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EDITOR'S NOTE:

Rabbit, Revisited—Antitrust Enforcement In China

BY JIM O'CONNELL

AS I WRITE THIS, *CHUN JIE*, CHINA'S annual two-week New Year's holiday—or Spring Festival, to use the literal English translation—has come to a close. The Year of the Water Snake has passed and the Year of the Wood Horse has begun.

Based on an entirely unscientific survey of random astrology and New Age websites, it would seem that among other things the horse is symbolic of financial volatility and energetic impulsiveness in the traditional Chinese zodiac, while a year dominated by the wood element can be expected to be marked by growth and new beginnings. So if, a year from now, we are all looking back on a year of volatile growth, remember that you read about it first here in the pages of ANTITRUST.

Two years ago I wrote an article for this magazine in which I reviewed antitrust enforcement in China during 2011, the Year of the Metal Rabbit.[1] The piece struck what was intended to be a generally optimistic tone, because while all was far from perfect, I thought there was reason for optimism. For example:

- Despite concerns that state-owned enterprises (SOEs) might get a pass from the Anti-Monopoly Law (AML), several prominent AML matters in 2011 involved SOEs.
- In the wake of concerns expressed about the Ministry of Commerce (MOFCOM) decision in 2009 to block Coca-Cola's attempt to acquire Huiyuan Juice Group, a local "famous brand," MOFCOM had unconditionally cleared two large acquisitions of other Chinese "famous brands" by foreign firms.
- MOFCOM's conditional clearance decisions, which are published, were becoming increasingly detailed and sophisticated and the agency had begun releasing enforcement statistics.
- The National Development & Reform Commission (NDRC) and the State Administration for Industry & Commerce (SAIC), which share enforcement of the AML's non-merger provisions, appeared to be proceeding with an appropriate degree of caution as they flexed their new AML authority.

Not all was rose-tinted, however. The duration of the typical merger review at MOFCOM was cause for concern as the Year of the Rabbit gave way to the Year of the Dragon. Although one example does not make a trend, the agency's "hold separate" remedy in the Seagate/Samsung case suggested a preference for the sort of interventionist, behavioral remedies that are generally disfavored by most jurisdictions in horizontal merger cases. And although China's "conduct" agencies—NDRC and SAIC—had for the most part not yet turned their attention to non-Chinese companies, I noted that such a development, perhaps in the IP space, was only a matter of time.

Two years on, it seems an appropriate time to ask whether there is still reason for optimism about AML enforcement. In a "policy" sense, there is. China has come remarkably far in a short period of time. As demonstrated in FTC Commissioner Maureen Ohlhausen's excellent account of her visit to China during the 5th anniversary celebrations of the AML last summer,[2] there are many leaders in China who recognize the importance both of sound competition policy and open discussion—and debate—about what that policy should be. And the AML enforcement authorities increasingly—if perhaps not yet systematically—release draft regulations for public comment and review.

So when a MOFCOM decision falls outside the international enforcement mainstream or an isolated story of agency overreach appears it is not a reason to reach for the smelling salts. Such developments do still matter, however, given China's significance as a global economic player and its importance as a market and a manufacturing center for so many companies around the world. And precedents, once established and accepted, can become difficult to change or overcome. Thus, while over-reaction should be discouraged, constructive criticism should be encouraged, particularly if China's citizens and companies are to enjoy the same benefits of competition as their counterparts in Europe and the U.S.

Which brings us to the focus of this note. Longer-term "policy" optimism is important and justified, but it is of little near-term practical value to a client facing a merger review by MOFCOM or a conduct investigation by NDRC or SAIC. Today, when the former asks whether its deal is likely to be delayed significantly by MOFCOM's review, even if the matter raises few or no significant issues, the answer unfortunately must be "yes." When the target of an investigation asks whether it can expect transparency and due process, counsel must refer her client to recent press accounts suggesting that, at a minimum, there can be no guarantees. And while one can certainly point to progress—such as MOFCOM's recently initial steps towards developing a simpler

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and faster review process for transactions that are not likely to raise issues—progress does not equal the certainty which clients and markets require.

