Merger Control in China: Understanding MOFCOM's Unique Approach

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Almost 15 years ago, the European Commission decided to block the merger between GE and Honeywell, which had been cleared by the US Department of Justice and a number of other jurisdictions. This decision unleashed a firestorm of criticism.[1] Since then, the enforcement of merger control provisions on both sides of the Atlantic has been - by and large – consistent.[2]

As merger control enforcement in the US and EU was converging, China developed as a third major antitrust jurisdiction.[3] The Anti-Monopoly Law ("AML") came into force in 2008 and its enforcement frequently makes the headlines.[4] On the merger control side, MOFCOM does not hesitate to take decisions in global transactions that are not consistent with those taken by other antitrust enforcers.[5]

MOFCOM's unique approach in some global transaction has not resulted in the same level of criticism as what the European Commission had to endure in the wake of GE/Honeywell. This could be because the additional remedies imposed were not perceived by the parties as onerous enough to complain publicly. This could also be because of the recognition that MOFCOM is a relatively new enforcer and is therefore going through a learning curve.

In this note, we review the most recent decisions in which MOFCOM did not follow its foreign counterparts and propose some explanations for its unique approach. Understanding MOFCOM's thinking will enable potential merging parties to identify early on some of the possible sticking points, adapt their message and engage with the appropriate stakeholders.

MOFCOM's Most Recent Conditional Approvals

Merck/AZ

On April 30, 2014, MOFCOM conditionally approved the acquisition of AZ Electronic Materials S.A. ("AZ") by Merck KGaA ("Merck").[6] Regulators in other jurisdictions,

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[1] See the references cited by Deborah Platt Majoras, GE-Honeywell: the U.S. Decision, 29 November 2001, available at http://www.justice.gov/atr/public/speeches/9893.pdf.
[2] See, for example, "Global Antitrust Policies: How Wide is the Gap?" , September 6, 2011, available at http://www.justice.gov/atr/public/articles/282930.pdf (noting the significant progress toward substantive and procedural convergence between the antitrust authorities in the United States and the European Union since GE/Honeywell).
[3] See, generally about the Anti-Monopoly Law, S. Harris, P. Wang, Y. Zhang, M. Cohen and S. Evrard, Anti-Monopoly Law and Practice in China, Oxford University Press, 2011.
[4] See, for example, Wall Street Journal, For Deal Makers, China is a Drag, available at http://online.wsj.com/news/articles/SB10001424052702304157204579473500128825052.
[5] An important caveat: under the AML, MOFCOM must only publish decisions resulting in a conditional approval or a prohibition. As of drafting of this article, MOFCOM had reviewed around 900 transactions and imposed conditions in 23 of them. Only 1 transaction resulted in a prohibition. We do not know to what extent MOFCOM's approach in transactions that were submitted for merger review in multiple jurisdictions but did not lead to a published decision by MOFCOM was consistent with that of foreign regulators. Therefore, the size of the sample of decisions from which to draw conclusions is limited.
[6] http://www.mofcom.gov.cn/article/b/e/201404/20140400569107.shtml

including Germany, the United States and Taiwan, cleared the transaction without conditions.

MOFCOM's review focused on two products that are components in the manufacture of flat panel displays (FPDs): liquid crystal and photoresist. MOFCOM found that, because both liquid crystal and photoresist are raw materials used for FPD manufacturing, they are "complementary" and constitute "adjacent" markets. MOFCOM recognized that given the low transportation costs and the absence of import barriers, the market for these products was worldwide. Merck and AZ have significant market shares in the two markets -- Merck has 60 percent share worldwide (70 percent in China) in liquid crystal, while AZ has 35 percent worldwide (50 percent in China) in photoresist. MOFCOM found that, after the concentration, Merck would become the largest supplier of both liquid crystal and photoresist, while other competitors are able to supply only one product alone and with limited capacity.

MOFCOM considered that Merck would have the ability to engage in tied or bundled sales and cross subsidies that could harm competition, and further analyzed that barriers to entry (including IP/patents) are high. This would restrict competition. To resolve those concerns, MOFCOM required Merck and AZ to commit for a period of three years:

- not to engage in tie-in sales that would force Chinese customers to purchase both Merck and AZ's products at the same time, including not to give cross subsidies between Merck's liquid crystal and AZ's photoresist;
- to license Merck liquid crystal patents on non-exclusive, commercially reasonable and non-discriminatory terms.

Microsoft/Nokia

On April 8, 2014, MOFCOM conditionally approved Microsoft's acquisition of Nokia's devices business, which manufactures mobile phones and tablets.[7] The transaction did not include Nokia's portfolio of patents, including those relevant for mobile devices. Besides China, the deal was subject to merger review in multiple jurisdictions, including the United States, the European Union, Brazil, India, South Korea and Taiwan. Only China and Taiwan imposed conditions so far, but the case is still under investigation in South Korea.

