HOLME ROBERTS & OWEN LLP
BULLETIN
Antitrust

Authored by Mimi D. Hu and Jesse W. Markham, Jr.

FIRST QUARTER 2009

CLIENT ADVISORY

RECENT DEVELOPMENT IN CHINA'S ANTITRUST ENFORCEMENT

On March 18, 2009, the Ministry of Commerce of the People's Republic of China (MOFCOM), the agency charged with enforcing the Anti-Monopoly Law (the AML), rejected Coca-Cola's $2.4 billion offer to acquire Huiyuan Juice Group Ltd.

MOFCOM's rejection of the Coca-Cola deal drew international criticism, particularly from those looking to expand in China. This ruling has protectionist overtones and may have a chilling effect on merger and acquisition (M&A) activity and foreign investment in China.

China's domestic consumer sector is "one of the rare global economic bright spots"[1] in today's troubled economy, making M&A opportunities there unusually attractive. Yet the failed Coca-Cola deal spells trouble. This advisory briefly examines China's AML and MOFCOM's rejection of the Coca-Cola/Huiyuan deal. Two concerns emerge from the AML and the MOFCOM decision, as discussed below: (1) the potential for delay and uncertainties, and (2) MOFCOM's troubling interpretation of the AML as protecting Chinese companies from foreign ownership and control. While the China market will continue to attract investment, planning M&A deals there just became more uncertain and risky.

THE AML AND MOFCOM

Until the early 1990s, state-owned enterprises (or state-imposed monopolies) dominated China's economy. The AML was introduced on August 1, 2008, and it was a large step towards a true market economy.

MOFCOM is China's merger reviewing agency. According to MOFCOM, it has received 40 notifications for proposed mergers or acquisitions since the AML went into effect.[2] Prior to its Coca-Cola decision, MOFCOM had unconditionally approved 23 of the 24 completed deals.[3] In the last deal, a merger between America's Anheuser-Busch and Belgium's InBev, MOFCOM conditioned its approval on restrictions of future acquisitions or investments.[4]

COCA-COLA'S OFFER FOR HUIYUAN

Coca-Cola's offer to acquire Huiyuan was a part of its campaign to expand in China. Huiyuan is an upscale brand and is the largest juice company in China. Coca-Cola's $2.4 billion offer was three times Huiyuan's market valuation when the deal was announced last September. The subsequent collapse of the global markets only sweetened that price. This deal would have been the largest outright acquisition by a foreign company in China.[5]

---

[1] "Squeezed Out," The Economist, Mar. 18, 2009.

[2] Andrew Batson, "China's Statement Blocking Coca-Cola Huiyuan Deal," Wall St. J., March 18, 2009. *See also*, Original Press Release in Chinese, http://www.mofcom.gov.cn/aarticle/ae/ai/200903/20090306108388.html.

[3] *Id.*

[4] The combined firm agreed to freeze its existing interest in several of China's domestic breweries. "Squeezed Out," *supra* note 1.

[5] *Id.*

ANTITRUST & COMPETITION GROUP

DENVER

Bobbee J. Musgrave, Co-Chair
bobbee.musgrave@hro.com

Tracy L. Ashmore
tracy.ashmore@hro.com

Michael J. Hofmann
michael.hofmann@hro.com

Steven J. Perfrement
steven.perfrement@hro.com

B. Lawrence Theis
larry.theis@hro.com

SALT LAKE CITY

Jay D. Gurmankin
jay.gurmankin@hro.com

SAN FRANCISCO

Jesse W. Markham, Jr., Co-Chair
jesse.markham@hro.com

Adam Brezine
adam.brezine@hro.com

Meryl L. Macklin
meryl.macklin@hro.com

Kyle L. Schriner
kyle.schriner@hro.com

Robert L. Stolebarger
robert.stolebarger@hro.com

The deal easily surpassed China's Merger Notification Threshold set forth in the Regulation on Notification Thresholds for Concentrations of Undertakings. Under this regulation, pre-merger notification to MOFCOM is required when the proposed transaction reaches either of two thresholds: (1) the combined global turnover in the last fiscal year exceeds RMB 10 billion (approximately US $1.47 billion), and the China-wide turnovers of at least two undertakings each exceed RMB 400 million (approximately US $59 million); or (2) the combined China turnovers of all businesses involved in the last fiscal year exceed RMB 2 billion (approximately US $294 million), and at least two participants in the proposed transaction generate turnovers in China each exceeding RMB 400 million (approximately US $59 million)[6]. Accordingly, Coca-Cola filed the AML notification materials on September 8, 2008.[7] MOFCOM requested additional information three times, and finally opened review on November 20 after determining that the notification material was complete. On December 20, MOFCOM conducted a second round of examination, ultimately disallowing the deal on March 18, 2009. MOFCOM explained the factors it considered in a short single page report:

> In accordance with the relevant provisions of the Antimonopoly Law, the Ministry of Commerce reviewed various aspects of this concentration including: market share and market control, the degree of market concentration, the impact on market access and technological progress, the impact on consumers and other business operators, and the impact of brands on market competition in the juice market.[8]