Merger Remedies

As noted above, one example does not a trend make. But what about four in the space of three years? What if those four decisions represent 20 percent of the total?

U.S. practitioners will be familiar with the concept of a "Hold Separate Stipulation and Order," commonly shortened to a "Hold Separate." Such orders, which the U.S. agencies often file with their complaints in matters that are being settled via consent decree, preserve the status quo temporarily, by requiring the merging parties to keep specified businesses or assets separate and independent—to keep the eggs unscrambled—pending their divestiture. It is a device which allows the parties to close their transaction before the actual remedy has been accomplished, while preserving the agency's ability to secure that remedy. It is not a remedy per se.

MOFCOM, in contrast, has used a Hold Separate in several cases as a kind of interim remedy that permits the parties to close their transaction—in nearly all such cases, a transaction which has already been cleared unconditionally by all other competition law authorities that reviewed the matter—provided that they keep certain businesses separate for at least some period of time. This "remedy" was first used in 2011, when MOFCOM permitted Seagate Technology plc to acquire the hard disk drive (HDD) business of Samsung Electronics Co. Ltd. on condition that Seagate

> maintain the Samsung business as a separate competitor which will continue independently to price and sell HDD products under the Samsung brand; establish firewalls between the Seagate and Samsung pricing and sales teams, which are to report to a supervisory trustee; ensure that the Samsung HDD production assets are maintained and operated independently; continue to maintain and expand the capacity (production output) of Samsung products . . . based on market demand; and establish an independent R&D center.[3]

MOFCOM justified this unusual intervention—in a transaction that its counterparts in Washington, Brussels, and Tokyo all cleared without conditions—in part on the importance of HDDs to the economy of China, where many products that incorporate HDDs are assembled. The decision permitted the parties to petition MOFCOM to reconsider the Hold Separate condition after a year had passed, and such a petition may be pending with MOFCOM.[4]

Based on this "reconsideration" provision, in early 2012 I suggested that the Hold Separate "remedy"

> may have been motivated by the timing of another matter—the proposed merger of Seagate's two next-largest competitors, Western Digital [Corp.] and Hitachi [Global Storage Technologies], which was also announced in 2011. The European Commission had decided to clear [that] transaction in November, subject to the condition that Western Digital sell off certain production assets for 3.5-inch HDDs, for which the Commission concluded the company would face limited post-merger competition. As MOFCOM was finalizing its Seagate decision, however, neither it nor its counterparts in Washington and Tokyo had decided whether or under what conditions to clear the Western Digital deal . . . . Perhaps MOFCOM, facing statutory time limits in the Seagate matter and concerned about Seagate absorbing Samsung's HDD business before it had resolved its investigation of Western Digital/Hitachi, decided to craft an order that would technically permit the deal to close while preserving the status quo, at least temporarily.[5]

That's a good theory as to why MOFCOM chose to allow the merger "to close, yet not close—at least, not yet."[6] But MOFCOM has since imposed similar "remedies" in three other matters, all involving non-Chinese firms—Marubeni/Gavilon, where the parties' combined share of the soybean import market that concerned MOFCOM was less than 20 percent; MediaTek/MStar; and the Western Digital/Hitachi deal. Thus, four of the agency's 21 conditional clearance decisions have included Hold Separates as remedies. This trend suggests that the agency has settled on the Hold Separate as a means of addressing concerns that a transaction may have anticompetitive effects in China without having to order structural relief or, where such relief is not possible, blocking the transaction altogether.

One can see the appeal of such an approach. The parties are able to close their transaction, in a manner of speaking, and the agency is able to guard against the competitive effects it has identified—and respond to what it may have heard from customers, competitors, or government agencies with policy goals other than protecting competition—without blocking the transaction and inviting comparisons with those of its counterparts around the world that may have cleared the deal.

