

## Merger Control Review 2018

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### Introduction

In 2018 the Anti-monopoly Law celebrated its 10th anniversary. Further, the antitrust enforcement functions of China's three former antitrust agencies (ie, the Ministry of Commerce (MOFCOM), the National Development and Reform Commission and the State Administration for Industry and Commerce) were consolidated into the new State Administration for Market Regulation (SAMR). The SAMR comprises 27 divisions, including the Anti-monopoly Bureau, which is responsible for the supervision and enforcement of the Anti-monopoly Law. The bureau's functions include:

- drafting anti-monopoly rules and guidelines;
- enforcing the Anti-monopoly Law;
- assisting enterprises in responding to foreign investigations;
- promoting the fair competition review system;
- undertaking international cooperation; and
- undertaking the day-to-day work of the State Council Anti-monopoly Committee<sup>2</sup>.

In 2018 the SAMR maintained a rigorous and prudent attitude towards merger control review. There was a significant increase in the number of cases concluded and the efficiency with which they were done so. As regards the cases which were conditionally approved, the SAMR imposed various tailored conditions. In addition, the SAMR investigated more non-filing cases and imposed more penalties on non-filers compared with 2017.

### Legislation

No material changes were made to the merger control rules in 2018. Further, the proposed Measure for the Review of Concentration of Business Operators (Revised Draft) has yet to be finalised.

On 29 September 2018 the SAMR published the following revised guidelines:

- Guiding Opinions on the Application for Concentrations of Business Operators;
- Guiding Opinions on the Filing Documents and Materials of Concentrations of Business Operators;
- Guidelines on Anti-monopoly Review for Concentrations of Business Operators;
- Explanations on Implementing the Notification Form on Anti-monopoly Review of Concentrations of Business Operators;
- Guiding Opinions on the Notification of Simple Cases of Concentrations of Business Operators;

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<sup>2</sup> *Provisions on the Function, Internal Organizations and Staffing of the SAMR*, 10 September 2018. The originals can be found on the website: [http://www.scopsp.gov.cn/bbyw/qwfb/201809/t20180910\\_308245.html](http://www.scopsp.gov.cn/bbyw/qwfb/201809/t20180910_308245.html)

- Guiding Opinions on Regulating the Names for Cases of Concentrations of Business Operators; and
- Supervision of Trustee Entrustment Sample Text<sup>3</sup>.

However, the above amendments concerned only the wording of the guidelines due to the institutional reform.

In addition, the Measure for the Review of Concentrations of Business Operators was materially revised and released for public comment. However, the official version of the measure has not been approved. Therefore, the measure published in 2009 still applies.

### **Unconditionally cleared cases**

According to data published on its website, the SAMR unconditionally approved 444 cases in 2018 – a significant increase from 325 in 2017. Among these cases, 359 were concluded in phase one (ie, within 30 days from the acceptance date), which accounts for 80.8% of all cases. Review efficiency increased considerably compared with 2017 (76.9% cases were concluded in phase one).

As regards simple cases, 362 were concluded in 2018 (81.53% of all cases). The proportion of simple cases increased slightly compared with 2017 (80.6% of all cases). On average, simple cases took 16 days to be concluded, a notable reduction from 24 days in 2017. Of these cases, 99.4% were concluded in phase one. This demonstrates that the simple case procedure has played an active role in enhancing the efficiency of concentration filing, particularly in terms of reducing review time.

