

## Navigating Chinese Merger Control: MOFCOM Prohibits P3 Shipping Alliance

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On June 17, 2014, the Anti-Monopoly Bureau of China's Ministry of Commerce (MOFCOM) issued just the second prohibition decision in its enforcement history, striking down the proposed P3 Network shipping alliance that would have created a long-term vessel-sharing agreement among Denmark's AP Møller-Maersk A/S (Maersk Line), Switzerland's Mediterranean Shipping Company (MSC) and France's CMA CGM.<sup>1</sup>

The prohibition follows MOFCOM's increasingly familiar approach of considering national economic concerns together with pure competition concerns during its merger review.<sup>2</sup> The prohibition also puts to rest any perception that MOFCOM had become unwilling to block significant transactions outright in the five years since its last prohibition. While Maersk Line's chief trade and marketing officer called the decision "a surprise,"<sup>3</sup> it highlights in stark detail the now indisputable importance of careful planning, preparation and active guidance necessary to navigate significant deals through the unpredictable Chinese review process.

### Background of the Proposed Alliance

A year ago, on June 18, 2013, Maersk Line, MSC and CMA CGM announced their intention to establish a long-term vessel-sharing alliance (the P3 Network) on trans-oceanic, east-west trade routes. The parties hoped to improve their container liner shipping efficiency and service quality through an "operational, but not commercial" cooperation.<sup>4</sup> To that end, the parties sought to create a combined fleet of 255 ships, running nearly 30 service loops along Asia-Europe, trans-Pacific and trans-Atlantic shipping routes, while continuing "to have fully independent sales, marketing and customer service functions".<sup>5</sup>

The alliance required regulatory approval from several jurisdictions, including the U.S. Federal Maritime Commission (FMC), the EU Commission, MOFCOM, and South Korea's Fair Trade Commission (KFTC). Even before the prohibition by MOFCOM, regulatory reception to the proposal had been divided. On March 24, 2014, the FMC approved the alliance, although U.S. Maritime Commissioner Richard Lidinsky dissented strongly, characterizing the P3 Network not as "an alliance or true vessel-

1 Ministry of Commerce, People's Republic of China, Notice No. 46 of 2014 on the Prohibition of Maersk, MSC, CMA CGM Establishing A Network Alliance (June 17, 2014), *available at*: <http://www.mofcom.gov.cn/article/b/e/201406/20140600628730.shtml> (Chinese).

2 Indeed, Chinese law requires MOFCOM to take such industrial policy concerns into account during merger control. See Anti-Monopoly Law of the People's Republic of China, Article 27(5) (instructing MOFCOM to consider during its review *inter alia* "[t]he effect of the concentration on national economic development").

3 Maersk Line Press Release, "The P3 Network Will Not be Implemented Following Decision by the Ministry of Commerce (MOFCOM) in China" (June 17, 2014), *available at*: <http://www.maerskpress.com/NEWS-ROOM/the-p3-network-will-not-be-implemented-following-decision-by-the-ministry-of-commerce-mofcom-in-china/s/a07aa90e-6fb1-4c8d-8c68-bbc126ab4ab4>.

4 Maersk Line Press Release, "Maersk Line, MSC and CMA CGM to Establish an Operational Alliance" (June 18, 2013), *available at*: <http://www.maerskline.com/da-dk/countries/int/news/news-articles/2013/06/operational-alliance>.

5 *Id.*

sharing arrangement” but rather as being “in effect a merger of the top three global liner companies”.<sup>6</sup> Commissioner Lidinsky considered that the alliance would allow the parties “to dominate vessel competition and narrow shipper options at U.S. ports.”<sup>7</sup> On June 3, 2014, the EU Commission informed the parties that it had decided not to open an investigation into the proposed alliance. However, the KFTC opened its investigation in February, and on March 3, the Korean Shipowners’ Association lodged “strong” objections with the KFTC, claiming that the alliance would restrict competition and violate the Korean Fair Trade Act.<sup>8</sup>

### MOFCOM’s Prohibition Decision

MOFCOM’s prohibition decision, while brief, defined the relevant product market and then articulated five factors tending to demonstrate that the proposed alliance would restrict competition.

With regard to market definition, MOFCOM found international container liner shipping services to be a relevant product market, with the relevant geographic markets being Asia-Europe routes, trans-Pacific routes and trans-Atlantic routes. Given the absence of affected Chinese ports on trans-Atlantic routes and the large number of competitors operating on trans-Pacific routes, the decision focused on container liner shipping services on Asia-Europe routes.<sup>9</sup>

In its review, MOFCOM found five factors to be particularly significant.

- While vessel-sharing arrangements were common in the industry as a result of the capital-intensive and high-risk nature of the business, the proposed alliance went beyond such loose associations and instead created a tight, jointly operated concentration in which only the technical management of individual vessels remained independent from an operations perspective.<sup>10</sup>
- The transaction would “significantly enhance” the market power of the parties, given that the combined post-transaction capacity share of the P3 Network would be 46.7 percent of Asia-Europe container liner shipping (considering collectively the individual shares of Maersk Line (20.6 percent), MSC (15.2 percent) and CMA CGM (10.9 percent)).<sup>11</sup>
- The degree of concentration in the market would increase significantly, calculating an increase of 1350 in the Herfindahl-Hirschman Index (HHI), from approximately 890 pre-transaction to 2240 post-transaction.<sup>12</sup> Pursuant to the U.S. Horizontal Merger Guidelines, U.S. antitrust regulators would consider an HHI of 2,240 to indicate a level of “moderate concentration” in a market.<sup>13</sup>
- The proposed transaction would increase barriers to entry in the market, although it did not support this finding with detailed analysis.<sup>14</sup>

6 Comments of Commissioner Richard A. Lidinsky, Jr. on Proposed P3 Vessel Sharing Agreement (March 24, 2014), *available at*: [http://www.fmc.gov/commissioner\\_lidinsky\\_comments\\_on\\_proposed\\_p3\\_agreement/](http://www.fmc.gov/commissioner_lidinsky_comments_on_proposed_p3_agreement/).