But such remedies come with a price. They deny the parties the full benefits of the efficiencies of their transaction, threaten to deny markets the benefits of increased innovation that mergers can produce, and cause uncertainty for the parties, their employees and customers, and the market, which is inefficient. They artificially force the merged entity to compete with itself, which is also inefficient. They can lead to significant compliance costs and, although MOFCOM tends to appoint trustees to manage oversight, the ongoing involvement in the parties' business and the overall market that compliance monitoring generally requires undoubtedly adds to the agency's workload. Perhaps most importantly, these Hold Separate remedies, while they may preserve the status quo, do not protect competition in a way that will allow the market to evolve—something they share with the remedies MOFCOM imposed in the Uralkali/Silvinit and Glencore/Xstrata deals, where the parties were in effect required to continue to serve the Chinese market on terms and according to practices similar to those that prevailed pre-transaction.

Merger enforcement is all about protecting competition, of course. But it is one thing to achieve that goal by setting

up a new competitor which can operate as an independent rival, incentivized to continue to offer customers the choices that the transaction might otherwise have eliminated. It is another to require the parties to act as if their transaction never happened, while holding out the possibility that the restriction might eventually be lifted.

Timing for Merger Reviews

Most clients with transactions that require AML filings are not overly concerned about what MOFCOM might make them do, because the vast majority of deals that are notified to MOFCOM—to date, 97 percent[7]—are cleared unconditionally, a record which is comparable to those of the FTC and DOJ. Rather, most clients are focused on whether the agency will review and clear their transaction in a timely manner. This is a valid concern, given that the majority of transactions are not cleared until some point well after the end of MOFCOM's initial 30-day merger review period, despite the fact that parties typically engage in pre-filing "consultations" with the agency that can add several weeks to the front-end of the process.

There are several possible explanations for this, and they are not mutually exclusive. Leading the list of likely causes is the fact that while the agency's workload has almost tripled over the last five years, the Anti-Monopoly Bureau's staff numbers have remained relatively constant, and small at that. Today, there are reportedly only about 30 employees in the Bureau altogether, administrative staff included.[8] Given these resource challenges—each MOFCOM case handler must be responsible for multiple transactions at any given time—as well as the length and complexity of AML merger filings, it should not be at all surprising that the agency's clearance decisions are often delayed.

MOFCOM's obligation to consider policy concerns other than competition may also contribute to delays. The AML lists "the effect of [the transaction] on the development of the national economy" among the factors that "shall be considered" by MOFCOM when reviewing a transaction, along with traditional factors, such as the parties' market shares, the degree of concentration in the relevant market, and the effect of the transaction on consumers.[9] This requirement prompts MOFCOM routinely to consult with other government ministries that have jurisdiction over other national policy concerns, quite a few of which are given an antitrust enforcement advisory role by the AML itself.[10] These consultations, the details of which are not public and are not shared with the merging parties, likely result in further delays, in part because their duration is not solely within MOFCOM's control.

There may be other factors at work, but regardless of their cause, MOFCOM, encouragingly, has acknowledged that clearance delays are a cause for concern. Shang Ming, the Director General of MOFCOM's Anti-Monopoly Bureau, has repeatedly pledged to seek ways for his agency to improve the efficiency of its merger reviews to reduce the number of investigations that extend beyond the first 30-day phase.[11] To that end, over the past year MOFCOM has been developing a fast-track review process for "simple" transactions, and on February 14, 2014, released the final version of its Interim Regulation on Standards Applicable to Simple Concentrations of Undertakings.[12] The regulation sets forth the criteria according to which MOFCOM may classify a transaction as "simple," which include:

- Horizontal transactions where the parties' combined market share is less than 15 percent; vertical transactions where the parties' combined shares in the relevant upstream and downstream markets are below 25 percent; and conglomerate mergers in which neither party has a share of 25 percent or more of any relevant market; and
- Transactions that create off-shore joint ventures that have no business activities in China; and acquisitions of off-shore targets that have no business activities in China.

MOFCOM can refuse "simple" treatment for any such transaction if, among other things, it determines that the relevant markets are difficult to define or that the transaction may raise entry barriers or negatively impact technology improvement, consumers, other companies, or China's overall economic development. MOFCOM may also rescind a grant of "simple" status if the parties withhold information or provide false or misleading information, or if third parties claim that the transaction may eliminate or restrict competition and provide sufficient evidence to support such claims.