According to MOFCOM, the transaction raised several competition concerns. First, Microsoft owned patents covering the Android operating system. The majority of Chinese smart phone manufacturers cannot avoid using these patents and do not own enough patents to use as a bargaining chip with Microsoft. Microsoft would have the incentive to put these Chinese competitors at a competitive disadvantage by increasing its royalties. This would have the result of restricting competition in the Chinese smart phone market.

[7] http://www.mofcom.gov.cn/article/b/e/201404/20140400542508.shtml

Second, Nokia would keep its mobile communications standard-essential patents ("SEP"). According to MOFCOM, Nokia's licensing incentives would change as a result of the sale of its mobile devices business. It would indeed no longer need cross licenses from competing mobile devices manufacturers. Nokia would therefore have the incentive and ability to increase its royalties. This increase would impact Chinese smart phones manufacturers by increasing their total costs.

MOFCOM approved the transaction subject to both Microsoft and Nokia agreeing to certain behavioral remedies regarding their respective patent portfolios, including the following obligations:

- Microsoft will continue to license SEP under FRAND terms and, in particular, shall not seek an injunction against Chinese smart phone makers,
- Microsoft will continue to license non-essential patents covering the Android operating system to Chinese smart phone manufacturers under financial terms that are not higher than those prevalent pre-transaction,
- Nokia will continue to license its SEP under FRAND terms and Nokia will have to pass on this obligation to any third party acquiring Nokia SEP.

The Fair Trade Commission of Taiwan ("TFTC"), which adopted its decision before MOFCOM, imposed the following conditions on the basis of similar grounds:

- Microsoft will not license smart phone-related patents with unreasonable royalties or under discriminatory terms that may affect smart phone manufacturers' choice of operating systems,
- Nokia will continue to license its SEPs under FRAND terms, and will ensure that any transferee of these patents also adopts FRAND licensing terms.

The transaction is still under review in South Korea.

Thermo Fischer/Life Technologies

On January 14, 2014, MOFCOM conditionally approved Thermo Fischer's acquisition of Life Technologies.[8] Both companies produce and supply analytical instruments and laboratory consumables such as reagents.

The transaction was subject to merger review in a number of other jurisdictions including Australia, Canada, the European Union, Japan, New Zealand, and the United States. Some of the remedies imposed by MOFCOM were imposed by other regulators as well. For example, the authorities in the EU, Canada and Australia also ordered Thermo Fischer to divest its cell culture and gene silencing businesses. In addition, MOFCOM did not order a divestiture to address the two companies' overlap in polymer-based magnetic beads, as did the authorities in the European Union and Canada.

[8] http://www.mofcom.gov.cn/article/b/e/201401/20140100463733.shtml

In two areas, MOFCOM imposed remedies that were not imposed by other regulators. In particular, MOFCOM focused on SSP typing kits and SDS-PAGE standard protein products. SSP typing kits are widely used in organ transplantation, and the parties' combined market share would be 40-50 percent. The merged company therefore would have market power and the ability to raise prices, according to MOFCOM. The parties' combined share for SDS-PAGE standard protein, used for protein testing, would be 56 percent in China. According to MOFCOM, the incremental market share would not be substantial, but the increase in market concentration would be "relatively high" and therefore "limit the options of downstream customers." MOFCOM required the merged company for the next ten years to:

- offer to Chinese customers a 1 percent annual discount off the catalogue prices of SSP typing kits and SDS-PAGE standard protein products and commit not to reduce the discounts to Chinese distributors,
- give third parties the choice of receiving the SSP typing kits and SDS-PAGE standard protein products through an OEM agreement or a perpetual and non-exclusive IP license relating to these two products.

In contrast, in respect of the SSP typing kits and SDS-PAGE products, authorities in other jurisdictions did not identify serious competition concerns. For example, the European Commission concluded that the transaction would not raise serious doubts in either of these markets taking into consideration a number of factors such as the parties' combined market share, alternative and credible competitors, high-level innovation characteristic of the industry, and new entry.

Explaining the Different Outcome

It is important to understand the reasons leading MOFCOM to impose remedies going beyond what foreign regulators have imposed.

One obvious reason would be that the facts are different. The relevant market may be geographically limited to China and the competitive conditions in that market may bear little resemblance with other geographic markets.

However, what is striking in the MOFCOM decisions discussed above is that it adopted a different decision with respect to markets that have a worldwide scope. In global markets, one would expect the facts to be similar and regulators around the world to reach similar conclusions. For example, in Merck/AZ, MOFCOM recognized that the markets for liquid crystal and photoresist were worldwide in scope, given the insignificant costs for transportation. Similarly, in Microsoft/Nokia, MOFCOM noted that the import restrictions, transportation costs and technologies requirements for the relevant products did not impose significant restraints on a worldwide basis.[9]

[9] However, for some "unique features" of the supply and purchase of those products in China, MOFCOM in its decision focused the competition analysis in the Chinese market.

Industrial Policy

Industrial policy is an integral part of the AML.[10] It is one of the factors that, by law, MOFCOM must consider when reviewing a transaction under the merger control provisions.

