China's Antitrust Regulator Ramps Up Scrutiny, Enforcement of Behavioral Remedies

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In March 2018, China's State Council announced the establishment of a unified market regulator, the State Administration for Market Regulation (SAMR), which now is responsible for all antitrust enforcement in China. Previously, antitrust enforcement in China was administered by three separate ministries, each responsible for different types of cases: the National Development and Reform Commission (NDRC) handled price-related conduct cases, the State Administration of Industry and Commerce (SAIC) dealt with nonprice-related conduct cases, and the Ministry of Commerce (MOFCOM) was responsible for merger reviews.

Since the consolidation process was completed in September 2018, SAMR has been strengthening overall enforcement of the Anti-Monopoly Law (AML) in China. With respect to merger control in particular, SAMR has significantly enhanced its supervision of the behavioral remedies it has imposed in its recent conditional approvals, taking a much more active role and working closely with the monitoring trustees post-closing.

Compared to its counterparts in the United States and the European Union, SAMR (like its predecessor MOFCOM) has a much stronger preference for using behavioral remedies in its merger review process to resolve competition concerns. The most common types of behavioral remedies imposed by SAMR (and which, of course, must subsequently be monitored) include commitments to: (i) maintain supply volume and quality to Chinese customers; (ii) maintain "fair and reasonable" pricing to Chinese customers; and (iii) not engage in any illegal tying or bundling. In addition to these, SAMR has also accepted a variety of other more creative behavioral remedies.

Of the 10 latest conditional cases approved by SAMR in 2017 and 2018, only two have not had any behavioral remedy (and one of these involved China's unique "hold separate" remedy).[1] The remaining eight all entail one or more behavioral remedies: Dow/DuPont (2017), Broadcom/Brocade (2017), HP/Samsung (2017), Agrium/Potash (2017), Maersk Line/Hamburg Süd (2017), Bayer/Monsanto (2018), Luxottica/Essilor (2018) and Linde/Praxair (2018). In most of these cases, approvals were not subject to any behavioral remedies in any other reviewing jurisdiction, or they include additional China-specific behavioral remedies absent from the remedy package approved by regulators in other jurisdictions.

Depending on the company's business practice, strict compliance with these behavioral remedies may become quite burdensome both in terms of time and expenses, as compliance procedures and training must be put in place, and data collection and submission obligations are substantial. These additional operational costs can become even more pronounced given the long tenures of some of these remedy periods, which may last for five or even 10 years. Indeed, some remedies do not have a specified expiration date, meaning that the post-closing entities are bound by these remedies indefinitely until the remedies are lifted by SAMR.

These additional operational costs will be exacerbated not only by the fees for the services of the monitoring trustee (which are borne by the subject company of the remedy), but also by additional legal fees to help ensure that the company remains in compliance. These additional costs can easily run into the hundreds of thousands or even millions of dollars over a full review period.

[1] China's hold-separate remedy is a hybrid of structural and behavioral remedies, which is rarely imposed and often alleged to be driven more by industrial policy concerns than true competition concerns.

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Enhanced Supervision and Monitoring

During 2018, SAMR appears to have significantly strengthened its supervision and enforcement of behavioral remedies. Under MOFCOM, the division responsible for such monitoring was significantly understaffed and tended to delegate to the individual monitoring trustees put into place in each transaction. Now, however, its enforcement division has added several new senior officials with prior experience in some of the most high-profile merger review cases.[2] In addition, former SAIC and NDRC officials — historically trained for conduct-type investigations — have also taken their place in the new Anti-Monopoly Bureau hierarchy, leading to a new focus and spotlight on post-closing compliance.

For example, the practice of encouraging or requiring physical site visits during the early stage of remedy implementation now appears to have become standardized (or at least far more common). Such site visits often consist of several days of on-site review and interviews at the parties' local operations, which can require intense preparation and data submission both beforehand and during. In addition, these site visits are now often prefaced by SAMR seeking additional consultation from important Chinese stakeholders that played a role in the merger review or could be impacted by the operation of the remedy, including Chinese customers (and under that category, distributors), competitors and trade associations.

For those cases that faced domestic challenges during the merger review, SAMR's continued/renewed consultation with the local industry may provide an additional opportunity for Chinese stakeholders to influence the scope of the remedy compliance. While the mature and experienced nature of SAMR's review team indicates that frivolous or unfounded complaints should not be entertained, certain critical comments or questions from important domestic stakeholders could draw SAMR's attention and additional scrutiny. Thus, while there would be no legal basis for SAMR to re-open the actual merits and substance of the remedies imposed during the legal review (at least absent materially changed circumstances), entities should still be cognizant of walking into a potentially challenging regulatory process in anticipation of complaints raised by local stakeholders.

During SAMR's site visit and interviews, companies should also watch out for other questions concerning the compliance with China's AML as a general matter (that is, outside the limited scope of the remedy obligations). Behavioral remedies are often imposed based on findings that the post-closing entity may have a dominant position in the relevant market(s). Thus, the site visit and industry consultation also give SAMR an opportunity to inspect whether the post-closing entity has abused such dominance — in a broader sense than being noncompliant with the remedies — or has in other ways violated the AML (for example, by entering into illegal resale-price-maintenance agreements with distributors). Certainly, data discovered during a site visit that points to such violations could lead to a full investigation at a later point. Although such risks were likely low in the MOFCOM era when the division was understaffed and responsible only for merger control activities, the consolidation of former conduct investigators from the NDRC and SAIC will only strengthen SAMR's ability to move quickly if it becomes concerned that the AML has been violated.

Enhanced Enforcement in Behavioral Remedies

The enhanced regulation of SAMR means that post-closing, the companies subject to behavioral remedies will face greater compliance scrutiny. This new consultation-based supervision approach significantly increases the burden of compliance for the post-closing entities and may lead to higher operational costs than the parties had previously expected.

From a deal-planning perspective, this means that parties that anticipate a difficult merger review by SAMR should assess the full potential cost of various behavioral remedies. While some remedies may look relatively innocuous on paper (such as maintaining historic levels of supply or agreeing not to enter into exclusive distribution arrangements), each remedy comes with material legal, operational, confidentiality and other responsibilities that may be in place for years.

Once a party has agreed to post-closing commitments and compliance, the merged entities should proactively develop a robust and reliable internal compliance program post-closing. Written compliance policies, manuals and trainings should be prepared and distributed to relevant employees, and care should be taken to demonstrate to SAMR and the monitoring trustee that the party is taking serious measures to ensure its own compliance (or risk even-greater ongoing scrutiny in an atmosphere of mistrust).

No merging or acquiring company ever considers the possibility of remedies lightly, but this recent ramp-up of enforcement and scrutiny for behavioral remedies in China should serve as a significant reminder of the potential burdens and costs that can come with such a remedy. It also highlights the importance of careful pre-planning and consideration when navigating the turbulent waters of China's merger review.

[2] For example, it is understood that the supervision division now includes two former division directors of Review Division I. In the past few years, Review Division I has been responsible for reviewing of some of the most high-profile technology cases, including Broadcom/Brocade, Qualcomm/NXP, NXP/Freescale, Dell/EMC and HP/Samsung.