In issuing the Simple Transaction Regulation, MOFCOM has begun fulfilling its promise to take concrete steps to address concerns that its merger review processes take too long. While encouraging, however, it is only intended by MOFCOM to be a first step. The agency still plans to explain how the process according to which it will determine whether a transaction is "simple" will work—whether parties must request it during pre-filing consultations, for example, and await MOFCOM's decision before filing their notification, or whether they may assert that theirs is a simple transaction and proceed accordingly unless MOFCOM rejects their assertion. Of perhaps greater significance: MOFCOM has not explained how parties may benefit from qualifying for "simple" status—whether their filing may be abbreviated, for example, or whether they can expect a clearance decision before the end of the initial 30-day waiting period. MOFCOM has indicated that it will provide further clarifications about these issues in future regulations.

Until the agency issues such guidance, it will be difficult to determine whether MOFCOM is likely to succeed in shortening the time needed for clearance or in reducing the burdens that the current process places on parties and on its own resources. The criteria for "simple" transactions themselves raise concerns in that regard:

- Many of the criteria are pegged to the parties' market shares—as opposed to a simpler factor, such as the overall size of the transaction—which means that parties must explain, and MOFCOM must decide, what the relevant market is before the agency can decide whether a transac-

tion is "simple." Unfortunately, the task of market definition, which is as critical in Chinese antitrust enforcement as it is in the U.S. and Europe, is often the most time-consuming aspect of the MOFCOM case handler's work. Because the fast-track process cannot avoid the market definition hurdle, it is not clear that it will reduce the review time dramatically for simple transactions.

- The considerable flexibility MOFCOM has given itself in deciding whether to classify a transaction as "simple" could result in substantial uncertainty for parties planning transactions. For example, if MOFCOM must first determine whether any of the exceptions apply before it may deem a transaction "simple," this could add further delay at the front end. Alternatively, if MOFCOM may decide during its substantive review of a transaction that the relevant markets involved are "difficult to define" or that the transaction, simple though it may be, might nevertheless have a negative impact on the Chinese economy, the parties' deal could lose its "simple" status, with as-yet unknown consequences for the investigation and the timing for clearance. (This latter concern will be less of an issue if the agency will make its "simple/complex" call at the pre-filing stage.)
- The regulation effectively invites third parties—customers, competitors, trade associations—to seek to influence MOFCOM's "simple/complex" call by providing input on issues such as market definition, competitive effects, and policy concerns other than competition. There is some risk that MOFCOM, faced with this information, could decide to rescind its determination that a transaction is "simple," which could cause significant delay and introduce further uncertainty into the clearance process. Also, if MOFCOM will solicit the views of other government agencies for even "simple" transactions that qualify for fast-track review, the agency's ability to accelerate the clock will continue to depend in part on the speed of those other agencies' responses.

Still, in issuing this first set of regulations regarding "simple" transactions—regulations which were released in draft form for public review and comment—MOFCOM has demonstrated that it has heard the concerns regarding its delayed merger clearances and that it is determined to do something about the problem. That alone is encouraging.

Due Process and Transparency

Less encouraging were reports in the press last summer of a meeting that took place in Beijing among representatives of foreign companies and the three AML enforcement agencies. Billed as a training session to mark the approaching fifth anniversary of the AML, it turned into something quite different when an official from one of the agencies reportedly encouraged the participating companies to engage in "self-criticism," confess any violations of the AML, and—perhaps most disturbingly—not work with outside counsel, or risk facing harsher penalties.[13] Sources who were present reported being told that half of the companies at the meeting were under investigation or had been probed by the agency, which apparently was news to most in the room. The official did not explain why he did not want foreign firms to hire outside counsel to represent them,[14] and it was later suggested that he had merely intended to warn meeting participants against the dangers of hiring "unscrupulous lawyers who promise[] they [can] make investigations go away."[15] The following week, the agency also offered assurances that it does not specifically target non-Chinese companies and that it treats foreign and domestic companies the same.[16] Those clarifications do not appear to have reassured observers.[17]

