MOFCOM Publishes Draft Merger Remedy Rules

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Since China's Anti-Monopoly Law (the "AML") came into effect in 2008, China's Ministry of Commerce ("MOFCOM") has adopted 18 conditional decisions requiring concessions from the companies concerned before their transactions could proceed. MOFCOM's remedy policy has attracted considerable attention among multinational companies, because MOFCOM's approach often differs from that of other antitrust authorities. The antitrust community thus eagerly awaited MOFCOM's first set of comprehensive rules on merger remedies.

MOFCOM's draft "Rules on Attaching Restrictive Conditions to Concentrations between Undertakings (Draft for Comment)" (the "Draft Rules"),[1] published on March 27, 2013, address a wide range of issues, including the design, implementation, monitoring, modification and waiver of merger remedies, as well as liability for breach. Unfortunately, the Draft Rules provide no guidance on the types of remedies MOFCOM prefers to address specific types of antitrust concern, in particular the unusual behavioral remedies MOFCOM has required in a number of recent cases. The Draft Rules also include a worrying new provision apparently allowing MOFCOM unilaterally to impose stricter remedies after the fact when it concludes that the originally approved remedies were insufficient.

Hopefully, 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.

BACKGROUND

The AML allows MOFCOM to impose remedies to lessen the negative impact of a concentration on competition (Article 29). Although MOFCOM has addressed merger remedies in prior rules and interpretations,[2] these measures do not provide a comprehensive framework. The Draft Rules are intended to provide the first set of 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 seminars in April and August

[1] See http://tfs.mofcom.gov.cn/article/as/201303/20130300068492.shtml.

[2] 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. 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.

2012. Participants in the August seminar discussed an advance draft of the Draft Rules (the "August Draft"), which were more detailed in some respects than the Draft Rules.

In practice, MOFCOM appears to prefer behavior remedies over structural remedies, such as divestitures, which are generally favored by other global antitrust authorities. 15 of MOFCOM's 18 conditional decisions appear to involve behavioral remedies.[3] For example**,** MOFCOM imposed hold-separate requirements in three transactions (*Marubeni/Gavilon*, *Western Digital/Hitachi*, and *Seagate/Samsung*), delaying efficiency benefits from those transactions without addressing the identified concerns. The *Wal-Mart/Yihaodian* decision imposed behavioral remedies that appeared designed to further MOFCOM's foreign investment policy without articulating a clear theory of harm. In *Google/Motorola*, unlike other reviewing authorities, MOFCOM required behavioral remedies to address hypothetical concerns that were not "merger specific" and could have been addressed under other provisions of the AML. MOFCOM also used behavioral remedies in *Glencore/Xstrata* and *Uralkali/Silvinit* to lock in favorable commercial positions for Chinese customers, without a clear analysis of how such remedies addressed specific antitrust theories of harm.

KEY ISSUES IN THE DRAFT RULES

Types of Merger Remedies

The Draft Rules divide merger remedies into three types: (i) structural; (ii) behavioral; and (iii) hybrid (Article 5). Unlike the August Draft, the Draft Rules do not list specific examples of structural remedies or behavioral 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. The absence of any such guidance is perhaps the most disappointing aspect of the Draft Rules, given the uncertainty created by MOFCOM's remedy practice in recent years.

Submission of Proposed Remedies

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[3] *Marubeni/Gavilon*, *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. Four of MOFCOM's conditional clearance decisions (*i.e.*, *Gencore/Xstrata*, *Western Digital/Hitachi*, *Panasonic/Sanyo* and *Mitsubishi Rayon/Lucite*) involved a combination of behavioral and structural remedies.

The AML and existing rules and interpretations provide no clear mechanism for MOFCOM to inform notifying parties of the nature of 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*" (Article 7) and request that the notifying parties propose remedies within a specified period, though the parties may also propose remedies earlier (Article 8). Although this is a welcome clarification, it remains to be seen how early MOFCOM will be willing to identify its concerns and how specific MOFCOM will be. As parties are unlikely to propose remedies before MOFCOM identifies its concerns, MOFCOM should identify its concerns as early as possible.

The final remedy proposal must be submitted no later than 20 days before the last day of the review process (Article 11), which appears to set an outer limit 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. In practice, 20 days would likely be quite tight, especially if MOFCOM plans to market test the proposed remedies, as permitted by Article 10.[4]

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). In practice, MOFCOM has suggested that parties withdraw and refile their notification to provide additional time.

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 where remedies are submitted late in the process.[5] Unlike the August Draft and the EU remedy rules, moreover, the Draft Rules do not provide a form to be used for remedy proposals or otherwise clarify the information parties need to provide. As a result, although the Draft Rules are helpful, MOFCOM's approach in a given case will likely continue to be difficult to predict.

Implementation

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[4] The August Draft provided that MOFCOM could publish proposed remedies for public comment, as in the United States. This procedure is not reflected in the Draft Rules, though MOFCOM presumably would not be precluded from publishing proposed remedies.

[5] *See* Article 10 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

The Draft Rules' discussion of merger remedy implementation focuses mainly on divestitures, in particular the divestiture process and the criteria a buyer must satisfy to be deemed suitable. The Draft Rules also set out new procedures for the use of up-front-buyer or fix-it-first remedies or alternative "crown-jewel" divestitures.