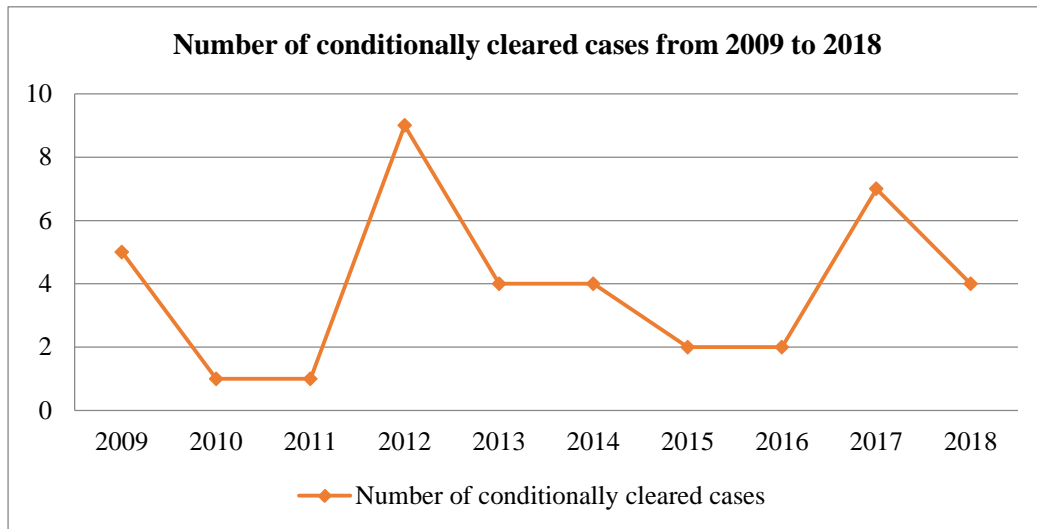
However, in practice, strict rules concerning the material and data required by the SAMR still apply. In particular, during the pre-review stage (before official case acceptance), notified parties must often submit detailed materials. Therefore, this requirement may also extend the wait time before case filing.

### **Conditionally cleared cases**

In 2018 the SAMR conditionally approved four cases. The figure below illustrates the number of cases which were conditionally cleared between 2009 and 2018.

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<sup>3</sup> The website of SAMR: [http://samr.saic.gov.cn/xw/yw/wjfb/index\\_1.html](http://samr.saic.gov.cn/xw/yw/wjfb/index_1.html)



The cases which were conditionally cleared in 2018 were:

- Bayer's acquisition of Monsanto<sup>4</sup>;
- the merger of Essilor International and Luxottica Group<sup>5</sup>;
- the merger of Linde AG and Praxair<sup>6</sup>; and
- United Technologies Corporations' acquisition of Rockwell Collins<sup>7</sup>.

These cases touched on industries relating to agriculture, lenses, the chemical industry and aerospace. Further, the relevant products were highly technical (eg, the Monsanto/Bayer case concerned pesticides, seeds and the digital agriculture market; the Linde AG/Praxair case concerned the production and service of industrial and special gases; and the Rockwell Collins/United Technologies Corporations case concerned aircraft manufacturing).

The long review period observed in each of the above cases was partly due to the complicated market and a lack of authoritative data. All cases were withdrawn just before the review period expired and were subsequently re-filed. Case withdrawal can buy parties more time to communicate with the SAMR if the concentration would otherwise be prohibited due to the lack of satisfactory commitments. Conversely, long review periods also reflect that the SAMR takes a prudent approach by consulting extensively with third parties, including:

- industry regulators;
- industry associations;
- upstream and downstream enterprises; and
- competitors.

Among the cases, the shortest review period was 372 days<sup>8</sup> and the longest was 428 days<sup>9</sup>. This is

<sup>4</sup> The original announcement of Monsanto/Bayer case can be found on SAMR's website: <http://fldj.mofcom.gov.cn/article/ztxx/201803/20180302719123.shtml>

<sup>5</sup> The original announcement of Essilor International/Luxottica Group case can be found on SAMR's website: [http://samr.saic.gov.cn/gg/201807/t20180726\\_275250.html](http://samr.saic.gov.cn/gg/201807/t20180726_275250.html)

<sup>6</sup> The original announcement of Linde AG/ Praxair case can be found on SAMR's website: [http://samr.saic.gov.cn/gg/201809/t20180930\\_276188.html](http://samr.saic.gov.cn/gg/201809/t20180930_276188.html)

<sup>7</sup> The original announcement of Rockwell Collins/United Technologies Corporations case can be found on SAMR's website: [http://samr.saic.gov.cn/gg/201811/t20181123\\_277177.html](http://samr.saic.gov.cn/gg/201811/t20181123_277177.html)

calculated from the date of submission of notification documents (rather than the date of official acceptance) to the date of receiving conditional approval.