7 *Id.*

8 See Greg Knowler, “No Sign of Korean Decision on P3 Network,” *Journal of Commerce* (June 9, 2013) *available at*: [http://www.joc.com/maritime-news/container-lines/p3-network/no-sign-korean-decision-p3-network\\_20140609.html](http://www.joc.com/maritime-news/container-lines/p3-network/no-sign-korean-decision-p3-network_20140609.html).

9 *Maersk/MSC/CMA*, paras. 3(1), 3(2).

10 *Id.* at para. 4(1).

11 *Id.* at para. 4(2).

12 *Id.* at para. 4(3).

13 U.S. Horizontal Merger Guidelines of the U.S. Department of Justice and the Federal Trade Commission (August 19, 2010), Section 5.3 *Market Concentration*.

14 *Maersk/MSC/CMA*, para. 4(4).

- The integration would enhance the parties’ market power and thereby “squeeze development” for other competitors.<sup>15</sup>

According to the decision, the parties put forth “several rounds” of proposed remedies, with the latest version submitted on June 9, 2014; however, these all were rejected, as MOFCOM considered them to lack the “appropriate and convincing evidence” necessary to resolve MOFCOM’s concerns.<sup>16</sup> As a result, MOFCOM found that the proposed alliance would have the effect of restricting competition on international shipping routes between Asia and Europe, and that the parties had failed to establish that: (i) the beneficial competitive effects of the alliance would “clearly exceed” the adverse effects and (ii) the alliance would comply with the public interest.<sup>17</sup>

### Implications of the Decision

In the five years since MOFCOM prohibited the proposed US\$ 2.5 billion acquisition of Chinese Huiyuan Juice Group Limited by U.S. Coca-Cola Co., MOFCOM consistently has demonstrated its willingness (and even its obligation) to consider national economic development concerns alongside pure competition concerns during its merger review process. Nevertheless, in recent years, MOFCOM has appeared to go to significant lengths to avoid prohibiting transactions outright — even those that potentially could have strong adverse implications for Chinese industrial policy. Thus, the institution of China’s unique “hold separate” remedy (discussed in our previous memos [here](#) and [here](#)) has permitted MOFCOM to adopt a “wait and see” approach with regard to transactions it felt threatened the economic well-being of Chinese customers, suppliers and competitors, when it might otherwise have simply blocked those deals in their entirety.

For the proposed P3 Network, it is clear that national economic concerns played an important role — however, they did not play the only role. Although some of China’s largest shipping companies such as China COSCO Holdings Inc. and China Shipping Container Lines were reportedly ambivalent about the P3 Network (perhaps due to their own participation in various shipping alliances), the relevant trade association for domestic competitors, the China Shipowners’ Association (CSA), worked actively to block the deal.<sup>18</sup> According to CSA, the alliance would in fact have resulted in combined market share of between 65 percent and 70 percent on shipping routes and resulted in higher shipping related costs for cargo holders not only in China but worldwide.<sup>19</sup>

In addition to the CSA’s concerns, MOFCOM also would have needed to consult with the Ministry of Transportation (MOT) and National Development and Reform Commission (NDRC) in coming to a final view on the alliance. Indeed, it is understood that Director General Shang Ming of the MOFCOM Anti-Monopoly Bureau took concerns about the deal sufficiently seriously to go himself on a research trip to Shanghai’s Yangshan deepwater port in order to better understand the industry before taking a decision. The diligence of MOFCOM and the *prima facie* legitimacy of its competition concerns — especially when coupled with the worries of FMC Commissioner Lidinsky and the wariness of the KFTC — lend credence to the suggestion that the prohibition was not motivated by industrial policy concerns alone.

<sup>15</sup> *Id.* at para. 4(5).

<sup>16</sup> *Id.* at para. 5.

<sup>17</sup> *Maersk/MSC/CMA*, para. 6. See also AML, Article 28.

<sup>18</sup> See, e.g., Carlos Tejada, “China Shows Regulatory Heft by Sinking Shipping Deal,” *Wall Street Journal* (June 17, 2014).

<sup>19</sup> See Joy C. Shaw, “China’s MOFCOM Seeks Input From Local Competitors, Industry Groups on P3 Network,” *PaRR Reports* (March 18, 2014).

Nevertheless, the prohibition drives home forcefully the point that the unique nature of merger review in China demands careful preparation and expertise, as well as a thorough advance understanding of the potential differences between MOFCOM’s review and that of other competition regulators. From sensitive pre-submission discussions with MOFCOM and other stakeholders to the crafting of acceptable and effective remedies within the necessary timetables, the process in China requires strong advanced planning and skillful navigation throughout. In order to avoid the “surprise” of an unanticipated prohibition, companies considering mergers, acquisitions, joint ventures and other collaborative agreements can simply no longer afford to use a “one-size-fits-all” approach when it comes to Chinese merger control.

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