

## Proposed Merger Control Rules under the Chinese Anti-Monopoly Law

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The PRC's Anti-Monopoly Law (the "AML") came into force on August 1, 2008. In January 2009, the Anti-Monopoly Bureau (the "AMB") of the Chinese Ministry of Commerce (the "MOFCOM"), which is responsible for the implementation of the merger-control related provisions of the AML, published a number of draft guidelines and rules. This Memorandum summarizes these draft guidelines and rules.

Although the MOFCOM solicited public comments on these drafts, they have already been the subjects of extensive internal review, and it is unclear whether the public comments will result in any meaningful changes in the final versions. Together with the implementing measures adopted in 2008 and earlier in January 2009,<sup>1</sup> these guidelines and rules will substantially complete the MOFCOM's first phase of rulemaking under the merger-control provisions of the AML.

### **I. BACKGROUND**

The AMB has established six divisions: the General Division, Investigation Division I, Investigation Division II, the Competition Policy Division, the Surveillance and Enforcement Division, and the Economic Analysis Division. According to information from MOFCOM officials, these divisions have the following responsibilities:

- The General Division is responsible for the day-to-day business of the Anti-Monopoly Commission of the State Council;

<sup>1</sup> State Council Regulation on Notification Thresholds of Concentrations of Undertakings; MOFCOM Guidelines on Merger Control Examination of Concentrations of Undertakings; MOFCOM flowchart of Merger Control Examination of Concentrations of Undertakings; MOFCOM Guidelines on Notification of Concentrations of Undertakings; MOFCOM Guidelines on Notification Materials of Concentrations of Undertakings; and MOFCOM Form for Notification of Concentrations of Undertakings.

- Investigation Division I is responsible for reviewing “on-shore concentrations,” *i.e.*, concentrations in which a PRC undertaking is directly involved;
- Investigation Division II is responsible for reviewing “off-shore concentrations”;
- The Competition Policy Division is for the time being taking the lead on drafting implementing rules and guidelines;
- The Surveillance and Enforcement Division is responsible for investigating concentrations that are above the notification thresholds but not legally notified and for monitoring concentrations below the notification thresholds but suspected of having or being likely to have anti-competitive effects. This division also appears to be involved in antitrust cases involving international trade and advises Chinese companies involved in overseas antitrust litigation; and
- The Economic Analysis Division provides internal economic analytical support relating to drafting legislation and the review of concentrations.

## **II. DRAFT GUIDELINES AND RULES PUBLISHED FOR PUBLIC COMMENT**

In January 2009, the AMB published for comment the following draft guidelines and rules:

- Guidelines on the Definition of Relevant Markets;
  - Provisional Rules on Investigation and Handling of Concentrations of Undertakings that are not Legally Notified;
  - Provisional Rules on the Collection of Evidence regarding Concentrations of Undertakings under the Notification Thresholds but Suspected of Being Anti-Competitive;
  - Provisional Rules on the Notification of Concentrations of Undertakings; and
  - Provisional Rules on the Examination of Concentrations of Undertakings.
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**A. DRAFT GUIDELINES ON THE DEFINITION OF RELEVANT MARKETS**

The draft Guidelines on the Definition of Relevant Markets (the “Market Definition Guidelines”), although published by the MOFCOM, apparently deal with market definition for the purpose of analyzing restrictive agreements and abuses of dominant positions, as well as for merger control purposes. Despite developing trends in the United States and the EC supporting the analysis of a transaction’s competitive effects even absent the definition of a relevant market, the draft Market Definition Guidelines state that the definition of relevant markets is a prerequisite for competition analysis and an important step in antitrust enforcement.

The draft Market Definition Guidelines provide guidance on the definition of both relevant product markets and geographic markets. The relevant product market comprises all products of the same group or category that are interchangeable or substitutable by reason of the products’ characteristics, their intended uses and their prices, in particular products regarded as close substitutes by customers. The relevant geographic market is the area in which the conditions of competition are basically homogeneous and appreciably different from other geographic markets. The draft Market Definition Guidelines also list a number of factors to be taken into consideration in defining relevant markets, including the product production cycle, service life, seasonal factors, popularity and fashionability, and intellectual property protections. In cases involving technology transfers and licensing agreements, innovation and technology markets will also be considered.

