CPI COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
February 2014 (1)

Towards a Simplified Review Procedure for Mergers in China

Ninette DODOO
Freshfields Bruckhaus Deringer

www.competitionpolicyinternational.com

Towards a Simplified Review Procedure for Mergers in China

Ninette DODOO[1]

I. INTRODUCTION

In 2013, the Ministry of Commerce ("MOFCOM") published the much-awaited *Interim Regulations on Standards Applicable to Simple Cases of Concentrations between Business Operators* ("Draft Regulations") for public comment.[2] MOFCOM clearance has often trailed clearance in other major jurisdictions, including for cases that raise no significant competition concerns, or with little or no nexus, with China. The Draft Regulations are a welcome development, and are indicative of MOFCOM's efforts to respond to criticism from the business community and observers about the length of its merger reviews. Some officials estimate that around 50 percent of notified transactions could be processed under the proposed procedure.[3]

In terms of policy design, MOFCOM has opted for a set of rules that define *ex ante* categories of transactions (or *simple cases*) that ordinarily do not give rise to competition concerns and whose review will presumably be completed on an expedited basis. However, there are exceptions and the Draft Regulations identify cases where the simple case designation—and thus the benefit of a fast track procedure—would not apply or could be withdrawn. These exceptions raise questions around the predictability and certainty of the simple case procedure. The Draft Regulations also stop short of a commitment by MOFCOM to review simple cases on a timely basis and within Phase I, and offer no guidance on the procedures that MOFCOM will adopt in such cases. That said, the introduction of this procedure is welcome.

In this article, we consider certain aspects of China's merger review process that underscore the need for a simplified procedure for non-problematic deals (Section II), the *ex ante* criteria adopted by MOFCOM to identify simple cases and the circumstances in which the simple case designation would not apply or could be withdrawn (Section III), and some of the

[1] The author is deputy head of the antitrust, competition and trade practice in China of Freshfields Bruckhaus Deringer. The views expressed in this article are personal, and are not attributable to Freshfields Bruckhaus Deringer or any of its clients.

[2] MOFCOM circulated an earlier iteration of the Draft Regulations for restricted comment as part of an initial consultation process.

[3] *See China's MOFCOM approves simple-case notification threshold, official says*, PaRR (December 2013). The 50 percent rate is comparable to the share of transactions reviewed by the European Commission under the simplified procedure before the recent amendments to the procedure to extend the scope of transactions covered were adopted. The European Commission's indicative roadmap of the planned "merger simplification project", published in January 2013, outlines the objective for extending the scope of the simplified procedure under the European Union Merger Regulation. It notes that, during the period 2008-2010, simplified cases represented about 56 percent of the European Commission's merger cases—increasing to slightly more than 60 percent in 2011 and 2012. The European Commission expects the extension of the coverage of the simplified procedure to increase the number of simplified cases by an additional 10 percent.

procedures that may need to be introduced in order to maximize the benefits of the proposed simple case procedure (Section IV).

II. TOWARDS CHANGE

China's Anti-Monopoly Law ("AML") requires merging parties to notify transactions to MOFCOM if certain turnover thresholds are met,[4] and not to complete the notified transaction until receipt of MOFCOM approval. It is common for MOFCOM's clearance to lag behind approvals in other jurisdictions, and this has had a consequential impact on deal timetables and transaction costs for merging parties. The reasons for the often-longer review period in China are varied. The main drivers lie in the nature and design of the merger control process.

First, the statutory review period does not commence until MOFCOM has declared the notification complete. There are no statutory deadlines for this pre-acceptance phase.[5] In practice, this period can take up to eight weeks or longer depending on: deal complexity; the nature of the products, services, or sectors involved; questions around market definition; internal priorities; resources; etc. MOFCOM has made noticeable efforts in recent months to shorten this period in some cases by, for example, setting deadlines for merging parties to respond to information requests, scoping and reducing the number of rounds of information requests during this period, and leaving thorny questions (e.g. around market definition) to be settled following case acceptance and the start of the statutory review period.

