C L I F F O R D
C H A N C E

Briefing note

November 2012

Walmart's acquisition of Chinese B2C online retail platform and potential ramifications for future deals in China's expanding retail sector

China's Ministry of Commerce (MOFCOM) recently adopted its 15th conditional clearance. The decision concerned the acquisition by Wal-Mart Stores Inc. (Wal-Mart), one of the world's largest supermarket chains, of a controlling stake in Newheight Holdings Ltd. (Newheight). Wal-Mart increased its stake in Newheight from 17.7% to 51.3% thereby becoming Newheight's controlling shareholder. As a result, it also acquired indirect control over Shanghai Yishiduo E-commerce Co., Ltd. (Yishiduo), a provider of value-added telecoms services and owner of Yihaodian, China's largest online supermarket.

In this briefing, we summarise the Wal-Mart / Newheight decision and outline some of the implications of this decision for businesses.

Since the enactment of the Anti-Monopoly Law (AML) in August 2008 MOFCOM has approved 15 transactions with remedies and blocked one transaction. This latest decision is MOFCOM's third published decision involving the consumer goods and retail (CG&R) sector,[1] and the first involving the online retail sector and, more generally, use of variable interest entity (VIE) structures. The decision is also one of the few instances where MOFCOM has applied a leveraging theory of harm to challenge a transaction.[2]

Key issues

- Wal-Mart/Newheight decision
- Leveraging theories of harm in the retail sector
- VIE structures and approach to such structures
- Implications of the decision for businesses

[1] The first case concerned the acquisition of Anheuser-Busch by InBev, the first conditional clearance decision under the AML. The second case involved MOFCOM's prohibition of Coca-Cola's proposed acquisition of Huiyuan juice company.
[2] MOFCOM first applied a leveraging theory of harm in 2009 to block the Coca-Cola/Huiyuan transaction.

Background

Wal-Mart’s acquisition of a controlling stake was notified to MOFCOM on 16 December 2011. Two months later, on 16 February 2012, MOFCOM declared the notification complete. This triggered an initial 30-calendar days review (or Phase I). On 16 March 2012, the transaction entered the Phase II review period of 90 calendar days. This was extended on 13 June 2012 to enable the parties to negotiate remedies with MOFCOM. On 3 July 2012, Wal-Mart submitted a final set of remedies and on 13 August 2012 MOFCOM approved the transaction subject to remedies.

Relevant market

MOFCOM determined that the relevant market was the Chinese business-to-consumer (B2C) online retail market, and did not segment this market further. MOFCOM considered, inter alia, Wal-Mart and Yishiduo’s respective activities, their business models and nature, demand and supply substitution, the consumption habits of consumers, transportation costs and tariffs. The decision notes that Wal-Mart’s activities focus on supermarkets (i.e. the bricks and mortar retail business), whilst Yishiduo is currently China’s largest online supermarket with its business scope including both online direct sales retail and the provision of value-added telecommunications services (VATS).

MOFCOM’s decision focused on the VATS business in China – namely engaging in online direct sales to customers in China. However, the decision does not provide further details or specify the precise scope of such services. Nor does the decision describe the structure and/or competitive dynamics of VATS in China.

Competition analysis

MOFCOM’s decision emphasized Wal-Mart’s competitive advantages in the retail sector given its strength in procurement, storage, product offering, retail outlet networks, services, logistics, and brand awareness. It found that Wal-Mart had mature warehousing and distribution systems, a wide range of supply channels and a high degree of brand awareness in its supermarkets making it a *major competitor* in China. MOFCOM also found that a number of factors influenced online retailers’ activities including logistics, services, warehousing, distribution, marketing and network platforms – with logistics and services being key drivers of success.

MOFCOM was concerned that post-acquisition:

- Wal-Mart would leverage its competitive advantages in the bricks and mortar retail business to online retail where Yihaodian is active, and substantially enhance Yihaodian’s competitive strength given its extensive product offering (including food and beverages, cosmetics, healthcare, sanitary products, kitchenware, bathroom products, and electrical appliances).

- Wal-Mart would have the ability to leverage its combined competitive strength of its bricks and mortar retail business and Yihaodian’s online retail business to expand rapidly into the VATS business, and as a result gain a favourable position in VATS. This would enable the merged entity to enhance its bargaining position vis-à-vis online users in terms of pricing, restricting or eliminating competition in VATS.

