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MOFCOM seeks to streamline and clarify the Chinese merger control process – draft regulations published

As part of a review process to streamline and clarify China's merger review process, the Ministry of Commerce of the People's Republic of China (MOFCOM) has published two draft regulations for public comments.

The first draft regulation, the *Regulations on Imposing Restrictive Conditions on Concentrations of Undertakings* (Restrictive Conditions Regulations), published on 27 March 2013, fleshes out procedures for implementing merger remedies. The second draft regulation, *Interim Regulations on Standards Employed for Simple Concentrations of Undertakings* (Simple Mergers Regulations), released on 3 April 2013, define the types of mergers that will be regarded as "simple" mergers.

Key issues

- MOFCOM has published two draft regulations for public comments – the Restrictive Conditions Regulations and the Simple Mergers Regulations
- The publication of these two draft regulations coincide with MOFCOM's conditional approval of Glencore's takeover of Xstrata. The Glencore/Xstrata decision together with the related Commitment Remedial Plan is a practical example of some of the conditions and procedures contemplated by the Restrictive Conditions Regulations
- The Restrictive Conditions Regulations address structural, behavioural and hybrid remedies for concentrations
- The Draft Simple Mergers Regulations address the types of mergers which would be considered as raising little or no significant competition issues

Introduction

The publication of these regulations coincide with MOFCOM's conditional approval of Glencore's takeover of Xstrata on 16 April 2013.[1]

For the first time, MOFCOM attached a Remedial Commitment Plan to its conditional approval decision. The Remedial Commitment Plan set out the details of the commercial terms and timelines agreed by Glencore, including the disposal of a major copper mine in Peru or crown jewels in lieu.

The *Glencore/Xstrata* decision together with the related Commitment Remedial Plan is a practical example of some of the conditions and procedures contemplated by the Restrictive Conditions Regulations.

In this briefing, we summarise the main provisions of the Restrictive Conditions Regulations and the Simple Mergers Regulations.

Restrictive Conditions Regulations

Prior to the publication of the Restrictive Conditions Regulations, MOFCOM published Interim Regulations on Implementation of Asset or Business Divestitures in Concentrations of Undertakings (Interim Divestiture Regulations) on 5 July 2010. The table on the next page summarises the major differences between the Interim Divestiture Regulations and the Restrictive Conditions Regulations.

