

MOFCOM Lifts Hold-Separate Remedies for the First Time

Skadden

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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

Frederic Depoortere

Brussels
32.2.639.0334
frederic.depoortere@skadden.com

Ingrid Vandenborre

Brussels
32.2.639.0336
ingrid.vandenborre@skadden.com

James S. Venit

Brussels
32.2.639.4501
james.venit@skadden.com

Andrew L. Foster

Hong Kong
852.3740.4864
andrew.foster@skadden.com

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Four Times Square
New York, NY 10036
212.735.3000

skadden.com

In late 2011 and early 2012, China's Ministry of Commerce (MOFCOM) introduced a new and unique merger control remedy with far-reaching implications. In two separate decisions involving nearly simultaneous global acquisitions of hard disk drive (HDD) businesses, MOFCOM imposed conditions that, *inter alia*, strictly required the acquiring companies to maintain indefinitely the independence of the target businesses (including design, production, brands, and sales and marketing) while implementing strict internal firewalls to protect against sharing of confidential information.¹

Each decision indicated that the acquiring company could apply to MOFCOM to have these "hold separate" conditions removed after a set period of time (one year in the first decision, two years in the second). Now, almost four years after the first decision and three and a half years after the second, both acquiring companies have finally reached agreements with MOFCOM to remove or modify these hold-separate remedies, after significant effort.

Timelines for Two Pilot Cases of MOFCOM's Unique Hold-Separate Remedy

On December 12, 2011, MOFCOM approved the acquisition by Seagate of Samsung's HDD business. Shortly thereafter, on March 2, 2012, MOFCOM approved the acquisition by Western Digital of the HDD business of Hitachi (now called Hitachi Global Storage Technologies, or HGST). In both cases, however, MOFCOM imposed the condition that the target company must be maintained as an independent legal entity with respect to all aspects of business (essentially prohibiting integration), including research and development (R&D), production, procurement, sales and marketing, after-sales and other critical functions. The remedies applied to the businesses globally, and monitoring trustees were appointed to ensure strict compliance.

The *Seagate/Samsung* decision indicated that Seagate could first apply to lift the remedy one year after the decision, in December 2012. The *Western Digital/Hitachi* decision indicated that Western Digital could first apply to lift the remedy two years after the decision, in March 2014. Seagate delayed submission of its application to remove the hold-separate condition until May 2013, while Western Digital submitted its application promptly in March 2014. However, the review processes took substantially longer than generally anticipated (more than two years in Seagate's case).

During each evaluation process, MOFCOM met with the applicants multiple times to discuss removal and required the applicants to submit detailed evidence. MOFCOM also consulted with other Chinese government agencies, industrial associations and customers, and even engaged independent third-party economic experts. Finally, on October 19, 2015, MOFCOM announced the partial removal of the conditions in *Western Digital/Hitachi*, and on October 22, 2015, MOFCOM announced the complete removal of the conditions in *Seagate/Samsung*.

MOFCOM's Primary Focus on Changes in Market Conditions

During its review of each application, MOFCOM engaged its own economists and focused primarily on the changes in market conditions with respect to the HDD market in recent years. Indeed, in the intervening period since the first announcement of the conditions, MOFCOM has published draft remedy guidelines that indicate that, in

¹ See Competition Remedies for Mergers, Acquisitions and Joint Ventures: China's Diverging Practice from EU and U.S. Agencies, <http://www.skadden.com/insights/competition-remedies-mergers-acquisitions-and-joint-ventures-chinas-diverging-practice-eu->.

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considering whether to remove restrictive conditions, MOFCOM will evaluate whether:

- (i) the parties have undergone any significant change,
- (ii) market conditions have undergone any significant change, and
- (iii) it has become unnecessary or impossible to implement the conditions.²

Although the guidelines themselves have not been officially ratified, MOFCOM has indeed followed this framework in both *Western Digital/Hitachi* and *Seagate/Samsung*.

In particular, MOFCOM observed that market conditions for HDDs have indeed changed over time, at least to some degree. Most importantly, MOFCOM found that the competitive constraint imposed by solid state drive (SSD) products on HDD products has increased, and excess capacity in the industry also has increased. Nevertheless, MOFCOM noted that the competitive landscape for HDD had not changed so significantly as to

² Article 27 of the Provisions on Imposing Restrictive Conditions on Concentration of Undertakings (for Trial Implementation).

justify complete removal of the hold separate for Western Digital. Rather, Western Digital's combined share with HGST still gave it a leading position in the HDD industry. MOFCOM therefore agreed to remove the hold separate with regard to all aspects of R&D and production for Western Digital and HGST, but imposed new conditions preserving the separation between the two brands' sales and marketing teams, to expire automatically (without application) two years from the date of the decision.

This did not pose a significant issue for Seagate given the comparatively small market share of Samsung's HDD business (approximately 6.5 percent in 2014), and MOFCOM lifted the *Seagate/Samsung* hold separate in its entirety.

Although MOFCOM has applied its hold-separate remedy in other cases since *Western Digital/Hitachi*, it has not done so since its August 27, 2013, decision in *MediaTek/Mstar*, a deal leading to a significant horizontal overlap with respect to LCD TV semiconductors. MOFCOM has shown less enthusiasm for its unique hold separate in recent years, but the long-running experiences of Seagate and Western Digital as the first two pilot subjects of the remedy may cause other acquirers to think twice before accepting such a request in the future.

Additional Contacts

Clifford H. Aronson

New York
212.735.2644
clifford.aronson@skadden.com

C. Benjamin Crisman, Jr.

Washington, D.C.
202.371.7330
benjamin.crisman@skadden.com

Paul M. Eckles

New York
212.735.2578
paul.eckles@skadden.com

Shepard Goldfein

New York
212.735.3610
shepard.goldfein@skadden.com

Peter E. Greene

New York
212.735.3620
peter.greene@skadden.com

Matthew P. Hendrickson

New York
212.735.2066
matthew.hendrickson@skadden.com

James A. Keyte

New York
212.735.2583
james.keyte@skadden.com

Karen Hoffman Lent

New York
212.735.3276
karen.lent@skadden.com

John H. Lyons

Washington, D.C.
202.371.7333
john.h.lyons@skadden.com

Jeffrey A. Mishkin

New York
212.735.3230
jeffrey.mishkin@skadden.com

John M. Nannes

Washington, D.C.
202.371.7500
john.nannes@skadden.com

Maria Raptis

212.735.2425
New York
maria.raptis@skadden.com

Neal R. Stoll

New York
212.735.3660
neal.stoll@skadden.com

Steven C. Sunshine

Washington, D.C.
202.371.7860
steve.sunshine@skadden.com