Long review periods may occur when:

- the transaction structure is complex and the related products are numerous (eg, the Linde AG/Praxair case involved 56 overlapping markets and eight vertical relationships);
- the definition of the relevant market is complex (eg, the trait market cited in the Monsanto/Bayer case)<sup>10</sup>;
- the SAMR is understaffed and its workload is too heavy;
- the parties fail to provide satisfactory documents to the SAMR, resulting in multiple submissions of supplementary materials;
- the SAMR cannot obtain a valid response within a specified time when soliciting opinions from third parties; and
- the SAMR takes a more rigorous approach to competition analysis – requiring higher levels of authenticity, completeness and material accuracy – and spends more time communicating with the filers and other parties.

The following features of the conditionally approved cases may reveal the SAMR's review practice and trends.

#### **Notable calculation method of market share in overlapped products**

In the Rockwell Collins/United Technologies Corporations case, the SAMR believed that the concentration would result in the parties obtaining a share of 65% to 70% in the global adjustable horizontal stabiliser actuator market. Based on the product's total volume, the market share would be only 40% to 45% after the acquisition. However, the SAMR believed that the part produced by aircraft manufacturers for their self-use would not enter the market; as such, that part was excluded. This would result in the market share of the merged entity increasing to 65% to 70% after the acquisition. The exclusion of the self-use part from the calculation of market share also happened in the global rudder brake pedal system market. This calculation method would make the total market volume shrink and the market share increase, which would have a material change on the evaluation of competition.

#### **Frequently used economic analysis and market research**

In all four of the above cases, the SAMR conducted an economic analysis during its review. Three of the cases directly disclosed the increment of the Herfindahl-Hirshman Index before and after

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<sup>8</sup> The review period of Linde AG/Praxair case was 372 days.

<sup>9</sup> The review period of Essilor International/Luxottica Group case was 428 days.

<sup>10</sup> Traits refer to the sum of heritable crop morphology and environmental suitability that directly decides performance including the crop production volume, maturity, weight, height, herbicide resistance and pesticide resistance, including transgenic traits and non-transgenic traits. Traits can be classified by species including soybean traits, corn traits, cotton traits, etc., and different crop traits, respectively, constitute independent relevant commodity markets.

the transaction<sup>11</sup>. Further, in the Essilor International/Luxottica Group case, the SAMR stated that the "analysis of critical transfer ratio of wholesale price and margin profit shows that...", which also implied that the SAMR used economic analysis to review the case. In the Essilor International/Luxottica Group case, the SAMR also conducted market research twice. All of these observations indicate that methods such as economic analysis and market research are frequently used in merger review.

### **Special concern of possible bundling in complementary relationships**

Although there is no overlap or vertical relationship, the SAMR may pay more attention to cases involving highly complementary relationships. It may intervene when the economic analysis shows that the merged entity may gain more profits by bundling or tying after the concentration. The SAMR has concerns as to the possible leverage effect associated with bundling or tying. An undertaking may leverage its power in a dominant market into another market and therefore reduce competition. For instance, in the Rockwell Collins/United Technologies Corporations case, the SAMR stated that:

*The United Technologies Corporations would have the most comprehensive product portfolio in the aviation parts industry after the transaction. With the advantage or even dominant position in the market, it could be capable of bundling or tying those parts or with other parts in the course of their sales.*

### **Implementation of behavioural and structural remedies**

Among the four cases which were conditionally approved in 2018, three were cleared with both behavioural and structural remedies. Compared with structural remedies, behavioural remedies were customised. The SAMR attached various customised conditions which closely related to competition concerns after carefully studying and analysing:

- the relevant market;
- the characteristics and competition status of the upstream and downstream market; and
- the economic analysis.

In addition, the SAMR also conducted several rounds of meetings with notifying and third parties. In the Linde AG/Praxair case, the entity was required to:

*continue to timely and stably provide Chinese customers with inert rare gas mixture, fluorine-containing rare gas mixture and hydrogen chloride rare gas mixture at reasonable prices and quantities after the concentration.*

In the Rockwell Collins/United Technologies Corporations case, the entity was required to:

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<sup>11</sup> The Herfindahl-Hirschman Index refers to a comprehensive index that measures the concentration of the industry. It refers to the sum of square of the proportion of each entity's income and assets in the industry. It is used to measure changes in market share. It could reflect the dispersion of the size of the manufacturers in the market. The larger the index is, the higher the market concentration is and, correspondingly, the more obvious the monopoly trend would be.