Second, compared with other major merger control regimes, MOFCOM tends to consult an inordinate number of stakeholders, including other government agencies and departments with industrial policy and/or relevant sector oversight and trade associations—as well as competitors, customers, and suppliers. The consultation process can be long and the speed with which stakeholders revert with comments is typically not within MOFCOM's control.

MOFCOM will typically delay its final decision until it has completed consulting relevant stakeholders. Phase II investigations are thus commonplace, as MOFCOM is often unable to complete its review within the initial Phase I review period.[6] Indeed, the AML does not require MOFCOM to establish serious competition concerns to trigger an in-depth or Phase II inquiry. That said, transactions that do not raise substantive competition concerns, but end up in Phase II, are often cleared within a few weeks of Phase II—generally within one to one-and-a-half months of the start of Phase II review.

[4] A transaction requires notification to MOFCOM if either of the following thresholds are met: (i) the combined worldwide turnover of the parties to the transaction exceeds RMB 10 billion, and each of at least two of them generates turnover in China of RMB 400 million or more; or (ii) the combined China turnover of the parties to the transaction exceeds RMB 2 billion, and each of at least two of them generates turnover in China of RMB 400 million or more.

[5] MOFCOM has a total statutory review period of 180 days: 30 days for Phase I, 90 days for Phase II review, and 60 days for an Extended Phase II review.

[6] According to an annual review for 2013 published on MOFCOM's website on December 4, 2013, during the period January 1 to October 31, 2013, MOFCOM received 185 merger filings, and it accepted 175 and closed 161 of them. The annual review also indicates that of the 161 closed cases, MOFCOM closed 21 (or 13 percent) in Phase I, 130 (or 80.7 percent) in Phase II, and 10 (or 6.3 percent) in the Extended Phase II period, respectively.

Third, unlike other major jurisdictions, the AML instructs MOFCOM to take non-competition issues into account during its merger review. The AML requires assessment of a transaction's impact on national economic development. The notion of national economic development is not defined under the AML or its implementing regulations, and it appears to encapsulate a broad spectrum of factors. It is not unusual for considerations related to industrial policy, foreign investment, national security, or security of supply and sourcing of products or services key to China's development to prolong MOFCOM's review, as it consults with and coordinates comments from relevant stakeholders on a notified transaction.

Last, there are significant constraints on MOFCOM's resources. The Anti-Monopoly Bureau within MOFCOM, which is responsible for processing notifications, reportedly has a small pool of 30-40 officials. Since the entry into force of the AML, the number of transactions notified to MOFCOM has steadily increased. In the past year, MOFCOM cleared 215 transactions.[7]

The review process in China is thus often protracted and fraught with unpredictable clearance timetables compared with other jurisdictions—often spanning four to five months from notification to clearance in the simplest of cases. The Draft Regulations signal MOFCOM's efforts to streamline merger review for transactions that pose little or no threats to competition in China and reduce the time it takes to review such transactions.

III. TOWARDS SIMPLICATION: QUALIFYING VS. EXCLUDED TRANSACTIONS

The Draft Regulations seek to establish criteria for distinguishing between simple cases and normal cases, namely transactions that meet the Chinese filing thresholds but present no significant competition concerns in China. The Comments to the International Competition Network Recommended Practices For Merger Analysis advise that "merger review laws and policies should provide competition agencies with the ability to differentiate mergers that are unlikely to have significant anticompetitive effects from those that require analysis."[8] This differentiation should allow competition authorities to focus available resources on transactions that require more detailed analysis and threaten to harm competition.[9] These recommended practices are non-binding and it is for each competition authority to design its own procedures for identifying non-problematic transactions and processing them expeditiously.

For merging parties, a simplified procedure typically reduces the administrative burden involved in preparing a notification in terms of the time, effort, and resources needed to prepare and submit a complete notification. A simplified procedure also offers merging parties certainty

[7] This is based on statistics published on MOFCOM's website. Four of the 215 approved transactions were cleared subject to conditions. The conditional clearances concerned, respectively, Glencore's acquisition of Xstrata, Marubeni's acquisition of Gavilon, Baxter's acquisition of Gambro, and MediaTek's acquisition of MStar. A significant proportion of mergers continue to be approved in China without remedies.