While the draft Market Definition Guidelines state that the main consideration in defining relevant product markets is demand-side substitutability, supply-side substitutability is also considered when it may impose similar competitive constraints over the behavior of the relevant undertakings. The less investment required to retrofit or adjust production facilities, the lower the additional risks, the faster production can be switched from one product to close substitutes, and the more competitive such products are in the market, the more likely different products are to belong to the same relevant market based on supply-side substitutability.

In situations where the definition of the relevant market is more complex, the draft Market Definition Guidelines adopt the “hypothetical monopolist” test. The hypothetical monopolist test, as outlined in the draft Market Definition Guidelines, would examine whether a hypothetical monopolist could profitably increase its product price by a small amount (*e.g.*, 5-10%) for a non-transitory period, defined as over one year. The guidelines note that while the benchmark price to be used in the calculation is normally the current market price, this price may not represent a true competitive price, for example where a company has a dominant position on the market or where the market price is affected by tacit coordination.

**B. DRAFT PROVISIONAL RULES ON INVESTIGATION AND HANDLING OF CONCENTRATIONS OF UNDERTAKINGS THAT ARE NOT LEGALLY NOTIFIED AND ON THE COLLECTION OF EVIDENCE REGARDING CONCENTRATIONS OF UNDERTAKINGS UNDER THE NOTIFICATION THRESHOLDS BUT SUSPECTED OF BEING ANTI-COMPETITIVE**

The Surveillance and Enforcement Division of the AMB is soliciting comments on drafts of “Provisional Rules on Investigation and Handling of Concentrations of Undertakings that are not Legally Notified” and “Provisional Rules on the Collection of Evidence regarding Concentrations of Undertakings under the Notification Thresholds, but Suspected of Being Anti-Competitive” (the “Small Concentration Rules”).

These two draft Rules reflect the main responsibilities of the Surveillance and Enforcement Division within the AMB, *i.e.*, to investigate concentrations that are above the notification thresholds but not legally notified and concentrations below the thresholds but suspected of having anti-competitive effects. Under both draft Rules, the Surveillance and Enforcement Division can act on information from informants or the media or on the advice of other relevant authorities.

In the case of concentrations that meet the mandatory notification thresholds set out in the State Council’s Notification Thresholds Regulation but were not notified, the MOFCOM can require the undertakings concerned to file a notification. If the concentration has already been implemented, the MOFCOM may impose sanctions based on its investigation. Possible sanctions include unwinding the transaction and fines of up to RMB 500,000, although so far no such sanctions appear to have been imposed.

Although the AML provides for mandatory notification of concentrations meeting the thresholds, the MOFCOM can also investigate concentrations that fall below the thresholds. There is no time limit on the MOFCOM’s power to investigate concentrations that do not meet the mandatory notification thresholds.

The draft Rules divide the procedure in such cases into three phases: preliminary analysis, collection of evidence and investigation. Where a complaint is made in writing with relevant facts and evidence, the MOFCOM is required to conduct a preliminary analysis. In its preliminary analysis, the MOFCOM can consider factors such as the parties’ market shares, the geographic scope of the concentration, competitors, undertakings active in upstream and downstream markets, consumers and, interestingly, public opinion.

If, based on its preliminary analysis, the MOFCOM suspects that a concentration that does not meet the mandatory notification thresholds has or is likely to eliminate

competition, the MOFCOM is required to initiate the evidence collection procedure. This procedure includes collecting information from public sources, questioning the parties and, where necessary, verifying information with industry associations, government agencies, suppliers, customers and competitors. The MOFCOM may collect evidence on the parties' market shares; the definition of the relevant market; the degree of market concentration and the state of competition in the relevant market; barriers to entry; reactions of consumers and other undertakings to the concentration; past anti-competitive practices of the parties; and the purpose of the concentration. At least two officials are required to participate in the collection of evidence, and they are required to keep a written record of their questioning that must be signed and confirmed by the persons being questioned.

After the collection of evidence, the MOFCOM will determine whether the concentration in question is suspected of having or being likely to have the effect of eliminating or restricting competition. When necessary, a formal investigation will follow. The Small Concentration Rules state that further rules to govern such investigations will be adopted.

**C. DRAFT PROVISIONAL RULES ON NOTIFICATIONS OF CONCENTRATIONS OF UNDERTAKINGS**

The Competition Policy Division of the AMB is soliciting public comments on the draft "Provisional Rules on Notifications of Concentrations of Undertakings" (the "Notification Rules").