Despite the decision’s emphasis on the impact of the transaction on the bricks and mortar retail business and the online retail sector, the decision suggests that MOFCOM’s principal concern was the perceived negative impact of Wal-Mart entering the VATS business in China. This is reflected in the remedies imposed by MOFCOM.

Conditions imposed

MOFCOM imposed the following remedies to address the identified concerns:

- Newheight Information Technology (Shanghai) Co., Ltd. (Newheight Shanghai)[3] shall limit its activities to online direct sales;
- Post-acquisition, Newheight Shanghai shall not use its Internet platform to provide Internet services to other trading parties without first obtaining a VATS permit; and
- Post-acquisition, Wal-Mart shall not engage in VATS business, which is currently conducted by Yishiduo, through a variable interest entity (VIE) structure.

Comments

MOFCOM's decision highlights its approach to market shares, leveraging theories of harm and the use of VIE structures as an investment structure in *restricted* sectors in China.

Market shares

In a departure from recent conditional clearance decisions, the decision does not mention or discuss the parties' market share in the relevant markets.

MOFCOM's decisions involving non-horizontal effects have tended not to refer to market shares – with a few exceptions.[4] The question arises as to whether there is less emphasis on market shares in cases involving non-horizontal mergers compared with horizontal mergers (which almost invariably refer to market shares).

In practice, MOFCOM decisions have generally been market share centric – echoing Article 27 of the AML, which lists market share as a factor to be considered in competition analyses.[5] MOFCOM's Interim Provisions on the analysis of competition effects further explain that market share is an *important factor* when analysing the structure of the relevant market, the merging parties' market position and that of competitors in the relevant market(s). The Interim Provisions also note that market share serves as a *direct* proxy of market position.[6]

---

[3] Although not entirely clear from the decision, Newheight Shanghai appears to be the entity that controls Yishiduo's online direct sales business.

[4] To date, MOFCOM has published 7 decisions that assess non-horizontal effects. These are Coca-Cola/Huiyuan, Mitsubishi Rayon/Lucite, GM/Delphi, GE/Shenhua, Henkel/Tiande, Google/Motorola Mobility and Wal-Mart/Newheight.

[5] Article 27 of the AML also lists the following factors: the level of market concentration, impact on consumers and other relevant undertakings, technological progress, and national economic development.

[6] Article 5, Interim Provisions on the assessment of the effect of concentrations of undertakings on competition (adopted on 5 September 2011).

Supermarkets, online retail and VATS and leveraging theories of harm

MOFCOM distinguished the bricks and mortar retail business from online retail, in line with international practice. Yet, the remedies imposed do not focus on the perceived negative effects of leveraging Wal-Mart's competitive advantages to online retail. Rather, the remedies seek to address the future impact of Wal-Mart's acquisition on China's VATS business:

- First, Yihaodian, indirectly controlled by Wal-Mart, could only engage in online direct sales through its own online retail platform (i.e. not through Wal-Mart).
- Second, Wal-Mart could not enter China's VATS business or operate a VATS business, which is currently conducted by Yishiduo, through a VIE structure.
- Third, Yihaodian, indirectly controlled by Wal-Mart, could not offer its online trading platform to other trading parties (e.g. Wal-Mart) without (such trading parties) first obtaining a VATS permit.

As framed, the remedies seemed geared to limit Wal-Mart's indirect involvement or participation in China's VATS business. The VATS business is a restricted sector under China's foreign investment regime, which means that foreign investors are subject to certain ownership restrictions.[7]

The remedies also suggest that MOFCOM was concerned that Wal-Mart's acquisition would enable Wal-Mart to penetrate the VATS business, ultimately restricting or eliminating competition at an unspecified future date. The decision does not specify the competition concerns associated with the VATS business. Similarly, the decision does not explain why Wal-Mart would have the necessary ability and incentive to engage in anti-competitive conduct resulting in the restriction or elimination of competition in the VATS business in China, or why competitors would be foreclosed. The decision also does not point to pre-merger dominance or market power on Wal-Mart's part – a pre-requisite for a leveraging theory – and limits itself to referring to Wal-Mart as a *major competitor*. Nor does the decision specify how the leveraging mechanism would operate, why this was likely, why competitors would be marginalized, or when the anticipated adverse effects in VATS would likely occur.