[8] *See* Comments to ICN Recommended Practices for Merger Analysis, Article I.A. The recommended practices reflect best practices among member competition authorities. MOFCOM is currently not a member of the ICN.

[9] *See* Comments to ICN Recommended Practices for Merger Analysis: "the identification of those mergers that potentially threaten to harm competition and expeditious clearance of non-problematic mergers can lead to more efficient use of agency resources and more effective analysis of critical legal and economic issues."

that the notified transaction does not raise substantive competition concerns, and a degree of predictability as to the likely timing of the competition authority's merger review.

For example, in the European Union—the model that MOFCOM's proposed simplified procedure most closely mirrors—transactions notified under the simplified procedure require significantly less resources than in normal cases. Further, they are subject to more limited information requirements, and may be approved in Phase I following a lighter review, which does not involve extensive market inquiry. It is against this background that we consider the Draft Regulations.

A. Qualifying Transactions

Article 2 of the Draft Regulations identifies six categories of cases that MOFCOM considers are unlikely to have significant anticompetitive effects in China. A principal criterion is market share. Article 2 defines a transaction as "*simple*" based on the following market share tests: (i) in the case of a horizontal merger, if the merging parties have a combined market share of less than 15 percent in the relevant market; (ii) in the case of a vertical merger, if the parties' market share is less than 25 percent in the relevant product upstream or downstream market; and (iii) in cases where the merging parties are not in a vertical relationship, if the parties have a market share of less than 25 percent.

The focus on market share is unfortunate, as market share-based tests are inherently imprecise. Market shares can be difficult to determine as this depends on market definition and the availability of reliable data and information. The European Commission similarly uses market share-based tests, and has done so for over a decade. However, the challenge in the China setting is the lack of detailed guidance and precedents on market definition. There are few precedents for market definition in China. This is because MOFCOM is not required to publish merger decisions unless they issue a prohibition or conditional clearance decision.[10] In addition, the few decisions that are published often do not contain a detailed analysis of market definition.

Moreover, MOFCOM's current practice is to define the relevant market(s) affected by a transaction and not to leave this open even in non-problematic cases. It tends to both define markets narrowly and explore alternative market definitions. There is thus a risk that merging parties may be required to consider all plausible alternative market definitions to satisfy MOFCOM that the relevant market share test for simple status is met. This could prove time-consuming and protracted, leading at least some merging parties to simply choose to follow the normal case route to avoid possible delays.

The Draft Regulations usefully provide other scenarios for simple case status, which are not market share-based. First, transactions involving non-Chinese targets are simple if the acquired foreign target does not engage in economic activity in China. Second, the creation of a joint venture ("JV") will qualify as simple if the JV is established outside China and does not engage in economic activity inside China. However, in both cases, engaging in economic activity is not defined, and it is unclear whether *any* level of economic activity in China (e.g. nominal sales or assets, or even a sales rep office) would preclude simple status. If de minimis sales or presence is unlikely to impact the competitive process in China, but is still considered to be

[10] MOFCOM has published full decisions in 22 cases since the AML came into force.

economic activity inside China, there is a risk that some transactions with no significant anticompetitive effects may still be reviewed under the normal case process.

Last, if a parent of a jointly controlled JV acquires sole control over the JV then the transaction will qualify as simple unless the parent and JV are competitors in a relevant market (see further below). JVs account for nearly 35 percent of MOFCOM's current caseload. A relatively high proportion of notified JVs have no China nexus or concern the restructuring of an existing JV, and thus are unlikely to harm competition or consumers in China.[11]

B. Excluded Transactions

Article 3 of the Draft Regulations establishes six broad exceptions to simple case designation. These exclusions appear to be aimed at carving out a subset of cases where the simple case qualification would not apply even if the Article 2 tests were met.