Issue/Provision	Interim Divestiture Regulations	Restrictive Conditions Regulations
Definition of remedies	▪ Sets out the definition of "divestiture" (i.e. assets or business being divested or divesting parts of assets and business and related conduct).	▪ Restrictive conditions or remedies include: - structural remedies: including divestiture of tangible assets, intellectual property rights (IPR) or related rights or interests; - behavioural remedies: including granting access to infrastructures, licensing of key technologies (including patents, proprietary techniques or other IPRs and termination of exclusive agreements by the undertakings participating in a concentration; and - hybrid remedies: which combine structural and behavioural remedies.
Time limits	▪ Divestiture Obligor[2] has to transfer divested businesses to the buyer and complete all relevant legal procedures such as transfer of ownership within three months after the date of execution of the sale and purchase agreement and other related agreements. ▪ Divestiture Obligor should submit to MOFCOM: (a) a list of candidates for Supervisory Trustee, within 15 days of the conditional approval decision; and (b) a list of candidates for Divestiture Trustee, within 30 days prior to entering into the divestiture period.	▪ Divestiture Obligor must transfer divested businesses to the buyer and complete all relevant legal procedures within three months of the date of execution of the sale and purchase agreement. This may be extended by a maximum of one month, with MOFCOM's approval. ▪ Divestiture Obligor should submit to MOFCOM: (a) a list of candidates for Supervisory Trustee,[3] within 15 days of the conditional clearance decision; and (b) a list of candidates for Divestiture Trustee,[4] within 30 days prior to entering into the divestiture period. If a Divestiture Obligor believes a Supervising Trustee is not necessary, it should submit a statement of reasons. ▪ Notifying parties should submit final versions of proposed restrictive conditions no later than 20 days prior to the expiry of the review period, although the Restrictive Conditions Regulations do not specify whether the 20-day obligation applies to each phase of MOFCOM's review period. ▪ If a time period for the implementation of behavioural conditions has not been specified in a conditional approval decision, this period will be 10 years.[5] ▪ If a time period for finding a purchaser and completing the sale and purchase agreement has not been specified in a decision, this period will be six months from the date of the decision. This may be extended by a maximum of three months, with MOFCOM's approval.
"Voluntary" versus "entrusted" divestiture	Does not make a distinction between "voluntary" and "entrusted" divestitures.	▪ "Voluntary" divestiture: where the Divestiture Obligor itself locates an appropriate buyer, executes the sale and purchase agreement and obtains approval from MOFCOM within the prescribed time periods set out in the conditional approval decision.
Sanctions	Does not set out sanctions for failure to comply with conditional approval decisions.	▪ Sanctions for failure to comply with conditional approval decisions include: (a) orders to cease the implementation of the merger; (b) orders setting out a deadline for disposing of shares or assets, imposing a deadline for the transfer of a business; (c) other orders which will ensure the status before the concentration is regained; and (d) a fine of up to RMB500,000. MOFCOM will also revoke its conditional approval decision and require the merging parties to re-file a notification.[6] ▪ If trustees provide false information or fail to perform their duties (pursuant to entrusted divestitures) in a diligent and conscientious manner, MOFCOM may: (a) order the trustee to make corrections; (b) return or confiscate the trustee's remuneration; (c) disqualify the trustee; and (d) in serious cases, MOFCOM may disqualify the trustee from future trustee appointments. ▪ If the purchaser of a divested business violates the regulations, MOFCOM may: (a) order the purchaser to make corrections; (b) in serious cases, MOFCOM may disqualify the purchaser.

The Restrictive Conditions Regulations will replace the Interim Divestiture Regulations once enacted.

The Interim Divestiture Regulations only deal with structural remedies including procedures for implementing structural remedies, while the Restrictive Conditions Regulations address structural, behavioural and hybrid remedies. The Restrictive Conditions Regulations also provide more guidance and transparency on conditional approval procedures, and set time limits for the submission of remedies proposals. The additional clarifications are welcome at a time when MOFCOM is approving an increasing number of transactions subject to conditions. 2012 was MOFCOM's most active year to date with a total of six conditional clearances – half of which involved the IT/high-technology sector.

In the Restrictive Conditions Regulations, MOFCOM has classified remedies as either being "structural", "behavioral" or "hybrid". MOFCOM has also listed examples of the types of remedies that it contemplates to fall under these categories. However, focus should not be placed on attempting to categorise remedies according to neat or stringent "boxes", but rather on why certain remedies are imposed and what competition concerns these remedies are aimed at addressing.

Some competition authorities also tend to favour structural remedies as these tend to be "cleaner" in terms of implementation; whereas behavioural remedies tend to be more challenging to implement and enforce. While earlier conditional approvals adopted by MOFCOM focused on structural remedies,[7] recent decisions (especially in the IT sector) have involved behavioural and hybrid remedies.[8] In this regard, guidance on how some commonly used behavioural remedies such as fair, reasonable and non-discriminatory provisions or firewall provisions, including hold-separate obligations, should be implemented would be welcome.

MOFCOM is also notably concerned with enforcement issues, and as a result has set out sanctions for merging parties, trustees and purchasers of divested businesses for the first time.

Some time limits for implementing remedies have been usefully set out in the Restrictive Regulations Conditions. However, further clarifications in the final regulations would be welcome, including when in the review process MOFCOM should inform the parties of competition concerns and the accompanying reasons. In practice, competition concerns can be raised relatively late in the review procedure.

