



CHINA MATTERS

Paul Hastings' Newsletter for Investing & Operating
in the People's Republic of China

September 2011

New MOFCOM Rules on Evaluating the Concentration of Business Operators

BY DAVID LIVDAHL, JENNY SHENG & HENRY LI

The Ministry of Commerce ("MOFCOM") issued the long-awaited *Interim Rules on Evaluating Competitive Effects of Concentration of Business Operators* (2011 Announcement No. 55) (the "Interim Rules") on August 29, 2011.¹ Before the formal promulgation of these Interim Rules, MOFCOM published a draft of the Interim Rules on June 3, 2011 for a ten-day solicitation of public comments. The formally promulgated Interim Rules keep almost all the contents of the June 3, 2011 draft. The Interim Rules, which took effect on September 5, 2011, provide some guidelines with respect to MOFCOM's evaluation of the competitive effect of a potential transaction.

1. Basis of the Interim Rules

The Interim Rules serve as a supplement to the Anti-Monopoly Law and elaborate on the methods and procedures to be adopted by MOFCOM in evaluating the competitive effect of a concentration of business operators.

According to the Anti-Monopoly Law (the "AML," promulgated by the Standing Committee of the National People's Congress on August 30, 2007 and in effect since August 1, 2008), the anti-monopoly law enforcement authority in charge of merger control (i.e., MOFCOM) must take into account the following factors when reviewing a concentration of business operators:

- i the market share of the business operators in the relevant market and their degree of control over such market;
- ii the degree of concentration in the relevant market;
- iii the effect of the concentration of business operators on entry into the market and technological progress;
- iv the effect of the concentration of business operators on consumers and other relevant business operators;
- v the effect of the concentration of business operators on the development of the national economy; and

- vi other factors that affect market competition that the State Council's Anti-Monopoly Law Enforcement Authorities believe should be taken into consideration.²

Pursuant to Article 4 of the Interim Rules, MOFCOM will first examine whether the concentration of business operators would result in or strengthen a business operator's (or a number of business operators') ability, motive and possibility to exclude or restrict competition. If the concentration is not between or among competitors in the same relevant market, MOFCOM will then focus on whether such concentration would exclude or restrict competition in upstream or downstream markets or affiliated markets.

2. Elements in Determining "Market Control"

The Interim Rules highlight market share as the key factor in analyzing the structure of the relevant market and the status of a business operator as well as its competitors. Also, the Interim Rules state that MOFCOM will consider the following items in determining whether a business operator obtains, or increases the degree of, control over the relevant market:

- i the market share of the business operators involved in the concentration in the relevant market and the competition in such market;
- ii the extent of substitutes for the products/services of the business operators involved in the concentration;
- iii the production capacity of the business operators in the relevant market which are not involved in the concentration, and the availability of substitutes for their products/services compared to those of the business operators involved in the concentration;
- iv the ability of the business operators involved in the concentration to control sales or supplies;
- v the ability of the consumers of the business operators involved in the concentration to switch their suppliers;
- vi the financial and technical capacity of the business operators involved in the concentration;
- vii the purchase capacity of the downstream customers of the business operators involved in the concentration; and
- viii other factors which should be taken into account.

The Interim Rules also require MOFCOM, in line with other major anti-monopoly jurisdictions, to adopt the Herfindahl-Hirschman Index ("HHI") and the Concentration Ratio Index ("CRn") to measure market concentration level in its review of a concentration of business operators.³ The higher the market concentration level, the more anti-competitive effect a concentration would be deemed to have.

The Interim Rules further elaborate that MOFCOM may view a concentration of business operators as enhancing barriers to entry of the relevant market because the business operators involved in the concentration could leverage their increased control over the market to impede other business operators from entering this market by methods such as control of sales channels and key facilities. Therefore, MOFCOM will, in its review process, examine the offsetting effect resulting from entry by potential competitors.⁴

During its review process, MOFCOM will also consider the positive effects of a concentration of business operators, such as economy of scale, integration of R&D resources and potential increase in consumer benefits associated with technology advancement or increased

competition pressure on other competitors due to the concentration.⁵ In addition, MOFCOM may take into account the effects of the concentration on public interest and economic efficiency, whether a business operator involved in the concentration is on the verge of bankruptcy, and whether buyers can exert an offsetting power over the concentration's anti-competitive effect.

3. Our Observations

Since MOFCOM published its first decision in 2008 on its anti-monopoly review of M&A transactions, its decisions were generally criticized by commentators as lacking in detailed analysis to support its conclusions. The promulgation of the Interim Rules may be viewed as an effort by MOFCOM to improve the transparency of its review process, although it has yet to provide more detailed guidelines to the business community and how MOFCOM will apply the Interim Rules in practice remains to be seen. It seems that MOFCOM will focus on, among others, the market share element to determine whether market control or elimination of competition will result from a concentration of business operators. Thus, it is crucial that parties involved in a potential concentration consult with professional consultants to create a realistic definition of the "relevant market" and a carefully defined formula for the calculation of market share.

Paul Hastings LLP is a global law firm with 18 offices in Asia, Europe and the United States. Paul Hastings has one of the largest, full-service, multi-jurisdictional legal practices in Asia with legal professionals in Beijing, Hong Kong, Shanghai and Tokyo.

Please feel free to discuss any aspect of this newsletter with your existing Paul Hastings contacts or any of the partners listed below:

BEIJING

David Livdahl: davidlivdahl@paulhastings.com

SHANGHAI

Jia Yan: jiayan@paulhastings.com

¹ However, the Interim Rules were not published on MOFCOM's website (<http://fdj.mofcom.gov.cn/aarticle/c/201109/20110907723357.html>) last accessed on September 13, 2011) until September 2, 2011.

² See Article 27 of the AML.

³ See Article 6 of the Interim Rules.

⁴ See Article 7 of the Interim Rules.

⁵ See Articles 8 and 10 of the Interim Rules.

Paul Hastings LLP is licensed in the People's Republic of China as a foreign law firm permitted to advise clients on certain aspects of their China Matters is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions.

IRS Circular 230 Disclosure: As required by U.S. Treasury Regulations governing tax practice, you are hereby advised that any written tax advice contained herein or attached was not written or intended to be used (and cannot be used) by any taxpayer for the purpose of avoiding penalties that may be imposed under the U.S. Internal Revenue Code.

Paul Hastings LLP is licensed in the People's Republic of China as a foreign law firm permitted to advise clients on certain aspects of their international transactions and operations. Like all foreign law firms operating in China, we are not authorized to practice Chinese law. You are hereby advised that this document prepared by us is based on our experience in advising clients on international business transactions and operations and on research and inquiries we deemed appropriate, and is not intended to be used (and cannot be used) as an opinion on the laws of China. To the extent you require such an opinion or the assistance of a qualified China lawyer, we would be pleased to assist you to identify an appropriate domestic China law firm. The author of this document does not hold a lawyer's license in the People's Republic of China.

Copyright © 2011 Paul Hastings LLP. Paul Hastings is a limited liability partnership.