The call for "self-criticism" and confession could have been an inartfully expressed invitation to companies to take advantage of the AML's leniency provisions, and one could set this story aside as an isolated incident involving a single agency official whose remarks were perhaps taken out of context. But the warnings about outside counsel are troubling and the subsequent clarifications insufficient. It should go without saying that companies that are under investigation for violating the law have a right to engage counsel to assist them and, if necessary, to represent them before the investigators. While one must of course be respectful of the different legal traditions and law enforcement systems of the jurisdictions in which one does business, competition law enforcement—like so many areas of the law—is a global endeavor. Competition, consumers, companies, and national economies all benefit when legal standards and investigatory and enforcement practices are as consistent as possible from jurisdiction to jurisdiction. Different approaches may be and are taken regarding things like standards for dominance, presumptions in merger reviews, judicial versus independent administrative agency review, and so on, but discouraging parties from retaining outside counsel is well outside the competition law enforcement mainstream. If that is not in fact the policy or preference of the AML agencies, a clear statement from the agencies to that effect should be considered.

Chris Hockett Chair's Letter in this issue discusses due process and procedural fairness concerns, which he has also made the subject of the Chair's Showcase at this year's ABA Section of Antitrust Law Spring Meeting. Among other principles, he notes in his Letter the importance of parties having the opportunity for meaningful engagement with investigators regarding the subjects of investigations, the possible theories of harm that the agency is exploring, and access to evidence collected by agencies. Like retention of counsel, these principles should not be controversial.

Outside the criminal context, surprise is not a valid law enforcement tool, and agencies benefit from transparency as much as companies do. For example, there is broad, international consensus that competition law enforcement should be based on an economic analysis of the effects of the specific conduct in question on the competitive process as a whole, and not merely upon the impact of the conduct on particular competitors or upon the form of the conduct. This is espe-

cially important when the conduct at issue is not clearly anticompetitive and is in fact nearly always procompetitive—such as mergers and other transactions, or unilateral decisions regarding things like pricing or the terms on which a company deals with competitors or customers, including whether and how it chooses to license its intellectual property.[18]

I will resist the urge to ring the Easterbrookian alarm bell about false positives too loudly here. But I will bang on it at least once to say that an analytical approach which does not recognize this—for example, one which focuses instead on the form of the conduct, or one which presumes that certain conduct is anticompetitive because of the market share of the company without conducting further analysis and engaging the company before a decision is effectively reached— can result in the erroneous condemnation of procompetitive conduct, which can have significantly negative effects on innovation and economic growth. Put simply, an agency is less likely to make a well-informed enforcement decision if it fails to examine competitive effects, which it cannot reasonably do if it does not engage the target of the investigation, including through the company's counsel. If decisions are instead reached through a "black box" process from which the targets of investigations are effectively excluded, many of those decisions inevitably will be wrong, with potentially serious implications for competition and consumers.

Turning back to China, the AML, which includes presumptions regarding "dominance" and lists specific conduct in which a dominant firm may not engage without having "a legitimate reason," does not specify that the enforcement agencies must conduct the sort of competitive effects analysis described above. But neither does it preclude them from doing so. Such reviews will help the AML agencies reach the correct decision, which, besides placing the agencies well within the international enforcement mainstream, will ultimately benefit Chinese consumers most of all. ■

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1 Jim O'Connell, *The Year of the Metal Rabbit: Antitrust Enforcement in China in 2011*, ANTITRUST, Spring 2012, at 65.

2 Maureen K. Ohlhausen, *Illuminating the Story of China's Anti-monopoly Law*, ANTITRUST SOURCE (Oct. 2013), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/oct13_full_source.authcheckdam.pdf.

3 O'Connell, *supra* note 1, at 70 (internal quotations removed).

4 *See Noble Trims PT on Seagate (STX) to $64; Sees Plenty of Positives Moving Forward*, STREETINSIDER.COM (Jan. 28, 2014), http://www.streetinsider.com/Analyst+Comments/Noble+Trims+PT+on+Seagate+%28STX%29+to+%2464%3B+Sees+Plenty+of+Positives+Moving+Forward/9094408.html.