Further clarification would also be welcome with respect to the 20-day requirement for submission of remedies proposals. Article 11 specifies that notifying parties should submit final versions of proposed remedies no later than 20 days before expiry of the review period without specifying the review period to which this provision refers – Phase I (30 calendar days), Phase II (90 calendar days), the Extended Phase II review period (60 calendar days), or the entire statutory period of 180 calendar days.

The Restrictive Conditions Regulations were published just before adoption of the *Glencore/Xstrata* conditional clearance decision. The lengthy process and the resulting detailed Remedial Commitment Plan entered into by Glencore set a benchmark for future complex merger reviews involving remedies.

A chief concern for merging parties is the timing of merger review in China. In *Glencore/Xstrata*, MOFCOM took more than a year from the date of submission of the merging parties' notification on 1 April 2012 to complete its review and approve the transaction on 16 April 2013. MOFCOM has a statutory review period of 180 calendar days.

In November 2012, Glencore pulled and re-filed its notification in order to restart the statutory review period. Glencore was unable to reach agreement with MOFCOM on appropriate remedies during the first 180-calendar day review period. In *Western Digital/Hitachi*, the merging parties similarly pulled and re-filed their notification, restarting MOFCOM's clock, to give them additional time to negotiate and agree on a remedies package with MOFCOM.

In practice, given the time taken to settle remedies with MOFCOM, agreeing the commercial terms of remedies in Phase I and possibly early in Phase II may prove difficult – unless merging parties propose remedies at a very early stage of the review process. *Glencore/Xstrata* and *Western Digital/Hitachi* also raise the prospect of increased use of the pull and re-file procedure in high-profile, complex mergers.

Simple Mergers Regulations

Prior to the publication of the Simple Mergers Regulations, MOFCOM circulated earlier draft regulations for restricted consultation – which set out proposed timeframes for different categories of transactions, including those that raise little or insignificant competition issues.

The major provisions under the Simple Mergers Regulations are described below:

"Simple" mergers are defined as: transactions involving competitors if their combined market share is <15%; transactions involving parties in a vertical relationship (i.e. active at different levels of the supply chain) if their market share in the relevant upstream or downstream market is <25%; and transactions involving parties that are not in a vertical relationship if their market share in each market is <25%.

"Simple" mergers also include the following types of transactions: a joint venture (JV) established outside China and does not engage in economic activity in China; where a party acquires the equity or assets of a foreign company and that company does not engage in economic activity in China; and where a JV is jointly controlled by two or more parties and one or more of them acquires control of that JV (e.g. where one of the JV's parents acquires sole control over the JV).

The definitions and market share thresholds create some uncertainties. It is unclear if the market share thresholds refer to global and/or China market shares – however the relevant market is defined. In cases involving parties that are not competitors or in a vertical relationship, it is not entirely clear whether the merging parties' market share must be less than 25% in "all" markets, including those unrelated to the proposed transaction, to qualify for simple treatment. In addition, will parties be required to obtain formal notice or confirmation from MOFCOM that it will treat a transaction as a simple? With a market share-centric test, there is a risk of a longer pre-consultation phase as market definitions and market shares proposed by the parties are tested to determine whether the transaction is simple.

The special attention given to JVs is welcome as a significant number of notified transactions in China involve JVs. It is unclear, however, what "engaging in economic activity" means, and what level of presence or activity would be permissible for parties to benefit from simple treatment. What if an entity only has a representative office, Research and Development centre, or nominal sales in China – would this constitute economic activity? If yes, there is a risk that a significant number of non-problematic transactions will still be subject to lengthy reviews.

Transactions that will not be regarded as "simple" include: where a JV is jointly controlled by two or more parties and one or more of them acquires control of that JV, and compete with the JV (e.g. where one of the JV's parents obtains sole control over the JV and that parent and JV compete in the relevant market); where the relevant market affected by the transaction is difficult to define; or where the transaction may have a detrimental impact on: (a) market access and/or technological progress; (b) consumers and other relevant companies; (c) national economic development; or (d) competition.