*not materially change the existing business model, including the current bidding model and subcontracting practices; and ensure that the negotiation in relation to contract terms such as quantities, qualities and delivery conditions are fair and reasonable; and the merged entity shall fully consider the historical and current status after the concentration.*

### **Concern that technological developments would impact competitors' research and development**

Before the transaction in the Rockwell Collins/United Technologies Corporations case, United Technologies was developing oxygen supply system products that would threaten Rockwell Collins' dominant position once launched. However, the concentration would:

- directly eliminate the potential competitor;
- enable United Technologies to reduce its competitive investment; and
- delay the product launch.

Therefore, the concentration would have an adverse effect on competition. Further, in the Essilor International/Luxottica Group case, the SAMR believed that the parties were each other's potential competitor, investing significant R&D funds into each other's leading product market. Essilor and Luxottica may thus become each other's main competitor in the future. However, the concentration would eliminate the constraint and materially restrict market competition. The SAMR pays close attention if one party is a strong potential competitor of the other in a concentration, even if the party's products have yet to enter the market.

### **Strict supervision and penalisation of non-filers**

In 2018 the SAMR significantly strengthened its supervision of and penalties for non-filing parties. Over the course of the year, 13 decisions were published, a sign that the SAMR is cracking down on non-filers. By the end of 2018, the SAMR and MOFCOM had released 30 non-filing cases and imposed total fines of Rmb9.85 million on 47 undertakings. The biggest fine issued was Rmb400,000, while the smallest was Rmb150,000. According to the statistics, since the merger review function was transferred from MOFCOM to the SAMR, penalty amounts have increased notably. The fine imposed on each party to a non-filing joint venture increased from Rmb150,000 to Rmb300,000. The SAMR initiates investigations of non-filing based on:

- self-observation;
- third-party reporting; and
- voluntary reporting by notifiable parties.

The non-filing of notifiable acquisitions is usually referred to as 'gun jumping'. The most common oversight of notifiable parties is the non-fulfilment of filing obligations in a step-by-step acquisition. The implement of the first-step transaction indicates that the concentration has started; failure to file first-step transactions with the SAMR will constitute gun jumping. A typical case is Paper Excellence BV's acquisition of Eldorado. The SAMR considers the object of the acquisition and the relationship between the different steps. Notifiable parties must submit their notifications

and file with the SAMR before implementing the first step of a package deal comprising several steps.

In addition, the SAMR has no mercy for non-filers that failed to file with the competition agency at some point, and it conducts retrospective investigations once a failure has been discovered. For example, Linde Hong Kong was penalised three times in 2018 for its non-filing of three former joint ventures. These joint ventures were established in either 2011 or 2012. It is notable that the SAMR severely punished non-filing which happened seven years ago.

The SAMR may impose a maximum fine of Rmb500,000 on non-filers. The nature, extent and duration of the non-filers' behaviour must be considered, as well as the transaction's competitive effects. In addition to fines, penalties may include:

- the cessation of the concentration;
- the disposal of shares or assets by a specified deadline;
- the transfer of certain business operations by a specified deadline; and
- other necessary measures (eg, publication).

In addition, once penalties have been published, the non-filer's business reputation and social image will be damaged and its subsequent notification or filings with other government agencies may be adversely affected.

### **Comment**

In 2018 law enforcement under the SAMR remained stable. Due to the rigorous attitude and the high-quality materials required by the SAMR, notifying parties must wait a relatively long time before a case is accepted. As regards conditionally approved cases, the SAMR implemented various tailored conditions which addressed specific competition concerns to eliminate the negative impact of a concentration. Further, the large number of gun-jumping cases and increased fines indicate that the SAMR is gradually cracking down on non-filers, while the proposed revision of the Anti-monopoly Law is expected to lead to an increase in penalties for non-filing.

Companies should pay close attention to the nature and pattern of merger control review, as well as the revision of the Anti-monopoly Law. Further, companies are advised to acknowledge the thresholds and criteria of merger filing in order to fulfil their obligations to avoid penalties and any adverse consequences of closing a transaction.