The following points in the draft Notification Rules are noteworthy:

- Under the AML, a concentration arises when an undertaking obtains "control" or "decisive influence" over another undertaking. The draft Notification Rules provide that "control" is conferred by (i) acquisition of more than 50% of the shares with voting rights or more than 50% of the assets of such other undertaking or (ii) the power, through acquisition of shares or assets or by contract or other means, to decide on the appointment of one or more board members and key management, budgets, operations and sales, pricing, important investments and other important management and operational decisions. The draft Notification Rules do not define "decisive influence".
- The draft Notification Rules confirm that the joint establishment of a new entity by two or more entities constitutes a concentration of undertakings under Article 20 of the AML. The draft Notification Rules do not require

that a joint venture be “full function” to qualify as a concentration. The term “joint establishment” is not defined, and it is unclear whether two or more parent companies would need to have “control” over the new enterprise within the meaning of the draft Notification Rules to be considered as a concentration.

- The draft Notification Rules define “turnover” for purposes of the mandatory notification thresholds as “amounts derived from the sale of products and the provision of services in the preceding fiscal year, after deduction of taxes and associated charges, except corporate income tax and deductible VAT”. The turnover of an undertaking concerned includes all turnover of members of its corporate group, excluding intra-group sales (including sales between companies that are jointly controlled by parties to the concentration). PRC turnover is defined as the turnover generated from customers located in China, excluding those in Hong Kong, Macau and Taiwan. No other guidance is provided regarding the geographic allocation of turnover.
- Where a concentration concerns only part of the seller, only the turnover of the acquired part of the seller is taken into account.
- Concentrations between the same companies or between companies belonging to the same groups that take place within one year are treated as one concentration for purposes of applying the mandatory notification thresholds. The one-year period starts at the closing of the first transaction and ends on the date when the agreement is concluded for the last transaction.
- Parties to concentrations below the notification thresholds can notify their transactions voluntarily, in which case the MOFCOM can decide whether or not to accept the notification and to conduct a review. During the MOFCOM’s review of a voluntary notification, the undertakings concerned may close the transaction at their own risk.
- Notifying parties may consult the MOFCOM on issues regarding their notifications before the notifications are filed. In general, the MOFCOM encourages parties to submit draft notifications before filing, as is the practice in the EU.
- The party(ies) required to file in respect of a notifiable concentration are, in the case of a merger, all undertakings concerned and, in all other cases, the undertakings acquiring a controlling right or exercising a decisive influence (and other undertakings are required to cooperate). If a party required to

notify a concentration does not file, the other undertakings concerned may do so.

- In addition to the notification itself (referred to in the draft Notification Rules as the notification letter and an explanation regarding the impact of the concentration on competition), the draft Rules require extensive supporting documents, which must be translated into Chinese. The supporting documents include the concentration agreement(s), “reports in support of the concentration agreement”, and the parties’ audited financial statements. The concept of “reports in support of the concentration agreement” is very broad, including feasibility studies, due diligence reports, research reports on industry development, reports on the concentration plan and forward-looking reports on the prospects of the parties after the transaction.
- Notification documents and materials must be submitted in electronic form and “shall be reasonably edited to facilitate reading.” A non-confidential version of the notification documents and materials must be submitted simultaneously with the confidential versions. If the notification materials are duplicates, copies or faxes, original documents have to be presented for verification, if the MOFCOM so requests. The Parties must submit a Chinese translation, as well as the original language version, of any documents in a foreign language. If the MOFCOM discovers that the notification documents and materials are not complete, it may require the notifying parties to supplement them within a specified time limit, failing which the notification will be considered invalid.

**D. DRAFT PROVISIONAL RULES ON THE EXAMINATION OF CONCENTRATIONS OF UNDERTAKINGS**

The Competition Policy Division of the AMB is also soliciting public comments on “Provisional Rules on the Examination of Concentrations of Undertakings” (the “Examination Rules”).

The following points in the draft Examination Rules are noteworthy:

- The draft Examination Rules provide for the possibility of withdrawal of a notification.
- The draft Examination Rules do not contain detailed provisions on the methods by which the MOFCOM can collect evidence in reviewing a notification, as do the draft Small Concentration Rules. The draft Examination Rules provide that the notifying parties have the right to make

statements and to bring a defense, and that the MOFCOM may seek the opinions of other government agencies, industry associations, customers and other undertakings.