Interestingly, MOFCOM never defined the relevant market in this deal, and although it referred to "the degree of market concentration," it is clear that the modest increase the deal presented was not a driving consideration. Despite the fact that Coca-Cola holds half of the domestic Chinese market for carbonated beverages, the juice market is highly fragmented. *The Economist* estimated that Coca-Cola and Huiyuan combined would not control more than 20 percent of the juice business.[9]

Instead, MOFCOM appears to have focused more on the fact that Coca-Cola might leverage its high brand recognition in carbonated drinks to exert influence in the juice market. MOFCOM apparently was concerned that the Coca-Cola brand would discourage potential entry into the juice market and threaten the survival of small and medium-sized juice companies in China. Even though the deal would not have greatly altered market concentration in any relevant market, MOFCOM nevertheless found the deal to have anticompetitive implications. This approach represents a stark departure from U.S. antitrust norms, and also raises the unavoidable concern that it may have in part been driven by an unarticulated policy of protecting major Chinese companies from foreign control.

MOFCOM's approach to the Coca-Cola/Huiyuan transaction has created a problematic backdrop for U.S. companies seeking investment opportunities in China. First, counsel advising U.S. clients on deal planning in China need to set aside U.S. antitrust principles and instead consider China's more activist approach. To some extent, direction can be taken from EU competition law principles, which China is clearly emulating. However, a layer of uncertainty still remains because China is apparently also considering nationality of ownership in its M&A review, which is not an articulated antitrust principle under U.S. or EU law. The AML is modeled after European and American antitrust laws, but competition philosophy in China is more closely aligned with the EU than with the more relaxed approach in the U.S. Theories that the EU would take seriously, such as monopoly leveraging and the potential for entry barriers resulting from brand recognition are not supported by U.S. law as articulated in the Horizontal Merger Guidelines. The U.S. Merger Guidelines focus on defining and assessing market power in relevant product and geographic markets.[10] In contrast, MOFCOM's statement denying the Coca-Cola deal did not define a relevant market, and was more concerned with Coca-Cola's brand recognition in a distinct market than it was with assessing traditional measures of power in the market that would be directly affected. Thus, U.S. principles did not govern this transaction and are unlikely to govern future ones.

---

[6] Regulation on Notification Thresholds for Concentrations of Undertaking, the State Council, available in Chinese at http://www.gov.cn.zwgk/2008-08/04/content_1063769.htm. The Regulation also permits discretionary review of transactions that do not reach the Notification Thresholds.

[7] Batson, *supra* note 2.

[8] *Id.*

[9] "Squeezed Out," *supra* note 1.

[10] 1992 Horizontal Merger Guidelines, available online at http://www.ftc.gov/bc/docs/horizmer.htm.

Secondly, businesses doing deals in China should consider the potential delays from extended review by the agency. Coca-Cola notified MOFCOM of its proposed acquisition of Huiyuan in September 2008. MOFCOM required Coca-Cola to make three supplemental submissions before deeming the notification complete. The AML requires MOFCOM to render a decision regarding whether to conduct further review and notify the business operators in writing within 30 days upon receipt of notification material.[11] However, the waiting period does not commence upon filing. The clock only starts after the parties have fully complied with MOFCOM's requests and when MOFCOM determines that the notification was complete. Although ultimately the delay occasioned by MOFCOM's review in the Huiyuan deal is not out of line with U.S. norms, the open-endedness of the process coupled with MOFCOM's lack of a track record means there are no assurances that a deal will not be bogged down by the agency's requests for additional information. For deals below the Notification Threshold, MOFCOM's discretionary review power is even less defined because the regulation does not provide any time limit for the discretionary review process. MOFCOM has yet to invoke its discretionary review power, and it will be interesting to see how this power is applied. An additional concern stems from MOFCOM's authority to revisit a closed deal years later. MOFCOM may unwind a transaction even after the companies and assets have been integrated. Foreign businesses must consider and calculate these possibilities of delay and future uncertainties.

CONCLUSION

MOFCOM is a newcomer to the international competition law enforcement community, and so its Coca-Cola decision is of particular interest as an indicator of its enforcement approach. In many respects MOFCOM and the AML itself follow familiar norms in the EU. However, the decision in this case marks an important departure in its expanded view of a leveraging problem and the nationalism that may have played a role. Given the philosophical uncertainties that continue to surround the AML, and the potential for extended delays pending open-ended agency deal reviews, investors in China should anticipate possible problems there that would not be encountered in other jurisdictions.

[11] Anti-Monopoly Law of the People's Republic of China, Art. 25, available online at http://www.china.org.cn/government/laws/2009-02/10/content_17254169.htm

This article is a periodic publication of Holme Roberts & Owen LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances, nor is it intended to address specific disclosure or compliance issues that may arise in particular circumstances or provide an exhaustive discussion of the topics discussed herein. The contents are intended for general informational and educational purposes only, and you are urged to consult counsel concerning your own situation and any specific legal questions you may have. For further information regarding the topics described herein, please contact any of the individuals listed on the right side of page one.