

## Legal Updates & News

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#### China Proposes New Antitrust Regulations for Mergers

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On January 19 and 20, 2009, the Anti-Monopoly Bureau (“AMB”) of the Chinese Ministry of Commerce (“MOFCOM”), the Chinese government authority charged with reviewing antitrust notifications of M&A transactions, proposed four new regulations related to China’s Anti-Monopoly Law (“AML”) and its merger review process. MOFCOM is accepting comments on the proposed regulations until February 16.

The proposed regulations provide additional clarity on several important issues relating to China’s merger enforcement powers, its pre-merger notification requirements and review process, and the investigation procedures it will employ. While the proposed regulations are generally consistent with the merger review process in other jurisdictions, there are some important differences. The final version of the regulations may reflect changes in response to public comments, and provide additional insight into China’s merger review process.

#### Key Implications

There are several noteworthy aspects to the proposed regulations:

- ***Transactions that do not satisfy notification thresholds remain subject to the AML.*** The proposed regulations make it clear that the AML’s prohibition on anticompetitive mergers applies to transactions regardless of whether they satisfy China’s merger notification thresholds. The regulations also establish procedures that MOFCOM will follow for the initiation of investigations and collection of evidence relating to non-reportable transactions.
- ***MOFCOM may investigate and punish parties that fail to submit a required notification or cooperate in a compliance investigation.*** The proposed regulations set forth procedures for investigating potential violations of China’s merger notification requirements. This suggests that MOFCOM intends to monitor compliance by parties to transactions and possibly bring enforcement actions for failure to submit required notifications.
- ***The draft regulations clarify how China’s notification thresholds apply to acquisitions of minority ownership interests, acquisitions of portions of a selling entity or business, and the formation of joint ventures.***

#### Summary of Proposed Regulations

##### ***Investigations of Non-Reportable Transactions.***

The AMB’s proposed regulations provide that MOFCOM may investigate whether non-reportable transactions are likely to eliminate or restrain competition. This is similar to the statutory scheme in the United States, under which the antitrust agencies may investigate potentially anticompetitive transactions that fall below the pre-merger filing threshold. It differs, however, from the European Union, where the European Commission may not investigate transactions that fall below the reporting threshold (although individual EU member states may review these types of transactions).

The proposed regulation sets forth a two-stage approach for the review of non-reportable transactions. First, MOFCOM would conduct an initial analysis that considers market share data, geographic areas covered by the parties, industry competitors, upstream and downstream businesses, consumer response, and public opinion. If MOFCOM determines that further investigation is necessary, it will then begin a more intensive investigation, which would include interviews and requests for additional information from the merging parties and third parties, such as customers or competitors. The merging parties will also have an opportunity to present arguments in support of the transaction before MOFCOM initiates an enforcement proceeding.

#### ***Investigations for Failure to Submit Pre-Merger Notification Filing.***

The AMB's proposed regulations provide that MOFCOM may investigate reportable transactions that the parties failed to notify. If the investigation occurs prior to closing, MOFCOM may require the parties to file a notification promptly. MOFCOM will then analyze the effects of the transaction.

If MOFCOM's investigation occurs after the parties close, then, in addition to examining the effects of the merger, MOFCOM may also impose penalties according to Article 48 of the AML. Potential penalties include the disposition of assets, transfer of the business, or other measures deemed necessary to restore competition in the relevant market to its pre-transaction status. MOFCOM may also impose a fine of up to 500,000 yuan. Parties investigated for failure to file a notification would have an opportunity to appear before MOFCOM.

#### ***Clarifications of Pre-Merger Notification Rules.***

The AMB's proposed regulations provide additional clarity with respect to several key issues. For example:

- ***Acquisitions of Minority Ownership Interests.*** The AML and prior regulations made it clear that the notification requirements applied to acquisitions of control of other undertakings, but did not expressly define "control." The proposed regulations define "obtaining the control of other business undertakings" as either:
  1. obtaining more than 50% of the voting shares or assets of the target; or
  2. obtaining less than 50% of the voting shares or assets of the target, but having the ability to appoint one or more members of the board or key management, or having authority over significant business decisions such as the setting the budget, pricing, or major investments.

This definition is noteworthy, in part, because it could be read to apply broadly to any acquisition of a minority ownership interest that includes a right to designate a member of the target company's board, regardless of whether the board member has the ability to exercise control or significant influence over important business decisions. The EU's merger notification requirements, in contrast, apply to the acquisition of a minority ownership interest only if it conveys the ability to exercise "decisive influence" over the target undertaking.

- ***Acquisitions of Part of Another Undertaking.*** The proposed regulations also illuminate the proper application of the notification rules' turnover thresholds to acquisitions of a part (rather than all) of one or more undertakings. The draft regulations state that the relevant turnover in these transactions is the turnover of the portion of the business that is being acquired. This clarification will be welcome news to multi-national companies that are engaged in a broad range of business activities inside China, and will enable MOFCOM to focus on transactions that may have a significant impact on China commerce.
- ***Joint Ventures.*** The proposed regulations state that the establishment of a new enterprise by two or more business undertakings can be a notifiable transaction in China. The final regulations may provide additional guidance as to how this provision will be applied to joint ventures that are limited in scope and have little or no impact on competition (e.g., an R&D or procurement joint venture), as compared to those ventures that involve a significant integration of competing businesses.
- ***Turnover Thresholds.*** The proposed regulations make it clear that the relevant turnover "within China" refers to revenues generated from purchasers located in China or from services provided within China. It would not, for instance, include export sales by Chinese entities to customers outside China.

#### ***Merger Review Process.***

The proposed regulations provide greater detail on the procedures MOFCOM will follow during merger-related investigations, as well as the rights of the parties involved. This includes an explanation of the type of evidence that MOFCOM will solicit from the merging and third parties, the basic procedures for any hearings that are conducted as part of MOFCOM's investigations, the protection of confidential information submitted by participating parties, and the rights of the parties to present their arguments and evidence.

The final regulations, or the application of those regulations in practice, may address some interesting issues presented by these rules. For instance, the proposed regulations give merging parties the right to participate in hearings and to possibly obtain transcripts of such hearings. The regulations, however, also contain provisions governing the protection of confidential information, and suggest that separate hearings may be conducted to limit access to such information. These procedures may afford parties some comfort that their confidential business information will be protected from public disclosure; on the other hand, they may limit the parties' ability to obtain access to MOFCOM's files and the evidence upon which it relies when making an enforcement decision. How the final regulations balance these considerations has important implications for the parties' ability to defend a transaction and rebut evidence submitted by third parties.

### **Conclusion**

The newly proposed regulations help clarify China's merger enforcement process and notification requirements. In particular, they suggest that MOFCOM is likely to spend some of its enforcement resources on examining the competitive implications of transactions that do not require pre-merger notification, as well as whether merging parties failed to submit required notifications. In addition, the draft regulations provide more detailed rules governing the application of China's notification requirements.

China's merger review process remains relatively new. The final version of these regulations, as well as MOFCOM's practice in applying them, will provide additional insight into compliance with this process. Parties to transactions that may affect China commerce should consult with experienced legal counsel early in the negotiations to obtain the latest information regarding the governing regulations and MOFCOM's merger review practice.