

31 January, 2012

*Antitrust,
Competition & Trade
Regulation*

Practical Aspects of the New Provisional Rules Governing MOFCOM Investigations of Unreported Mergers

By Yujing Shu, Siobhan Kahmann and Iris He

On December 30, 2011, the Chinese Ministry of Commerce (“MOFCOM”) published the *Provisional Rules on the Investigation and Handling of Concentrations between Undertakings not Notified in Compliance with the Law* (“Provisional Rules”).¹ These rules shortly come into force, on February 1, 2012, and set out MOFCOM’s official investigation procedure and sanctions for companies which fail to notify their mergers: a sure sign that the authority is determined to strengthen its law enforcement mechanisms under the existing merger control regime.

This alert provides a practical overview of the investigation procedure and a company’s rights and obligations, in addition to potential issues, including a lengthy investigation, inspections of company premises, automatic suspension of the merger, and the imposition of fines.

Background

The PRC Anti-Monopoly Law (“AML”) requires companies to file pre-merger notifications with MOFCOM. An obligation to file a pre-merger notification arises where a business concentration occurs (namely through (i) a merger, or (ii) the acquisition of control over other companies by acquiring their shares or assets, or (iii) the acquisition of control or the ability to exert decisive influence over other companies by contract or any other means) and the relevant turnover/revenue thresholds are fulfilled.² For more information on the merger review timeline and documentation required in a pre-merger notification, please refer to our previous client alert [“An Update on China’s Merger Control Laws – From a Practical Perspective”](#).

One of the legal consequences for companies failing to comply with the above-mentioned filing obligation is that the proposed merger transaction may not be implemented. MOFCOM may also sanction such companies under Art. 48 of the AML by imposing a fine of less than RMB 500,000 (USD 79,000 approx.) and/or unwinding the merger. In practice to date, however, there have been no reported cases of any of the aforesaid sanctions imposed due to unreported mergers, since the AML was implemented on August 8, 2008.

According to an official MOFCOM interpretation of the Provisional Rules, a total of 382 merger notifications have been reviewed since the implementation of the AML.³ Among these cases, only one proposed merger was blocked⁴ and 10 were conditionally approved. The remaining

¹ Decree No. 6 (2011). The Provisional Rules in Chinese are available on the following MOFCOM link: <http://www.mofcom.gov.cn/aarticle/b/c/201201/20120107914884.html>.

² There are two alternative turnover/revenue thresholds under *Provisions of the State Council on the Application Criteria for Concentrations of Business Operators*, namely:

- i. the total combined worldwide turnover of all companies participating in the proposed concentration for the previous financial year exceeded RMB10 billion (USD 1.5 billion approx.), and at least two of the companies each had China-based turnover which exceeded RMB400 million (USD 60 million approx.); or
- ii. the total combined China turnover of all companies participating in the proposed concentration for the previous financial year exceeded RMB 2 billion (USD 0.3 billion approx.), and at least two of the companies each had China-based turnover which exceeded RMB400 million (USD 60 approx.).

³ Interpretation by MOFCOM on the issuance of *Provisional Rules on the Investigation of and Handling of Concentrations between Undertakings Not Notified in Compliance with the Law* published on January 10, 2012.

⁴ The high profile MOFCOM decision to block the proposed acquisition of Huiyuan by Coca-Cola in 2009.

Practical Aspects of the New Provisional Rules

applications, representing 97.1%, were approved unconditionally. With such a high approval rate, MOFCOM noted that some mergers may not have been notified, in violation of the AML.⁵ In light of these findings, the Provisional Rules are to enter into force very soon, in order to discourage and prevent future failures to notify.

Applicability of the Provisional Rules

It is useful to first clarify the applicability of the Provisional Rules. These rules apply where a company, obliged to file a merger notification with MOFCOM in advance of the implementation of the transaction, fails to do so. Any such company will now be subject to a potential investigation by MOFCOM.

The Provisional Rules apply regardless of the place of implementation of the merger, or where the companies concerned are situated. If a merger transaction, implemented outside China, has a significant influence on the Chinese market, the parties are still obliged to file a notification.⁶ Hence, offshore companies are also subject to investigation for non-filing under the Provisional Rules, and must be aware of the potential consequences, including an extremely long investigation (which can last much longer than a normal merger review), inspection of company premises, automatic suspension of the merger where a 2nd phase investigation is commenced, and fines.

MOFCOM Investigation Procedure

The investigation procedure applicable under the Provisional Rules involves the following four stages. A flow chart setting out the relevant timeframes is attached at the end of this alert.

1. *Case initiation*: suspected cases can be brought to the attention of MOFCOM by any entity or natural person, or via other channels. MOFCOM will verify the facts/evidence of the suspected case. If it is established that preliminary facts/evidence for the suspected violation exist, MOFCOM will initiate the case and notify the company under investigation (“Case Initiation Notice”).
2. *Preliminary investigation*: within 30 days of receipt of the Case Initiation Notice, the company must submit all documents/materials required by MOFCOM to establish whether: (1) the investigated transaction constitutes a concentration; (2) the concentration fulfils the notification thresholds; (3) the transaction was implemented before notification; and (4) other relevant matters.

Within 60 days of receipt of the above documents, MOFCOM will complete its preliminary investigation (meaning the 1st phase of the investigation can last up to 90 days). If no failure to notify is established, MOFCOM will close its investigation and notify the company. Where a failure to notify is established, MOFCOM will conduct a further investigation and notify the company (“Further Investigation Notice”). Upon receipt, the company must suspend the merger.