First, a transaction between a parent and its JV in circumstances where a jointly controlling parent acquires sole control over the former JV, is not considered simple if the parent and JV are competitors in a relevant market. It is not clear why a merger between a parent and its JV that results in a low post-merger combined share (or below the 15 percent market share test for *simple* horizontal mergers) should raise greater competition concerns than a horizontal merger between previously independent competitors that leads to an equally low post-merger combined share. The European Commission establishes a similar exception but, as it explains in its Notice on simplified procedure, such cases are exceptional and assume that the merged entity will have a significant market position.[12] The extent to which the parties actually competed pre-merger also plays an important role.

Second, a case is not simple if the relevant market is difficult to define. Other competition authorities with a simplified procedure for non-problematic transactions similarly exclude the benefit of the lighter procedure where market definition is difficult. However, such situations are exceptional and are often confined to special cases (e.g. where market definition raises novel legal issues). With the limited number of Chinese precedents and MOFCOM's tendency to drill down market definition, this exception could mean that a number of transactions with no significant competition concerns will remain subject to the normal merger procedure. The question of market definition should, of course, not be relevant to the non-market share based simple status

[11] As of December 31, 2013, MOFCOM had reviewed nearly 750 transactions since the entry into force of the AML. Based on statistics published by MOFCOM, approximately 33 percent of the cleared transactions involved joint ventures.

[12] Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004, ¶16:

> [a] particular competition concern could arise in circumstances where a former joint venture is integrated into the group or network of its remaining single controlling shareholder, whereby the disciplining constraints exercised by the potentially diverging incentives of the different controlling shareholders are removed and its strategic market position could be strengthened. For example, in a scenario in which undertaking A and undertaking B jointly control a joint venture C, a concentration [where] A acquires sole control of C may give rise to competition concerns [if] C is a direct competitor of A and where C and A will hold a substantial combined market position and where this removes a degree of independence previously held by C.

See also Cases IV/M.1328, *KLM/Martinair*, Twenty-Ninth Report on Competition Policy 1999 ¶¶165-166, and COMP/M.5141 *KLM/Martinair*, 17.12.2008 ¶¶14-22.

tests under Article 2. But, where market definition is a key element in the assessment, it will be important to limit the circumstances in which MOFCOM officials may rely on the exception to deny simple status.

Third, transactions are not simple if they are likely to have a detrimental impact on market access, technological progress, consumers or other third parties, national economic development, or competition. This is consistent with the criteria that the AML requires MOFCOM to consider when conducting merger reviews. However, Article 3 does not explain the particular circumstances in which a simple case (which otherwise satisfies the simple status test) may have such an impact. Nor do the AML or MOFCOM's guidelines on the assessment of competition effects shed any further light.[13] This leaves considerable discretion to MOFCOM. In particular, national economic development enables an array of non-competition considerations–often driven by other government agencies or departments with industrial policy or sector responsibility–to be taken into account. In the absence of guidance, it will be difficult to predict with certainty whether MOFCOM could decide that a transaction may have a detrimental effect on China's economic development.

Last, under Article 4 of the Draft Regulations, MOFCOM may withdraw the simple case qualification if: (i) a notifying party provides incomplete, false, or misleading information;[14] (ii) a third party complains that the notified transaction has or may have the effect of restricting or eliminating competition; or (iii) there are material changes to the notified transaction or to market conditions.

Article 4 does not set any time limits for MOFCOM to withdraw the simple qualification. Equally, third parties are not subject to any deadlines within which to challenge a transaction. The broad scope of Article 4 suggests that MOFCOM may return to the normal merger procedure at any time during the 180-day statutory review period, and that it may re-evaluate a transaction it has already approved at the request of a third party or based on changed market conditions.

IV. TOWARDS AN EFFECTIVE SIMPLIFIED REVIEW PROCEDURE

The simple case criteria proposed in the Draft Regulations are an initial step in the establishment of comprehensive set of regulations for implementing the envisaged simplified review procedure. The effectiveness of the Draft Regulations in shortening merger review periods for transactions which raise no significant competition concerns in China risks being undermined without complementary procedural regulations, which clarify the implications of simple status. It thus remains to be seen how effective the envisaged simplified review procedure will be.

