

Implications of China's conditional competition approval of Glencore/Xstrata

On 16 April 2013, the Ministry of Commerce of the People's Republic of China (MOFCOM) gave conditional approval to the US\$30 billion takeover of Xstrata plc by Glencore International plc. MOFCOM granted its conditional approval more than a year after the transaction was first notified.

MOFCOM's conditional approval reflects an increased level of detail, including in the nature of the divestiture and supply terms required by MOFCOM as merger remedies and may provide useful insight into how it will review complex mergers in the future.

Introduction

The approval and the attendant detail of both the *Glencore/Xstrata* decision and the merger conditions need to be considered in the context of MOFCOM's release of draft regulations for consultation dealing with:

- (a) Regulations on Imposing Restrictive Conditions on Concentrations of Undertakings; and
- (b) Interim Regulations on Standards Employed for Simple Concentrations of Undertakings (Simple Mergers Regulations).

These draft regulations, upon which MOFCOM is currently conducting consultations, provide the background for the increased level of detail and

structure of MOFCOM's decision in *Glencore/Xstrata*.

MOFCOM may well be using the recent *Glencore/Xstrata* decision as an example of how it will review complex mergers in the future and the level of detail of the merger divestiture and other remedies that it will require.

In addition to the guidance that the decision and the remedies provide, the *Glencore/Xstrata* decision provides an insight into how MOFCOM may assess similar types of mergers in the resources or other industry sectors that are of strategic importance in China, such as food and agriculture.

Background

In *Glencore/Xstrata*, MOFCOM's assessment focused on the markets for copper concentrate, zinc concentrate and lead concentrate – in particular copper concentrate – where

Key issues

- The *Glencore/Xstrata* decision provides insight into how China's MOFCOM may assess mergers in the resources sector as well other industry sectors that are of strategic importance in China such as food and agriculture
- MOFCOM formed the view that the proposed combination was likely to have the effect of eliminating or restricting competition in the markets for copper concentrate, zinc and lead concentrate
- MOFCOM imposed both structural and behavioural conditions including the divestiture of an overseas assets by Glencore

Glencore and Xstrata had overlapping activities.

Despite the fact that, from an international perspective, the merged entity may be viewed as possessing a relatively limited market share of China's copper concentrate market (17.8% of China's imports in 2011), MOFCOM imposed both structural and behavioural conditions. These included divestiture.

Glencore is required to sell the US\$5.7 billion Las Bambas copper

project in Peru, expected to produce 400,000 tonnes per annum. Failure to do so in the required time frame will have significant consequences, namely the sale of other Glencore assets at prices without a reserve.

The merged entity is also to guarantee a specified supply of copper concentrate to China under an annual contract process over the next eight years. The minimum in 2013 will be 900,000 tonnes, equivalent to Glencore and Xstrata's average copper sales in China in the past two years. Interestingly, the requirement to sell under an annual contract is a divergence with the move in some commodities markets to spot pricing (such as in the iron ore market). MOFCOM imposed similar directives on sales contracts as a condition in its conditional approval of Uralkali's acquisition of Silvinit, both major producers of potassium chloride used in fertilisers.¹

MOFCOM's competition concerns

MOFCOM formed the view that the proposed combination was likely to have the effect of eliminating or restricting competition in the markets for copper concentrate, zinc concentrate and lead concentrate.

MOFCOM also found that in respect of the copper, zinc and lead resources controlled by the merged entity and therefore the resulting level of supplies of those concentrates to China, there would be a significant increase in vertical integration by Glencore and a consequent significant impact downstream on Chinese buyers.

This was found by MOFCOM not to have been ameliorated by the ability of competitors to enter the market or

by countervailing buyer power of companies operating in China.

Merger remedies

Asset divestiture

Glencore is required to divest the Las Bambas project by 30 June 2015, using its reasonable efforts to secure an approved purchaser as described in section 16 of the Remedial Commitment Plan.

Section 16 on its face is not dissimilar to clauses required by other agencies requiring an independent purchaser with suitable qualifications, which satisfies other competition jurisdictions and which does not exclude or restrict competition in China. It is required to submit details of a buyer to MOFCOM by 31 August 2014 and enter into a binding agreement by 30 September 2014.

Unless MOFCOM agrees to any extensions, failure to complete the transfer by 30 June 2015 will see a divestiture trustee appointed to sell, pursuant to an unreserved auction, Glencore's interests in the Tampakan, Frieda River, El Pachon and Alumbra projects.

Supply terms

From 2013 to 31 December 2020, Glencore is to provide long-term contracts for the supply of copper concentrates to Chinese customers.

These will provide for 200,000 tonnes to be sold based on benchmark prices to be set between the main mining enterprises and the main smelting plants in China, with the remaining 700,000 tonnes to be determined based on prices resulting from such process.

The supply in the following years is to be proportionally adjusted upwards or downwards by Glencore's annual

production budget. Zinc and lead concentrate is to continue to be sold under long-term contracts based on fair and reasonable terms.

Trustee

Finally, Glencore is to appoint an independent monitoring trustee to monitor and report on Glencore's performance of MOFCOM's conditions.

While the merger remedies are focused on the impact on China, the detail in the terms and conditions, while more than usual for China so far, is becoming increasingly familiar with other regulators.

