Skadden

Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

January 13, 2014

The Year in Review – Antitrust and Competition Enforcement in China in 2013

Over the last two years, China has emerged as one of the most significant jurisdictions worldwide for antitrust and competition matters. Now more than ever, firms doing business in China or participating in major transactions impacting China's interests must carefully plan and prepare to take account of Chinese competition policy. Chinese competition agencies now increasingly alter the timing to clear global mergers and acquisitions and can materially affect the day-to-day business practices of international firms in China. In addition, China has joined the ranks of competition regulators taking an active interest in international cartels, while domestic civil litigation has also begun to develop into a viable means of redress for private complaints.

As discussed in more detail below:

- China's merger control practice has become increasingly confident and vigorous, and the Anti-Monopoly Bureau of the Ministry of Commerce (MOFCOM) continues to apply a unique "hold separate" remedy, allowing transactions to close but preventing integration of business operations and assets for years, subject to on-going review and "reconsideration";
- China has for the first time levied fines for international cartel activity and continues to increase its domestic policing of the pricing activities of international firms in China; and
- Civil litigation of private, domestic antitrust claims has begun to produce sophisticated analyses from Chinese higher courts.

These activities will only increase in 2014, heightening the importance of careful planning and preparation, both for global mergers and acquisitions and for companies' domestic Chinese operations.

1. A Brief Review of the Competition Regime in China

The Anti-Monopoly Law (AML) — the first comprehensive law of its kind in China — has only been in effect for five years. Nevertheless, the three Anti-Monopoly Enforcement Agencies (AMEAs) have quickly hit their stride, showing confidence and independence seldom seen in such young regimes. MOFCOM administers China's merger control review and evaluated approximately 200 transactions in 2013. MOFCOM still clears most deals unconditionally, but even routine transactions often spend several more months under review in China than they would in other jurisdictions, while particularly sensitive transactions can spend more than a year in review, with MOFCOM sometimes imposing significant remedies in deals cleared unconditionally by the U.S. and EU.

China's two other AMEAs are the Anti-Monopoly Bureaus of the National Development Reform Commission (NDRC) and the State Administration for Industry and Commerce (SAIC). The NDRC is primarily responsible for enforcing the AML with regards to any price-related anticompetitive conduct, such as price-fixing and retail price maintenance, while the SAIC enforces the AML's provisions on non-price-related conduct,

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Simon Baxter
Brussels
+32.2.639.0310
simon.baxter@skadden.com

Sharis A. Pozen
Washington, D.C.
+1.202.371.7555
sharis.pozen@skadden.com

Frederic Depoortere
Brussels
+32.2.639.0334
frederic.depoortere@skadden.com

Andrew L. Foster
Beijing
+86.10.6535.5531
andrew.foster@skadden.com

* * *

Four Times Square, New York, NY 10036
Telephone: +1.212.735.3000

WWW.SKADDEN.COM

such as tying and bundling. The AMEAs have not clarified how this distinction between price- and non-price-related conduct is applied in practice, however, resulting in a certain amount of overlap in the agencies' activities.

2. Merger Control

In the AML's first five years, MOFCOM has approved an overwhelming majority of transactions unconditionally. Indeed, in reviewing some 700 transactions, MOFCOM has prohibited only one deal (the proposed 2009 *Coca-Cola/Huiyuan* acquisition) and imposed remedies in 20 decisions. However, fully half of these conditional decisions have come down in the past two years, demonstrating MOFCOM's increased confidence in fashioning and imposing conditions. Moreover, as MOFCOM review typically takes into account comments and input not only from important state ministries (such as the NDRC and the Ministry of Industry and Information Technology) but also from Chinese stakeholders (including customers, suppliers and even competitors), the time required for review has increased while outcomes have become less predictable in recent years. The duration of MOFCOM review for conditional approvals, which already averaged 8.4 months per transaction in 2012, increased to 11.1 months in 2013.

The last two years have also seen the creation and propagation of a type of condition unique to China — the so-called "hold separate" remedy. In four cases since late 2011, MOFCOM has conditionally approved the transaction, permitting closing while nevertheless freezing the ability of the merging firms to integrate their assets or business operations for a minimum review period (usually one to three years) before the firms can apply for "reconsideration" and lifting of the condition. During the review period, the acquirer and target operations must be held separate, generally on a worldwide basis, while an appointed trustee monitors contracts, pricing, customer relations and other business practices, sending reports back to MOFCOM on a semi-annual or quarterly basis. In addition to the moratorium on integration, these decisions often include conditions such as information firewalls and strict limitations on the exercise of shareholder rights for the acquirers.

None of the four transactions have involved Chinese firms, and three of the four — *Samsung/Seagate*, *Western Digital/Hitachi* and *MediaTek/MStar* — have occurred in high-tech industries (hard disk drives and LCD TV control chips) where Chinese manufacturing customers or suppliers stood to be particularly affected. The first "reconsideration" application is currently before by MOFCOM, making it difficult to predict whether these remedies will be easily lifted following the prescribed review period.

In the 2013 *Glencore/Xstrata* transaction, MOFCOM imposed a structural remedy surprising for its requirement that Glencore divest its interests in a Peruvian mine, confirming that MOFCOM clearly considers it has the power to impose remedies outside of China. Press reports now indicate a strong likelihood that the mine will ultimately be acquired by one of China's state-owned mining conglomerates, specifically MMG Limited — the Hong Kong-listed offshore arm of China Minmetals Corporation.