VIE structures and approach to such structures

The limitations on Wal-Mart's use of a VIE structure to operate a VATS business similar to the online direct sales business operated by Yihaodian marks the first time that MOFCOM has provided a view on VIE structures in a published decision.[8]

The VIE structure is an investment structure that foreign investors have used in the past to invest indirectly in *restricted* sectors in China.[9] For example, foreign investment in VATS – such as Internet content provision,

---

[7] Foreign investment in China is classified as "encouraged", "permitted", "restricted" or "prohibited". Different foreign ownership rules, government approvals and tax policies apply depending on the classification.

[8] Generally, MOFCOM consults widely during its review. This includes other government agencies (such as the National Development and Reform Commission (NDRC) and the Ministry of Industry and Information Technology), competitors, suppliers, customers and trade associations. It can be expected that MOFCOM consulted other government agencies before reaching its decision.

[9] The VIE structure was first developed to circumvent foreign investment restrictions in restricted sectors such as telecommunications and

online media, online gaming, and operation of an online retail platform – must be made through a Sino-foreign JV in which the foreign investor may hold a maximum 50% equity stake. The approvals required for such JVs are generally difficult to obtain. Chinese domestic companies have also made use of this vehicle in the past for offshore financing or listing.[10] The VIE structure enables a foreign investor to control (but not directly own) and obtain economic benefits from an operating company via a series of contractual arrangements. The VIE structure thus enables the foreign investor to enjoy the economic benefits from investing in a restricted sector without obtaining the required regulatory approvals for a direct investment.

MOFCOM's decision does not mention the regulatory issues or restrictions associated with online retail and/or the VATS business. At the same time, the decision does not state expressly that VIE structures are unlawful. Nonetheless, the remedies imposed make clear that MOFCOM will carefully examine transactions involving an acquisition of control over a VIE structure.

Implications for businesses

The decision shows that the retail sector continues to attract close attention in China.[11]

The decision also highlights the often lengthy and detailed review of transactions that are complex or occur in sensitive sectors in China. MOFCOM took the full review period of 180 calendar days to clear the transaction. The timetable from notification to clearance was more than 7 months.

Businesses should continue to be mindful that obtaining merger control approval in China may impact deal timetables and factor in adequate time in deal timetables. It remains prudent to engage with MOFCOM early in the process – especially in cases that are likely to attract attention – in order to identify and address concerns as early as possible.

This decision also indicates that VIE structures are subject to review under the AML. The decision does not state expressly that VIE structures are unlawful but suggests that VIE structures will continue to be scrutinized and monitored by the Chinese government.

---

media. See, further, Clifford Chance briefing *VIE structure in China faces scrutiny* (http://www.cliffordchance.com/publicationviews/publications/2011/10/vie_structure_inchinafacesscrutiny.html).

[10] The VIE structure was first used by Sina Corporation in 2000 – one of the first Chinese Internet companies to list on Nasdaq. Other Chinese companies that have made use of the VIE structure in the past include Sohu, Netease, Shanda, Ctrip, Baidu, Youku and Dangdang (which listed on Nasdaq or New York Stock Exchange (NYSE)) as well as Tencent and Alibaba.com (which listed on the Hong Kong Stock Exchange (HKSE)).

[11] Other recent activity concerning the CG&R sector involve certain commercial practices scrutinised under the Price Law, Anti-Unfair Competition Law or conduct rules under the AML. Examples include the fine that the NDRC imposed on Unilever in 2011 in connection with a price announcement and a recent *Circular on the Issuance of a Work Plan on Screening and Rectification of the Illegal Collection of Fees by Large Retail Enterprises from Suppliers*, issued jointly by MOFCOM, the NDRC, the Ministry of Public Security, the State Administration of Taxation and the State Administration for Industry and Commerce.

Authors

Ninette Dodoo
Head of Antitrust Practice, China
T: +86 106535 2256
E: ninette.dodoo
@cliffordchance.com

Yong Bai
T: +86 106535 2286
E: yong.bai
@cliffordchance.com

Angie Ng
T: +852 2826 3404
E: angie.ng
@cliffordchance.com