed in some respects than the Draft Rules..

II. KEY ISSUES IN THE DRAFT RULES

A. Principles for Assessing Potential Merger Remedies

The AML and the existing rules and interpretations do not clearly set out the criteria for the assessment of merger remedies. Article 29 of the AML and Article 13 of the Competition Effects Rules require that merger remedies "*lessen*" competition concerns arising out of relevant transactions. However, the Examination Rules (Articles 12 and 13) refer to remedies "*removing*" competition concerns, apparently setting a higher standard. Article 2 of the Draft Rules provides that MOFCOM may attach restrictive conditions that "*lessen*" the negative impact of concentrations, thus following the more flexible AML test.

In addition, Article 9 of the Draft Rules sets out general principles that MOFCOM will use to assess proposed remedies, namely a remedy's effectiveness, viability, and timeliness.

B. Types of Merger Remedies

The Draft Rules divide merger remedies into three types: (i) structural remedies; (ii) behavioral remedies; and (iii) hybrid remedies (Article 5). Unlike the August Draft, the Draft Rules do not list specific examples of structural remedies or behavioral remedies.

² Regarding the Divestiture Rules, please see our alert memorandum "China's MOFCOM Issues Provisional Rules on Divestiture Remedies", available at http://www.cgsh.com/chinas_mofcom_issues_provisional_rules_on_divestiture_remedies/.

Unlike the EU and the United States remedies rules, which state a clear preference for structural remedies, in particular divestitures, in connection with horizontal mergers, the Draft Rules provide no guidance on the situations in which structural or behavioral remedies may be appropriate. In practice, MOFCOM has preferred behavior remedies over structural remedies: ten of MOFCOM's 16 conditional decisions appear to involve pure behavioral remedies.³

C. Submission of Proposed Remedies

Unlike the EU and U.S. procedures, the AML and existing rules and interpretations provide no clear mechanism for MOFCOM to inform notifying parties of the precise nature of competition concerns that should be addressed by remedies. The Draft Rules remedy this gap by stating that MOFCOM should identify and explain its competition concerns “*at an appropriate point,*” and request that the notifying parties propose remedies (Article 7). Although this is a welcome addition, it remains to be seen how early MOFCOM will be willing to identify its concerns.

According to the Draft Rules, when MOFCOM identifies its competition concerns it will specify a time period during which the notifying parties may propose merger remedies to address those concerns. Notifying parties also may propose remedies before MOFCOM identifies its competition concerns (Article 8). Article 11 provides that the final remedy proposal shall be submitted no later than 20 days before the last day of the review process. This provision apparently sets an outer limit for the submission of remedies of 160 days from MOFCOM's “acceptance” of a notification, *i.e.*, 20 days before the end of MOFCOM's extended Phase II review period. The Draft Rules further provide that if the notifying parties do not propose remedies in the specified time period or do not propose remedies that are sufficient to lessen the negative impact of the concentration on competition, MOFCOM shall prohibit the concentration (Article 8).

The Draft Rules provide greater flexibility than the EU rules, which set out a detailed timetable for the submission of remedies in Phase I or Phase II and possible extensions of the Commission's review period to give it more time to assess proposed remedies. As a result, although the additional detail is helpful, it seems likely that MOFCOM's practice in relation to the timing for the submission and assessment of merger remedies will continue to be less predictable than in the EU.

³ ARM/G&D/Gemalto, Wal-Mart/Yihaodian, Google/Motorola, Henkel HK/Tiande/JV, Seagate/Samsung, GE/Shenhua JV, Uralkali/Silvinit, Novartis/Alcon, GM/Delphi, and InBev/AB involved pure behavioral remedies, while three decisions (*i.e.*, Western Digital/Hitachi, Panasonic/Sanyo and Mitsubishi Rayon/Lucite decisions) involved a combination of behavioral and structural remedies.

Unlike the August Draft, the Draft Rules do not mention any form to be used with remedy proposals or otherwise clarify the information parties need to provide when proposing remedies.

D. Market Testing of Remedy Proposals

Article 10 provides that MOFCOM may solicit comments from relevant government agencies, industry associations, undertakings and consumers, including by issuing questionnaires and holding hearings. The August Draft provided that MOFCOM could publish proposed remedies for public comment, as in the U.S. This procedure is not reflected in the Draft Rules.

E. Implementation

The Draft Rules' discussion of the implementation of merger remedies focuses mainly on divestitures. In particular, the Draft Rules detail the steps involved in the divestiture process and, like the Divestiture Rules, the criteria that a buyer must satisfy to be deemed suitable. The Draft Rules also set out new procedures for the use of up-front buyers or fix-it-first remedies or the submission of alternative "crown-jewel" divestiture assets where there is significant doubt about the notifying parties' ability to complete the divestiture.

1. Divestiture Process

The Draft Rules largely incorporate the provisions of the Divestiture Rules regarding the divestiture process, but they make a number of clarifications and additions, in particular in relation to the time periods for completion of divestitures.