3. *Further investigation*: at the 2nd stage of investigation, the company is effectively required to file a merger notification. Within 30 days of receipt of a Further Investigation Notice, the company must submit all relevant documents in accordance with the notification requirements set forth in the *Measures for Antitrust Notification of Concentrations between Undertakings*.

Within 180 days of receipt of ‘complete’⁷ documents/materials, MOFCOM will undertake a further investigation to conclude whether the transaction had anti-competitive effects in the

⁵ Ibid, fn 3.

⁶ Ibid, fn 2.

⁷ According to our previous experience in handling merger notifications, the normal merger notification process generally takes half to one month for MOFCOM to accept the filing documents as complete and commence the 180-day timeline for the authority to review the notification.

Practical Aspects of the New Provisional Rules

relevant market under the AML, the *Measures for Reviewing Concentrations between Undertakings* and other relevant laws. Upon conclusion, MOFCOM will notify the company of the investigation result, including evidence. The company will submit a written plea in response, including facts and evidence, after which MOFCOM will determine its final decision.

Consequently, the company is subject to longer prescribed review periods in this 2nd phase investigation than the total normal merger notification process (180 days). This 2nd phase can last for up to 210 days, and the merger is automatically suspended. Both investigation phases combined can therefore last up to a total of 300 days, equating to roughly 10 months.

4. *Sanctions*: a company which MOFCOM determines has failed to file a notifiable merger transaction will be subject to sanctions under Art. 13 of the Provisional Rules. Fines of up to RMB 500,000 (USD 79,000 approx.) may be imposed and/or the company ordered to unwind the merger by stopping the implementation of the transaction, disposing of shares/assets within a time limit, transferring the business within a time limit or other necessary measures. MOFCOM will take account of considerations such as the nature, degree and duration of the violation in failing to file the notification, and the anti-competitive effect of the transaction on the market. Unfavourable MOFCOM decisions may be made public. Such possible damage to the company's public image serves to deter violation of the filing obligations.

Rights and Obligations of the Company Under Investigation

Companies are advised to take note of their rights and obligations under the Provisional Rules.

- *Obligation to assist in the investigation*: the company, interested parties and relevant third parties are obliged to cooperate with MOFCOM in its performance of duties, and may not refuse or impede its investigation. Uncooperative individuals or entities will be subject to sanctions under Art. 52 of the AML with fines of up to RMB 20,000 (USD 3,200 approx.) for individuals and RMB 200,000 (USD 32,000 approx.) for entities, or in serious circumstances up to RMB 100,000 (USD 15,800 approx.) for individuals and RMB 1 million (USD 158,000 approx.) for entities.
- *Right to give opinion during investigation*: the company, interested parties and relevant others have the right to submit arguments concerning any facts, evidence, arguments, comments, etc on the case during the investigation. Such facts/reasons/evidence submitted will be verified by MOFCOM.
- *Right to comment on the investigation results*: at the end of the 2nd phase investigation, the company has the right to provide written pleas with facts/evidence.
- *Right of appeal of MOFCOM's decision*: the company can appeal MOFCOM's decision under an administrative review procedure, and may also file an administrative law suit in court.
- *Confidentiality issues*: MOFCOM, the company and all others shall keep any business secrets and other sensitive information confidential, unless such information requires disclosure by law. MOFCOM officials in violation of these obligations will be sanctioned by law.

Conclusion

The Provisional Rules strengthen the existing obligations on companies to file a merger notification with MOFCOM. It is the clear intention of the authority to tighten its scrutiny on all notifiable merger transactions, and to deter any companies attempting to slip through the net.

Practical Aspects of the New Provisional Rules

However, there is so far no precedent for penalizing companies violating the AML, so the amount of resources MOFCOM will ultimately place upon, and the extent to which the authority will uphold the Provisional Rules remains to be seen. Only time will tell how significant the impact of these rules will be in practice, and the scrutiny which MOFCOM will give extra-territorial merger transactions. However, in spite of their somewhat procedural nature and potentially low fines, all companies must be aware of the not insignificant additional commercial risk the Provisional Rules introduce for non-filing in China. It is, therefore, highly recommended to seek legal advice in the event of any possibility of a Chinese merger filing being required, as opposed to taking the risk of becoming a potential Provisional Rules test case.

Authors:

Yujing Shu

jing.shu@klgates.com

+86.10.5817.6100

Siobhan Kahmann

siobhan.kahmann@klgates.com

+32.(0)2.336.1910

Iris He

iris.he@klgates.com

+86.10.5817.6106

K&L GATES

Anchorage Austin Beijing Berlin Boston Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt Harrisburg
Hong Kong London Los Angeles Miami Moscow Newark New York Orange County Palo Alto Paris Pittsburgh Portland Raleigh
Research Triangle Park San Diego San Francisco São Paulo Seattle Shanghai Singapore Spokane Taipei Tokyo Warsaw Washington, D.C.

K&L Gates includes lawyers practicing out of 40 offices located in North America, Europe, Asia, South America, and the Middle East, and represents numerous GLOBAL 500, FORTUNE 100, and FTSE 100 corporations, in addition to growth and middle market companies, entrepreneurs, capital market participants and public sector entities. For more information about K&L Gates or its locations and registrations, visit www.klgates.com.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

©2012 K&L Gates LLP. All Rights Reserved.