5 *Id.* at 71 (internal citations omitted).

6 *Id.* at 70.

7 Yuni Yan Sobel, *Domestic-to-Domestic Transactions—A Gap in China's Merger Control Regime?*, ANTITRUST SOURCE (Feb. 2014) (noting that MOFCOM has cleared 728 transactions unconditionally since the AML went into effect, imposed conditions in 21 cases, and blocked one transaction outright), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/feb14_sobel_2_20f.authcheckdam.pdf.

8 Fei Deng & Cunzhen Huang, *A Five Year Review of Merger Enforcement in China*, ANTITRUST SOURCE (Oct. 2013), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/oct13_full_source.authcheckdam.pdf). Deng and Huang also demonstrate that the duration of investigations of transactions that MOFCOM has ultimately decided to clear conditionally is also increasing year to year, on average.

9 Anti-Monopoly Law of the People's Republic of China (AML), art. 27 (promulgated by the Standing Committee of the National People's Congress on Aug. 30, 2007 and effective on Aug. 1, 2008).

10 *See* AML, art. 9. In addition to MOFCOM, NDRC, and SAIC, the "Anti-Monopoly Commission," which is housed at MOFCOM, includes representatives from four ministries (the Ministry of Industry and Information Technology, the Ministry of Supervision, the Ministry of Transport, and the Ministry of Finance), four commissions (State-Owned Assets Supervision and Administration Commission, State Electricity Regulatory Commission, China Banking Regulatory Commission, and China Insurance Regulatory Commission), the State Intellectual Property Office, and the Legal Affairs Office of the State Council.

11 *See, e.g.*, *China to Speed M&A Deal Assessment in 2012—MOFCOM*, REUTERS (Dec. 27, 2011).

12 Ministry of Commerce of the People's Republic of China, Interim Regulation on Standards Applicable to Simple Concentrations of Undertakings, Notice No. 12 of 2014 (Feb. 14, 2014), *available (in Chinese) at* http://www.mofcom.gov.cn/article/b/c/201402/20140200487038.shtml.

13 *See, e.g.*, Anna Zhang, *Who's Afraid of China's NDRC*, AM. LAW., Feb. 10, 2014, *available at* http://www.americanlawyer.com/id=1202642281109/Who's-Afraid-of-China's-NDRC?slreturn=20140119163314; Melissa Lipman, *Chinese Official Urges IBM, GE to Cop to Antitrust Violations*, LAW360 (Aug. 21, 2013), http://www.law360.com/articles/466715/chinese-official-urges-ibm-ge-to-cop-to-antitrust-violations; Michael Martina, Exclusive: Tough-Talking China Pricing Regulator Sought Confessions from Foreign Firms, Reuters (Aug. 21, 2013) (quoting one participant's characterization of the official's remarks as "if you put up a fight, I could double or triple your fines").

14 *See* Martina, *supra* note 13.

15 Zhang, *supra* note 13.

16 *See* Melissa Lipman, *China Isn't Targeting Foreign Cos., Antitrust Officials Say*, LAW360 (Aug. 27, 2013), http://www.law360.com/articles/468009/china-isn-t-targeting-foreign-cos-antitrust-officials-say; Zhang, *supra* note 13.

17 *See, e.g.*, Zhang, *supra* note 13 (reporting claims that the Chinese agencies "require more direct communications with the target company and often view external counsel, or even in-house lawyers, as interference").

18 Gerald M. Masoudi, Dep. Assistant Att'y Gen., U.S. Dep't of Justice, Intellectual Property & Competition: Four Principles for Encouraging Innovation, Remarks at the Digital Americas Meeting 7–8 (Apr. 11, 2006) ("Competition law enforcers . . . protect a competitive process, not a particular result . . . . When a complainant begins a presentation by telling the Antitrust Division that a royalty rate is 'excessive,' the staff responds that the complainant is putting the cart before the horse. A complaining party must first identify some anticompetitive conduct . . . ."), *available at* http://www.justice.gov/atr/public/speeches/215645.pdf.