Ramifications – things to consider:

Timing: Glencore first lodged an application with MOFCOM on 1 April 2012. Acceptance of the application by MOFCOM was acknowledged on 17 May 2012 triggering the start of the Phase I review.

In June 2012, MOFCOM began its Phase II review. In September 2012, MOFCOM extended its review with Glencore's consent² and Glencore submitted two rounds of solutions that did not fully address MOFCOM's concerns.

Glencore's application was withdrawn on 6 November 2012 and re-filed on 23 November 2012,³ following which it was accepted by MOFCOM on 29 November 2012. On 29 March 2013, with the consent of Glencore, MOFCOM extended the further review period.

As a consequence, the process took, in total, more than a year. This type of time frame is important for merger participants and investment bankers.

More generally, a significant number of transactions notified to MOFCOM, including no issues transactions, routinely enter into Phase II review resulting in lengthy review timetables – sometimes spanning four to six months from submission of the notification to clearance by MOFCOM.

MOFCOM's lengthy review procedures reflect the unique institutional design of China's merger control regime, which involves a multi-layered consultation process that includes other government agencies, such as China's economic planning agency, the National Development and Reform Commission and sometimes sector-specific agencies, as well as industry associations and third parties.

MOFCOM's Simple Mergers Regulations are intended to address the noted delays in "non-problematic" transactions.

The Simple Mergers Regulations define "simple" cases as including

- (a) transactions between competitors with a combined market share of less than 15%;
- (b) transactions between parties active at different levels of the supply chain if the parties have a market share of less than 25% at either level of the relevant market;
- (c) transactions between parties active in complementary markets if the parties have a market share of less than 25% in each market; and
- (d) the creation of a joint venture outside China if the joint venture does not engage in economic activity in China.

Although welcome, the Simple Mergers Regulations create a degree of uncertainty as to the precise scope of transactions that are targeted – which we discuss elsewhere.⁴

Competition and industrial policy issues: That the *Glencore/Xstrata* decision focuses on the impact of the transaction on China's security of supply of copper and copper concentrate is not altogether surprising – at least in the China context.

In 2011, China attracted 68.5% of global copper concentrate supply with Glencore and Xstrata together accounting for 17.8% of total copper concentrate imports into China.

China's Anti-Monopoly Law (AML) requires MOFCOM to take non-competition issues into account – notably a transaction's impact on national economic development – alongside its competition analyses, including in cases that ostensibly, raise no substantive competition concerns.

Merger participants in other sectors with similar market shares that could be subject to this type of competition analysis, such as energy, agriculture and raw materials/commodities and chemicals should take note.

Structuring of undertakings: Requirements for divestitures of overseas assets by competition regulators to address competition concerns in an agency's home jurisdiction are not unheard of, including in China.

In 2009, MOFCOM imposed remedies in *Panasonic/Sanyo*⁵, which included the divestment of a manufacturing facility in Japan.

The *Glencore/Xstrata* decision reaffirms, in the nature of the mix of structural and behavioural

remedies, MOFCOM's willingness to commercially renegotiate supply terms to address its concerns and to focus especially on the impact on businesses in China – as it did in *Uralkali/Silvinit*⁶. Merger participants will need to be pragmatic in assessing the nature of remedies that may be required by MOFCOM and attendant timelines.

Conclusion

The commercial terms of the remedies are the most detailed to date. These are expected to be used as a reference point for the level of detail required by other merging parties.

Structural and/or behavioural remedies are not uncommon in China. That said, behavioural remedies are not necessarily a soft option: they can be far-reaching, and raise long-term administrative burdens and monitoring costs for merging parties.

The decision reflects MOFCOM's resolve to engage with merging parties to address identified concerns whether of a competition or mixed competition/non-competition nature.

For merging parties, this is positive news. But, the consequential impact on deal timetables and the commercial terms of remedies required to secure clearance may be too onerous a price to pay for some.

The *Glencore/Xstrata* decision highlights the importance of obtaining early antitrust merger advice.

Footnotes

1 *Announcement No. 33 of 2011 of Antitrust Review Decision on Conditional Approval of the Acquisition of OAO Silvinit by OAO Uralkali*, 2 June 2011. See our briefing entitled [Horizontal mergers in the China context: The Uralkali/Silvinit potash merger and continuity of supply obligations published 8 August 2011](#) on www.cliffordchance.com.

2 MOFCOM may exceptionally conduct an Extended Phase II review, including at parties' request.

3 This is, of course, not the first time that merging parties have resorted to "pull and re-file" measures in order to address concerns raised during the merger review process. See *Announcement No.9 of Antitrust Review Decision on Conditional Approval of the acquisition of Hitachi Global Storage Technology by Western Digital Corporation*, 2 March 2012

4 See our briefings entitled MOFCOM seeks to streamline and clarify the Chinese merger control process – draft regulations published 24 April 2012 and [Simplified merger control on the horizon: Convergence across jurisdictions](#) published 12 April 2013 on www.cliffordchance.com.

5 *Announcement No. 82 of 2009 of Antitrust Review Decision Conditional Approval of Panasonic's acquisition of Sanyo* published on 30 October 2009.

6 See Footnote 1.

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