The exceptions create certain ambiguities. For example, in the case of JVs, if a parent obtains sole control over the JV and that parent competes with the JV, it is not entirely clear why such transaction should not qualify as "simple" if the combined market share of the parent and JV does not exceed 15%. It is also unclear in what circumstances MOFCOM will determine that a market is difficult to define.

The other exceptions reflect the criteria that the Anti-Monopoly Law (AML) requires MOFCOM to consider during its merger reviews. Like the AML, national economic development is not defined. It may prove difficult for merging parties to predict whether MOFCOM will determine that a transaction has a negative impact on national economic development.

Based on the Simple Mergers Regulations, third parties may challenge the simple case determination, and force MOFCOM to revoke its decision that a transaction is simple.

An earlier draft of the Simple Mergers Regulations indicated that MOFCOM would endeavour to expedite its review of simple cases. However, there is a risk that the sought after objective of reducing delays could be frustrated by the ambiguities inherent in some of the definitions of simple cases and exceptions (and their interplay), and given the right of third parties to challenge MOFCOM's simple case determinations. It also remains unclear whether simple mergers will be subject to a shorter or simplified notification form. A common complaint from businesses is that the merger control notification form in China is overly burdensome in terms of required information – especially for no issues cases.

Comments

The draft regulations and MOFCOM's approach to remedies in *Glencore/Xstrata* have attracted press and business attention, including in resource-rich countries such as Australia, as MOFCOM seeks to streamline its merger control procedures in an effort to offer increasing levels of predictability, clarity and certainty in merger reviews.

The draft regulations offer welcome guidance on MOFCOM's approach to remedies and the treatment of simple cases. Although they leave a number of questions unanswered and provide little guidance on certain procedural aspects of the merger control review process, they nonetheless represent important developments in China's evolving merger control regime.

Footnotes

[1] See our briefing Implications of China's conditional approval of *Glencore/Xstrata* published on 24 April 2013 on www.cliffordchance.com.

[2] The term "Divesture Obligor" is defined in both the Interim Divestiture Regulations and the Restrictive Conditions Regulations as an undertaking involved in the concentration who is obliges to divest its assets or business.

[3] The term "Supervisory Trustee" is defined in both the Interim Divestiture Regulations and the Restrictive Conditions Regulations as a natural person, legal entity or other organisation entrusted by the notifying party to supervise the whole process of the business divestiture or behavioural conditions.

[4] The term "Divestiture Trustee" is defined in both the Interim Divestiture Regulations and the Restrictive Conditions Regulations as a natural person, legal person or other organisation entrusted by the Divestiture Obligor to find suitable Purchaser(s) and enter into sales agreements and other relevant agreements during an "Entrusted" divestiture.

[5] The basis for the 10-year prescription is not entirely clear, although its practical consequence may be circumscribed somewhat, as merging parties may ask MOFCOM to modify and/or waive the remedies imposed – at any time as the Restrictive Conditions Regulations suggest.

[6] The procedure for re-filing a notification in this context and the scope of MOFCOM's review are not specified. For example, would MOFCOM review the already approved transaction in light of the prevailing market conditions, and would it seek to impose the same or a modified set of restrictive conditions on the merged entity?

[7] See, for example, *MRC/Lucite*, 24 April 2009; *Pfizer/Wyeth*, 30 October 2009; *Novartis/Alcon*, 2 June 2011; and *Penelope/Savio Macchine Tessili SPA*, 31 October 2011.

[8] See, for example, *GE/Shenhua*, 10 November 2011; *Seagate/Samsung*, 12 December 2011; *Henkel/Tiande*, 9 February 2012; *Western Digital/Hitachi*, 2 March 2011; *Google/Motorola*, 19 May 2012; and most recently *Glencore/Xstrata*, 16 April 2013

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