Article 1 of the AML provides that it is enacted for the purpose of "promoting the healthy development of the socialist market economy." According to Article 4, the State shall formulate and implement "competition rules compatible with the socialist market economy, perfect macroeconomic supervision and control, and develop a united, open, competitive and orderly market system." In the context of merger control, Article 24 states that when reviewing a transaction, MOFCOM should consider several factors, including "the effect of the concentration on national economic development." There have been calls from foreign regulators urging MOFCOM not to consider industrial policy when reviewing a merger.[11] However, to the extent that this approach is mandated by the AML, one cannot expect MOFCOM to disregard the legal framework.

In addition, it is important to note that during the decision making process, MOFCOM routinely reaches out to other important ministries such as the National Development and Reform Commission ("NDRC") which may put more emphasis on industrial policy. MOFCOM's decisions are relatively short and never explicitly state whether industrial policy factors have been considered. One can however speculate that industrial policy considerations could have been one of the motivations for the imposition of the following remedies:

- The obligation to continue to sell potassium chloride to the Chinese market as a condition to the merger between two Russian suppliers of potash (Uralkali/Silvinit). In its decision, MOFCOM particularly noted that "China is highly dependent on the international market of potassium chloride and around half of its demands for potassium chloride are met by sea borne trade and cross-border trade."
- The obligation to hold-separate the parties' hard disk drive divisions in the Seagate/Samsung and Western Digital/Hitachi cases, where MOFCOM was concerned about the lack of buyer power from computer manufacturers who will pass on the cost to Chinese PC consumers; MOFCOM stated in Western Digital/Hitachi that "at present, China is the world's largest consuming country of personal computers and this concentration will adversely affect the interests of Chinese consumers."
- The obligation to hold-separate the parties' soy bean business in the Marubeni/Gavilon case, because, among other reasons, "China relies heavily on

[10] See also Wendy Ng, Policy Objectives of Public Enforcement of the Anti-Monopoly Law : An Assessment of the First Five Years, in Emch and Stallibrass (ed.), China's Anti-Monopoly Law, The First Five Years, Kluwer, p. 35 and following.
[11] See Maureen K. Ohlhausen, Nurturing Competition Regimes: Evaluation and Evolution, 31 July 2013, available at http://www.ftc.gov/sites/default/files/documents/public_statements/nurturing-competition-regimes-evaluation-and-evolution/130731comppolicychina.pdf.

imports of soybeans, while soybean crushing enterprises in China have a low degree of concentration, small production scale and weak bargaining power."

- The obligation to continue to license Android to cell phone manufacturers likely to protect the Chinese handset industry as MOFCOM focused its analysis in the Chinese market and kept the ability to continue imposing conditions after 5 years based on an assessment of market conditions in China;
- In Microsoft/Nokia, the obligation not to seek injunctions or exclusion orders based on standard essential patents against smart phones made in China, and the obligation to continue to license non-standard essential patents to Chinese smart phone manufacturers;
- In Thermo Fischer/Life Technologies, the obligation to decrease prices for Chinese consumers.

A More Conservative Approach

MOFCOM is still a relatively new jurisdiction. Its decision making process cannot rely on an extensive body of case law or administrative decisions like other "older" jurisdictions such as the US and the EU.

This may explain a relatively more conservative approach towards possible competition law issues. Notably, the imposition of hold-separate remedies may signal that in some cases MOFCOM does not feel sufficiently comfortable to prohibit a transaction (or order divestitures) but on the other hand does not feel sufficiently comfortable to clear it unconditionally.

Unease With "Voluntary Commitments"

In some cases, MOFCOM has requested the parties to formalize "informal" commitments. For example, in Google/Motorola, Google pledged to continue licensing Motorola's patents. In its decision, the European Commission took notice of that pledge and considered that in light of it, Google would be unlikely to increase the then applicable royalty rate. MOFCOM preferred that such commitments be set in stone as formal remedies. MOFCOM also did not seem to take at face value the parties' argument that they lacked the incentive to discriminate against other terminal manufacturers with respect to Android. MOFCOM preferred that Google offer a commitment in this respect (probably assuming that if Google claims it has no incentives to discriminate, it should not be an issue to offer a commitment).

Conclusion

We can expect that over time, as it gains more experience, MOFCOM will become less conservative.

Industrial policy considerations are likely to continue to influence MOFCOM's decision-making process. Given its legal obligation to consider the impact of a transaction on the national economic development, MOFCOM will continue to assess the impact on Chinese competitors, customers or licensee. This may result in other decisions in which MOFCOM takes a different approach.

The divergence should however not be overstated. Out of the 900 transactions that MOFCOM has reviewed so far, only 24 resulted in a prohibition or in the imposition of conditions. Some of these 24 transactions were only subject to merger review in China and not elsewhere. Thus, divergence seems to be limited.

Finally, merging parties can anticipate possible industrial policy considerations and shape their message to limit the perceived impact on Chinese competitors, customers or licensees.