The Draft Rules clarify two distinct time periods in the self-divestiture process: (i) an initial period for the notifying parties to find a suitable buyer and sign an agreement (Article 17); and (ii) a period after the purchase agreement is signed during which the divestiture must be completed (Article 20). The first period will be set in the review decision, but if not otherwise specified, this period will be 6 months, subject to extension by up to three months. The second period is set as three months, which may be extended by up to one month. These periods are in line with the EU Commission's practice; U.S. authorities often allow less time for divesting parties to complete an approved divestiture.

2. Suitable Buyer

The Draft Rules are largely in line with the Divestiture Rules with regard to the requirements that must be met for a divestiture buyer to be considered suitable (Articles 15, 16, and 21).

In line with EU remedies practice and typical U.S. practice, the Draft Rules (Article 15) add a requirement that the buyer not purchase the divested business by raising capital from the undertakings participating in the concentration. In addition, Article 21 adds that the transaction must receive clearance from MOFOCM if the transaction reaches the standard merger control notification thresholds. In the U.S., by contrast, divestitures need not obtain a separate merger clearance.

3. Up-Front Buyer Divestitures

In a standard divestiture, the notified transaction may be closed immediately after MOFCOM issues its review decision, well before the divesting party finds a suitable buyer for the divested business. The Draft Rules (Article 18) provide that MOFCOM may require that the divesting party find a buyer and sign the purchase agreement before implementing the notified transaction if (i) it will be difficult to maintain the competitiveness and marketability of the divested businesses before the divestiture; (ii) the identity of the buyer has a decisive influence on whether the divested business can restore competition in the market; (iii) there are very few qualified buyers for the divested business or it will be otherwise difficult to find a suitable buyer within the specified time limit; or (iv) MOFCOM identifies some other circumstance requiring special treatment. The Draft Rules do not make the distinction made by the EU merger remedies notice between up-front buyer remedies and “fix-it-first” remedies, where a divestiture agreement needs to be entered into not only before the closing of the notified transaction, but even before the clearance decision is adopted.

4. Crown Jewel Provisions

The Draft Rules also introduce a “crown jewel” provision in Article 19. If MOFCOM is particularly concerned about the divesting party’s ability to find a suitable buyer, MOFCOM’s review decision may require the divesting party to agree that the divesting party must agree to sell an alternative set of assets should it prove unable to sell the original package. Alternative “crown jewel” proposals are typically designed to be more attractive to potential buyers to increase the certainty of completion of the divestiture.

The Draft Rules do not discuss the relationship between up-front buyer remedies and crown-jewel remedies. A crown jewel divestiture should presumably be used as an alternative to an up-front buyer divestiture, rather than in combination, since both are used to increase the certainty of implementation. Up-front-buyer divestitures are normally a more straightforward way to eliminate any uncertainty than crown jewel divestitures.

5. Behavioral Remedies

The Draft Rules state that MOFCOM’s review decision will set the duration for implementing behavioral remedies, but if the decision is silent, the behavioral remedies shall apply for ten years (Article 13). In practice, the longest duration applied thus far appears to

be eight years (*ARM/G&D/Gemalto*), the same period applicable to the remedies imposed in that case by the EU Commission.

F. Associated Obligations

1. Trustees

The Draft Rules continue to include the trustee mechanism introduced by the Divestiture Rules and often applied by MOFCOM in its decisional practice. Article 4 of the Draft Rules provides that monitoring trustees are responsible for monitoring the parties' compliance with their divestiture or behavioral remedy obligations, and divestiture trustees are responsible for executing a divestiture during a trustee-divestiture period (when a divesting party was unable to complete the divestiture itself). The Draft Rules do not include the Divestiture Rules' provision that the monitoring and divestiture trustee may be the same natural person, legal entity or organization.

The Draft Rules (Article 25) list the requirements for qualification as a trustee, all of which have been observed in MOFCOM's practice. However, the Draft Rules lack guidance as to how a trustee is selected and appointed.⁴ In practice, MOFCOM appears to take a more intrusive approach than the EU Commission.

The Draft Rules set up monitoring and punishment mechanisms for trustees (Article 28 and 35) to help ensure that trustees maintain their independence. These provisions may also help prevent trustees from exceeding their mandate, though the Draft Rules do not mention this issue. The Draft Rules also prohibit monitoring trustees from disclosing to the parties any reports the trustee submits to MOFCOM.

2. Obligations of Merging Parties

Articles 23 and 24 of the Draft Rules describe ancillary obligations of the merging parties in connection with divestitures, including preserving the competitiveness of the divested business, providing support to the trustee and providing transitional support to the buyer. These requirements are consistent with the Divestiture Rules and international merger remedy practice.

⁴ In the past, MOFCOM typically has asked the undertaking concerned to propose three trustee candidates, and MOFCOM then appoints one of the three as the trustee.