MOFCOM is currently considering a complementary set of regulations that will explain how the simplified review procedure will be implemented. To maximize the anticipated benefits of simple case qualification, it will be important to implement procedures that, inter alia, offer

[13] *See* Article 27 of the AML and Provisional Regulation on the Assessment of the Impact on Competition of Concentrations between Business Operators, [2011] MOFCOM Order No. 55, Aug. 29, 2011.

[14] The prospect of sanctions if incomplete, false, or misleading information is provided should limit the circumstances in which this scenario could arise.

predictability as to the merger review timetable, certainty that a transaction does not raise substantive competition concerns, and lessen the administrative burden on merging parties when preparing notifications under the simplified route. Below, we consider a few guiding principles.

In terms of the merger review timetable, a commitment to a complete review of a simple case within Phase I (i.e. within 30 days of case acceptance) will be important. The consultation process outlined above may need to be adapted and streamlined to facilitate completion of MOFCOM's review within Phase I. It will also be useful to set time limits for making a simple status request and its determination, and for withdrawing simple status, especially if driven by a third party.

Given the current design of the merger review process, the determination of whether a transaction merits simple status should be settled ideally during the pre-acceptance phase. Merging parties may be required to indicate whether a transaction merits simple status, and to provide the necessary information to support such status during the pre-acceptance phase. This would enable MOFCOM, as it reviews the notification for completeness, to determine whether a transaction deserves simple status. Early determination of simple status will give merging parties the necessary comfort that their transaction does not raise significant competition concerns and that it will be reviewed on an expedited basis.

During the determination, it will be important to involve one or more members of the case team who will review the transaction after case acceptance. This will ensure that the determination is less likely to be subject to withdrawal, unless exceptional circumstances arise after case acceptance.[15] In addition, a third party that seeks to challenge a simple case designation should be required to substantiate its complaint.

With respect to information requirements, pre-consultation discussions with the Anti-Monopoly Bureau within MOFCOM may, of course, assist in scoping the information to be provided when filing a case under the simplified review procedure. Because such meetings are discretionary, merging parties and their advisers may need to decide in the first instance what information is not necessary for a simple case. A few sections of the current notification form already allow notifying parties to omit certain information. These sections may serve as a useful starting point for determining what information can be omitted in simple cases. It remains to be seen whether MOFCOM will adopt an alternative notification format for simple cases.[16]

---

[15] If MOFCOM does not accept the merging parties' simple case designation, or decides to withdraw that designation, early notification will enable merging parties to submit additional information, if necessary, for an extended review.

[16] An ICN Notification & Procedures Subgroup paper notes:

> [t]he choice between a short and a long form offers an important mechanism for flexibility in transactions deemed to lack significant anti-competitive impact… Both forms typically ask for… information for administrative purposes, information about the parties to the filing, and a description of the transaction. Both forms also ask for some level of competitive analysis. The difference lies, for the most part, in the breadth of information required relating to competitive effects.

See Information Requirements for Merger Notification, presented at the 8th Annual Conference of the ICN in 2009, II.A.1 and 3. Flexibility can be assured whether a competition authority uses alternative notification forms or permits notifying parties to make a full or simplified notification using a single form (e.g. by permitting parties to omit specific sections of the notification form).

V. CONCLUSION

The Draft Regulations seek to identify categories of cases that are unlikely to have significant anticompetitive effects and can presumably be earmarked for expedited review. The envisaged simple case procedure will allow MOFCOM to focus on transactions that require more detailed analysis. For merging parties, simple status should facilitate the planning of deal timetables and completion on a timely basis.

The Draft Regulations are a significant and positive development in the evolution of MOFCOM's merger control process. The identification of specific categories of cases that may benefit from expedited review is welcome. However, the broad exceptions to the simple case designation, and the scenarios in which simple status can be withdrawn, risk undermining the effectiveness of the proposed simplified procedure.

MOFCOM is expected to introduce a further set of regulations on how the simplified review procedure will be implemented. It is hoped that these regulations will outline how simple status will be determined and when such a determination will be made. Further, it is hoped that the practical implications for treating a case as simple—in particular, the timing of the merger review and the information that merging parties need to provide—will be further detailed.