- The MOFCOM may also convene confidential hearings. Hearings may be held at any time during the procedure. The MOFCOM 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. A written record of hearings may be made, in which case the chairman and all participants shall sign (or stamp) the report, but a written record is not required.
- After its preliminary review, the MOFCOM will decide whether or not to undertake a further review. If the MOFCOM informs the notifying parties that it has decided not to undertake a further review, or if it makes no decision within the time limit, the parties may implement the concentration. If the MOFCOM decides to initiate a further review (Phase II), it must notify the parties in writing.
- In Phase II, if the MOFCOM concludes that a concentration has or is likely to eliminate or restrict competition, it may send the notifying parties a statement of its objections, setting out a reasonable time limit for the undertakings concerned to bring a defense in writing.
- The undertakings concerned or the MOFCOM may propose remedies to eliminate any anti-competitive effects. These remedies may include structural remedies, behavioral remedies and combinations thereof. The undertakings concerned may modify proposed remedies or propose new ones during the review process.
- During Phase II, the MOFCOM may decide to prohibit a notified concentration or approve it subject to conditions. Prohibition decisions or decisions approving a concentration subject to conditions shall be published in a timely manner.

### **III. CONCLUSION**

With the publication of the draft guidelines and rules in January 2009, the MOFCOM has substantially completed the first package of implementing measures to flesh out the merger control regime under the AML. The draft Examination Rules and

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the draft Notification Rules overlap in some respects with previously adopted measures. In the event of inconsistency, the final Notification and Examination Rules will prevail.

The PRC's merger control system, as detailed in the final and draft implementing measures, is inspired in many respects by the EC Merger Regulation and the related notices and guidelines of the European Commission (although the adopted and draft PRC measures are much less complete and detailed than the EC rules, which is not surprising since the AML has been in force only about six months). Unless the MOFCOM applies its rules very flexibly and/or develops simplified procedures for dealing with non-controversial cases, however, PRC notifications are likely to be significantly more burdensome than EC notifications, in particular owing to the requirement that a wide range of supporting materials be submitted with the notification in Chinese. In this regard, the MOFCOM's Guidelines on Notification Materials of Concentrations of Undertakings provide that a summary in Chinese of the main parts of certain supporting documents would suffice, but this possibility is not mentioned in the draft Notification Rules.

Other noteworthy aspects of the draft Guidelines and Rules include the following:

- The draft Market Definition Guidelines, which are generally in line with EU and US practice, say that the hypothetical monopolist test will be used only in situations that are complex or where the market definition is in dispute, rather than as the conceptual basis for the definition of relevant markets. The draft Market Definition Guidelines do not elaborate on the references to "innovation" or "technology" markets, concepts that have sometimes created confusion in the EU and in the United States. The guidelines are also unclear on the definition of relevant markets when there is evidence of "price discrimination".
- Although the AML provides for mandatory notification of concentrations meeting the turnover thresholds, the MOFCOM's jurisdiction is not limited to such transactions, and parties to transactions falling below the thresholds can notify their concentrations voluntarily.
- The draft Guidelines and Rules fail to resolve several procedural ambiguities arising from previous implementing measures. These include:
  - Whether a notification can be filed based on a letter of intent or similar document, or only based on a binding agreement;

- The timeframe for the MOFCOM to determine whether a notification is complete, an issue that could prove especially significant in view of the open-ended requirements for supporting documents; and
  - Whether the time limits for the MOFCOM's review refer to calendar days or business days.
- The draft Notification Rules' definition of "control" appears to be inspired by the EC Merger Regulation concepts of "sole control" and "joint control", but the conditions on which rights to appoint members of the Board or senior management and/or to approve strategic decisions will qualify as "control" are much more vague than the definition of "joint control" in EC law. The draft Notification Rules also create a potential for confusion in that they include in the definition of "control" rights to influence an undertaking's management, but do not define the term "decisive influence", the acquisition of which (like an acquisition of control) can give rise to a concentration under the AML. Perhaps the definition of "control" in the draft Notification Rules is intended to cover both "control" and "decisive influence" within the meaning of the AML, but this is not clear.
  - The draft Notification Rules confirm that the AML applies to the formation of joint ventures, but the treatment of joint ventures is much less clear than under the EC Merger Regulation. In particular, it appears that joint ventures may be notifiable regardless of whether they are "full function" or whether two or more undertakings will have "joint control" over the joint venture.
  - A significant drawback in the MOFCOM's merger control regime is the absence of any short form notification or simplified procedure for non-controversial cases.
  - The draft Notification Rules require the submission of extremely broad and ill-defined categories of documents. For example, locating "reports in support of the concentration agreement" might require the search of the files and e-mail of hundreds of document custodians. Such a search may yield enormous volumes of material that must be reviewed prior to translation and submission. In addition, the MOFCOM may seek any number of additional materials. Because the scope of the required document production is left rather vague, the MOFCOM has broad

powers to halt the review based on a claim that the notification is incomplete.