G. Modification and Waiver

Realizing that MOFCOM cannot predict all possible contingencies at the time a remedy is imposed, the Draft Rules (Articles 30–33) include a mechanism to allow for the modification or waiver of remedies.

A modification may be necessary where market conditions have changed such that the purposes of the commitment are no longer being achieved. Unusually, the Draft Rules indicate that merger remedies may be modified or waived not only at the request of the merged entity (Article 31), but also *ex officio* (Article 30). Article 30 indicates that MOFCOM may impose stricter remedies after the fact “*if the market competitive situation has changed to the extent that the restrictive conditions cannot lessen the negative impact*”. The Draft Rules do not set any time limit on MOFCOM’s ability to impose stricter remedies. MOFCOM’s ability to impose stricter remedies than those agreed to by the notifying parties is worrying, in particular because the Draft Rules do not describe the criteria that MOFCOM must apply in such cases or provide procedural protections for interested parties.

Article 32 of the Draft Rules provides that when evaluating an application to modify or waive remedies, MOFCOM should consider whether (i) the underlying transaction the review decision is based on has significantly changed; (ii) the competitive landscape of the relevant market has substantively changed; or (iii) the public interest supports a modification or waiver.

H. Liability

The Draft Rules for the first time provide for sanctions on a divesting party for non-compliance with remedy commitments (Article 34), on trustees for providing false information or not fulfilling their responsibilities (including rectification of the breach, return or confiscation of trustee compensation, and disqualification) (Article 35), and on the buyer of the divested business for not abiding by the Draft Rules (including rectification of the breach and disqualification) (Article 36).

While Article 48 of the AML provides for sanctions (including unwinding or halting the implementation of the concentration or taking other necessary measures to restore competition prior to the concentration, and a fine of no more than RMB 500,000), it could be argued that such sanctions would only be imposed if an undertaking implemented a concentration without a prior clearance from the MOFCOM .

The Draft Rules (Article 34) make clear that AML Article 48 sanctions are available for a serious breach of a divesting party’s remedy commitments and provide that in such cases, MOFCOM shall withdraw its review decision and ask the undertakings concerned to re-notify the transaction. In less serious cases, MOFCOM shall require the parties to rectify their non-compliance within a specified time period.

If a divesting party violates associated obligations (such as “preservation obligations” and “transitional obligations”) rather than the obligation to complete a divestiture, Article 34 of the Draft Rules provides that MOFCOM shall order the divesting party to propose new remedies. In serious cases, MOFCOM shall withdraw the review decision and ask the undertakings concerned to re-notify the transaction.

Article 34 of the Draft Rules are not exactly consistent with Article 15 of the Examination Rules, which provides that if the remedy obligations are not complied with, MOFCOM may establish a time limit for correction and take further actions in accordance with the AML if undertakings fail to make these corrections. It remains to be seen how these provisions will relate to each other in practice.

III. CONCLUSION

The Draft Rules provide a comprehensive framework and general guidance for the design and implementation of remedies. These rules largely echo those of the United States and the EU. They also try to incorporate the lessons learned from MOFCOM’s existing 16 conditional clearances.

As noted above, however, a number of issues are not addressed in the Draft Rules or need further clarification. For example, there is no specific timetable for MOFCOM to communicate its concerns, without which it would be very difficult for notifying parties to propose remedies. In the past, MOFCOM has sometimes identified its concerns at a late stage of its review, leaving little time for MOFCOM and the notifying parties to discuss how best to address these concerns.

In addition, the Draft Rules provide no guidance on the form of remedy MOFCOM prefers for particular transaction types or when presented with a particular competitive theory of harm. While it is not surprising that MOFCOM would want to avoid being bound by a statement of such preferences, the Draft Rules provide no reassurance to notifying parties concerned about MOFCOM’s past tendency to apply merger remedies that are not generally accepted in international practice or that may even have been viewed as anti-competitive.

The absence of standard forms to be used when submitting proposed remedies leaves continuing uncertainty about the information that parties will be required to provide.

Moreover, the Draft Rules lack guidance on the role of monitoring trustees. The Draft Rules prohibit monitoring trustees from disclosing to the undertakings concerned any reports that the trustees submit to MOFCOM. Sharing non-confidential versions of trustees’ reports and other submissions to MOFCOM would facilitate communications between notifying parties and monitoring trustees. In addition, since it is not uncommon for trustees to exceed their mandate make unreasonable demands of the divesting party or monitored

company, it would be welcomed if MOFCOM could confirm that it will monitor and review trustee's performance to ensure that that this does not happen.

A surprising and worrying aspect of the Draft Rules is MOFCOM's ability to impose stricter remedies on the merged entity than those agreed to by the notifying parties, apparently without limit in time and with no clear procedural protections for the merged entity.

By establishing procedures that basically resemble the international antitrust norm, the Draft Rules help to increase the transparency and predictability of the process of negotiating and implementing merger remedies in China.

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