1. Divestiture Process

The Draft Rules largely restate the Divestiture Rules regarding the divestiture process, but they make a number of clarifications and additions, in particular in relation to time periods. The Draft Rules clarify two distinct time periods in the so-called "self-divestiture" process. Unless otherwise stated in the decision, these are: (i) a six-month period (subject to extension by up to three months) for the notifying parties to find a suitable buyer and sign an agreement (Article 17); and (ii) a three-month period (subject to extension by up to one month) after the purchase agreement is signed during which the divestiture must be completed (Article 20). These periods are in line with the EU Commission's practice. US authorities more frequently require up-front divestitures and typically allow less time to complete approved divestitures, but under US law divestitures do not require separate merger approval.

2. Suitable Buyers

The Draft Rules are largely in line with the Divestiture Rules with regard to the requirements for suitable divestiture buyers: buyers must be independent of the parties, have the requisite resources and capability to run the business and receive all necessary governmental authorizations (Articles 15, 16, and 21). In line with EU rules and typical US 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 MOFCOM if the transaction reaches the standard merger control notification thresholds. In the US, as noted, divestitures need not obtain a separate merger clearance.

3. Up-Front Buyers

In a standard "self-divestiture" process, the notified transaction may be closed immediately after MOFCOM issues its decision. The Draft Rules 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 other circumstances requiring special treatment (Article 18).

Unlike the EU merger remedies notice, the Draft Rules do not distinguish between up-front buyer and "fix-it-first" remedies. In the EU, an up-front buyer remedy requires that the divesting undertaking commit not to close the underlying transaction until such time as binding agreements have been entered into with an approved buyer. In a "fix-it-first" remedy, the divesting undertaking commits to identify and enter into a binding agreement with an approved buyer before the review decision is adopted.[6]

4. Crown Jewel Provisions

The Draft Rules also introduce a "crown jewel" provision (Article 19), allowing MOFCOM to require the divesting party to sell an alternative set of assets should it prove unable to sell the original package. "Crown jewel" assets are typically designed to be more attractive to potential buyers to increase the certainty of completion.

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 such uncertainty than crown jewel divestitures.

5. Behavioral Remedies

The Draft Rules state that MOFCOM's decision will set the duration for implementing behavioral remedies, but if the decision is silent, behavioral remedies shall apply for ten years (Article 13). In practice, the longest defined duration applied thus far appears to be eight years (*ARM/G&D/Gemalto* and *Glencore/Xstrata*).

[6] *See* paras 50 and 53-57 of Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004. It is noteworthy that "up-front buyer remedies" and "fix-it-first remedies" have different meanings in the United States.

Trustee and Ancillary Obligations

1. Trustees

The Draft Rules include the trustee mechanism introduced by the Divestiture Rules and often applied by MOFCOM. 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 is unable to complete the divestiture itself) (Article 4).

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.[7] In practice, MOFCOM appears to take a more intrusive approach in selecting trustees 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 discourage trustees from exceeding their mandates, but the Draft Rules do not mention this issue. The Draft Rules also prohibit monitoring trustees from disclosing to the parties any reports the trustees submit to MOFCOM.[8]

2. Ancillary Obligations

Articles 23 and 24 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.

Modification and Waiver

The Draft Rules (Articles 30–33) include mechanisms allowing for the modification or waiver of remedies. 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

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[7] 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.

[8] In EU practice, a redacted copy of such reports is shared with the undertaking concerned.

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*." 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 has significantly changed; (ii) the competitive landscape has substantively changed; or (iii) the public interest supports a modification or waiver.

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. The Draft Rules do not set any time limit on MOFCOM's ability to impose stricter remedies.

Liability

The Draft Rules for the first time provide for sanctions for non-compliance with remedy commitments (Article 34), on trustees for providing false information or not fulfilling their responsibilities (Article 35) and on the buyers of the divested business for not abiding by the Draft Rules (Article 36).

For a serious breach of remedy commitments, MOFCOM will be able to enforce sanctions available under Article 48 of the AML, 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 ancillary obligations rather than the obligation to complete a divestiture, Article 34 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.

The Draft Rules do not indicate what circumstances are considered "serious." Moreover, Article 34 of the Draft Rules is not consistent with Article 15 of the Examination Rules, which provides that if 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.

CONCLUSION

The Draft Rules provide a comprehensive framework and general guidance for the design and implementation of remedies in Chinese merger cases. These rules largely echo those of the United States and the EU and incorporate lessons from MOFCOM's existing 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 late in its review, leaving little time to fashion suitable remedies. The absence of standard forms to be used when submitting proposed remedies also leaves uncertainty about the information that parties will be required to provide.

The Draft Rules also 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, although sharing non-confidential versions of trustees' reports and other submissions to MOFCOM would facilitate communications between notifying parties and monitoring trustees. In addition, it would be welcome if MOFCOM would confirm that it will monitor and review trustees' performance to ensure that trustees do not exceed their mandates or make unreasonable demands.

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 undertakings concerned, apparently without limit in time and with no clear procedural protections for the merged entity.

Perhaps most importantly, the Draft Rules provide no guidance on the forms of remedy MOFCOM prefers to address particular theories of harm. While it is not surprising that MOFCOM would want to avoid limiting its flexibility, MOFCOM's practice of applying non-standard merger remedies is a source of considerable concern to the business community. Greater clarity on this point would be greatly appreciated in the final rules.