3. Price-Fixing and Pricing Activities

The past year also marked significant new steps in antitrust enforcement by the NDRC and SAIC with regard to international cartels as well as pricing activities in Chinese domestic markets.

In January 2013, China joined the EU, U.S. and other jurisdictions in levying fines against six LCD panel manufacturers for price-fixing activities between 2001 and 2006. The NDRC led the investigation, which related to conduct pre-dating the passage of the AML and thus was conducted under an older Chinese statute (the Price Law) that contains price-fixing prohibitions similar to those found in the AML. The investigation marks the first fines ever handed down by Chinese regulators for international cartel

activity, an importance belied by the comparatively small size of the fines (¥353 million, approximately US$56 million) compared to those of the U.S. (US$1.4 billion to date, with criminal charges brought against 22 executives) and EU (€648 million, approximately US$890 million).

Little clarity resulted from the investigation with regard to issues of leniency or immunity, however, given that the Price Law (unlike the AML) makes no formal provision for leniency. While the AML establishes in principle that leniency should be available for cartel participants, the statute leaves its availability entirely to the discretion of the NDRC or SAIC.[1] Moreover the respective NDRC and SAIC guidelines relating to leniency have inconsistent provisions, particularly with regard to the eligibility of applicants who are not first in time and the eligibility of so-called "ringleaders" for leniency. Future guidance and action by the NDRC and SAIC will hopefully bring more clarity to Chinese cartel enforcement practice.

The NDRC has also become very active in recent months in conducting investigations into the pricing activities of international firms in China, ostensibly under the AML. Historically, the NDRC has had responsibility under the Price Law to regulate directly pricing of commodities and goods in Chinese markets. Thus, while such regulation would be considered anathema to competition regulators in the U.S., EU and other jurisdictions, it is far more accepted in China.[2]

In July, however, a division chief at the NDRC held a closed-door meeting with senior in-house counsel from approximately 30 international firms billed as a training session for multinationals to mark the fifth anniversary of the AML. At the meeting, the official reportedly indicated that at least half of the firms were or had been under investigation by the NDRC for pricing issues and reportedly suggested that providing admissions of guilt and "self-criticisms" rather than hiring experienced legal counsel could result in more favorable treatment during the course of the investigation.

While more senior NDRC officials have subsequently disavowed these comments in public, indicating that the NDRC does not seek to curb the legal rights of companies under investigation, the NDRC has also subsequently announced significant penalties for pricing activities. For example, six infant milk formula manufacturers, including Mead Johnson and Danone, were fined a total of ¥667.7 million (approximately US$110 million) for allegedly restricting competition, setting curbs on minimum prices for distributors, and, again, disrupting market order. None of the firms are contesting the penalties.

In addition, the NDRC has announced that it is presently investigating approximately 60 firms in the pharmaceutical industry, while in November Qualcomm — the world's largest maker of chips for smartphones — announced that it is the subject of an AML-related NDRC investigation. The NDRC has also announced that the telecommunications, banking, petroleum and automobile sectors are now under "close" watch as potential targets of future investigations. These investigations appear to be part of wider initiative undertaken by new President Xi Jinping attempting to prevent rising consumer prices, notwithstanding the lack of any obvious anticompetitive behavior by the firms in question.

4. Civil Actions

The AML also provides a mechanism for civil litigation to resolve private antitrust complaints in China. While this system has been evolving slowly, 2013 brought some important developments. The most closely watched case has been a resale price maintenance action brought against Johnson & Johnson Medical by its Chinese distributor, Rainbow Medical.

---

1 *AML*, Art. 46.

2 For example, in May 2011, the NDRC fined Unilever ¥2 million (approximately US$330,000) under the Price Law on the grounds that it disturbed market order by spreading news of a price increase of household products.

Rainbow Medical's contract with J&J afforded it an exclusive regional distributorship, imposing contractual minimum pricing levels. When Rainbow Medical had won contracts outside its region by bidding below those minimum levels, J&J terminated the distributorship. Rainbow Medical subsequently brought suit against J&J. In the first instance, the court dismissed the suit, finding that Rainbow had not discharged its burden of proof in showing the existence of a dominant position and the existence of anticompetitive effects. On appeal to the Shanghai Higher People's Court, however, Rainbow Medical prevailed, securing damages of ¥530,000 (approximately US$90,000) in lost profits.

The appellate court provided a sophisticated and detailed analysis, including a careful examination of relevant economic evidence. The court held that in such civil litigation, the plaintiff will bear the burden of proof on two main issues — the existence of an anticompetitive agreement and the existence of anticompetitive effects flowing from the agreement. Moreover, the court set out several expected prerequisites for bringing a successful suit, including: (i) establishing a relevant market and demonstrating insufficient competition on that market; (ii) showing that the defendant held a strong market position; (iii) demonstrating the motivation of the defendant to breach the provisions of the AML; and (iv) setting forth the anticompetitive effects produced by the agreement. The court indicated as well that it would consider and balance any alleged anticompetitive effects against procompetitive effects demonstrated by the defendant.

* * *

Over the past year, each of the Chinese AMEAs, as well as the Chinese courts, has demonstrated increased activity and confidence in competition enforcement. This more vigorous enforcement and scrutiny is unlikely to abate in 2014. As a result, international firms operating in China or interacting with Chinese suppliers, customers or distributors should carefully review their current activities and incorporate China-specific legal strategies and compliance mechanisms. It is also critical that firms planning cross-border M&A now prepare diligently for potential MOFCOM review. Without careful planning, the increased engagement, confidence and sophistication of Chinese AML enforcement could create significant pitfalls for the unwary.