- The MOFCOM may collect information from a wide variety of sources, but its procedures for the collection of information are less clear in the draft Examination Rules than in the draft Small Concentration Rules. It appears that in its review of notified transactions, the MOFCOM intends to rely more heavily on hearings than on written questionnaires to customers, suppliers and competitors. Hearings may apparently be held more than once and in Phase I or Phase II, compared to the EC Commission practice of holding informal meetings and somewhat more formal “state of play” meetings in the course of its review, but only one oral hearing in Phase II. In view of the apparent importance of hearings in the MOFCOM’s review procedure, it is troubling that the draft Examination Rules do not require a written record to be made of all hearings.
- The MOFCOM’s rules regarding the submission of remedies in concentrations raising competitive issues are more flexible than those of the EC Commission, since the draft Examination Rules do not appear to disfavor behavioral remedies and there are no time limits on the submission of remedies. On the other hand, unlike the EC Commission, the MOFCOM can apparently propose remedies on its own initiative and approve transactions subject to conditions that have not been agreed to by the parties.

For additional information, please do not hesitate to contact Stephan Barthelmess, Brian Byrne, Christopher Cook, Maurits Dolmans, Thomas Graf, Francisco-Enrique González-Díaz, Nicholas Levy, James Modrall, Till Müller-Ibold, Robbert Snelders, Romano Subiotto, John Temple Lang, Dirk Vandermeersch, or Antoine Winckler of the Firm’s Brussels office (+32 2 287 2000); Mario Siragusa, Marco D’Ostuni or Giuseppe Scassellati-Sforzolini in Rome (+39 06 69 52 21); Dirk Schroeder or Romina Polley in Cologne (+49 221 800 400); François Brunet in Paris (+33 1 40 74 68 00); Shaun Goodman in London (+44 20 7614 2200).

CLEARY GOTTLIEB STEEN & HAMILTON LLP

**BRUSSELS**

Rue de la Loi 57  
1040 Brussels, Belgium  
32 2 287 2000  
32 2 231 1661 Fax

**NEW YORK**

One Liberty Plaza  
New York, NY 10006-1470  
1 212 225 2000  
1 212 225 3999 Fax

**WASHINGTON**

2000 Pennsylvania Avenue, NW  
Washington, DC 20006-1801  
1 202 974 1500  
1 202 974 1999 Fax

**PARIS**

12, rue de Tilsitt  
75008 Paris, France  
33 1 40 74 68 00  
33 1 40 74 68 88 Fax

**LONDON**

City Place House  
55 Basinghall Street  
London EC2V 5EH, England  
44 20 7614 2200  
44 20 7600 1698 Fax

**MOSCOW**

Cleary Gottlieb Steen & Hamilton LLP  
CGS&H Limited Liability Company  
Paveletskaya Square 2/3  
Moscow, Russia 115054  
7 495 660 8500  
7 495 660 8505 Fax

**FRANKFURT**

Main Tower  
Neue Mainzer Strasse 52  
60311 Frankfurt am Main, Germany  
49 69 97103 0  
49 69 97103 199 Fax

**COLOGNE**

Theodor-Heuss-Ring 9  
50668 Cologne, Germany  
49 221 80040 0  
49 221 80040 199 Fax

**ROME**

Piazza di Spagna 15  
00187 Rome, Italy  
39 06 69 52 21  
39 06 69 20 06 65 Fax

**MILAN**

Via San Paolo 7  
20121 Milan, Italy  
39 02 72 60 81  
39 02 86 98 44 40 Fax

**HONG KONG**

Bank of China Tower  
One Garden Road  
Hong Kong  
852 2521 4122  
852 2845 9026 Fax

**BEIJING**

Twin Towers – West  
12 B Jianguomen Wai Da Jie  
Chaoyang District  
Beijing 100022, China  
86 10 5920 1000  
86 10 5879 3902 Fax